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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2002

Commission file number 1-11921

E*TRADE Group, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**94-2844166**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**

4500 Bohannon Drive, Menlo Park, CA 94025
(Address of principal executive offices and zip code)

(650) 331-6000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

As of July 31, 2002, there were 365,445,155 shares of common stock and 1,661,383 shares exchangeable into common stock outstanding. The Exchangeable Shares, which were issued by EGI Canada Corporation in connection with the acquisition of VERSUS Technologies, Inc. (renamed E*TRADE Technologies Corporation effective January 2, 2001), are exchangeable at any time into common stock on a one-for-one basis and entitle holders to dividend, voting and other rights equivalent to holders of the registrant's common stock.

E*TRADE GROUP, INC.

FORM 10-Q QUARTERLY REPORT
For the Quarter Ended June 30, 2002

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The page numbers in this Table of Contents reflect actual page numbers, not EDGAR page tag numbers.

References to E*TRADE, Company, "we", "us" and "our" in this Form 10-Q refer to E*TRADE Group, Inc. and its subsidiaries unless the context requires otherwise.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

E*TRADE GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share amounts)
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2002	2001	2002	2001
Revenues:				
Brokerage revenues:				
Commissions	$ 71,352	$ 100,173	$ 153,879	$ 215,998
Principal transactions	52,092	31,441	107,407	62,613
Other brokerage-related	43,799	43,650	80,560	92,610
Interest income	50,975	80,718	104,026	181,463
Interest expense	(3,089)	(26,665)	(6,982)	(65,400)
Net brokerage revenues	215,129	229,317	438,890	487,284
Banking revenues:				
Gain on sales of originated loans	22,613	24,871	47,288	34,055
Gain on sale of loans held-for-sale and securities—net	17,054	8,314	38,676	27,424
Other banking-related	12,077	9,047	22,461	17,491
Interest income	191,424	217,797	394,092	434,482
Interest expense	(137,852)	(179,511)	(286,703)	(359,877)
Provision for loan losses	(4,383)	(1,656)	(7,765)	(3,099)
Net banking revenues	100,933	78,862	208,049	150,476
Total net revenues	316,062	308,179	646,939	637,760
Cost of services	133,795	150,458	274,547	292,893
Operating expenses:				
Selling and marketing	49,014	55,399	117,978	149,097
Technology development	15,043	23,420	29,547	45,701
General and administrative	50,832	61,906	104,861	122,148
Amortization of goodwill and other intangibles	7,557	9,022	14,281	17,021
Acquisition-related expenses	7,406	517	8,666	517
Facility restructuring and other nonrecurring charges	1,628	—	1,405	—
Executive agreement	(23,485)	—	(23,485)	—
Total operating expenses	107,995	150,264	253,253	334,484
Total cost of services and operating expenses	241,790	300,722	527,800	627,377
Operating income	74,272	7,457	119,139	10,383
Non-operating income (expense):				
Corporate interest income	3,569	5,220	7,149	10,998
Corporate interest expense	(11,803)	(12,759)	(24,199)	(23,987)
Loss on investments	(6,790)	(10,969)	(7,170)	(15,573)
Equity in income (losses) of investments	3,617	(1,811)	3,901	(5,152)
Unrealized losses on venture funds	(3,283)	(11,031)	(2,991)	(20,569)
Fair value adjustments of financial derivatives	769	(1,710)	(222)	(1,376)
Other	(405)	292	(1,359)	(408)
Total non-operating expenses	(14,326)	(32,768)	(24,891)	(56,067)
Pre-tax income (loss)	59,946	(25,311)	94,248	(45,684)
Income tax expense (benefit)	26,076	(12,655)	40,827	(25,897)
Minority interest in subsidiaries	180	(350)	373	(315)
Income (loss) before extraordinary items and cumulative effect of accounting change	33,690	(12,306)	53,048	(19,472)
Extraordinary gain (loss) on early extinguishment of debt, net of tax (See Note 6)	(900)	2,111	3,174	74
Cumulative effect of accounting change (See Note 7)	—	—	(299,413)	—
Net income (loss)	$ 32,790	$ (10,195)	$(243,191)	$ (19,398)
Income (loss) per share before extraordinary items and cumulative effect of accounting change:				
Basic	$ 0.09	$ (0.04)	$ 0.15	$ (0.06)

Diluted	$ 0.09	$ (0.04)	$ 0.15	$ (0.06)
Net income (loss) per share:				
Basic	$ 0.09	$ (0.03)	$ (0.69)	$ (0.06)
Diluted	$ 0.09	$ (0.03)	$ (0.69)	$ (0.06)
Shares used in computation of per share data (See Note 8):				
Basic	356,760	321,550	351,822	319,405
Diluted	362,498	321,550	359,829	319,405

See notes to condensed consolidated financial statements.

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E*TRADE GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(in thousands, except share amounts)
(unaudited)

	June 30, 2002	December 31, 2001
ASSETS		
Cash and equivalents	$ 1,015,953	$ 836,201
Cash and investments required to be segregated under Federal or other regulations	730,819	764,729
Brokerage receivables—net	1,888,055	2,139,153
Mortgage-backed securities	4,754,234	3,556,619
Loans receivable—net of allowance for loan losses of $15,709 at June 30, 2002 and $19,874 at December 31, 2001	7,222,742	6,394,368
Loans held-for-sale	542,468	1,616,089
Investments	1,188,728	1,168,623
Property and equipment—net	399,011	331,724
Goodwill	333,090	559,918
Other intangible assets	160,853	129,927
Other assets	590,964	675,063
Total assets	$ 18,826,917	$ 18,172,414
LIABILITIES AND SHAREOWNERS' EQUITY		
Liabilities:		
Brokerage payables	$ 2,479,769	$ 2,699,984
Banking deposits	8,334,718	8,082,859
Borrowings by bank subsidiary	5,103,858	4,170,440
Convertible subordinated notes	695,330	760,250
Accounts payable, accrued and other liabilities	620,409	818,464
Total liabilities	17,234,084	16,531,997
Company-obligated mandatorily redeemable preferred capital securities of subsidiary trusts holding solely junior subordinated debentures of ETFC (redemption value $97,375)	93,789	69,503
Commitments and contingencies		
Shareowners' equity:		
Preferred stock, shares authorized: 1,000,000; issued and outstanding: none at June 30, 2002 and December 31, 2001	—	—
Shares exchangeable into common stock, $.01 par value, shares authorized: 10,644,223; issued and outstanding: 1,661,744 at June 30, 2002 and 1,825,632 at December 31, 2001	17	18
Common stock, $.01 par value, shares authorized: 600,000,000; issued and outstanding: 368,384,496 at June 30, 2002 and 347,592,480 at December 31, 2001	3,684	3,476
Additional paid-in capital	2,236,514	2,072,701
Shareowners' notes receivable	(30,402)	(32,707)
Deferred stock compensation	(23,485)	(28,110)
Accumulated deficit	(490,278)	(247,087)
Accumulated other comprehensive loss	(197,006)	(197,377)
Total shareowners' equity	1,499,044	1,570,914
Total liabilities and shareowners' equity	$ 18,826,917	$ 18,172,414

See notes to condensed consolidated financial statements.

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E*TRADE GROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Six Months Ended June 30,	
	2002	2001
Net cash provided (used in) operating activities	$ 745,747	$ (71,106)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of mortgage-backed securities, available-for-sale securities and other investments	(5,748,128)	(5,086,576)
Proceeds from sales, maturities of and principal payments on mortgage-backed securities, available-for- sale securities and other investments	4,828,639	5,566,323
Net increase in loans receivable	(715,085)	(1,250,753)
Decrease in restricted deposits	71,888	165
Purchases of property and equipment, net of property and equipment received in business acquisitions	(98,753)	(96,234)
Investing derivative activity	(66,746)	(93,050)
Other	(1,194)	6,505
Net cash used in investing activities	(1,729,379)	(953,620)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in banking deposits	251,859	1,936,797
Advances from the Federal Home Loan Bank	987,055	1,175,300
Payments on advances from the Federal Home Loan Bank	(1,037,055)	(1,925,839)
Net increase (decrease) in securities sold under agreements to repurchase	680,008	(45,927)
Net increase in other borrowed funds	303,388	—
Proceeds from issuance of trust preferred securities	24,260	—
Proceeds from issuance of common stock from associate stock transactions	12,019	20,497
Payments on bank loans and lines of credit	(12,276)	(28,498)
Repayment of capital lease obligations	(8,653)	(6,359)
Repurchase of treasury stock	(15,089)	—
Issuance of shareowners’ notes receivable	—	(12,500)
(Issuances) repayments of loans to related parties and associates, net of loans repaid/issued	(3,194)	2,465
Financing derivative activity	(20,509)	—
Net proceeds from convertible subordinated notes	—	315,250
Other	1,571	7
Net cash provided by financing activities	1,163,384	1,431,193
INCREASE IN CASH AND EQUIVALENTS	179,752	406,467
CASH AND EQUIVALENTS—Beginning of period	836,201	456,878
CASH AND EQUIVALENTS—End of period	$ 1,015,953	$ 863,345
SUPPLEMENTAL DISCLOSURES:		
Selected adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	$ 68,127	$ 69,233
Amortization of premium of investment securities	$ 34,009	$ 5,879
Non-cash investing and financing activities:		
Tax benefit on exercise of stock options	$ 2,773	$ 8,618
Transfer from loans to other real estate owned and repossessed assets	$ 17,365	$ 1,466
Assets acquired under capital lease obligations	$ 763	$ 2,148
Reclassification of loans held for investment to loans held for sale	$ 65,035	$ 802,865
Purchase acquisitions, net of cash acquired:		
Common stock issued and stock options assumed	$ 83,073	$ 96,202
Cash paid, less acquired (including acquisition costs)	—	1,521
Net deferred tax liability	9,170	
Net liabilities assumed	10,065	4,763
Reduction in payable for purchase of international subsidiary	—	(12,341)
Carrying value of joint-venture investment	—	1,258
Fair value of assets acquired (including goodwill of $71,708 and $35,010)	$ 102,308	$ 91,403

See notes to condensed consolidated financial statements.

E*TRADE GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. ORGANIZATION AND BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements include E*TRADE Group, Inc. ("the Parent"), a financial services holding company, and its subsidiaries, collectively ("the Company" or "E*TRADE"), including but not limited to E*TRADE Securities, Incorporated ("E*TRADE Securities"), a securities broker-dealer, TIR (Holdings) Limited ("E*TRADE Institutional"), a provider of global securities brokerage and other related services to institutional clients, E*TRADE Financial Corporation ("ETFC"), a provider of financial services whose primary business is conducted by E*TRADE Bank ("the Bank") and E*TRADE Global Asset Management, Inc. ("ETGAM"), a funds manager and registered broker-dealer, and Dempsey and Company, LLC ("Dempsey"), a specialist and market-making firm. The Bank is a federally chartered savings bank that provides deposit accounts insured by the Federal Deposit Insurance Corporation ("FDIC") to customers nationwide. Additional ETFC subsidiaries are E*TRADE Access, Inc. ("E*TRADE Access"), an independent network of centrally-managed automated teller machines ("ATMs") in the United States and Canada, E*TRADE Advisory Services, Inc. ("E*TRADE Advisory Services") and E*TRADE Mortgage Corporation ("E*TRADE Mortgage"), an Internet-based mortgage loan originator.

In September 2000, the Company entered into a joint venture with Ernst & Young LLP ("E&Y") to form Enlight Holdings LLC ("Enlight Holdings"), which in turn owns eAdvisor, to develop an online personalized financial advice and planning tool for individuals. As of December 31, 2001, the Company owned 49% of Enlight Holdings. In February 2002, the Company determined that as a result of additional contributions and changes in the number of board of director seats, the Company has the ability to control the operations of Enlight Holdings and therefore the Company has consolidated its financial position and results of operations into the Company's consolidated financial statements. Prior to consolidation, the income (loss) from equity investments related to eAdvisor were not material. In addition, the Company sold its Norwegian subsidiary in May 2002. The sale was for cash and the gain on the sale was not material.

Beginning in January 2002, the Company changed its presentation of revenue from that previously presented; however, no changes to its accounting policies or methods were made. Under the new format, net brokerage revenues consist of commissions, principal transactions, other brokerage-related revenues, interest income and interest expense. Commissions include domestic and international transaction revenues. Previously, international transactions were included under the caption "global and institutional." Principal transactions include revenues from institutional activities, previously included in global and institutional, and market-making activities, previously included in other revenues. Other brokerage-related revenues include payments for order flow, E*TRADE Business Solutions Group, Inc. ("Business Solutions Group") revenue, advertising revenue, mutual fund revenue and fees for brokerage-related services, including account maintenance fees and order handling fees. Except for payment for order flow, which was previously included in transaction revenues, other brokerage-related items were included in other revenues. Net banking revenues consist of gain on sale of originated loans, gain on sale of loans held-for-sale and securities-net, other banking-related revenues, interest income, interest expense and provision for loan losses. Other banking-related revenues are primarily comprised of ATM revenues.

On July 30, 1999, the Company entered into a lease agreement for its 164,500 square foot technology operation center located near Atlanta, Georgia. To secure the lease, the Company posted cash collateral, which was $71.9 million at December 31, 2001. On March 27, 2002, the Company exercised its purchase option and used the cash collateral to fund the purchase on April 29, 2002.

These unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"), and, in the opinion of management, reflect

adjustments consisting only of normal recurring adjustments necessary to present fairly the financial position, results of operations and cash flows for the periods presented in conformity with accounting principles generally accepted in the United States of America. These unaudited condensed consolidated financial statements should be read in conjunction with the audited annual consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2001.

In April 2002, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 145, *Rescission of FASB Statement No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections.* SFAS 145 requires that any gains or losses on extinguishment of debt that were classified as an extraordinary item in prior periods that are not unusual in nature and infrequent in occurrence be reclassified to other income (expense), beginning in fiscal 2003, with early adoption encouraged. The Company expects to adopt the requirements of SFAS No. 145 in the fourth quarter of fiscal 2002.

In June 2002, the FASB issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, which addresses accounting for restructuring and similar costs. SFAS 146 supersedes previous accounting guidance, principally Emerging Issues Task Force Issue No. 94-3. SFAS 146 requires that the liability for costs associated with an exit or disposal activity be recognized when the liability is incurred. Under Issue 94-3, a liability for an exit cost was recognized at the date of the Company's commitment to an exit plan rather than when the liability is incurred. SFAS 146 also establishes that the liability should initially be measured and recorded at fair value. Accordingly, SFAS 146 may affect the timing of recognizing future restructuring costs as well as the amounts recognized. The Company will adopt the provisions of SFAS 146 for any restructuring activities which may be initiated after December 31, 2002.

Certain prior period items in these unaudited condensed consolidated financial statements have been reclassified to conform to the current period presentation.

NOTE 2. BUSINESS ACQUISITIONS

On June 3, 2002, the Company acquired 100% of privately-held Tradescape Securities, LLC, a direct access brokerage firm for active online traders and a subsidiary of Tradescape Corp., together with Tradescape Technologies, LLC, including its high-speed direct access trading software, technology and network services, and Momentum Securities, LLC, an onsite brokerage firm for individual professional traders, collectively ("Tradescape"), in order to expand its brokerage business in onsite trading. The Company did not acquire any interest in, and exercises no management control over, Tradescape Corp. or Market XT, Inc., which remains a wholly owned subsidiary of Tradescape Corp. The Company acquired Tradescape for an aggregate purchase price of $96.2 million, comprised of approximately 11.8 million shares of the Company's common stock valued at $83.1 million (based on the average of the closing prices of the Company's common stock on the date the shares to be issued were determined and for the three days before and after) and acquisition costs of approximately $13.1 million. The acquisition costs include the fair value of operating leases assumed by the Company, duplicative property and equipment, legal costs and accounting costs. In addition, the Company agreed to pay additional contingent stock consideration of up to $180 million if Tradescape's operating results exceed certain targets and revenue goals for the remainder of fiscal 2002 and for all of fiscal 2003. The Company also incurred $5.4 million of non-capitalizable costs, related to rebranding costs in connection with the Tradescape acquisition, which are included in acquisition-related expenses. The acquisition was accounted for using the purchase method of accounting and the results of Tradescape's operations have been combined with those of the Company from the date of acquisition. The Company has not included in its operating results any revenue of Tradescape prior to the date of acquisition.

The purchase price has been preliminarily allocated as follows (in thousands):

Net tangible assets of Tradescape	$	3,017
Proprietary agreements and other intangibles		30,600
Net deferred tax liability		(9,170)
Goodwill		71,708
Total Purchase Price	$	96,155

The acquired net tangible assets of Tradescape were allocated in the accompanying condensed consolidated balance sheets as follows (in thousands):

Brokerage receivables—net	$	3,811
Investments		604
Property and equipment—net		7,906
Other assets		7,837
Accounts payable, accrued and other liabilities		(17,141)
	$	3,017

The value allocated to proprietary agreements will be amortized over seven years and other intangibles will be amortized over four to six years, all using a straight-line method. The value allocated to goodwill (all of which is included in the Domestic Retail Brokerage Segment) will not be amortized. This purchase price allocation is preliminary and has been allocated based on the estimated fair value of net tangible and intangible assets acquired. If contingent stock consideration is paid, the Company will increase the purchase price with a corresponding increase to goodwill. The Company has engaged an independent valuation firm to assist in the allocation and expects the finalization of these allocations to occur in the three months ended September 30, 2002.

The proforma information below assumes that the acquisitions of Tradescape, Dempsey (acquired in October 2001), Web Street, Inc. ("Web Street") (acquired in May 2001) and E*TRADE Mortgage (acquired in February 2001) occurred at the beginning of fiscal 2001 and includes the effect of amortization of intangibles acquired from that date (in thousands, except per share amounts):

	Six Months Ended June 30,	
	2002	2001
Net revenues	$ 679,366	$ 762,555
Income (loss) before extraordinary items and cumulative effect of accounting change	$ 44,619	$ (10,269)
Net loss	$ (251,620)	$ (10,195)
Basic and diluted income (loss) per share before extraordinary items and cumulative effect of accounting change	$ 0.12	$ (0.03)
Basic and diluted net loss per share	$ (0.69)	$ (0.03)

The proforma information is for information purposes only and is not necessarily indicative of the results of future operations nor results that would have been achieved had these acquisitions taken place at the beginning of fiscal 2001.

NOTE 3. FACILITY RESTRUCTURING CHARGES

On August 29, 2001, the Company announced a restructuring plan aimed at streamlining operations primarily by consolidating facilities in the United States and Europe. This restructuring resulted in a pre-tax charge of $202.8 million ($148.0 million after tax) in fiscal 2001. The restructuring was designed to consolidate certain facilities to bring together key decision-makers and streamline operations.

The Company recorded a pre-tax restructuring charge of $128.5 million related to its facilities consolidation, representing the undiscounted value of ongoing lease commitments offset by anticipated third party subleases. The charge also includes a pre-tax write-off of leasehold improvements and furniture and fixtures totaling $38.6 million. The charge did not include relocation costs to be incurred over the next 12 months and expensed as incurred. The cash outflow related to this action is being paid out over the length of committed lease terms of 7 to 11 years. In the six months ended June 30, 2002, the Company adjusted its facilities charge by $1.5 million as management has determined that it will use more facility space and receive less from certain future subleases than originally estimated in the restructuring plan.

The Company also recorded a pre-tax restructuring charge of $52.5 million related to the write-off of capitalized software and hardware related to terminated technology projects and the write-off of other fixed assets. In calculating the charge related to its asset write-off, the Company calculated the amount of the write-offs as the net book value of assets less the amount of estimated proceeds upon disposition for certain saleable assets, including real estate properties owned. In the six months ended June 30, 2002, a related party, though not obligated, reimbursed the Company for the value of the impairment of one of these properties, which was recorded in the initial restructuring charge. The reimbursement of approximately $0.7 million was offset by an additional increase in the restructuring accrual resulting from the identification of additional excess equipment of approximately $0.2 million and an additional increase related to realized losses on other of the aforementioned real estate properties of $0.4 million not originally estimated in the restructuring plan.

The restructuring accrual also included other pre-tax charges of $21.8 million in 2001 for committed expenses, termination of consulting agreements, severance and cancellation penalties on various services that will no longer be required in the facilities the Company is vacating. The Company increased the restructuring charge, included in Other below, by $2.9 million in the six months ended June 30, 2002 primarily for additional severance arrangements made with associates who were notified during the first and second quarters. Severance is recorded in the period in which affected associates are identified and communication is made to these individuals.

A summary of the facility restructuring charges is outlined as follows (in thousands):

	Facility Consolidation	Asset Write-Off	Other	Total
Facility restructuring charges recorded in fiscal 2001	$ 128,469	$ 52,532	$ 21,764	$ 202,765
Activity for fiscal 2001:				
Cash payments	(7,534)	(49)	(8,846)	(16,429)
Non-cash charges	(38,570)	(52,483)	(5,740)	(96,793)
Restructuring liabilities at December 31, 2001	82,365	—	7,178	89,543
Activity for the six months ended June 30, 2002:				
Adjustments and additional charges	(1,456)	(72)	2,933	1,405
Cash payments	(9,930)	—	(6,464)	(16,394)
Non-cash charges	(1,496)	72	—	(1,424)
Restructuring liabilities at June 30, 2002	$ 69,483	$ —	$ 3,647	$ 73,130

NOTE 4. EXECUTIVE AGREEMENT

In May 2002, the Company completed ongoing negotiations and executed a new two-year employment agreement (the “Employment Agreement”) with its Chairman of the Board and Chief Executive Officer (“CEO”). The Company previously disclosed the Employment Agreement on a Form 8-K filed on May 10, 2002. Among other terms (including, but not limited to, the reduction of the CEO’s salary to zero for at least the first year of the contract term and the limitations of any potential bonuses), the Employment Agreement and related

arrangements with the CEO contain the following concessions by the CEO that resulted in an immediate benefit to the Company and which were recorded as a non-recurring credit:

- The CEO waived his right to receive vested benefits in the Supplemental Executive Retirement Plan (“SERP”) totaling $16.1 million, previously deposited into a trust on his behalf on January 1, 2001 and 2002; these amounts had been previously recorded as part of general and administrative expenses in fiscal 2001. Of this amount, $14.0 million was returned to the Company and $2.1 million was paid out as a one-time bonus to non-executive associates of the Company.

- The CEO waived his right to have the Company defray payment for the tax effect of his restricted stock grants. An accrued liability for unpaid estimated taxes of $9.5 million for unvested shares as of March 31, 2002 was reversed and credited to executive agreement. Such amounts had been accrued in general and administrative expenses as follows: $7.3 million in fiscal 2001 and $2.2 million in the three months ended March 31, 2002.

As of June 30, 2002, the Company has reduced its SERP obligation to the CEO by $16.1 million for vested SERP contributions waived by the CEO. The $14.0 million in reduced SERP benefits that was retained by the Company combined with $9.5 million related to the foregone tax reimbursements on the restricted stock award, have been recorded as a non-recurring credit totaling $23.5 million to operating expenses for the three and six months ended June 30, 2002. The $2.1 million that was previously credited to the CEO’s SERP account and distributed to associates had no net effect on the results of operations.

NOTE 5. ACCOUNTING FOR DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING ACTIVITIES

The Company enters into derivative transactions principally to protect against the risk of market price or interest rate movements on the value of certain assets and future cash flows. The Company is also required to recognize certain contracts and commitments as derivatives when the characteristics of those contracts and commitments meet the definition of a derivative as promulgated by SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*.

Fair Value Hedges

The Company uses a combination of interest rate swaps, caps and floors to substantially offset the change in value of certain fixed rate assets. In calculating the effective portion of the fair value hedges under SFAS 133, the change in the fair value of the derivative is recognized currently in earnings, as is the change in value of the hedged item attributable to the risk being hedged. Accordingly, the net difference or hedge ineffectiveness, if any, is recognized currently in the consolidated statements of operations as fair value adjustments of financial derivatives in other non-operating income (expense). Fair value hedge ineffectiveness resulted in a loss of $1.9 million for the three months ended June 30, 2002, income of $0.3 million for the three months ended June 30, 2001, loss of $5.6 million for the six months ended June 30, 2002 and income of $1.8 million for the six months ended June 30, 2001.

During the three and six months ended June 30, 2002 and June 30, 2001, certain fair value hedges were derecognized and therefore hedge accounting was discontinued during the period. Changes in the fair value of these derivative instruments after the discontinuance of fair value hedge accounting are recorded in gain on sale of loans held-for-sale and securities-net, in the consolidated statements of operations, which totaled $3.0 million of losses for the three months ended June 30, 2002, $3.5 million of losses for the three months ended June 30, 2001, $4.1 million of gains for the six months ended June 30, 2002 and $5.2 million of losses for the six months ended June 30, 2001. In addition, the Company recognized $0.3 million for the three months ended June 30, 2002, $1.0 million for the three months ended June 30, 2001, $5.5 million for the six months ended June 30, 2002 and $1.2 million for the six months ended June 30, 2001, of hedge ineffectiveness expense in fair value adjustments of financial derivatives, related to these derecognized fair value hedges during the fair value hedge accounting period.

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The following table summarizes information related to our financial derivatives in fair value hedge relationships as of June 30, 2002 (dollars in thousands):

Assets Hedged	Notional Amount	Fair Value	Asset	Liability	Weighted Average Pay Rate	Weighted Average Receive Rate	Weighted Average Strike Rate	Weighted Average Remaining Life (years)
Loans:								
Pay fixed interest rate swaps	$ 2,061,973	$(41,888)	$ —	$ (41,888)	4.59%	1.88%	— %	3.13
Purchased interest rate options—caps	3,699,027	51,460	51,460	—	—	—	5.30	4.21
Purchased interest rate options—floors	1,168,000	8,801	8,801	—	—	—	4.52	3.98
Total Loans	6,929,000	18,373	60,261	(41,888)	4.59	1.88	5.11	3.85
Mortgage-Backed Securities:								
Pay fixed interest rate swaps	800,527	(15,683)	—	(15,683)	4.78	1.90	—	4.72
Purchased interest rate options—caps	2,027,973	58,817	58,817	—	—	—	5.46	5.39
Purchased interest rate options—floors	1,607,750	11,231	11,231	—	—	—	4.58	5.11
Total Mortgage-Backed Securities	4,436,250	54,365	70,048	(15,683)	4.78	1.90	5.07	5.17
Investment Securities:								
Pay fixed interest rate swaps	199,500	(3,070)	—	(3,070)	5.30	1.86	—	6.78
Total Fair Value Hedges	$11,564,750	$ 69,668	$130,309	$ (60,641)	4.68%	1.88%	5.09%	4.41

Cash Flow Hedges

The Company also uses interest rate swaps to hedge the variability of future cash flows associated with existing variable rate liabilities and forecasted issuances of liabilities. These cash flow hedge relationships are treated as effective hedges as long as the future issuances of liabilities remain probable and the hedges continue to meet the requirements of SFAS 133. The Company expects to reclassify approximately a pre-tax amount of $96.3 million of net unrealized losses reported in other comprehensive income ("OCI") to the consolidated statements of operations during the next twelve months. The Company expects to hedge the forecasted issuance of liabilities over a maximum term of seven years.

During the period ended June 30, 2002, the Company terminated $3.3 billion of notional amount of interest rate swaps in cash flow hedge relationships. The fair market value of the derivatives terminated was $(189.1) million as of their respective termination dates. The Company will reclassify the loss accumulated in OCI on the derivative instruments terminated to interest expense over the periods the hedged forecasted issuance of liabilities will affect earnings, which range from six months to 5.3 years. During the quarter ended June 30, 2002, the Company reclassified a pre-tax amount of $12.0 million from OCI to interest expense, related to the derivatives terminated.

The Company measures ineffectiveness for these cash flow hedges in accordance with SFAS 133 and reports this amount as fair value adjustments of financial derivatives in the non-operating income (expense) section of its consolidated statements of operations. The Company recognized $2.7 million of income for cash flow hedge ineffectiveness for the three months ended June 30, 2002 and $5.4 million for the six months ended June 30, 2002. The ineffectiveness for the three and six months ended June 30, 2001 did not have a material impact on earnings.

The following table summarizes information related to our financial derivatives in cash flow hedge relationships hedging variable rate liabilities and the forecasted issuances of liabilities, as of June 30, 2002 (dollars in thousands):

Liabilities Hedged	Notional Amount	Fair Value	Asset	Liability	Weighted Average Pay Rate	Weighted Average Receive Rate	Weighted Average Remaining Life (years)
Time Deposits:							
Pay fixed interest rate swaps	$ 790,500	$(55,249)	$ —	$ (55,249)	6.46%	2.38%	2.82
Repurchase Agreements:							
Pay fixed interest rate swaps	878,500	(13,419)	—	(13,419)	4.59	1.86	3.36
Federal Home Loan Bank Advances:							
Pay fixed interest rate swaps	235,000	(21,125)	—	(21,125)	7.02	1.88	3.12
Total Cash Flow Hedges	$1,904,000	$(89,793)	$ —	$ (89,793)	5.67%	2.08%	3.11

Mortgage Banking Activities

The Company enters into commitments to originate loans whereby the interest rate on the loan is determined prior to funding; these commitments are referred to as Interest Rate Lock Commitments (“IRLCs”). IRLCs on loans that are intended to be sold are considered to be derivatives and are therefore recorded at fair value with changes in fair value recorded in earnings. The net change in the IRLCs and the related hedging instruments resulted in a net loss of $2.3 million for the three months ended June 30, 2002, losses of $4.6 million for the three months ended June 30, 2001, gains of $0.3 million for the six months ended June 30, 2002 and losses of $5.6 million for the six months ended June 30, 2001.

NOTE 6. EXTRAORDINARY GAIN (LOSS) ON EARLY EXTINGUISHMENT OF DEBT

The Company recorded an extraordinary loss on early extinguishment of debt of $0.9 million (net of tax benefit of $0.5 million) for the three months ended June 30, 2002 and a $3.2 million gain (net of tax expense of $2.2 million) for the six months ended June 30, 2002. In the three months ended June 30, 2002, amounts recorded included $1.1 million gain (net of tax expense of $0.8 million) and for the six months ended June 30, 2002 amounts included a $5.2 million gain (net of tax expense of $3.5 million), on exchanges in the aggregate of $64.9 million of the Company’s 6% convertible subordinated notes for 6.5 million shares of common stock, offset by a $2.0 million loss (net of tax benefit of $1.3 million) for the three and six months ended June 30, 2002 as a result of the early redemptions of $100 million of adjustable rate advances from the Federal Home Loan Bank (“FHLB”). The FHLB advances were entered into as a result of normal funding requirements of the Company’s banking operations. The losses consisted primarily of prepayment penalties and costs associated with these early redemptions.

The Company recorded an extraordinary gain on early extinguishment of debt of $2.1 million (net of tax expense of $1.8 million) for the three months ended June 30, 2001 and $0.1 million gain (net of tax expense of $0.6 million) for the six months ended June 30, 2001. In the three and six months ended June 30, 2001, amounts recorded included a $5.0 million gain (net of tax expense of $3.4 million), on exchanges in the aggregate of $30.0 million of the Company’s 6% convertible subordinated notes for 2.7 million shares of common stock, offset by a $2.9 million loss (net of tax benefit of $1.6 million) for the three months ended June 30, 2001 and a $4.9 million loss (net of tax benefit of $2.8 million) for the six months ended June 30, 2001, recorded as a result of the early redemptions of $100 million and $600 million, respectively, of adjustable and fixed rate advances from the FHLB. The FHLB advances were entered into as a result of normal funding requirements of the Company’s banking operations. The losses consisted primarily of prepayment penalties and costs associated with these early redemptions.

NOTE 7. GOODWILL AND OTHER INTANGIBLE ASSETS

On January 1, 2002, the Company adopted SFAS No. 142, *Goodwill and Other Intangible Assets*, which requires that all intangible assets with finite useful lives be amortized and that goodwill and intangible assets with indefinite lives not be amortized, but rather tested upon adoption and at least annually for impairment. In accordance with SFAS 142, the Company discontinued the amortization of its recorded goodwill as of that date, identified its reporting units based on its current segment reporting structure and allocated all recorded goodwill, as well as other assets and liabilities, to the reporting units. The Company determined the fair value of its reporting units utilizing discounted cash flow models and relative market multiples for comparable businesses. The Company compared the fair value of each of its reporting units to its carrying value. This evaluation indicated that goodwill associated with its reporting units in the Global and Institutional and its Wealth Management segments were impaired. This impairment is primarily attributable to the change in the evaluation criteria for goodwill from an undiscounted cash flow approach, which was previously utilized under the guidance in Accounting Principle Board Opinion No. 17, to the fair value approach, which is stipulated in SFAS 142. A non-cash charge totaling $299.4 million has been recorded as a change in accounting principle effective January 1, 2002 to write-off goodwill of $292.6 million in the Global and Institutional segment and $6.8 million in the Wealth Management segment. The changes in carrying value of the remaining goodwill following this impairment write down, by segment, as of June 30, 2002 was (in thousands):

	Domestic Retail Brokerage and Other	Banking	Total
Balance as of January 1, 2002	$ 147,336	$ 114,046	$ 261,382
Goodwill due to Tradescape acquisition	71,708	—	71,708
Balance as of June 30, 2002	$ 219,044	$ 114,046	$ 333,090

Other intangible assets, which will continue to be amortized on a straight-line basis, consist of the following (in thousands):

	Weighted Average Useful Life(1) (years)	As of June 30, 2002			As of December 31, 2001		
		Gross Amount	Accumulated Amortization	Net Amount	Gross Amount	Accumulated Amortization	Net Amount
Specialist books	30	$ 59,800	$ 1,495	$ 58,305	$ 59,800	$ 506	$ 59,294
Active accounts(2)	7	54,229	15,279	38,950	52,599	7,514	45,085
ATM contracts	5	30,767	11,466	19,301	30,714	8,455	22,259
Deposit intangibles(2)	3	14,634	2,431	12,203	3,165	549	2,616
Proprietary agreements	7	13,500	85	13,415	—	—	—
Other	6	19,324	645	18,679	824	151	673
Total		$192,254	$ 31,401	$160,853	$147,102	$ 17,175	$129,927

(1) The Company evaluated the useful lives of its other intangible assets and determined that they should continue to be amortized based on the original useful lives assigned on a straight-line basis.
(2) Amortized using an accelerated method.

Amortization expense of other intangible assets was $7.6 million for the three months ended June 30, 2002, $14.3 million for the six months ended June 30, 2002, $1.1 million for the three months ended June 30, 2001 and $2.6 million for the six months ended June 30, 2001. Assuming no future impairments of these assets or additions as the result of acquisitions, annual amortization expense will be $15.0 million for the remainder of fiscal 2002, $28.4 million in fiscal 2003, $24.8 million in fiscal 2004, $16.2 million in fiscal 2005, $12.1 million in fiscal 2006 and $64.4 million thereafter.

A reconciliation of previously reported net income and earnings per share to the amounts adjusted for the exclusion of goodwill amortization is provided below (in thousands except per share amounts):

	Three Months Ended June 30,					
	2002			2001		
		Per Share			Per Share	
	Amount	Basic	Diluted	Amount	Basic	Diluted
Reported income (loss) before extraordinary items	$ 33,690	$ 0.09	$ 0.09	$ (12,306)	$ (0.04)	$ (0.04)
Add: Goodwill amortization	—	—	—	7,904	0.02	0.02
Adjusted income (loss) before extraordinary items	33,690	0.09	0.09	(4,402)	(0.02)	(0.02)
Extraordinary gain (loss)	(900)	0.00	0.00	2,111	0.01	0.01
Adjusted net income (loss)	$ 32,790	$ 0.09	$ 0.09	$ (2,291)	$ (0.01)	$ (0.01)

	Six Months Ended June 30,					
	2002			2001		
		Per Share			Per Share	
	Amount	Basic	Diluted	Amount	Basic	Diluted
Reported income (loss) before extraordinary items and cumulative effect of accounting change	$ 53,048	$ 0.15	$ 0.15	$ (19,472)	$ (0.06)	$ (0.06)
Add: Goodwill amortization	—	—	—	14,396	0.04	0.04
Adjusted income (loss) before extraordinary items	53,048	0.15	0.15	(5,076)	(0.02)	(0.02)
Extraordinary gain	3,174	0.01	0.01	74	0.00	0.00
Adjusted net income (loss)	$ 56,222	$ 0.16	$ 0.16	$ (5,002)	$ (0.02)	$ (0.02)

NOTE 8. NET INCOME (LOSS) PER SHARE

The following table sets forth the computation of the numerator and denominator used in the computation of basic and diluted net income (loss) per share (in thousands):

	Three Months Ended June 30,			Six Months Ended June 30,		
	2002		2001	2002		2001
	Basic income per share	Diluted income per share	Basic and diluted loss per share	Basic income (loss) per share	Diluted income (loss) per share	Basic and diluted loss per share
Numerator:						
Income (loss) before extraordinary items and cumulative effect of accounting change	$ 33,690	$ 33,690	$ (12,306)	$ 53,048	$ 53,048	$ (19,472)
Extraordinary gain (loss) on early extinguishment of debt, net of tax	(900)	(900)	2,111	3,174	3,174	74
Cumulative effect of accounting change	—	—	—	(299,413)	(299,413)	—
Net income (loss)	$ 32,790	$ 32,790	$ (10,195)	$ (243,191)	$ (243,191)	$ (19,398)
Denominator:						
Weighted average shares outstanding	356,760	356,760	321,550	351,822	351,822	319,405
Dilutive effect of options issued to associates	—	4,567	—	—	7,244	—
Dilutive effect of warrants outstanding	—	1,171	—	—	763	—
	356,760	362,498	321,550	351,822	359,829	319,405

Because the Company reported a loss before cumulative effect of accounting change for the three and six months ended June 30, 2001, the calculation of diluted loss per share does not include common stock equivalents as they are anti-dilutive and would result in a reduction of loss per share. If the Company had reported net income for the three months ended June 30, 2001, there would have been 6,535,000 additional shares for options outstanding and 198,000 additional shares for warrants outstanding. If the Company had reported net income for the six months ended June 30, 2001, there would have been 8,412,000 additional shares for options outstanding and 198,000 additional shares for warrants outstanding. Shares of common stock issuable under convertible subordinated notes were excluded from the calculations of diluted loss per share, as the effect of applying the treasury stock method on an as-if-converted basis would be anti-dilutive, of approximately 45,687,000 for the three months ended June 30, 2002, 46,564,000 for the six months ended June 30, 2002, 37,724,000 for the three months ended June 30, 2001 and 32,661,000 for the six months ended June 30, 2001.

The following options to purchase shares of common stock have not been included in the computation of diluted net income (loss) per share because the options' exercise price was greater than the average market price of the Company's common stock for the periods presented, and therefore, the effect would be anti-dilutive (in thousands, except exercise price data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2002	2001	2002	2001
Options excluded from computation of diluted net loss per share	26,661	18,964	18,616	18,816
Exercise price ranges:				
High	$ 58.19	$ 58.19	$ 58.19	$ 58.19
Low	$ 6.91	$ 7.97	$ 8.27	$ 9.18

NOTE 9. BROKERAGE RECEIVABLES—NET AND PAYABLES

Brokerage receivables—net and payables consist of the following (in thousands):

	June 30, 2002	December 31, 2001
Receivable from customers and non-customers (less allowance for doubtful accounts of $2,817 at June 30, 2002 and $3,608 at December 31, 2001)	$ 1,510,331	$ 1,631,845
Receivable from brokers, dealers and clearing organizations:		
Net settlement and deposits with clearing organizations	128,550	113,527
Deposits paid for securities borrowed	235,946	371,682
Securities failed to deliver	2,170	776
Other	11,058	21,323
Total brokerage receivables—net	$ 1,888,055	$ 2,139,153
Payable to customers and non-customers	$ 2,018,879	$ 2,018,352
Payable to brokers, dealers and clearing organizations:		
Deposits received for securities loaned	426,656	648,168
Securities failed to receive	2,098	1,491
Other	32,136	31,973
Total brokerage payables	$ 2,479,769	$ 2,699,984

Receivable from and payable to brokers, dealers and clearing organizations result from the Company's brokerage activities. Receivable from customers and non-customers represents credit extended to customers and non-customers to finance their purchases of securities on margin. Credit extended to customers and non-customers with respect to margin accounts was $1,299 million at June 30, 2002 and $1,537 million at

December 31, 2001. Securities owned by customers and non-customers are held as collateral for amounts due on margin balances, the value of which is not reflected in the accompanying consolidated balance sheets. As of June 30, 2002, the Company has received collateral primarily in connection with securities borrowed and customer margin loans with a market value of $1,616 million, which it can sell or repledge. Of this amount, $590 million has been pledged or sold as of June 30, 2002 in connection with securities loans, bank borrowings and deposits with clearing organizations. Included in deposits paid for securities borrowed and deposits received for securities loaned at June 30, 2002 are amounts from transactions involving MJK Clearing and three other brokers. The parties in this transaction have a dispute over the amounts owed, as more fully described in Note 15 “Commitments, Contingencies and Other Regulatory Matters.” Payable to customers and non-customers represents free credit balances and other customer and non-customer funds pending completion of securities transactions. The Company pays interest on certain customer and non-customer credit balances.

NOTE 10. INVESTMENTS

Investments are comprised of trading and available-for-sale debt and equity securities, as defined under the provisions of SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Also included in investments are investments in entities in which the Company owns between 20% and 50%, or in which there are other indicators of significant influence. These investments are generally accounted for using the equity method; those investments in which there is a less than 20% ownership are generally carried at cost. Investments consist of the following (in thousands):

	June 30, 2002	December 31, 2001
Trading securities	$ 280,418	$ 87,392
Available-for-sale investment securities	782,711	998,487
Equity method and other investments:		
Joint ventures	63,166	28,664
Venture capital funds	21,601	17,553
Other investments	40,832	36,527
Total investments	$ 1,188,728	$ 1,168,623

Included in available-for-sale securities are investments in several companies that are publicly traded and carried at fair value. Unrealized gains related to available-for-sale investments were $1.0 million at June 30, 2002 and $6.9 million at December 31, 2001. Unrealized losses related to available-for-sale investments were $23.5 million at June 30, 2002 and $19.9 million at December 31, 2001.

During the quarter ended June 30, 2002, the Company contributed approximately $6.5 million to a related party venture fund, E*TRADE eCommerce Fund, L.P. and $2.3 million to the ArrowPath Fund II, L.P. During the six months ended June 30, 2002, the Company recorded impairment write-downs of approximately $3.1 million associated with a privately-held equity investment and $2.1 million associated with E*TRADE eCommerce Fund, L.P.

Joint Ventures

In June 1998, the Company entered into a joint venture agreement with SOFTBANK Corporation, a related party, forming E*TRADE Japan K.K. to provide online securities trading services to residents of Japan. As part of its commitment to the joint venture, the Company was required to provide a continuing level of systems support to E*TRADE Japan K.K. In April 2002, the Company entered into a definitive agreement to terminate its systems support obligations and agreed to provide transition services through July 2003. The Company incurred system support costs of $0.9 million in the three months ended June 30, 2002, $2.4 million in the six months ended June 30, 2002, $0.8 million in the three months ended June 30, 2001 and $1.0 million in the six months ended June 30, 2001.

In May 2002, the Company purchased 31,250 of newly issued shares in E*TRADE Japan K.K. in exchange for 3.4 million shares of the Company's common stock in a private transaction, valued based on the fair market value of the Company's common stock on that day at $30.7 million. Following the transaction, the Company's ownership in E*TRADE Japan K.K. increased from 29% to 36%.

NOTE 11. RELATED PARTY TRANSACTION

As of June 30, 2002, the Company had outstanding advances of $4.5 million to a founder and director of the Company, which were fully repaid by the director as of August 12, 2002. These advances accrued interest at a rate of 3.75% annually (based on the applicable federal rate) and were collateralized by shares of the Company's common stock currently held in the name of the director. Proceeds from these advances were used as additional collateral for securities of the director.

NOTE 12. LINE OF CREDIT AND OTHER BORROWINGS

In November 2001, the Company renewed a $50 million line of credit under an agreement with a bank that expires in October 2002. Utilizations under the line of credit are collateralized by investment securities that are owned by the Company. Borrowings under the line of credit bear interest at 0.35% above LIBOR (2.19% at June 30, 2002). As of June 30, 2002, the Company had less than $1.0 million in a standby letter of credit outstanding under this line.

The Company has one installment purchase contract and term loans from financial institutions which are collateralized by equipment owned by the Company. Borrowings under these term loans bear interest at 3.00% to 3.25% above LIBOR (4.84% to 5.09% at June 30, 2002). The Company had approximately $9.5 million outstanding under these loans at June 30, 2002, which is included in accounts payable, accrued and other liabilities.

NOTE 13. OTHER BORROWINGS

In June 2002, ETFC formed ETFC Capital Trust V ("ETFCCT V"), a business trust formed solely for the purpose of issuing capital securities, which ETFCCT V sold at par, 15,000 shares of Floating Rate Cumulative Preferred Securities, with a liquidation amount of $1,000 per capital security, for a total of $15.0 million and invested the net proceeds in ETFC's Floating Rate Junior Subordinated Debentures. These subordinated debentures mature in 2032 and have a variable annual dividend rate at 3.65% above the three-month LIBOR, payable quarterly, beginning in September 2002. The net proceeds were invested in the Bank and used for the Bank's general corporate purposes, which include funding the Bank's continued growth.

In April 2002, ETFC formed ETFC Capital Trust IV ("ETFCCT IV"), a business trust formed solely for the purpose of issuing capital securities, which ETFCCT IV sold at par, 10,000 shares of Floating Rate MMCapS, with a liquidation amount of $1,000 per capital security, for a total of $10.0 million and invested the net proceeds in ETFC's Floating Rate Junior Subordinated Debentures. These subordinated debentures mature in 2032 and have a variable annual dividend rate at 3.70% above the six-month LIBOR, payable semi-annually, beginning in October 2002. The net proceeds were invested in the Bank and used for the Bank's general corporate purposes, which include funding the Bank's continued growth.

NOTE 14. COLLATERALIZED DEBT OBLIGATION

In September 2001, the Company entered into a Warehousing Agreement with a financial advisor for the purpose of acquiring a portfolio of investment grade asset-backed securities ("Collateral"). The financial advisor and the Company intend to transfer this Collateral into one or more newly formed special purpose entities which will sell certain classes of notes to be secured by the Collateral. The terms of the agreement required the Company to make a $10 million deposit which can be applied against any net loss realized by the advisor if

certain defined events occur, which result in the notes not being sold and the Collateral being liquidated; the Company has no liability for net losses in excess of the deposit in the event of liquidation of the Collateral. At June 30, 2002, the financial advisor had purchased $171.1 million of Collateral, which had unrealized gains of $0.3 million at June 30, 2002.

NOTE 15. COMMITMENTS, CONTINGENCIES AND OTHER REGULATORY MATTERS

In the ordinary course of its business, E*TRADE Securities engaged in certain stock loan transactions with MJK Clearing, Inc. (“MJK”), involving the lending of Nasdaq-listed common stock of GenesisIntermedia, Inc. (“GENI”) and other securities from MJK to E*TRADE Securities. Subsequently, E*TRADE Securities redelivered the GENI and/or other securities received from MJK to three other broker-dealers: Wedbush Morgan Securities (“Wedbush”), Nomura Securities, Inc. (“Nomura”) and Fiserv Securities, Inc. (“Fiserv”). On September 25, 2001, Nasdaq halted trading in the stock of GENI, which had last traded at a price of $5.90 before the halt. Subsequently, MJK was ordered to cease operations by the SEC.

Wedbush, Nomura and Fiserv have commenced separate legal actions against E*TRADE Securities. These actions seek various forms of equitable relief and seek repayment of a total of approximately $60.0 million, plus interest, received by E*TRADE Securities in connection with the GENI and other stock loan transactions. Such amounts are included in deposits paid for securities borrowed and deposits received for securities loaned at June 30, 2002 in the accompanying consolidated balance sheets. E*TRADE Securities believes that the plaintiffs must look to MJK as the debtor for repayment, and that it has defenses in each of these actions and will vigorously defend itself in all matters. E*TRADE Securities is unable to predict the ultimate outcome or the amount of any potential losses.

As of June 30, 2002, the Bank had commitments to purchase $273.7 million in fixed rate and $278.2 million in variable rate loans, commitments to originate $509.6 million in fixed rate and $68.9 million in variable rate loans and commitments to sell $181.0 million in mortgage-backed securities. In addition, the Bank had certificates of deposit approximating $2.8 billion scheduled to mature in less than one year. In the normal course of business, the Bank makes various commitments to extend credit and incur contingent liabilities that are not reflected in the accompanying consolidated balance sheets.

The Company is a defendant in civil actions arising in the normal course of business. These currently include, among other actions, putative class actions alleging various causes of action for “unfair or deceptive business practices” that were filed against the Company between November 21, 1997 and March 11, 1999, as a result of various systems interruptions that the Company previously experienced. To date, only one of these putative class actions has been certified. The Company believes that these actions are without merit and intends to defend against them vigorously. An unfavorable outcome in any of these matters for which the Company’s pending insurance claims are rejected could harm the Company’s business.

The securities and banking industries are subject to extensive regulation under federal, state and applicable international laws. As a result, the Company is required to comply with many complex laws and rules and its ability to so comply is dependent in large part upon the establishment and maintenance of a qualified compliance system. From time to time, the Company has been threatened with, or named as a defendant in, lawsuits, arbitrations and administrative claims involving securities, banking and other matters. The Company is also subject to periodic regulatory audits and inspections. Compliance and trading problems that are reported to regulators such as the SEC, the National Association of Securities Dealers Regulation, Inc. (“NASDR”) or the Office of Thrift Supervision (“OTS”) by dissatisfied customers or others are investigated by such regulators, and may, if pursued, result in formal claims being filed against the Company by customers and/or disciplinary action being taken against the Company by regulators. Any such claims or disciplinary actions that are decided against the Company could harm the Company’s business.

The Company maintains insurance coverage in such amounts and with such coverages, deductibles and policy limits as management believes are reasonable and prudent. The principal insurance coverage it maintains covers comprehensive general liability, commercial property damage, hardware/software damage, directors and officers, certain criminal acts against the Company and errors and omissions. The Company believes that such insurance coverage is adequate for the purpose of its business. The Company's ability to maintain this level of insurance coverage in the future, however, is subject to the availability of affordable insurance in the market place, and world events, including the terrorist attacks of September 11, 2001, may impair the Company's ability to obtain insurance in the future.

NOTE 16. SHAREOWNERS' EQUITY

Deferred Stock Compensation

Amortization of deferred stock compensation was $1.7 million for the three months ended June 30, 2002, $4.6 million for the six months ended June 30, 2002, $2.6 million for the three months ended June 30, 2001 and $4.1 million for the six months ended June 30, 2001.

Stock Repurchase

During the three months ended June 30, 2002, the Company repurchased approximately 2.7 million shares of common stock for an aggregate purchase price of approximately $15.1 million. These shares were purchased under a multi-year stock buyback program approved by the Company's Board of Directors in September 2001 authorizing the Company to repurchase up to 50.0 million shares of common stock. In July 2002, the Company purchased approximately 3.4 million shares of its common stock from SOFTBANK Holdings, Inc. in a private transaction at a purchase price of $3.60 per share. Pursuant to the stock buyback program, the Company remains authorized to repurchase up to 13.4 million additional shares, subsequent to the shares purchased in July.

NOTE 17. COMPREHENSIVE INCOME (LOSS)

The reconciliation of net income (loss) to comprehensive income (loss) is as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2002	2001	2002	2001
Net income (loss)	$ 32,790	$ (10,195)	$ (243,191)	$ (19,398)
Changes in other comprehensive income (loss):				
Unrealized loss on available-for-sale securities, net of tax	(4,309)	(19,322)	(23,245)	(26,673)
Reclassification of realized (gains) losses on available-for-sale securities, net of tax	41,883	(1,166)	30,907	(21,263)
Unrealized gain (loss) on derivative instruments, net of tax, and reclassification adjustments (see Note 5)	(19,272)	26,158	(3,711)	(24,810)
Amortization of de-designated and terminated hedges and transition adjustments, net of tax	(9,363)	9,490	(9,100)	10,910
Cumulative translation adjustments	5,766	277	5,520	(4,020)
Total comprehensive income (loss)	$ 47,495	$ 5,242	$ (242,820)	$ (85,254)

NOTE 18. SEGMENT INFORMATION

Segment Information

The Company has separated its financial services into four categories: Domestic Retail Brokerage; Banking; Global and Institutional; and Wealth Management and Other. There have been no changes to these categories from fiscal 2001. As the Wealth Management and Other operations business represents emerging activities which are not currently material to the consolidated results and has characteristics comparable to the offerings of other retail brokerage firms, management has aggregated Wealth Management and Other with Domestic Retail Brokerage to form one of three reportable segments. Corporate administration costs are included in Domestic Retail Brokerage and Other.

Financial information for the Company's reportable segments is presented in the table below, and the totals are equal to the Company's consolidated amounts as reported in the unaudited condensed consolidated financial statements (in thousands):

	Domestic Retail Brokerage & Other	Banking	Global and Institutional	Total
Three Months Ended June 30, 2002:				
Interest income—net of interest expense	$ 45,598	$ 53,572	$ 2,288	$ 101,458
Non-interest revenue—net of provision for loan losses	129,541	47,361	37,702	214,604
Net revenues	$ 175,139	$ 100,933	$ 39,990	$ 316,062
Operating income (loss)	$ 34,686	$ 43,886	$ (4,300)	$ 74,272
Three Months Ended June 30, 2001:				
Interest income—net of interest expense	$ 51,920	$ 38,286	$ 2,133	$ 92,339
Non-interest revenue—net of provision for loan losses	138,185	40,576	37,079	215,840
Net revenues	$ 190,105	$ 78,862	$ 39,212	$ 308,179
Operating income (loss)	$ (4,369)	$ 22,373	$ (10,547)	$ 7,457
Six Months Ended June 30, 2002:				
Interest income—net of interest expense	$ 92,723	$ 107,389	$ 4,321	$ 204,433
Non-interest revenue—net of provision for loan losses	266,698	100,660	75,148	442,506
Net revenues	$ 359,421	$ 208,049	$ 79,469	$ 646,939
Operating income (loss)	$ 32,520	$ 95,338	$ (8,719)	$ 119,139
Cumulative effect of accounting change	$ (6,823)	$ —	$ (292,590)	$ (299,413)
Six Months Ended June 30, 2001:				
Interest income—net of interest expense	$ 111,568	$ 74,605	$ 4,495	$ 190,668
Non-interest revenue—net of provision for loan losses	296,879	75,871	74,342	447,092
Net revenues	$ 408,447	$ 150,476	$ 78,837	$ 637,760
Operating income (loss)	$ (12,550)	$ 46,833	$ (23,900)	$ 10,383
As of June 30, 2002:				
Segment assets	$ 3,507,367	$ 14,627,858	$ 691,692	$ 18,826,917
As of December 31, 2001:				
Segment assets	$ 4,272,345	$ 13,458,433	$ 441,636	$ 18,172,414

No single customer accounted for greater than 10% of total revenues in the three and six months ended June 30, 2002 or 2001.

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NOTE 19. REGULATORY REQUIREMENTS

E*TRADE Securities is subject to the Uniform Net Capital Rule (the "Rule") under the Securities Exchange Act of 1934 administered by the SEC and the NASDR, which requires the maintenance of minimum net capital. E*TRADE Securities has elected to use the alternative method permitted by the Rule, which requires that E*TRADE Securities maintain minimum net capital equal to the greater of $250,000 or two percent of aggregate debit balances arising from customer transactions, as defined. E*TRADE Securities had amounts in relation to the Rule as follows (dollars in thousands):

	June 30, 2002	December 31, 2001
Net capital	$ 125,535	$ 240,141
Percentage of aggregate debit balances	9%	14%
Required net capital	$ 27,775	$ 34,208
Excess net capital	$ 97,760	$ 205,933

Under the alternative method, a broker-dealer may not repay subordinated borrowings, pay cash dividends or make any unsecured advances or loans to its parent or employees if such payment would result in net capital of less than 5% of aggregate debit balances or less than 120% of its minimum dollar amount requirement. In January 2002, E*TRADE Securities paid a dividend to E*TRADE Group in the amount of $50 million.

The table below summarizes the minimum capital requirements for the Company's other U.S. broker-dealer subsidiaries (in thousands):

	June 30, 2002			December 31, 2001		
	Required Net Capital	Net Capital	Excess Net Capital	Required Net Capital	Net Capital	Excess Net Capital
E*TRADE Institutional Securities, Inc.	$ 271	$ 7,104	$ 6,833	$ 250	$6,407	$ 6,157
E*TRADE Global Asset Management, Inc.	$ 100	$20,865	$ 20,765	$ 282	$8,999	$ 8,717
E*TRADE Canada Securities Corporation	$ 100	$ 260	$ 160	$ 100	$ 283	$ 183
GVR Company, LLC	$ 1,000	$ 4,012	$ 3,012	$ 1,000	$4,100	$ 3,100
Dempsey & Company, LLC	$ 549	$17,279	$ 16,730	$ 802	$8,787	$ 7,985
Tradescape Securities, LLC	$ 100	$ 148	$ 48	$ N/A	$ N/A	$ N/A
Momentum Securities, LLC	$ 688	$ 906	$ 218	$ N/A	$ N/A	$ N/A
E*TRADE Marquette Securities, Inc.	$ N/A	$ N/A	$ N/A	$ 250	$ 532	$ 282
Web Street and subsidiary	$ N/A	$ N/A	$ N/A	$ 250	$ 796	$ 546

In June 2002, the Company discovered that Momentum Securities, LLC ("Momentum") was deficient on its net capital for the month ending May 31, 2002. This deficiency was prior to the Company's acquisition of Momentum effective June 3, 2002. Since its acquisition of Momentum, the Company has contributed a total of approximately $8 million to Momentum so that it may meet all of its operational and capital requirements.

In April 2002, the Company withdrew and closed E*TRADE Marquette Securities, Inc. and Web Street and subsidiary broker-dealers and has consolidated the activities into the Company's other broker-dealer subsidiaries. The Company's broker-dealer subsidiaries, located in Canada, Europe and South East Asia, have various and differing capital requirements, all of which were met at June 30, 2002 and December 31, 2001. At June 30, 2002, these companies had an aggregate net capital of $79.4 million, required net capital of $28.3 million and excess net capital of $51.1 million. At December 31, 2001, these companies had an aggregate net capital of $69.7 million, required net capital of $29.7 million and excess net capital of $40.0 million.

The Bank is also subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory—and possibly additional discretionary—actions by regulators that, if undertaken, could have a direct material effect on the Bank's

financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank’s assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank’s capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of Total and Tier I Capital to risk-weighted assets, Core Capital to adjusted tangible assets and Tangible Capital to tangible assets. Management believes that, as of June 30, 2002 the Bank has met all capital adequacy requirements to which it was subject. As of June 30, 2002 and December 31, 2001, the OTS categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum Total and Tier I Capital to risk-weighted assets and Core Capital to adjusted tangible assets as set forth in the following table. There are no conditions or events since that notification that management believes have changed the institution’s category. Events beyond management’s control, such as fluctuations in interest rates or a downturn in the economy in areas in which the Bank’s loans or securities are concentrated, could adversely affect future earnings and consequently, the Bank’s ability to meet its future capital requirements.

The Bank’s required and actual capital amounts and ratios are presented in the table below (dollars in thousands):

	Actual		Required for Capital Adequacy Purposes		Required to be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of June 30, 2002:						
Total Capital to risk-weighted assets	$914,721	12.46%	>$587,084	>8.0%	>$733,855	>10.0%
Tier I Capital to risk-weighted assets	$899,117	12.25%	N/A	N/A	>$440,313	>6.0%
Core Capital to adjusted tangible assets	$899,117	6.19%	>$581,307	>4.0%	>$726,633	>5.0%
Tangible Capital to tangible assets	$899,117	6.19%	>$217,990	>1.5%	N/A	N/A
As of December 31, 2001:						
Total Capital to risk-weighted assets	$836,866	11.52%	>$580,986	>8.0%	>$726,233	>10.0%
Tier I Capital to risk-weighted assets	$819,367	11.28%	N/A	N/A	>$435,740	>6.0%
Core Capital to adjusted tangible assets	$819,367	6.07%	>$539,671	>4.0%	>$674,588	>5.0%
Tangible Capital to tangible assets	$819,367	6.07%	>$202,377	>1.5%	N/A	N/A

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

*Statements made in this document, other than statements of historical information, are forward-looking statements that are made pursuant to the safe harbor provisions of Section 21E of the Securities Exchange Act of 1934. These forward-looking statements may sometimes be identified by words such as "expect", "may", "looking forward", "we plan", "we believe", "are planned", "could be" and "currently anticipate". Although we believe these statements, as well as other oral and written forward-looking statements made by us or on behalf of E*TRADE Group, Inc. from time to time, to be true and reasonable, we can give no assurance that these plans, intentions or expectations will be achieved. Actual results, performance or achievements could differ materially from those contemplated, expressed or implied by the forward-looking statements. Important factors that could cause actual results to differ materially from our forward-looking statements are set forth in our other filings with the SEC, and in this document under the heading "Risk Factors", beginning in the section captioned "Management's Discussion and Analysis of Financial Condition and Results of Operations". We caution that the risks and factors discussed below and in such filings are not exclusive. We do not undertake to update any forward-looking statement that may be made from time to time by or on behalf of E*TRADE.*

Critical Accounting Policies and Estimates

The preparation of our financial results of operations and financial position require us to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and related notes for the period presented, and actual results could differ from our estimates. The critical accounting estimates, which are both important to the portrayal of our financial condition and which require complex, subjective judgments, are accrued restructuring costs, determination of the allowance for loan losses, the classification and carrying value of investments, accounting for financial derivatives, the recognition of deferred tax assets and the valuation of goodwill; these areas are more fully described in "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for the year ended December 31, 2001.

Results of Operations

Key Performance Indicators

The following tables set forth several key performance indicators, including the operations of Tradescape since the date of acquisition on June 3, 2002, which management utilizes in measuring our performance and in explaining the results of our operations for the comparative three and six months presented and as of June 30, 2002 and December 31, 2001 (dollars in thousands except cost per net new account and average commission per global brokerage transaction):

	June 30, 2002	December 31, 2001	Percentage Change
Active global brokerage accounts(1)(2)	3,648,234	3,511,941	4%
Active banking accounts(3)	503,830	490,913	3%
Total active accounts at period end	4,152,064	4,002,854	4%
Total assets in global brokerage accounts(2)	$ 38,012,376	$ 44,764,197	(15)%
Total deposits in banking accounts	8,334,718	8,082,859	3%
Total assets/deposits in customer accounts at period end	$ 46,347,094	$ 52,847,056	(12)%

	Three Months Ended June 30,		Percentage Change	Six Months Ended June 30,		Percentage Change
	2002	2001		2002	2001	
Net new global brokerage accounts(1)(2)	50,018	73,450	(32)%	136,293	197,414	(31)%
Net new banking accounts(3)	(15,324)	30,039	(151)%	12,917	72,187	(82)%
Total net new accounts	34,694	103,489	(66)%	149,210	269,601	(45)%
Cost per net new account	$ 496	$ 232	114%	$ 324	$ 328	(1)%
Total global brokerage transactions(2)	6,954,474	7,424,353	(6)%	13,099,139	15,834,366	(17)%
Daily average global brokerage transactions(2)	108,664	117,847	(8)%	105,638	126,675	(17)%
Average commission per global brokerage transaction(2)	$ 10.26	$ 13.49	(24)%	$ 11.75	$ 13.64	(14)%

(1) Global brokerage accounts are considered active if the account has a positive asset balance, or if a trade has been made in the account in the past six months or if the account was opened in connection with a corporate employee stock benefit program. Customers may have separate or multiple accounts for each relationship they maintain with us, including separate or multiple brokerage and banking accounts.
(2) Global brokerage account, transaction and asset data includes domestic and international information.
(3) Bank deposit accounts are considered active if a customer has made an initial deposit and the account is not considered abandoned or dormant under applicable Federal and State laws, and the account has not been closed. Bank loan accounts are considered active if the Company owns marketing rights to the account or customer.

The following table sets forth the increases and decreases in average customer margin balances, average customer money market fund balances, average stock borrow balances, average stock loan balances and average customer credit balances for the three and six months indicated (dollars in millions):

	Three Months Ended June 30,		Percentage Change	Six Months Ended June 30,		Percentage Change
	2002	2001		2002	2001	
Average customer margin balances	$ 1,451	$ 2,057	(29)%	$ 1,496	$ 2,486	(40)%
Average customer money market fund balances	$ 7,917	$ 8,634	(8)%	$ 8,183	$ 8,615	(5)%
Average stock borrow balances	$ 245	$ 1,954	(87)%	$ 250	$ 1,741	(86)%
Average stock loan balances	$ 389	$ 2,321	(83)%	$ 452	$ 2,457	(82)%
Average customer credit balances	$ 1,426	$ 1,304	9%	$ 1,463	$ 1,315	11%

The following table sets forth the components of both gross and net revenues and percentage change information related to certain items on our consolidated statements of operations for the periods indicated (dollars in thousands):

	Three Months Ended June 30,			Six Months Ended June 30,		
	2002	2001	Percentage Change	2002	2001	Percentage Change
Brokerage revenues:						
Commission	$ 71,352	$ 100,173	(29)%	$ 153,879	$ 215,998	(29)%
Principal transactions	52,092	31,441	66%	107,407	62,613	72%
Other brokerage-related	43,799	43,650	0%	80,560	92,610	(13)%
Interest income	50,975	80,718	(37)%	104,026	181,463	(43)%
Interest expense	(3,089)	(26,665)	(88)%	(6,982)	(65,400)	(89)%
Net brokerage revenues	215,129	229,317	(6)%	438,890	487,284	(10)%
Banking revenues:						
Gain on sales of originated loans	22,613	24,871	(9)%	47,288	34,055	39%
Gain on sale of loans held-for-sale and securities—net	17,054	8,314	105%	38,676	27,424	41%
Other banking-related	12,077	9,047	33%	22,461	17,491	28%
Interest income	191,424	217,797	(12)%	394,092	434,482	(9)%
Interest expense	(137,852)	(179,511)	(23)%	(286,703)	(359,877)	(20)%
Provision for loan losses	(4,383)	(1,656)	165%	(7,765)	(3,099)	151%
Net banking revenues	100,933	78,862	28%	208,049	150,476	38%
Total net revenues	$ 316,062	$ 308,179	3%	$ 646,939	$ 637,760	1%

Revenues

Beginning in January 2002, we changed our presentation of revenue from that previously presented; however, no changes to our accounting policies or methods were made. Under the new format, net brokerage revenues consist of commissions, principal transactions, other brokerage-related revenues, interest income and interest expense. Commissions include domestic and international transaction revenues. Previously, international transactions were included under the caption “global and institutional.” Principal transactions include revenues from institutional activities, previously included in global and institutional, and market-making activities, previously included in other revenues. Other brokerage-related revenues include payments for order flow, Business Solutions Group revenue, advertising revenue, mutual fund revenue and fees for brokerage-related services, including account maintenance fees and order handling fees. Except for payments for order flow, which was previously included in transaction revenues, other brokerage-related items were included in other revenues. Net banking revenues consist of gain on sale of originated loans, gain on sale of loans held-for-sale and securities—net, other banking-related revenues, interest income, interest expense and provision for loan losses. Other banking-related revenues are primarily comprised of automated teller machine revenues.

Total net revenues increased 3% for the three months ended June 30, 2002 and 1% for the six months ended June 30, 2002 from the comparable periods in 2001. Net brokerage revenues decreased 6% for the three months June 30, 2002 and 10% for the six months ended June 30, 2002 from the comparable periods in 2001. The decrease in brokerage revenues for both periods was mainly due to decreases in commission revenues, other brokerage-related revenues and net interest income, offset by an increase in principal transactions reflecting our acquisition of Dempsey in October 2001. Net banking revenues increased 28% for the three months ended June 30, 2002 and 38% for the six months ended June 30, 2002 from the comparable periods in 2001. The increase in net banking revenues for both periods was mainly due to increases in net interest income, gain on sale of loans held-for-sale and securities—net and other banking-related revenues.

Brokerage Revenues

Commission revenues, which are earned as customers execute securities transactions, decreased 29% for the three months and six months ended June 30, 2002 from the comparable periods in 2001. These revenues are primarily affected by global brokerage transaction volume, the average commission per global brokerage transaction and the transaction mix.

Daily average global brokerage transactions decreased 8% for the three months ended June 30, 2002 and 17% for the six months ended June 30, 2002 from the comparable periods in 2001, largely reflective of a continuing market decline. A decrease in the average commission per global brokerage transaction from $13.49 for the three months ended June 30, 2001 to $10.26 for the three months ended June 30, 2002 also affected the decrease in commission revenues. For the six months ended June 30, 2002, as compared to the comparable period in 2001, the average commission per global brokerage transaction decreased 14% from $13.64 for the six months ended June 30, 2001 to $11.75 for the six months ended June 30, 2002. Contributing to the decrease in commissions per global brokerage transaction is the acquisition of Tradescape which alone provided approximately 83,000 average daily global transactions for the month of June 2002, and typically has lower commissions per transaction. The decrease in commission revenues was also affected by transaction mix, with option transactions, which have higher commissions than equity transactions, representing a smaller percentage of total transactions for the three and six months ended June 30, 2002 compared to the same periods in 2001.

Principal transactions, which comprise our institutional and market-making revenues, increased 66% for the three months ended June 30, 2002 and 72% for the six months ended June 30, 2002, from the comparable periods in 2001. These increases are primarily due to market-making revenues from Dempsey. There were no revenues from market-making activities prior to our acquisition of Dempsey in October 2001.

Other brokerage-related revenues, which are mainly comprised of payments for order flow, Business Solutions Group revenue, advertising revenue, mutual fund revenues and fees for brokerage-related services, including account maintenance fees and order handling fees, remained flat for the three months ended June 30, 2002 and decreased 13% for the six months ended June 30, 2002, from the comparable periods in 2001. The decrease for the six months ended June 30, 2001 is primarily due to a decrease in payment for order flow revenue partially offset by an increase in other brokerage-related fees. The decrease in payment for order flow revenue is primarily due to competitive forces and the advent of decimalization in the major market exchanges beginning in January 2001 and implemented by Nasdaq in March 2001. Further, following the acquisition of Dempsey in October 2001, revenues from order flow executed through Dempsey is eliminated in our consolidation of operating results.

Interest income from brokerage-related activities is primarily comprised of interest earned by our brokerage subsidiaries on credit extended to customers to finance their purchases of securities on margin and fees on customer assets invested in money market accounts. Brokerage interest income decreased 37% for the three months ended June 30, 2002 and 43% for the six months ended June 30, 2002, from the comparable periods in 2001. The decrease in brokerage interest income primarily reflects the decrease in average customer margin balances, which decreased 29% for the three months ended June 30, 2002 and 40% for the six months ended June 30, 2002. The continued market decline over the past year and the economic recession has reduced borrowing on margin by customers as a means of leveraging their investments.

Interest expense from brokerage-related activities is primarily comprised of interest paid to customers on certain credit balances, interest paid to banks and interest paid to other broker-dealers through our brokerage subsidiary’s stock loan program. Brokerage interest expense decreased 88% for the three months ended June 30, 2002 and 89% for the six months ended June 30, 2002, from the comparable periods in 2001. The decrease in brokerage interest expense primarily reflects an overall decrease in average customer credit rates and average stock loan balances, which decreased 83% for the three months ended June 30, 2002 and 82% for the six months ended June 30, 2002, from the comparable periods in 2001.

Banking Revenues

Gain on sales of originated loans decreased 9% for the three months ended June 30, 2002 and increased 39% for the six months ended June 30, 2002, from the comparable periods in 2001. The decrease for the three months ended June 30, 2002, is due to a decreased level of volume of originations as compared to the prior year quarter. The increase for the six months ended June 30, 2002, is due to an increased level of volume of originations in the March 2002 quarter as compared to the prior year quarter, primarily as a result of our acquisition of E*TRADE Mortgage in February 2001. The March 2002 quarter benefited from a full three months of activity as compared to two months in the March 2001 quarter.

Gain on sale of loans held-for-sale and securities-net consist primarily of gains on sales of Bank loans held-for-sale, available-for-sale mortgage-backed and investment securities, trading activity, impairment of Bank securities and gains and losses related to market value adjustments and sales of derivative financial instruments. Gains on sales of loans held-for-sale and securities-net increased 105% for the three months ended June 30, 2002 and 41% for the six months ended June 30, 2002, from the comparable periods in 2001. These changes relate primarily to gains on sales of mortgage-backed and investment securities, which increased 51% for the three months ended June 30, 2002, from the prior year quarter. In addition, losses on derivative financial instruments, which occurred after discontinuance of hedge accounting, decreased 76% for the three months ended June 30, 2002, from the prior year quarter and 123% for the six months ended June 30, 2002 to the prior six-month period. Losses on derivative financial instrument sales decreased to $3.1 million for the three months ended June 30, 2002, from $13.0 million for the prior year quarter. For the six months ended June 30, 2002, gains on derivative financial instruments were $4.0 million compared to losses of $17.3 million in the prior year six-month period. The increases noted above were partially offset by a decrease in gains on sales of Bank loans purchased from correspondents which decreased 101% for the three months ended June 30, 2002 and 56% for the six months ended June 30, 2002, from the comparable periods in 2001. As of June 30, 2002, we held approximately $14 million of corporate bonds issued by the Qwest Corporation (“Qwest”), as part of our investment portfolio. As of August 5, 2002, the market value of this investment was $11.6 million, as determined using quoted market prices. We continue to monitor any developments related to Qwest’s ability to repay these bonds in accordance with their contractual repayment terms.

Other banking-related revenues are comprised of ATM fees and miscellaneous fees imposed on deposit accounts. Other banking-related revenues increased 33% for the three months ended June 30, 2002 and 28% for the six months ended June 30, 2002, from the comparable periods in 2001. These increases are due to higher ATM transaction surcharge volume, primarily caused by a 14% increase in the number of ATMs in our network from June 30, 2001 to June 30, 2002.

Interest income from banking-related activities reflects interest earned on assets, consisting primarily of loans receivable and mortgage-backed securities. Banking interest income decreased 12% for the three months ended June 30, 2002 and 9% for the six months ended June 30, 2002, from the comparable periods in 2001. Decreases in banking interest income reflect decreases in average yield, partially offset by increases in average interest-earning banking asset balances and increase in higher yielding interest-earning assets such as our increase in our automobile loan portfolio. Average interest-earning banking assets increased 8% for the three months ended June 30, 2002 and 12% for the six months ended June 30, 2002, from the comparable periods in 2001. The average yield on interest-earning banking assets decreased to 5.81% for the three months ended June 30, 2002 from 7.14% for the three months ended June 30, 2001 and decreased to 5.91% for the six months ended June 30, 2002 from 7.30% for the six months ended June 30, 2001.

Interest expense from banking-related activities is incurred through interest-bearing banking liabilities that include customer deposits, advances from the FHLB and other borrowings. Banking interest expense decreased 23% for the three months ended June 30, 2002 and 20% for the six months ended June 30, 2002, from the comparable periods in 2001. The decrease in banking interest expense reflects a decrease in the average cost of borrowings partially offset by an increase in average interest-bearing banking liability balances. Average interest-bearing banking liability balances increased 10% for the three months ended June 30, 2002 and 12% for the six

months ended June 30, 2002, from the comparable periods in 2001. The average cost of borrowings decreased to 4.37% for the three months ended June 30, 2002 from 6.26% for the three months ended June 30, 2001 and decreased to 4.58% for the six months ended June 30, 2002 from 6.44% for the six months ended June 30, 2001. Net interest spread increased from 0.88% for the three months ended June 30, 2001 to 1.44% for the three months ended June 30, 2002 and an increase from 0.86% for the six months ended June 30, 2001 to 1.33% for the six months ended June 30, 2002. This increase is the result of several initiatives put in place to improve overall spreads. The Bank has purchased assets which have higher yields, evidenced by the growth of its automobile loan portfolio to $2.1 billion and the home equity loan portfolio to $124.0 million. Additionally, the net interest spread also increased because the Bank's funding costs decreased because of a shift in the structure of our deposit base from time deposits to transactional accounts that carry a lower cost of funds than certificates of deposits. Decreases in wholesale funding rates also contributed to the decrease in the Bank's funding costs.

The following tables present average balance data and income and expense data for our banking operations and the related interest yields and rates for the three and six months ended June 30, 2002 and 2001. The tables also present information with respect to net interest margin, an indicator of profitability. Another indicator of profitability is net interest spread, which is the difference between the weighted average yield earned on interest-earning banking assets and weighted average rate paid on interest-bearing banking liabilities (dollars in thousands):

	Three Months Ended June 30, 2002			Three Months Ended June 30, 2001		
	Average Balance	Interest Income/ Expense	Average Annualized Yield/Cost	Average Balance	Interest Income/ Expense	Average Annualized Yield/Cost
Interest-earning banking assets:						
Loans receivable, net	$ 7,112,457	$ 112,890	6.35%	$ 6,787,799	$ 127,975	7.54%
Interest-bearing deposits	160,498	996	2.49%	213,246	2,855	5.37%
Mortgage-backed and related available-for-sale securities	4,733,777	63,324	5.35%	3,879,478	63,431	6.54%
Available-for-sale investment securities	939,294	12,137	5.21%	1,190,537	21,938	7.37%
Investment in FHLB stock	80,482	704	3.51%	65,175	1,049	6.46%
Trading securities	158,716	1,373	3.46%	70,028	549	3.14%
Total interest-earning banking assets	13,185,224	$ 191,424	5.81%	12,206,263	$ 217,797	7.14%
Non-interest-earning banking assets	569,239			534,732		
Total banking assets	$ 13,754,463			$ 12,740,995		
Interest-bearing banking liabilities:						
Retail deposits	$ 8,570,648	$ 86,517	4.05%	$ 6,919,219	$ 107,441	6.22%
Brokered callable certificates of deposit	83,801	633	3.03%	26,628	384	5.79%
FHLB advances	856,476	13,804	6.38%	1,281,064	20,334	6.28%
Other borrowings	3,133,854	36,898	4.66%	3,278,114	51,352	6.20%
Total interest-bearing banking liabilities	12,644,779	$ 137,852	4.37%	11,505,025	$ 179,511	6.26%
Non-interest bearing banking liabilities	349,805			514,466		
Total banking liabilities	12,994,584			12,019,491		
Total banking shareowner's equity	759,879			721,504		
Total banking liabilities and shareowner's equity	$ 13,754,463			$ 12,740,995		
Excess of interest-earning banking assets over interest-bearing banking liabilities/net interest income	$ 540,445	$ 53,572		$ 701,238	$ 38,286	
Net interest spread			1.44%			0.88%
Net interest margin (net yield on interest-earning banking assets)			1.63%			1.26%
Ratio of interest-earning banking assets to interest-bearing banking liabilities			104.27%			106.10%
Return on average total banking assets			0.70%			0.31%
Return on average banking equity			12.69%			5.44%
Average equity to average total banking assets			5.52%			5.97%

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	Six Months Ended June 30, 2002			Six Months Ended June 30, 2001		
	Average Balance	Interest Income/ Expense	Average Annualized Yield/Cost	Average Balance	Interest Income/ Expense	Average Annualized Yield/Cost
Interest-earning banking assets:						
Loans receivable, net	$ 7,554,742	$ 245,276	6.49%	$ 6,252,358	$ 239,317	7.66%
Interest-bearing deposits	234,419	2,684	2.31%	191,440	5,820	6.13%
Mortgage-backed and related available-for-sale securities	4,358,476	116,111	5.33%	4,338,892	148,869	6.86%
Available-for-sale investment securities	1,030,846	26,455	5.17%	953,966	35,102	7.36%
Investment in FHLB stock	69,559	1,843	5.34%	74,216	2,539	6.90%
Trading securities	106,525	1,723	3.23%	99,250	2,835	5.71%
Total interest-earning banking assets	13,354,567	$ 394,092	5.91%	11,910,122	$ 434,482	7.30%
Non-interest-earning banking assets	574,106			405,417		
Total banking assets	$ 13,928,673			$ 12,315,539		
Interest-bearing banking liabilities:						
Retail deposits	$ 8,489,022	$ 180,987	4.30%	$ 6,554,078	$ 207,509	6.38%
Brokered callable certificates of deposit	52,207	758	2.93%	58,956	1,809	6.19%
FHLB advances	890,167	28,482	6.36%	1,452,242	47,933	6.56%
Other borrowings	3,217,448	76,476	4.73%	3,210,668	102,626	6.36%
Total interest-bearing banking liabilities	12,648,844	$ 286,703	4.58%	11,275,944	$ 359,877	6.44%
Non-interest bearing banking liabilities	537,218			352,735		
Total banking liabilities	13,186,062			11,628,679		
Total banking shareowner's equity	742,611			686,860		
Total banking liabilities and shareowner's equity	$ 13,928,673			$ 12,315,539		
Excess of interest-earning banking assets over interest-bearing banking liabilities/net interest income	$ 705,723	$ 107,389		$ 634,178	$ 74,605	
Net interest spread			1.33%			0.86%
Net interest margin (net yield on interest-earning banking assets)			1.61%			1.26%
Ratio of interest-earning banking assets to interest-bearing banking liabilities			105.58%			105.62%
Return on average total banking assets			0.78%			0.37%
Return on average banking equity			14.58%			6.60%
Average equity to average total banking assets			5.33%			5.97%

Loans Receivable and Provision for Loan Losses

The provision for loan losses recorded reflects adjustments in our allowance for loan losses based upon management's review and assessment of the risk in our loan portfolio. The provision for loan losses was $4.4 million for the three months ended June 30, 2002, $7.8 million for the six months ended June 30, 2002, $1.7 million for the three months ended June 30, 2001 and $3.1 million for the six months ended June 30, 2001. The increase in the provision for loan losses primarily reflects the growth in and composition of our Banking loan portfolio as well as the Bank's decision to invest a greater portion of its assets in loans with higher yields, and therefore, increased credit risk, such as automobile loans. As of June 30, 2002, the total loan loss allowance was $15.7 million, or 0.22% of total loans held-for-investment and 66.5% of total non-performing loans of $23.6 million. As of December 31, 2001, the total loan loss allowance was $19.9 million, or 0.31% of total loans held-for-investment and 96.1% of total non-performing loans of $20.7 million. The decrease in the loan loss allowance as a percentage of total held-for-investment loans outstanding relates to two factors. The

December 31, 2001 allowance for loan losses included approximately $4.7 million of purchased allowance for loan losses recorded in the fourth quarter of 2001 related to the purchase of an automobile portfolio. During the six months ended June 30, 2002, the Company had significant charge-offs against the recorded allowance for the acquired delinquent loans. Secondly, the decrease is reflective of a large automobile loan portfolio acquisition made during the three months ended June 30, 2002. The pool consisted of newly originated loans, underwritten to high FICO score standards.

The following table presents information concerning our banking loan portfolio, by type of loan, as of June 30, 2002 and December 31, 2001 (dollars in thousands):

	June 30, 2002		
	Held-for-Investment	Held-for- Sale	Total Loans
Real estate loans:			
One- to four-family	$ 4,926,119	$ 542,471	$ 5,468,590
Multi-family	111	—	111
Commercial	13,452	—	13,452
Mixed-use	554	—	554
Consumer and other loans:			
Automobiles, mobile homes and recreational vehicles	2,086,904	—	2,086,904
Home equity lines of credit and second mortgage loans	160,687	103	160,790
Other	4,510	—	4,510
Total loans	7,192,337	542,574	7,734,911
Unamortized premiums (discounts), net	46,114	(106)	46,008
Less allowance for loan losses	(15,709)	—	(15,709)
Total	$ 7,222,742	$ 542,468	$ 7,765,210

	December 31, 2001		
	Held-for- Investment	Held-for- Sale	Total Loans
Real estate loans:			
One- to four-family	$ 4,696,681	$ 1,621,783	$ 6,318,464
Multi-family	183	—	183
Commercial	1,981	—	1,981
Mixed-use	635	—	635
Consumer and other loans:			
Automobiles, mobile homes and recreational vehicles	1,635,050	—	1,635,050
Home equity lines of credit and second mortgage	22,720	339	23,059
Other	12,188	49	12,237
Total loans	6,369,438	1,622,171	7,991,609
Unamortized premiums (discounts), net	44,804	(6,082)	38,722
Less allowance for loan losses	(19,874)	—	(19,874)
Total	$ 6,394,368	$ 1,616,089	$ 8,010,457

The following table presents information about our non-accrual loans and repossessed assets as of the periods indicated (dollars in thousands):

	June 30, 2002	December 31, 2001
Loans accounted for on a non-accrual basis:		
Real estate loans:		
One- to four-family	$ 21,853	$ 20,595
Commercial	—	—
Automobiles, mobile homes and recreational vehicles	1,787	91
Total non-performing loans	23,640	20,686
Repossessed assets	3,714	3,328
Total non-performing assets	$ 27,354	$ 24,014
Total non-performing loans as a percentage of held-for-investment loans	0.33%	0.32%
Total non-performing assets as a percentage of held-for-investment loans	0.38%	0.37%
Total non-performing assets as a percentage of total banking assets	0.19%	0.18%
Total loan loss allowance as a percentage of total non-performing loans	66.45%	96.07%

The total loan loss allowance, as a percentage of total non-performing loans, decreased from 96.1% as of December 31, 2001, to 66.5% as of June 30, 2002. The Bank's portfolio of held-for-investment loans increased to $7.2 billion from $6.4 billion during the six-month period ended June 30, 2002, due to several large bulk loan purchases. Allocations to the total loan loss allowance are a function of both the performing and non-performing loans. During the quarter, net charge-offs exceeded the loan loss provision by approximately $1.0 million. This was due to expected losses on the Bank's automobile loan portfolio as several large pools reached their peak loss period.

Interest income is not accrued for loans classified as non-performing and any income accrued through the initial 90-day delinquency is reversed. Had these loans performed, additional income of $435,000 for the three months ended June 30, 2002, $869,000 for the six months ended June 30, 2002, $319,000 for the three months ended June 30, 2001 and $635,000 for the six months ended June 30, 2001, would have been recognized. As of June 30, 2002 and December 31, 2001, there were no commitments to lend additional funds to these borrowers.

Activity in the allowance for loan losses is summarized as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2002	2001	2002	2001
Allowance for loan losses, beginning of the period	$ 16,699	$ 13,821	$ 19,874	$ 12,565
Provision for loan losses	4,383	1,656	7,765	3,099
Charge-offs, net	(5,373)	(397)	(11,930)	(584)
Allowance for loan losses, end of period	$ 15,709	$ 15,080	$ 15,709	$ 15,080

The average recorded investment in impaired loans was $2.8 million for the three months ended June 30, 2002, $2.2 million for the six months ended June 30, 2002, $1.9 million for the three months ended June 30, 2001 and $1.9 million for the six months ended June 30, 2001. The Company's charge-off policy for impaired loans is consistent with its charge-off policy for other loans; impaired loans are charged-off when, in the opinion of management, all principal and interest due on the impaired loan will not be fully collected. Consistent with the Company's method for non-accrual loans, payments received on impaired loans are recognized as interest income or applied to principal when it is doubtful that full payment will be collected. As of June 30, 2002 and December 31, 2001, the Company had no restructured loans.

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Cost of Services and Operating Expenses

The following table sets forth the components of cost of services and operating expenses and percentage change information for the three and six months ended June 30, 2002 and 2001 (dollars in thousands):

	Three Months Ended June 30,		Percentage Change	Six Months Ended June 30,		Percentage Change
	2002	2001		2002	2001	
Cost of services	$133,795	$150,458	(11)%	$274,547	$292,893	(6)%
Cost of services as a percentage of net revenues	42%	49%		42%	46%	
Operating expenses:						
Selling and marketing	$ 49,014	$ 55,399	(12)%	$117,978	$149,097	(21)%
Technology development	15,043	23,420	(36)%	29,547	45,701	(35)%
General and administrative	50,832	61,906	(18)%	104,861	122,148	(14)%
Amortization of goodwill and other intangibles	7,557	9,022	(16)%	14,281	17,021	(16)%
Acquisition-related expenses	7,406	517	1,332%	8,666	517	1,576%
Facility restructuring and other nonrecurring charges	1,628	—	*	1,405	—	*
Executive agreement	(23,485)	—	*	(23,485)	—	*
Total operating expenses	$107,995	$150,264	(28)%	$253,253	$334,484	(24)%

* Percentage change not meaningful.

Cost of Services

Cost of services as a percentage of net revenues were 42% for the three and six months ended June 30, 2002, 49% for the three months ended June 30, 2001 and 46% for the six months ended June 30, 2001. The decreases in cost of services as a percentage of net revenues is primarily a result of rearchitecture of systems and networking that reduced operating costs. In addition, an increase in the use of online statements and trading confirmations, better utilization of customer services staffing and consolidation of international operations have reduced the costs of supporting our customers.

Selling and Marketing

Selling and marketing expenses decreased 12% for the three months ended June 30, 2002 and 21% for the six months ended June 30, 2002, from the comparable periods in 2001. The selling and marketing expenditures reflect expenditures for advertising placements, creative development and collateral materials resulting from a variety of advertising campaigns directed at expanding brand identity, growing the customer base and increasing market share. The decreases in selling and marketing expenses are primarily due to reductions in customer acquisition spending, including advertising, online, direct mailing and promotional activities, which are expected to remain at lower than prior year levels. Cost per net new account increased from $232 for the three months ended June 30, 2001 to $496 for the three months ended June 30, 2002, primarily due to a reduction in total net new accounts driven by expected decreases in banking deposit and brokerage accounts as we chose not to continue to offer rates in the top 1% nationally. In addition, this increase is also a result of increased marketing spend aimed at attracting higher-value active traders. Cost per net new account improved slightly from $328 for the six months ended June 30, 2001 to $324 for the six months ended June 30, 2002, due to acquisitions and the deepening of our product penetration with our customers through the recent expansion into the automobile and home equity line of credit loan markets, which have lower costs per net new account. Going forward, our focus will be on developing current customer households, continuing to deepen product penetration and increasing

assets per household instead of cost per net new account. Acquisitions will focus on new households via core Bank and Brokerage business and leveraging our sales channels to cross-sell other financial products to our customer base.

Technology Development

Technology development expenses decreased 36% for the three months ended June 30, 2002 and 35% for the six months ended June 30, 2002, from the comparable periods in 2001. Completion of development projects for customer relationship management, international locations, internal systems and promotional capabilities during 2001 allowed us to reduce the use of outside consultants and related expenses versus the same periods last year. A focused process for approval of development projects has improved development efficiency and our current resource levels are expected to meet projected business requirements.

General and Administrative

General and administrative expenses decreased 18% for the three months ended June 30, 2002 and 14% for the six months ended June 30, 2002, from the comparable periods in 2001. The reduction in our general and administrative expenses in the three and six months ended June 30, 2002 is primarily attributable to reductions realized from our restructuring plans initiated in August 2001 and the completion of ongoing negotiations and execution of a new employment agreement with our Chairman of the Board and Chief Executive Officer ("CEO") resulting in a reduction in compensation and benefit expenses. Further contributing to the decrease for the six months ended June 30, 2002 from the comparable period in 2001, we had recorded a $9.6 million compensation charge related to vested funds contributed to our Supplemental Executive Retirement Plan ("SERP") for the three months ended March 31, 2001 which was waived by our CEO and recorded as a non-recurring credit in the three months ended June 30, 2002. Offsetting these decreases were increases in costs associated with our fiscal 2001 acquisitions of Web Street and Dempsey and our acquisition of Tradescape in June 2002. In addition, E*TRADE Mortgage, which was acquired by us in February 2001, was not reflected in the full six months ended June 30, 2001.

Amortization of Goodwill and Other Intangibles

Amortization of goodwill and other intangibles was $7.6 million for the three months ended June 30, 2002, $14.3 million for the six months ended June 30, 2002, $9.0 million for the three months ended June 30, 2001 and $17.0 million for the six months ended June 30, 2001. The overall decrease in the amortization of goodwill and other intangibles primarily relates to our ceasing of goodwill amortization upon adoption of SFAS No. 142 *Goodwill and Other Intangible Assets* on January 1, 2002. The amortization expense for the three and six months ended June 30, 2002 relates to our other intangible assets from acquisitions including E*TRADE Access, which was acquired during fiscal 2000, the acquisitions of Web Street, E*TRADE Mortgage, Dempsey and certain deposit accounts from Advanta National Bank, a subsidiary of Advanta Corporation, in fiscal 2001, the acquisition of certain customer deposit accounts from Chase Manhattan Bank USA, National Association in February 2002 and the acquisition of Tradescape in June 2002. We expect the amortization of goodwill and other intangibles to increase for the remaining of fiscal 2002 as we have recognized only one month of amortization expense for the intangibles related to our acquisition of Tradescape as of June 30, 2002.

Acquisition-Related Expenses

Acquisition-related expenses were $7.4 million for the three months ended June 30, 2002, $8.7 million for the six months ended June 30, 2002 and $0.5 million for the three and six months ended June 30, 2001, and primarily represent management continuity payments associated with our acquisition of Dempsey for both the three and six months ended June 30, 2002 and 2001. In addition, certain costs associated with our acquisition of Tradescape are included in acquisition-related expenses for the three months ended June 30, 2002.

Facility Restructuring and Other Nonrecurring Charges

Facility restructuring and other nonrecurring charges reflected a $1.6 million charge for the three months ended June 30, 2002 and a $1.4 million charge for the six months ended June 30, 2002, which comprised adjustments to our prior estimated charges to reflect current estimates and/or resolution of certain of these costs. See Note 3 to the Condensed Consolidated Financial Statements.

Executive Agreement

During the three months ended June 30, 2002, we completed negotiations that had been ongoing for several months and executed a new employment agreement with our CEO. The new employment agreement closely aligns the CEO's interests with those of our shareowners and includes significant concessions by the CEO, certain of which have been reflected as a non-recurring reduction in our operating expenses. Under this new employment agreement, the CEO's base salary will be zero; however, this base salary may be reviewed and adjusted by the Board in light of the Company's performance following the one year anniversary of the agreement. In addition, the CEO's bonus opportunity has been set for a target of $4 million in the event the Company meets its performance objectives. The actual bonus may exceed $4 million in the event that, in the opinion of the Board, the Company substantially exceeds expectations. Among concessions that are reflected in a non-recurring reduction in our operating expenses this quarter, our CEO waived his right to receive vested benefits in our Supplemental Executive Retirement Plan ("SERP") totaling $16.1 million that were previously deposited into a trust; these amounts had been previously recorded as part of general and administrative expenses in fiscal year 2001. Of this amount, $14.0 million was retained by the Company and $2.1 million was paid out as a one-time bonus to eligible non-executive associates of the Company. (The amounts distributed to non-executive associates had no net effect on the results of operations.) In addition, our CEO waived his right to have the Company defray payment for the tax effect on his restricted stock grants. The accrued liability for unpaid estimated taxes of $9.5 million for unvested shares as of March 31, 2002 was reversed and credited to executive agreement. The total benefit to the Company for amounts previously paid on our CEO's behalf or due under his employment at the date of the new agreement (net of the amounts distributed to the non-executive associates of the Company which had no net effect on the results of operations) totaled $23.5 million and is reflected as a non-recurring reduction in our operating expenses in the consolidated statement of operations.

Non-Operating Expenses

The following table sets forth the components of non-operating expenses and percentage change information for the three and six months ended June 30, 2002 and 2001 (dollars in thousands):

	Three Months Ended June 30,			Six Months Ended June 30,		
	2002	2001	Percentage Change	2002	2001	Percentage Change
Corporate interest income	$ 3,569	$ 5,220	(32)%	$ 7,149	$ 10,998	(35)%
Corporate interest expense	(11,803)	(12,759)	(7)%	(24,199)	(23,987)	1%
Loss on investments	(6,790)	(10,969)	(38)%	(7,170)	(15,573)	(54)%
Equity in income (losses) of investments	3,617	(1,811)	300%	3,901	(5,152)	176%
Unrealized losses on venture funds	(3,283)	(11,031)	(70)%	(2,991)	(20,569)	(85)%
Fair value adjustments of financial derivatives	769	(1,710)	145%	(222)	(1,376)	(84)%
Other	(405)	292	(239)%	(1,359)	(408)	233%
Total non-operating expenses	$ (14,326)	$ (32,768)	(56)%	$ (24,891)	$ (56,067)	(56)%

Corporate interest income was $3.6 million for the three months ended June 30, 2002, $7.1 million for the six months ended June 30, 2002, $5.2 million for the three months ended June 30, 2001 and $11.0 million for the six months ended June 30, 2001. Corporate interest income includes interest income earned on corporate

investment balances and related party notes. The decrease in corporate interest income was primarily due to lower interest yields earned on these corporate investments as market rates have declined. Further, corporate interest income reflects a decrease in the related party note balance on the remaining related party notes.

Corporate interest expense was $11.8 million for the three months ended June 30, 2002, $24.2 million for the six months ended June 30, 2002, $12.8 million for the three months ended June 30, 2001 and $24.0 million for the six months ended June 30, 2001. Corporate interest expense primarily relates to interest expense resulting from the issuance of our convertible subordinated notes. During the six months ended June 30, 2001, we had $650 million outstanding convertible subordinated notes at 6.00% and $325 million of convertible subordinated notes at 6.75%. From June 2001 through June 30, 2002, we retired approximately $280 million of our 6.00% convertible subordinated notes, resulting in a decrease in related interest expense for the three and six months ended June 30, 2002.

Loss on investments were $6.8 million for the three months ended June 30, 2002, $7.2 million for the six months ended June 30, 2002, $11.0 million for the three months ended June 30, 2001 and $15.6 million for the six months ended June 30, 2001. For the three and six months ended June 30, 2002, losses on investments included impairment write downs on a privately-held equity investment of approximately $3.1 million. For the three months ended June 30, 2001, losses on investments included a $10.6 million impairment write down on several publicly traded equity securities and two of our proprietary mutual funds, a $0.6 million realized loss on our seed investments in the E*TRADE Global Titan Fund, E*TRADE Financial Sector Index Fund and the E*TRADE Russell 2000 Index Fund and a $1.8 million realized loss on the sale of publicly traded equity securities. For the six months ended June 30, 2001, loss on investment included an additional loss of $2.5 million that was realized on the sale of a publicly traded equity security.

Equity in income (losses) of investments was $3.6 million income for the three months ended June 30, 2002, $3.9 million income for the six months ended June 30, 2002, a $1.8 million loss for the three months ended June 30, 2001 and a $5.2 million loss for the six months ended June 30, 2001, which resulted from our minority ownership in investments that are accounted for under the equity method. Equity in income for the three and six months ended June 30, 2002 is due primarily to our equity method investments, including E*TRADE Japan K.K. and the KAP Group. for the three and six months ended June 30, 2002. Our equity method investments included E*TRADE Japan K.K., eAdvisor and SoundView Technology Group, Inc. (“Soundview”) for the three and six months ended June 30, 2001. The losses for the three and six months ended June 30, 2001, are due primarily to losses recorded on our investment in Soundview, partially offset by income recorded on our equity investment in E*TRADE Japan K.K. For the three months ended June 30, 2001, Soundview reported a net loss of $267.8 million, including a goodwill impairment charge of $249.7 million related to its acquisition of E*Offering. Our original carrying value for our investment in Soundview common stock did not include any amount for the goodwill originally recorded by Soundview in its acquisition of E*Offering because the carrying value was based on the book value of E*Offering. Accordingly, we would not recognize any portion of Soundview’s impairment charge in connection with recording our proportionate share of Soundview’s losses under the equity method of accounting. Due to certain events in 2001, we discontinued the use of the equity method of accounting for our holdings in Soundview effective for the quarter ended September 30, 2001.

Unrealized losses on venture funds was $3.3 million for the three months ended June 30, 2002, $3.0 million for the six months ended June 30, 2002, $11.0 million for the three months ended June 30, 2001 and $20.6 million for the six months ended June 30, 2001, primarily due to our participation in Softbank Capital Partners, L.P. for the three and six months ended June 30, 2002 and E*TRADE eCommerce Fund, L.P. for the three and six months ended June 30, 2001. In addition, for the three and six months ended June 30, 2002, amounts included an impairment write down on our E*TRADE eCommerce Fund, L.P., of $2.1 million. These changes represent market fluctuations on public investments held by the funds and changes in the estimated value of their non-public investments.

We recorded a gain of $0.8 million for the three months ended June 30, 2002, a $0.2 million loss for the six months ended June 30, 2002, a $1.7 million loss for the three months ended June 30, 2001 and a $1.4 million

loss for the six months ended June 30, 2001, for the fair value adjustments of financial derivatives. The amounts for the three and six months ended June 30, 2002, represent gain (loss) for the ineffective portions of changes in the fair value of fair value hedges. In the three months ended June 30, 2001, the amount represents a $2.1 million loss on the valuation of warrants, offset by a $0.4 million gain for the ineffective portions of changes in the fair value of fair value and cash flow hedges. In the six months ended June 30, 2001, the amount represents a $3.2 million loss on the valuation of warrants, offset by a $1.8 million gain representing the ineffective portions of changes in the fair value of fair value and cash flow hedges.

Other non-operating expense was $0.4 million for the three months ended June 30, 2002, expense of $1.4 million for the six months ended June 30, 2002, income of $0.3 million for the three months ended June 30, 2001 and expense of $0.4 million for the six months ended June 30, 2001. Other non-operating income (expense), which is primarily comprised of foreign exchange gains (losses), was recorded primarily as a result of fluctuations in foreign exchange rates for assets and liabilities held on our balance sheet that are denominated in non-functional currencies and fixed asset disposals.

Income Tax Expense (Benefit)

Income tax expense (benefit) represents the benefit for federal and state income taxes at an effective tax provision rate of 43.5% for the three months ended June 30, 2002, 43.3% for the six months ended June 30, 2002, a tax benefit rate of 50% for the three months ended June 30, 2001 and 57% for the six months ended June 30, 2001. The rate for the three and six months ended June 30, 2002 reflects an increase in tax for our valuation allowance for capital losses and differences between our statutory and foreign effective tax rate, and a decrease in taxes due to the research and development income tax credit and state tax planning. The rate for the three and six months ended June 30, 2001 reflects an increase in the tax benefit due to federal and state research and development income tax credits, a decrease of the tax benefit for the amortization of goodwill and differences between our statutory and foreign effective tax rates.

Minority Interest in Subsidiaries

Minority interest in subsidiaries was $0.2 million for the three months ended June 30, 2002, $0.4 million for the six months ended June 30, 2002, $(0.4) million for the three months ended June 30, 2001 and $(0.3) million for the six months ended June 30, 2001. Minority interest in subsidiaries results primarily from minority equity interests in various broker-dealer subsidiaries of Tradescape, LLC and ETFC's interest payments to subsidiary trusts which have issued Company-obligated mandatorily redeemable capital securities and which hold junior subordinated debentures of ETFC. Also included in minority interest in subsidiaries for the three and six months ended June 30, 2002 and 2001 is the net loss attributed to a minority interest in one of our international affiliates. In the three and six months ended June 30, 2002, we consolidated the results of eAdvisor, a joint venture previously accounted for under the equity method. As a result, minority interest in subsidiaries for the three and six months ended June 30, 2002 also includes a minority interest in eAdvisor. See Note 1 to the Condensed Consolidated Financial Statements.

Extraordinary Gain (Loss) on Early Extinguishment of Debt

The Company recorded an extraordinary loss on early extinguishment of debt, net of tax, of $0.9 million for the three months ended June 30, 2002, a $3.2 million gain for the six months ended June 30, 2002, a $2.1 million gain for the three months ended June 30, 2001 and a $0.1 million gain for the six months ended June 30, 2001.

For the three months ended June 30, 2002, amounts recorded included a $1.1 million gain (net of tax expense of $0.8 million) and for the six months ended June 30, 2002, amounts also include a $5.2 million gain (net of tax expense of $3.5 million) on exchanges in the aggregate of $64.9 million of our 6% convertible subordinated notes for approximately 6.5 million shares of our common stock, offset by a $2.0 million loss (net of tax benefit of $1.3 million) for the three and six months ended June 30, 2002 as a result of the early

redemptions of $100 million adjustable rate advances from the Federal Home Loan Bank (the "FHLB"). The FHLB advances were entered into as a result of normal funding requirements of the Company's banking operations. The loss consisted primarily of prepayment penalties and costs associated with these early redemptions.

For the three and six months ended June 30, 2001, amounts recorded included a $5.0 million gain (net of tax expense of $3.4 million) on exchanges in the aggregate of $30.0 million of our 6% convertible subordinated notes for approximately 2.7 million shares of our common stock, offset by a $2.9 million loss (net of tax benefit of $1.6 million) for the three months ended June 30, 2001 and a $4.9 million loss (net of tax benefit of $2.8 million) for the six months ended June 30, 2001 as a result of the early redemptions of $100 million and $600 million, respectively, of adjustable and fixed rate advances from the FHLB. The FHLB advances were entered into as a result of normal funding requirements of the Company's banking operations. The loss consisted primarily of prepayment penalties and costs associated with these early redemptions.

In April 2002, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 145, *Rescission of FASB Statement No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections.* SFAS 145 requires that any gains or losses on extinguishment of debt that were classified as an extraordinary item in prior periods that are not unusual in nature and infrequent in occurrence be reclassified to other income (expense), beginning in fiscal 2003, with early adoption encouraged. We plan to adopt the requirements of SFAS No. 145 in our consolidated financial statements beginning in the fourth quarter of fiscal 2002.

Cumulative Effect of Accounting Change

Cumulative effect of accounting change was $299.4 million for the six months ended June 30, 2002. The accounting change was due to our adoption of SFAS No. 142, *Goodwill and Other Intangible Assets*, whereby we reviewed our goodwill for impairment using the fair market value test and as a result wrote-down goodwill associated with some of our international subsidiaries acquired in the previous years. As required under SFAS 142, we will continue to review at least annually the impairment (if any) of all of our goodwill positions and record future impairment charges to operating expenses. See Note 7 to the Condensed Consolidated Financial Statements.

Liquidity and Capital Resources

Equity Retirements

In the three months ended June 30, 2002, we repurchased and retired approximately 2.7 million shares of common stock for an aggregate purchase price of approximately $15.1 million. In addition, in July 2002, we purchased approximately 3.4 million shares of our common stock from SOFTBANK Holdings, Inc. in a private transaction at a purchase price of $3.60 per share, for an aggregate purchase price of approximately $12.2 million. These shares were repurchased under a multi-year stock buyback program approved by our Board of Directors in September 2001, authorizing us to repurchase up to 50.0 million shares of common stock. Pursuant to the stock buyback program approved by the Board, we remain authorized to repurchase up to 13.4 million additional shares of common stock.

Debt Issuances and Retirements

During the six months ended June 30, 2002, we retired $64.9 million of our 6% convertible subordinated notes in exchange for approximately 6.5 million shares of our common stock. In addition, we early redeemed $100 million of our adjustable rate advances from the FHLB.

In April 2002, ETFC formed ETFC Capital Trust IV ("ETFCCT IV"), a business trust formed solely for the purpose of issuing capital securities, which ETFCCT IV sold at par, 10,000 shares of Floating Rate MMCapS,

with a liquidation amount of $1,000 per capital security, for a total of $10.0 million and invested the net proceeds in ETFC's Floating Rate Junior Subordinated Debentures. The Subordinated Debentures mature in 2032 and have a variable annual dividend rate at 3.70% above the six-month LIBOR, payable semi-annually, beginning in October 2002. The net proceeds were invested in the Bank and used for the Bank's general corporate purposes, which include funding the Bank's continued growth.

In June 2002, ETFC formed ETFC Capital Trust V ("ETFCCT V"), a business trust formed solely for the purpose of issuing capital securities, which ETFCCT V sold at par, 15,000 shares of Floating Rate Cumulative Preferred Securities, with a liquidation amount of $1,000 per capital security, for a total of $15.0 million and invested the net proceeds in ETFC's Floating Rate Junior Subordinated Debentures. The Subordinated Debentures mature in 2032 and have a variable annual dividend rate at 3.65% above the three-month LIBOR, payable quarterly, beginning in September 2002. The net proceeds were invested in the Bank and used for the Bank's general corporate purposes, which include funding the Bank's continued growth.

Technology Center Financing

On July 30, 1999, we entered into a lease agreement for our 164,500 square foot technology operation center located near Atlanta, Georgia. To secure the lease, we posted cash collateral, which was $71.9 million at December 31, 2001. On March 27, 2002, we exercised our purchase option, and used the cash collateral to fund the purchase on April 29, 2002.

Other Sources of Liquidity

We have financing facilities totaling $275 million to meet the needs of E*TRADE Securities. These facilities, if used, would be collateralized by customer securities or restricted cash included in other assets. There were no borrowings outstanding under these lines as of June 30, 2002. In addition, we have a short-term line of credit for up to $50 million, collateralized by marketable securities owned by us, of which we had less than $1.0 million in a standby letter of credit outstanding under this line as of June 30, 2002. We also have term loans collateralized by equipment owned by us and one installment purchase contract, of which $9.5 million was outstanding as of June 30, 2002. We have also entered into numerous agreements with other broker-dealers to provide financing under our stock loan program.

We currently anticipate that our available cash resources, credit facilities and liquid portfolio of equity securities will be sufficient to meet our presently anticipated working capital and capital expenditure requirements for at least the next 12 months. We may need to raise additional funds in order to support more rapid expansion, develop new or enhanced services and products, respond to competitive pressures, acquire complementary businesses or technologies or take advantage of unanticipated opportunities. Our future liquidity and capital requirements will depend upon numerous factors, including costs and timing of expansion of technology development efforts and the success of such efforts, the success of our existing and new service offerings and competing technological and market developments. Our forecast of the period of time through which our financial resources will be adequate to support our operations is a forward-looking statement that involves risks and uncertainties, and actual results could vary. If additional funds are raised through the issuance of equity securities, the percentage ownership of the shareowners in our company will be reduced, shareowners may experience additional dilution in net book value per share or such equity securities may have rights, preferences or privileges senior to those of the holders of our common stock. There can be no assurance that additional financing will be available when needed on terms favorable to our Company, if at all. See "Risk Factors—We may need additional funds in the future which may not be available and which may result in dilution of the value of our common stock." If adequate funds are not available on acceptable terms, we may be unable to develop or enhance our services and products, take advantage of future opportunities or respond to competitive pressures, any of which could harm our business. See "Risk Factors—If we are unable to quickly introduce new products and services that satisfy changing customer needs, we could lose customers and have difficulty attracting new customers."

Cash provided by operating activities was $745.7 million for the six months ended June 30, 2002. Cash provided by operating activities resulted primarily from net loss of $243.2 million, adjusted for non-cash items totaling $423.3 million (including depreciation and amortization expenses, amortization of losses on de-designated cash flow hedges and discount accretion of $118.1 million, cumulative effect of accounting change of $299.4 million, and change in deferred taxes of $35.3 million), a net decrease in bank-related assets in excess of liabilities of $69.7 million, a net decrease in brokerage-related assets in excess of liabilities of $791.1 million, offset by a decrease in operating cash from derivative activity of $196.1 million and an increase in accounts payable, accrued and other liabilities of $121.7 million. Cash used in operating activities was $71.1 million for the six months ended June 30, 2001. Cash used in operating activities resulted primarily from a net loss of $19.4 million, adjusted for non-cash items totaling $91.2 million (including depreciation and amortization expenses and discount accretion of $75.1 million and realized and unrealized gains (losses) on investments and venture funds of $15.9 million), a net decrease in bank-related assets in excess of liabilities of $274.2 million, offset by a net increase in brokerage-related assets in excess of liabilities of $429.7 million.

Cash used in investing activities was $1,729.4 million for the six months ended June 30, 2002 and $953.6 million for the six months ended June 30, 2001. For the six months ended June 30, 2002, cash used in investing activities resulted primarily from purchases of securities in excess of sale/maturity of $919.5 million, an increase in loans receivable of $715.1 million, purchases of property and equipment of $98.8 million, investing derivative activity of $66.7 million, offset by a decrease in restricted deposits of $71.9 million. For the six months ended June 30, 2001, cash used in investing activities resulted primarily from an increase in loans receivable of $1,250.8 million, purchases of property and equipment of $96.2 million, investing derivative activity of $93.1 million, partially offset by an excess of the net sale/maturity of investments over the purchases of investments of $479.7 million.

Cash provided by financing activities was $1,163.4 million for the six months ended June 30, 2002 primarily resulting from an increase in banking deposits, net advances from the FHLB, net increases in securities sold under agreements to repurchase and other borrowed funds, offset by payments on advances from the FHLB. Cash provided by financing activities was $1,431.2 million for the six months ended June 30, 2001, primarily resulting from an increase in banking deposits and an increase in proceeds from the issuance of subordinated debt, offset by payments on advances from the FHLB.

RISK FACTORS

RISKS RELATING TO THE NATURE OF THE ONLINE FINANCIAL SERVICES BUSINESS

We face competition from competitors, some of whom have significantly greater financial, technical, marketing and other resources, which could cause us to lower our prices or to lose a significant portion of our market share

The market for financial services delivered through technology-enabled media, including the Internet is rapidly evolving and intensely competitive. We expect competition to continue and intensify in the future. We face direct competition from retail and institutional brokerage firms, banks, thrifts and other savings and lending institutions, mortgage companies, specialists, market makers, insurance companies, electronic communication networks ("ECNs"), mutual fund companies, credit card companies, Internet portals, providers of equity compensation and other corporate-focused financial products, financial advisors, financial media providers and other financial products and services organizations.

Many of our competitors have longer operating histories and significantly greater financial, technical, marketing and other resources than we do. In addition, many of our competitors offer a wider range of brokerage, lending, banking, advisory and other financial services and products than we do, and thus may be able to respond more quickly to new or changing opportunities or demands. Many of our competitors also have greater name recognition and/or greater acceptance as providers of a full range of financial products and services, and larger customer bases that could be leveraged, thereby gaining market share from us. These competitors may conduct more extensive promotional activities and offer better terms and lower prices to customers than we do, possibly even sparking price wars in various areas of the financial service industry in which we compete. Moreover, some of our competitors have established cooperative relationships among themselves or with third parties to enhance their services and products. It is possible that new competitors, alliances or industry consolidation among existing or future competitors may significantly reduce our market share or our ability to compete effectively.

If we do not act or are unable to take advantage of consolidation opportunities in the online financial services industry, or if we overextend our consolidation efforts, we could be at a competitive disadvantage, or lose our independence

There has been significant consolidation in the online financial services industry over the last several years, particularly in those financial services primarily offered on-line, and the consolidation is likely to continue and even accelerate in the future. Should we fail to take advantage of viable consolidation opportunities, we could be placed at a competitive disadvantage relative to our competitors who have taken appropriate advantage of these opportunities. Similarly, if we overextend our efforts in such a way that we acquire businesses that we are unable to integrate or properly manage, we could also be placed at a competitive disadvantage relative to competitors who did not make such consolidation investments. In addition, our diversification strategy could make us unattractive to potential acquirors whose business lines are not as diverse as ours, thereby limiting shareowner value.

As a significant portion of our revenues come from online investing services, downturns or disruptions in the securities markets have harmed and could further significantly harm our business, including by reducing transaction volumes and margin borrowing and increasing our dependence on our more active customers who receive lower prices

A significant portion of our revenues in recent years has been from online investing services, and although we continue to diversify our revenue sources, we expect this business to continue to account for a significant portion of our revenues in the foreseeable future. We, like other financial services firms, are directly affected by economic and political conditions, broad trends in business and finance, and changes in volume and price levels of securities and futures transactions. The U.S. securities markets are characterized by considerable fluctuation and downturns in these markets have harmed our operating results, including our transaction volume and the rate of growth of new accounts, and could continue to do so in the future.

Significant downturns in the U.S. securities markets occurred in October 1987 and October 1989, and a significant downturn has been occurring since March 2000. Consequently, transaction volume has decreased industry-wide, and many broker-dealers, including E*TRADE Securities, have been adversely affected. The decrease in transaction volume has been more significant with respect to our less active customers, increasing our dependence on our more active Power E*TRADE and Tradescape customers who receive more favorable pricing based on their transaction volume. Decreases in volumes, as well as security prices, are also typically associated with a decrease in margin borrowing. Because we generate revenue from interest charged on margin borrowing, such decreases result in a reduction of revenue to E*TRADE Securities. When transaction volume is low, our operating results are harmed in part because some of our overhead costs remain relatively fixed. The possibility exists that prices and transaction volumes in U.S. securities markets will continue to move downward, either of which could harm our business going forward. Some of our competitors with more diverse product and service offerings might withstand such a downturn in the securities industry better than we could.

Downturns in the securities markets increase the risk that parties to margin lending or stock loan transactions with us will fail to honor their commitments and that the value of the collateral we hold in connection with those transactions will not be adequate, increasing our risk of losses from our margin lending or stock loan activities

We sometimes allow customers to purchase securities on margin, and we are therefore subject to the risk inherent in extending credit. This risk is especially great when the market declines rapidly and the value of the collateral we hold could potentially fall below the amount of a customer's indebtedness. Similarly, as part of our broker-dealer operations, we frequently enter into arrangements with other broker-dealers for the lending of various securities. Under specific regulatory guidelines, any time we borrow or lend securities, we must simultaneously disburse or receive cash deposits. If we fail to maintain adequate cash deposit levels at all times, we risk losses if there are sharp changes in market values of many securities and the counterparties to the borrowing and lending transactions fail to honor their commitments. The significant downturn in public equity markets since their record high in March 2000 has led to a greater risk that parties to stock lending transactions may fail to meet their commitments. Any such losses could harm our financial position and results of operations.

If we are unsuccessful in managing the effects of changes in interest rates and the interest-bearing assets in our portfolio, our financial condition and results of operations could suffer

The results of operations for the Bank depend in large part upon the level of its net interest income, that is, the difference between interest income from interest-earning assets (such as loans and mortgage-backed securities) and interest expense on interest-bearing liabilities (such as deposits and borrowings). Changes in market interest rates and the yield curve could reduce the value of the Bank's financial assets and thereby reduce net interest income. Fixed-rate investments, mortgage-backed and related securities and mortgage loans generally decline in value as interest rates rise. Many factors affect interest rates, including governmental monetary policies and domestic and international economic and political conditions. Currently, the Bank's net interest income would be harmed by material fluctuations in interest rates.

The Bank attempts to mitigate this interest rate risk by using derivative contracts that are designed to offset, in whole or in part, the variability in value or cash flow of various assets or liabilities caused by changes in interest rates. There can be no assurances that these derivative contracts move either directionally or proportionately as intended. SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, which we adopted on October 1, 2000 and have followed since that time, requires that the hedge ineffectiveness, or the difference between the changes in value of the hedged item versus the change in value of the hedging instruments, be recognized in earnings as of the reporting date. Our financial results may prove to be more volatile due to this reporting requirement.

Further, as part of its diversified portfolio of interest-bearing assets, the Bank holds a portfolio of corporate bonds. With the downturn in the securities markets and general economic conditions, there is a risk that some of

these corporate bonds may become impaired before they reach maturity, or that upon maturity they may not realize their full principal value. If this were to occur, the Bank's portfolio could suffer impairment charges as losses are realized, and ultimately our financial position could suffer.

The Bank's diversification of its asset portfolio to include higher-yielding investments which carry a higher inherent risk of default in its portfolio may increase the risk of charge-offs which could reduce our profitability

As the Bank diversifies its asset portfolio through purchases of higher-yielding asset classes, such as automobile loans and recreational vehicle loans, we will have to manage assets that carry a higher inherent risk of default than we have experienced with our existing portfolio. Consequently, the level of charge-offs associated with these assets may be higher than previously experienced. If expectations of future charge-offs increase, a corresponding increase in the amount of our loan loss allowance would be required. The increased level of provision for loan losses recorded to meet additional loan loss allowance requirements could adversely impact our financial results if those higher yields do not cover the provision for loan losses.

If we are unable to quickly introduce new products and services that satisfy changing customer needs, we could lose customers and have difficulty attracting new customers

Our future profitability depends significantly on our ability to innovate by developing, maintaining and enhancing our services and products. There are significant challenges to such development, maintenance and enhancement, including technical risks. There can be no assurance that we will be successful in achieving any of the following:

- effectively using new technologies;
- adapting our services and products to meet emerging industry standards; or
- developing, introducing and marketing new services and products to meet customer demand.

If we are unable to develop and introduce enhanced or new services and products quickly enough to respond to market or customer requirements, or if they do not achieve market acceptance, our business could be harmed.

Risks associated with trading transactions at our specialist/market maker could result in trading losses

A majority of our specialist and market making revenues at Dempsey are derived from trading by Dempsey as a principal. Dempsey may incur trading losses relating to the purchase, sale or short sale of securities for its own account. In any period, Dempsey also may incur trading losses in its specialist stocks and market maker stocks for reasons such as price declines, lack of trading volume and the required performance of specialist and market maker obligations. From time to time, Dempsey may have large position concentrations in securities of a single issuer or issuers engaged in a specific industry. In general, because Dempsey's inventory of securities is marked to market on a daily basis, any downward price movement in those securities will result in a reduction of our revenues and operating profits. Dempsey also operates a proprietary trading desk separately from its specialist and market maker operations. We may incur trading losses as a result of these trading activities.

Reduced spreads in securities pricing, levels of trading activity and trading through market makers and/or specialists could harm our specialist and market maker business

The listed marketplaces other than Nasdaq moved from trading using fractional share prices to trading using decimals in January 2001, and the Nasdaq initiated decimalization in March 2001. As a result, spreads that specialists and market makers receive in trading equity securities have declined and may continue to decline, which could harm revenues generated by Dempsey and, in turn, harm our operating results. Also, the advent of decimalization led to a decline in order flow revenue received by us from market makers and marketplaces. Similarly, a reduction in the volume and/or volatility of trading activity could also reduce spreads that specialists and market makers receive, also harming revenues generated by Dempsey and, in turn, our operating results.

Alternative trading systems that have developed over the past few years could also reduce the levels of trading of exchange-listed securities through specialists and the levels of over-the-counter trading through market makers, also potentially harming Dempsey's, and in turn, our revenues. We cannot assure that these developments will not cause a decrease in the transaction volumes of Dempsey's specialist operations.

In addition, Electronic Communication Networks ("ECN"s) have emerged as an alternative forum to which broker-dealers and institutional investors can direct their limit orders. This allows broker-dealers and institutional investors to avoid directing their trades through market makers. As a result, Dempsey may experience a reduction in its flow of limit orders. It is possible that ECNs will continue to capture a greater amount of limit order flow.

If our international efforts are not successful, our business growth will be harmed and our resources will not have been used efficiently

One component of our strategy is a planned increase in efforts to attract more international customers. To date, we have limited experience in providing brokerage services internationally, and the Bank has had only limited experience providing banking services to customers outside the United States. There can be no assurance that we and/or our international licensees will be able to market our branded services and products successfully in international markets.

In order to expand our services globally, we must comply with the regulatory controls of each specific country in which we conduct business. Our international expansion could be limited by the compliance requirements of other regulatory jurisdictions, including the European Union's Privacy Directive regulating the use and transfer of customer data. We intend to rely primarily on local third parties and our subsidiaries for regulatory compliance in foreign jurisdictions.

In addition, there are certain risks inherent in doing business in international markets, particularly in the heavily regulated brokerage and banking industries, such as:

- unexpected changes in regulatory requirements and trade barriers;
- difficulties in staffing and managing foreign operations;
- the level of investor interest in cross-border trading;
- authentication of online customers;
- political instability;
- fluctuations in currency exchange rates;
- reduced protection for intellectual property rights in some countries;
- seasonal reductions in business activity during the summer months in Europe and certain other parts of the world;
- the level of acceptance and adoption of the Internet in international markets; and
- potentially adverse tax consequences.

Any of the foregoing could harm our international operations. In addition, because some of these international markets are served through license arrangements with others, we rely upon these third parties for a variety of business and regulatory compliance matters. We have limited control over the management and direction of these third parties. We run the risk that their action or inaction, including their failure to follow proper practices with respect to their own corporate governance, could harm our operations and/or our reputation. Additionally, certain of our international licensees have the right to grant sublicenses. Generally, we have less control over sublicensees than we do over licensees. As a result, the risk to our operations and reputation is higher.

Our failure to successfully integrate the companies that we acquire into our existing operations could harm our business

In recent years, we have acquired E*TRADE Access, eInvesting, E*TRADE Advisory Services, E*TRADE Technologies, E*TRADE Mortgage, Web Street, several of our international affiliates, Dempsey and Tradescape. We may also acquire other companies or technologies in the future, and we regularly evaluate such opportunities. Acquisitions entail numerous risks, including, but not limited to:

- difficulty in retaining or hiring skilled personnel who have proven management expertise in the business line we acquire;
- difficulties in the assimilation and integration of acquired operations and products;
- diversion of management's attention from other business concerns;
- existence of undetected problems or potential liabilities that could have a significant, negative impact on the business or operations of the acquired company;
- failure to achieve anticipated cost savings;
- failure to retain existing customers of the acquired companies;
- amortization of acquired intangible assets, with the effect of reducing our reported earnings; and
- potential loss of key associates of acquired companies.

No assurance can be given as to our ability to integrate successfully any operations, technology, personnel, services or new businesses or products that might be acquired in the future. Failure to successfully assimilate acquired organizations could harm our business. In addition, there can be no assurance that we will realize a positive return on any of these investments or that any of our future acquisitions will not be dilutive to earnings.

Our ratio of debt to equity may make it more difficult to make payments on our debts or to obtain financing

At June 30, 2002, we had an outstanding balance of $695.3 million in convertible subordinated notes. Combined with decreases in shareowners' equity reflecting the facility restructuring and nonrecurring charge in August 2001, the effects of the share buyback program through June 2002, and the cumulative effect of accounting change recorded in the quarter ended March 31, 2002, our ratio of debt (our convertible debt, capital lease obligations and term loans) to equity (expressed as a percentage) was 48% as of June 30, 2002. We may incur additional indebtedness in the future. The level of our indebtedness, among other things, could:

- make it more difficult to make payments on our debt;
- make it more difficult or costly for us to obtain any necessary financing in the future for working capital, capital expenditures, debt service requirements or other purposes;
- limit our flexibility in planning for or reacting to changes in our business; and
- make us more vulnerable in the event of a downturn in our business.

Our efforts to expand recognition of the E*TRADE brand to areas of the financial services industry other than online trading may not be effective

As we diversify the scope of the products and services we offer, the brand "E*TRADE" or "E*TRADE Financial" may not be as effective for us in the future, which could harm our revenues. In addition, our efforts to further our brand as a diversified financial services institution are largely dependent on our use of effective marketing and advertising efforts. If these efforts are not successful, we will not have used resources effectively.

RISKS RELATING TO THE REGULATION OF OUR BUSINESS

If changes in government regulation, including banking and securities rules and regulations, favor our competition or restrict our business practices, our ability to attract and retain customers and our profitability may suffer

The securities and banking industries in the United States are subject to extensive regulation under both federal and state laws. Because we are a self-clearing broker-dealer, we have to comply with many additional laws and rules. These include rules relating to possession and control of customer funds and securities, margin lending and execution and settlement of transactions. Our ability to comply with these rules depends largely on the establishment and maintenance of a qualified compliance system. We are also subject to additional laws and rules as a result of our specialist and market maker operations in Dempsey.

Similarly, E*TRADE Group and ETFC, as savings and loan holding companies, and E*TRADE Bank, as a federally chartered savings bank and subsidiary of ETFC, are subject to extensive regulation, supervision and examination by the OTS, and, in the case of the Bank, the FDIC. Such regulation covers all banking business, including lending practices, safeguarding deposits, capital structure, record keeping, transactions with affiliates and conduct and qualifications of personnel.

Because of our international presence, we are also subject to the regulatory controls of each specific country in which we conduct business.

Because we operate in an industry subject to extensive regulation, the competitive landscape in our industry can change significantly as a result of new regulation, changes in existing regulation, or changes in the interpretation or enforcement of existing laws and rules.

There can be no assurance that federal, state or foreign agencies will not further regulate our business. We may also be subject to additional regulation as the market for online commerce evolves. We may also be subject to federal, state or foreign money transmitter laws and state and foreign sales or use tax laws. If such laws are enacted or deemed applicable to us, our business or operations could be rendered more costly or burdensome, less efficient or even impossible. Any of the foregoing could harm our business, financial condition and operating results.

If we fail to comply with applicable securities, banking and insurance regulations, we could be subject to disciplinary actions, damages, penalties or restrictions that could significantly harm our business

The SEC, the NASD or other self-regulatory organizations and state securities commissions can, among other things, censure, fine, issue cease-and-desist orders or suspend or expel a broker-dealer or any of its officers or employees. The OTS may take similar action with respect to our banking activities. Our ability to comply with all applicable laws and rules is largely dependent on our establishment, maintenance and enforcement of an effective compliance system. Our failure to establish and enforce proper compliance procedures, or failure of any of our associates to follow these procedures and applicable laws and regulations, regardless of whether such failure is intentional, could subject us to significant losses, disciplinary or other actions due to actual or claimed noncompliance in the future, which could harm our business.

If we do not maintain the capital levels required by regulators, we may be fined or forced out of business

The SEC, NASD, OTS and various other regulatory agencies have stringent rules with respect to the maintenance of specific levels of net capital by securities broker-dealers and regulatory capital by banks. Net capital is the net worth of a broker or dealer (assets minus liabilities), less deductions for certain types of assets. If a securities firm fails to maintain the required net capital, it may be subject to suspension or revocation of registration by the SEC and suspension or expulsion by the NASD, and could ultimately lead to the firm's liquidation. In the past, our broker-dealer subsidiaries have depended largely on capital contributions by us in

order to comply with net capital requirements. If such net capital rules are changed or expanded, or if there is an unusually large charge against net capital, regardless of the basis for such charge, operations that require an intensive use of capital could be limited. Such operations may include investing activities, marketing and the financing of customer account balances. Also, our ability to withdraw capital from brokerage subsidiaries could be restricted, which in turn could limit our ability to pay dividends, repay debt and redeem or purchase shares of our outstanding stock. A large operating loss or charge against net capital could adversely affect our ability to expand or even maintain our present levels of business, which could harm our business. See Note 19 to our most current financial statements for the minimum net capital requirements for our domestic broker-dealer subsidiaries for the current reporting period.

Similarly, banks, such as the Bank, are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could harm a bank’s operations and financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, a bank must meet specific capital guidelines that involve quantitative measures of a bank’s assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. A bank’s capital amounts and classification are also subject to qualitative judgments by the regulators about the strength of components of the bank’s capital, risk weightings of assets and off-balance-sheet transactions, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require a bank to maintain minimum amounts and ratios of Total and Tier 1 Capital to risk-weighted assets and of Core Capital to adjusted tangible assets. To satisfy the capital requirements for a well capitalized financial institution, a bank must maintain minimum Total and Tier 1 Capital to risk-weighted assets and Core Capital to adjusted tangible assets ratios as set forth in the following table. See Note 19 to our most recent financial statements for the capital adequacy requirements for the Bank for the current reporting period.

Regulatory review of our advertising practices could hinder our ability to operate our business and result in fines and other penalties

All marketing activities by E*TRADE Securities are regulated by the NASD, and all marketing materials must be reviewed by an E*TRADE Securities Series 24 licensed principal prior to release. The NASD has in the past asked us to revise certain marketing materials. In June 2001, we settled a formal NASD investigation into our advertising practices and were fined by the NASD in connection with three advertisements that were placed in 1999. The NASD can impose certain penalties for violations of its advertising regulations, including:

- censures or fines;
- suspension of all advertising;
- the issuance of cease-and-desist orders; or
- the suspension or expulsion of a broker-dealer or any of its officers or employees.

In addition, the federal banking agencies impose restrictions on bank advertising of non-deposit investment products to minimize the likelihood of customer confusion.

If we were deemed to solicit orders from our customers or make investment recommendations, we would become subject to additional regulations that could be burdensome and subject us to fines and other penalties

If we were deemed to solicit orders from our customers or make investment recommendations, we would become subject to additional rules and regulations governing, among other things, sales practices and the suitability of recommendations to customers. Compliance with these regulations could be burdensome, and, if we fail to comply, we could be subject to fines and other penalties.

Due to our acquisition of ETFC, we are subject to regulations that could restrict our ability to take advantage of good business opportunities and that may be burdensome to comply with

Upon the completion of our acquisition of ETFC and its subsidiary, the Bank, in January, 2000, we became subject to regulation as a savings and loan holding company. As a result, we, as well as the Bank, are required to file periodic reports with the OTS, and are subject to examination by the OTS. The OTS also has certain types of enforcement powers over ETFC and us, including the ability to issue cease-and-desist orders, force divestiture of the Bank and impose civil money penalties for violations of federal banking laws and regulations or for unsafe or unsound banking practices. In addition, under the Graham-Leach-Bliley Act, our activities are now restricted to activities that are financial in nature and certain real estate-related activities. We may make merchant banking investments in companies whose activities are not financial in nature, if those investments are engaged in for the purpose of appreciation and ultimate resale of the investment and we do not manage or operate the company. Such merchant banking investments may be subject to maximum holding periods and special record keeping and risk management requirements.

We believe that all of our existing activities and investments are permissible under the new legislation, but the OTS has not yet interpreted these provisions. Even if all of our existing activities and investments are permissible, under the new legislation we will be constrained in pursuing future new activities that are not financial in nature. We are also limited in our ability to invest in other savings and loan holding companies. These restrictions could prevent us from pursuing certain activities and transactions that could be beneficial to us.

In addition to regulation of us and ETFC as savings and loan holding companies, federal savings banks such as the Bank are subject to extensive regulation of their activities and investments, their capitalization, their risk management policies and procedures and their relationship with affiliated companies. In addition, as a condition to approving our acquisition of ETFC, the OTS imposed various notice and other requirements, primarily a requirement that the Bank obtain prior approval from the OTS of any future material changes to the Bank's business plan. Acquisitions of and mergers with other financial institutions, purchases of deposits and loan portfolios, the establishment of new Bank subsidiaries and the commencement of new activities by Bank subsidiaries require the prior approval of the OTS. These regulations and conditions could place us at a competitive disadvantage in an environment in which consolidation within the financial services industry is prevalent. Also, these regulations and conditions could affect our ability to realize synergies from future acquisitions, could negatively affect both us and the Bank following the acquisition and could also delay or prevent the development, introduction and marketing of new products and services.

RISKS RELATING TO OWNING OUR STOCK

Our historical quarterly results have fluctuated and do not reliably indicate future operating results

We do not believe that our historical operating results should be relied upon as an indication of our future operating results. We expect to experience large fluctuations in future quarterly operating results that may be caused by many factors, including the following:

- fluctuations in interest rates, which will impact our investment and loan portfolios and the volume of our loan originations;
- changes in trading volume in securities markets;
- the success of, or costs associated with, acquisitions, joint ventures or other strategic relationships;
- changes in key personnel;
- fluctuations in the fair market value of our equity investments in other companies, including through existing or future private investment funds managed by us;
- seasonal trends;

- purchases and sales of securities and other assets as part of the Bank's portfolio restructuring efforts;
- customer acquisition costs, which may be affected by competitive conditions in the marketplace;
- the timing of introductions or enhancements to online financial services and products by us or our competitors;
- market acceptance of online financial services and products;
- domestic and international regulation of the brokerage, banking and Internet industries;
- accounting for derivative instruments and hedging activities;
- changes in domestic or international tax rates;
- changes in pricing policies by us or our competitors;
- fluctuation in foreign exchange rates; and
- changes in the level of operating expenses to support projected growth.

We have also experienced fluctuations in the average number of customer transactions per day. Thus, the rate of growth in customer transactions at any given time is not necessarily indicative of future transaction activity.

We have incurred losses in the past and we cannot assure you that we will be profitable

Although we earned $32.8 million for the three months ended June 30, 2002, we have incurred operating losses in prior periods and we may incur operating losses in the future. We reported net losses of $276.0 million for the three months ended March 31, 2002, which includes an extraordinary gain on extinguishment of debt of $4.1 million and a cumulative effect of accounting change of $(299.4) million, net loss of $241.5 million in fiscal 2001, which includes facility restructuring and other nonrecurring charges of $202.8 million, net income of $19.2 million in fiscal 2000 and net loss of $56.8 million in fiscal 1999. Although we achieved profitability in fiscal 2000 due in part to sales of investment securities, we cannot assure you that profitability will be achieved in future periods.

Similarly, from time to time we provide certain guidance or forward looking statements concerning our expected operating metrics for a particular future period, based on good faith estimates. As set forth more particularly in our standard "safe harbor" statements, we cannot assure you that we will meet or exceed any expected operating metrics for any particular period.

The market price of our common stock may continue to be volatile which could cause litigation against us and the inability of shareowners to resell their shares at or above the prices at which they acquired them

From January 1, 2001 through June 30, 2002, the price per share of our common stock has ranged from a high of $15.38 to a low of $4.07. The market price of our common stock has been, and is likely to continue to be, highly volatile and subject to wide fluctuations due to various factors, many of which may be beyond our control, including:

- quarterly variations in operating results;
- volatility in the stock market;
- volatility in the general economy;
- large block transactions in our common stock by institutional investors:
- changes in investor sentiment;
- changes in interest rates;

- announcements of acquisitions, technological innovations or new software, services or products by us or our competitors; and
- changes in financial estimates and recommendations by securities analysts.

In addition, there have been large fluctuations in the prices and trading volumes of securities of many technology, Internet and financial services companies. This volatility is often unrelated or disproportionate to the operating performance of these companies. Broad market and industry factors may decrease the market price of our common stock. In the past, volatility in the market price of a company's securities has often led to securities class action litigation. Such litigation could result in substantial costs to us and divert our attention and resources, which could harm our business. Declines in the market price of our common stock or failure of the market price to increase could also harm our ability to retain key associates, reduce our access to capital and otherwise harm aspects of our business.

We may need additional funds in the future which may not be available and which may result in dilution of the value of our common stock

In the future, we may need to raise additional funds for various purposes, including to expand our technology resources, to hire additional associates, to make acquisitions or to increase the Bank's total assets or deposit base. Additional financing may not be available on favorable terms, if at all. If adequate funds are not available on acceptable terms, we may be unable to fund our business growth plans. In addition, if funds are available, the result of our issuing securities could be to dilute the value of shares of our common stock and cause the market price to fall.

Provisions in our certificate of incorporation and bylaws, our stockholder rights plan, stock incentive plans, contracts and management retention agreements and Delaware law could prevent or delay an acquisition of us that a shareowner may consider to be favorable

Certain provisions of our certificate of incorporation and bylaws may discourage, delay or prevent a third party from acquiring control of us in a merger, acquisition or similar transaction that a shareowner may consider favorable. Such provisions include:

- authorization for the issuance of "blank check" preferred stock;
- provision for a classified Board of Directors with staggered, three-year terms;
- the prohibition of cumulative voting in the election of directors;
- a super-majority voting requirement to effect business combinations or certain amendments to our certificate of incorporation and bylaws;
- limits on the persons who may call special meetings of shareowners;
- the prohibition of shareowner action by written consent; and
- advance notice requirements for nominations to the Board of Directors or for proposing matters that can be acted on by shareowners at shareowner meetings.

Attempts to acquire control of E*TRADE may also be delayed or prevented by our stockholder rights plan. The stockholder rights plan is designed to enhance the ability of our Board of Directors to protect shareowners against, among other things, unsolicited attempts to acquire control of E*TRADE that do not offer an adequate price to all shareowners or are otherwise not in the best interests of the company and our shareowners. In addition, certain provisions of our stock incentive plans, management retention and employment agreements (including severance payments, stock option acceleration and loan forgiveness with associated tax gross-ups), and Delaware law may also discourage, delay or prevent someone from acquiring or merging with us.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

For quantitative and qualitative disclosures about market risk, we have evaluated such risk for our domestic retail brokerage, banking, global and institutional and wealth management and other segments separately. The following discussion about our market risk disclosures includes forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements as a result of certain factors, including those set forth in the section entitled "Risk Factors" and elsewhere in this filing.

Domestic Retail Brokerage, Global and Institutional and Wealth Management and Other

Our domestic retail brokerage, global and institutional and wealth management and other operations are exposed to market risk related to changes in interest rates, foreign currency exchange rates and equity security price risk. However, we do not believe any such exposures are material. To reduce certain risks, we utilize derivative financial instruments; however, we do not hold derivative financial instruments for speculative or trading purposes.

Interest Rate Sensitivity

During the six months ended June 30, 2002, we had a variable rate bank line of credit, variable rate term loans and one installment purchase contract. As of June 30, 2002, we had less than $1.0 million in a standby letter of credit outstanding under this line and $9.5 million outstanding under these loans. The line of credit and term loans and the monthly interest payments are subject to interest rate risk. If market interest rates were to increase immediately and uniformly by one percent at June 30, 2002, the interest payments would increase by an immaterial amount.

Foreign Currency Exchange Risk

A portion of our operations consists of brokerage and investment services outside of the United States. As a result, our results of operations could be adversely affected by factors such as changes in foreign currency exchange rates or economic conditions in the foreign markets in which we provide our services. We are primarily exposed to changes in exchange rates on the Japanese yen, the British pound, the Canadian dollar and the Euro. When the U.S. dollar strengthens against these currencies, the U.S. dollar value of non-U.S. dollar-based revenues decreases. When the U.S. dollar weakens against these currencies, the U.S. dollar value of non-U.S. dollar-based revenues increases. Correspondingly, the U.S. dollar value of non-U.S. dollar-based costs increases when the U.S. dollar weakens and decreases when the U.S. dollar strengthens. We are a net payer of British pounds and, as such, benefit from a stronger dollar, and are adversely affected by a weaker dollar relative to the British pound. However, we are a net receiver of currencies other than British pounds, and as such, benefit from a weaker dollar, and are adversely affected by a stronger dollar relative to these currencies. Accordingly, changes in exchange rates may adversely affect our consolidated sales and operating margins as expressed in U.S. dollars.

To mitigate the short-term effect of changes in currency exchange rates on our non-U.S. dollar-based revenues and operating expenses, we routinely hedge our material net non-U.S. dollar-based exposures by entering into foreign exchange forward and option contracts. Currently, hedges of transactions do not extend beyond twelve months and are immaterial. Given the short-term nature of our foreign exchange forward and option contracts, our exposure to risk associated with currency market movement on the instruments is not material.

Financial Instruments

For our working capital and reserves, which are required to be segregated under Federal or other regulations, we primarily invest in money market funds, resale agreements, certificates of deposit and commercial paper. Money market funds do not have maturity dates and do not present a material market risk. The other financial instruments are fixed rate investments with short maturities and do not present a material interest rate risk.

Banking Operations

Our banking operations acquire and manage interest-bearing assets and liabilities in the normal course of business. Interest-bearing instruments include investment securities, loans, deposits, borrowings and derivative financial instruments. As interest-bearing, these instruments are subject to changes in market value as interest rates change. Market risk is the potential for adverse decline in market values. The market values of bank instruments have a direct or indirect impact on Bank earnings, equity and various regulatory constraints.

Interest Rate Risk

The acquisition, maintenance and disposition of assets and liabilities are critical elements of the Bank's operations. Throughout the process these instruments are subject to market risk, which is the potential for adverse declines in market values. There are numerous factors that may influence the speed and direction of changes in market value including, but not limited to, liquidity, the absolute level of interest rates, the shape of the yield curve and the implied volatility of future interest rate movements. The net market values of bank instruments may direct or indirectly impact the Bank's current or future earnings and is also subject to certain regulatory constraints.

Our Board of Directors delegates responsibility for the day-to-day management of market risk to the Bank's Asset Liability Management Committee. The Asset Liability Management Committee is responsible for measuring, managing and reporting the Bank's aggregate market risk within the policy guidelines and limits established by the Board of Directors. The Bank maintains a Risk Management Group which is independent of the Bank's portfolio management functions to assist the Asset Liability Management Committee in its responsibilities of measuring and managing market risk.

The market risk profile of the Bank is a net result of the combination of all interest-sensitive assets, liabilities and derivatives. At June 30, 2002, approximately 71% of the market value of the Bank's total assets were comprised of residential mortgages and mortgaged-backed securities. The values of these assets are sensitive to changes in interest rates as well as expected prepayment levels. The Bank's liability structure consists primarily of transactional deposit relationships such as money market accounts, shorter-term certificates of deposit and wholesale collateralized borrowings. The derivative portfolio of the Bank is positioned to decrease the overall market risk resulting from the combination of assets and liabilities. The Bank's market risk is discussed and quantified in more detail in the Scenario Analysis section below.

Most of the Bank's assets are generally classified as non-trading portfolios and, as such, are not marked-to-market through earnings for accounting purposes. The Bank did maintain a trading portfolio of investment-grade securities throughout the first six months of 2002. The market value of the trading portfolio at June 30, 2002 was $269 million. The trading portfolio at June 30, 2002 was predominantly investment-grade collateralized mortgage obligations and agency mortgage-backed securities.

Scenario Analysis

Scenario analysis is a more advanced approach to estimating interest rate risk exposure. Under the Net Present Value of Equity ("NPVE") approach, the present value of all existing assets, liabilities, derivatives and forward commitments are estimated and then combined to produce a Net Present Value of Equity figure. The sensitivity of this value to changes in interest rates is then determined by applying alternative interest rate scenarios, which include, but are not limited to, instantaneous parallel shifts up and down of 100, 200 and 300 basis points. The sensitivity of NPVE as of June 30, 2002 and December 31, 2001 and the limits established by the Board of Directors are listed below:

Parallel Change in Interest Rates (bps)	Change in NPVE As of June 30, 2002	Change in NPVE As of December 31, 2001	Board Limit
+300	-28%	-13%	-55%
+200	-20%	-11%	-30%
+100	- 9%	- 6%	-15%
Base Case	—	—	—
-100	- 1%	3%	-15%
-200	- 8%	- 7%	-30%
-300	-12%	-29%	-55%

The increase in NPVE sensitivity in the +200 and +300 scenarios was the result of active interest rate sensitivity management by the Bank. Given an environment of declining rates and increasing mortgage refinancing, the Bank terminated interest rate derivatives that hedged the market value in rising interest rate scenarios. This action was taken to maximize value as rates declined, while maintaining up-rate sensitivities well within Board prescribed limits. As of June 30, 2002, the Bank's overall interest rate risk exposure would be classified as "minimal" under the criteria published by the Bank's regulator, the OTS.

PART II. OTHER INFORMATION

Item 1. Legal and Administrative Proceedings

On November 21, 1997, a putative class action was filed in the Superior Court of California, County of Santa Clara, by Larry R. Cooper. The action alleges, among other things, that our advertising regarding our commission rates and ability to execute transactions through our online brokerage service was false and deceptive. The action seeks injunctive relief, and unspecified compensatory damages, punitive damages, and attorney's fees. On June 1, 1999, the Court entered an order denying plaintiffs' motion for class certification. On January 25, 2000, the Court ordered plaintiff to submit all claims seeking monetary relief to arbitration and stayed all other claims pending the outcome of arbitration. In July 2001, Plaintiff filed an arbitration claim with the National Association of Securities Dealers, Inc., and in October 2001, we submitted our answer. Subsequently, a NASD arbitration panel issued a ruling indicating that it would not assert jurisdiction over plaintiff's representative claims and scheduled the hearing of plaintiff's individual claims for arbitration for October 14, 2002. At this time, we are unable to predict the ultimate outcome of this matter.

On March 1, 1999, a putative class action was filed in the Court of Common Pleas, Cuyahoga County, Ohio, by Truc Q. Hoang. The action alleges, among other things, that plaintiff experienced problems accessing her account and placing orders and seeks injunctive relief and unspecified damages for breach of contract, breach of fiduciary duty, unjust enrichment, fraud, unfair and deceptive trade practices, negligence and intentional torts. On September 1, 1999, the Court of Common Pleas denied our motion to compel arbitration and we appealed. On March 16, 2000, the Court of Appeals reversed and remanded this case to the Court of Common Pleas ruling that our motion to compel arbitration could not be decided until the Court of Common Pleas first determined whether this case should be certified as a class action. On September 29, 2000, Plaintiff filed her First Amended Complaint limiting the class of potential plaintiffs to customers who are Ohio residents, and we filed an Answer denying Plaintiff's claims. Subsequently, the Court scheduled the hearing of Plaintiff's Motion for Class Certification for April 23, 2002, and by order dated June 7, 2002, the Court granted plaintiff's motion for class certification. In response, the Company has filed a timely Notice of Appeal, and on July 23, 2002, the trial court granted a separate motion the Company filed to stay all further trial court proceedings pending the outcome of the Company's appeal of the trial Court's order granting class certification. At this time, we are unable to predict the ultimate outcome of this action.

On March 11, 1999, a putative class action was filed in the Superior Court of California, County of Santa Clara, by Elie Wurtman. The action alleges, among other things, that Plaintiff experienced problems accessing his account and placing orders and seeks injunctive relief and unspecified damages for negligence and violations of the Consumer Legal Remedies Act and California Unfair Business Practices Act. After the Court of Appeal affirmed the Superior Court's previous ruling denying our Motion to Compel Arbitration, we demurred to Plaintiff's Amended Complaint. Thereafter, Plaintiff filed his First Amended Complaint on or about March 21, 2001, and we filed an Answer on April 3, 2001, denying Plaintiff's claims. The Court has set the hearing of Plaintiff's motion for class certification for September 19, 2002. At this time, we are unable to predict the ultimate outcome of this proceeding.

In the ordinary course of its business, E*TRADE Securities engaged in certain stock loan transactions with MJK Clearing, Inc., ("MJK"), involving the lending of Nasdaq-listed common stock of GenesisIntermedia, Inc. ("GENI"), and other securities from MJK to E*TRADE Securities. Subsequently, E*TRADE Securities redelivered the GENI and/or other securities received from MJK to three other broker-dealers, Wedbush Morgan Securities, ("Wedbush"), Nomura Securities, Inc., ("Nomura") and Fiserv Securities, Inc., ("Fiserv"). On September 25, 2001, Nasdaq halted trading in the stock of GENI, which had last traded at a price of $5.90 before the halt. As a result, MJK was unable to meet its collateral requirements on the GENI and other securities with certain counterparties to those transactions. Subsequently, MJK was ordered to cease operations by the SEC. These events have led to the following disputes between the participants in the above described stock loan transactions:

By a complaint dated October 1, 2001, a lawsuit was filed in the Superior Court for the State of California, County of Los Angeles entitled, "Wedbush Morgan Securities Inc. v. E*TRADE Securities, Inc.", asserting

claims for injunctive relief, specific performance, declaratory relief and breach of written contract and seeking (in addition to equitable relief) approximately $8 million in damages from E*TRADE Securities, Inc. Subsequently, Wedbush and the Company agreed to binding arbitration, and the Company filed an arbitration claim with the NYSE in November of 2001 asserting a claim for declaratory relief and seeking approximately $15 million in damages from Wedbush. Thereafter, Wedbush answered and filed a counterclaim with the NYSE against the Company on December 12, 2001 reasserting the breach of contract claim it set forth in its original complaint. At this time, we are unable to predict the outcome of this dispute.

By a complaint dated October 4, 2001, a lawsuit was filed in the United States District Court for the Eastern District of Pennsylvania entitled, "Fiserv Securities Inc. v. E*TRADE Securities, Inc." Fiserv filed an amended complaint dated July 2, 2002, seeking $27 million in damages plus interest, punitive damages, attorney fees and other relief from E*TRADE Securities, Inc. for breach of contract, conversion and unjust enrichment. On July 17, 2002, the Company filed an amended answer denying Fiserv's claims and asserting affirmative defenses. This case is scheduled to be placed in the trial pool on January 31, 2003; however, a trial date has not been set. At this time, we are unable to predict the ultimate outcome of this dispute.

By a complaint dated October 22, 2001, a lawsuit was filed in the United States District Court for the Southern District of New York entitled, "Nomura Securities International, Inc., v. E*TRADE Securities, Inc." Nomura filed an amended complaint dated October 29, 2001, seeking approximately $10 million in damages plus interest, unspecified punitive damages, attorney fees and injunctive and other relief from E*TRADE Securities, Inc. for conversion and breach of contract. On November 19, 2001, the Company filed an amended answer and interposing affirmative defenses and three counterclaims for conversion, money had and received, and unjust enrichment seeking to recover approximately $5 million in damages plus interest, punitive damages, attorneys fees and other relief from Nomura. At this time, we are unable to predict the ultimate outcome of this dispute.

By a Complaint dated December 28, 2001, Thomas Barry, a shareholder, filed a shareholder derivative action on his own behalf and purportedly on behalf of E*TRADE Group, Inc. itself as a Nominal Defendant, against Christos M. Cotsakos, the Company's Chairman of the Board and Chief Executive Officer, and each current member of the Company's Board of Directors, as individuals, in the Superior Court of the State of California, County of San Mateo. Before defendants were obligated to answer this complaint, Mr. Barry filed a "First Amended Shareholder Derivative Complaint" on or about February 26, 2002, for breach of fiduciary duties, waste of corporate assets, abuse of control, and gross mismanagement for acts including, but not limited to, the Board's cancellation and settlement of a $15.0 million loan to Mr. Cotsakos in exchange for his waiver of certain monetary and other rights under his employment agreement; the Board's agreeing as part and parcel of the cancellation and settlement of the foregoing loan to make an additional payment to Mr. Cotsakos of $15.2 million to compensate him for tax liabilities resulting from the cancellation and settlement of the foregoing loan; the Board's approval of other loans to officers and directors, including a $15.0 million loan to founder and director William Porter; and the Company's alleged failure to make full and adequate disclosures about such events in the Company's previous regulatory filings. Mr. Barry seeks damages allegedly sustained by the Company as a result of defendants' alleged acts, as well as his attorney's fees and costs, against all defendants except the Company. On or about April 30, 2002, demurrers (motions to dismiss) to Mr. Barry's First Amended Shareholder Derivative Complaint were filed on behalf of nominal defendant E*TRADE Group, Inc., and the individually-named members of the Company's Board of Directors, contending, among other things, that the Court must dismiss Mr. Barry's complaint because he failed to satisfy his legal obligation to raise his concerns with the Company's Board of Directors before commencing legal action. Subsequently, on May 23, 2002, all parties agreed to enter into a memorandum of understanding to settle the matter under the terms of which the Company has agreed, among other things, without admitting any wrongdoing or liability, to make certain corporate governance enhancements and to pay certain fees and costs incurred by Mr. Barry in prosecuting this action. Although the parties have agreed in principle to settle this dispute, a final settlement agreement has yet to be executed or presented to the Court for its approval.

We believe the foregoing claims against the Company are without merit and, except as to matters that we have reported as tentatively settled, intend to defend against them vigorously. An unfavorable outcome in any

matters which are not covered by insurance could have a material adverse effect on our business, financial condition and results of operations. In addition, even if the ultimate outcomes are resolved in our favor, the defense of such litigation could entail considerable cost and the diversion of the efforts of management, either of which could have a material adverse effect on our results of operation.

The securities and banking industries are subject to extensive regulation under federal, state and applicable international laws. As a result, we are required to comply with many complex laws and rules and our ability to comply is dependent in large part upon the establishment and maintenance of qualified compliance systems. From time to time, we have been threatened with, or named as a defendant in, lawsuits, arbitrations and administrative claims involving securities, banking and other matters. We are also subject to periodic regulatory audits and inspections. Compliance and trading problems that are reported to regulators such as the SEC, the NASDR or the OTS by dissatisfied customers or others are investigated by such regulators, and may, if pursued, result in formal claims being filed against us by customers and/or disciplinary action being taken against us by regulators. Any such claims or disciplinary actions that are decided against us could have a material adverse effect on our business, financial condition and results of operations.

Reference is made to the information reported in prior filings with the Securities and Exchange Commission under Item 3, Legal and Administrative Proceedings, in our Annual Report on Form 10-K, for the year ended December 31, 2001.

We maintain insurance coverage in such amounts and with such coverages, deductibles and policy limits as management believes are reasonable and prudent. The principal insurance coverage we maintain covers comprehensive general liability, commercial property damage, hardware/software damage, directors and officers, certain criminal acts against the Company and errors and omissions. We believe that such insurance coverage is adequate for the purpose of our business. Our ability to maintain this level of insurance coverage in the future, however, is subject to the availability of affordable insurance in the market place, and world events, including the terrorist attacks of September 11, 2001, may impair our ability to obtain insurance in the future.

Item 2. Changes in Securities and Use of Proceeds

In February 2002, holders of aggregate principal amount of $28,710,000 of our 6% convertible notes agreed to exchange such notes for an aggregate of 2,796,675 shares of common stock in exchanges exempt from registration pursuant to Section 3(a)(9) of the Securities Act of 1933.

In March 2002, holders of aggregate principal amount of $21,210,000 of our 6% convertible notes agreed to exchange such notes for an aggregate of 1,923,215 shares of common stock in exchanges exempt from registration pursuant to Section 3(a)(9) of the Securities Act of 1933.

In April 2002, holders of aggregate principal amount of $10,000,000 of our 6% convertible notes agreed to exchange such notes for an aggregate of 1,110,000 shares of common stock in exchanges exempt from registration pursuant to Section 3(a)(9) of the Securities Act of 1933.

In May 2002, holders of aggregate principal amount of $5,000,000 of our 6% convertible notes agreed to exchange such notes for an aggregate of 622,500 shares of common stock in exchanges exempt from registration pursuant to Section 3(a)(9) of the Securities Act of 1933.

In May 2002, the Company issued 3,380,879 shares of common stock to E*TRADE Japan K.K. in a transaction in which E*TRADE Japan K.K. purchased these shares of Company common stock and the Company purchased 62,500 shares (as adjusted to reflect a 2-for-1 stock split on July 19, 2002) of E*TRADE Japan K.K. No underwriters were involved, and there were no underwriting discounts or commissions. The securities were issued in reliance upon the exemption from registration provided under Section 4(2) of the Securities Act based on the fact that the common stock was sold by the issuer in a transaction not involving a public offering.

In May 2002, the Company authorized the issuance of an aggregate of 2,100 shares of unregistered Company common stock in connection with the exercise of certain warrants to purchase shares of common stock, the obligations under which were assumed in connection with the Company's acquisition of Telebanc. No underwriters were involved and there were no underwriting discounts or commissions. The warrants were originally issued in reliance upon the exemption from registration provided under Section 4(2) of the Securities Act based on the fact that warrants were sold by the original issuer in a sale not involving a public offering.

In June 2002, the Company issued 9,400,042 shares of common stock in connection with the acquisition of Tradescape Securities, LLC, including Momentum Securities, LLC. No underwriters were involved, and there were no underwriting discounts or commissions. The securities were issued in reliance upon the exemption from registration provided under Section 4(2) of the Securities Act based on the fact that the common stock was sold by the issuer in a transaction not involving a public offering.

In July 2002, the Company issued 474,496 shares of common stock in connection with the acquisition of a license to software from A.B. Watley Group Inc. on April 8, 2002. No underwriters were involved, and there were no underwriting discounts or commissions. The securities were issued in reliance upon the exemption from registration provided under Section 4(2) of the Securities Act based on the fact that the common stock was sold by the issuer in a transaction not involving a public offering.

Item 3. Defaults Upon Senior Securities—Not applicable.

Item 4. Submission of Matters to a Vote of Security Holders

The annual meeting of shareowners was held on May 24, 2002. Christos M. Cotsakos, David Hayden and William A. Porter were elected as directors, as tabulated below:

Director	For	Withhold
Christos M. Cotsakos	296,494,878	30,548,867
David C. Hayden	268,534,750	58,508,995
William A. Porter	304,282,689	22,761,056

In addition, Messrs. Peter Chernin, Ronald D. Fisher, William E. Ford, George Hayter, Lewis E. Randall and Dr. Lester C. Thurow will continue as directors.

The proposal to approve a 341,904 share increase in the maximum number of shares of Common Stock reserved for issuance under the E*TRADE Group, Inc. 1996 Stock Purchase Plan was approved, as tabulated below:

For	Against	Abstain	Total
305,616,707	16,094,685	5,332,353	327,043,745

The proposal to approve the adoption of the 2002 Associate Stock Purchase Plan and the reservation of 5,000,000 shares of Common Stock for issuance pursuant to the terms of the 2002 Plan was approved as tabulated below:

For	Against	Abstain	Total
302,759,405	18,913,358	5,370,982	327,043,745

The proposal to ratify the selection of Deloitte & Touche LLP as independent public accountants for the Company for fiscal year 2002 was approved, as tabulated below:

For	Against	Abstain	Total
315,125,294	11,497,138	421,313	327,043,745

Item 5. Other Information—None

Item 6. Exhibits and Reports on Form 8-K

(a) *Exhibits*

Exhibit Number	
2.1*	Agreement and Plan of Merger, dated April 10, 2002, by and among the Company, Tradescape Corp., Tradescape Technology Holdings, Inc. and Tradescape Momentum Holdings, Inc.

* Filed herewith.

(b) *Reports on Form 8-K*

On May 10, 2002, the Company filed a Current Report on Form 8-K to report the announcement of an agreement with Chairman of the Board and Chief Executive Officer Christos M. Cotsakos for a two-year employment contract.

On July 26, 2002, the Company filed a Current Report on Form 8-K to report that on July 24, 2002, the Board of Directors accepted the resignation of Mr. David C. Hayden as a Director.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Dated: August 12, 2002

E*TRADE Group, Inc.
(Registrant)

By /s/ CHRISTOS M. COTSAKOS

Christos M. Cotsakos
Chairman of the Board and Chief Executive Officer
(Principal Executive Officer)

By /s/ LEONARD C. PURKIS

Leonard C. Purkis
Chief Financial Officer
(Principal Financial and Accounting Officer)

Exhibit 2.1

AGREEMENT AND PLAN OF MERGER

BY AND AMONG

E*TRADE GROUP, INC.,

TTH ACQUISITION CORP.,

MHI ACQUISITION CORP.,

TRADESCAPE CORP.,

TRADESCAPE TECHNOLOGY HOLDINGS INC.

AND

TRADESCAPE MOMEMTUM HOLDINGS INC.

Dated as of April 10, 2002

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MERGER AGREEMENT

THIS AGREEMENT AND PLAN OF MERGER (this “Agreement”), dated as of April 10, 2002, is being entered into by and among Tradescape Corp., a Delaware corporation (the “Company”), Tradescape Technology Holdings Inc., a Delaware corporation and a wholly owned subsidiary of the Company (“TTH”), Tradescape Momentum Holdings Inc., a Delaware corporation and a wholly owned subsidiary of the Company (“MHI” and, together with TTH, the “Target Companies,” and each a “Target Company”), E*TRADE Group, Inc., a Delaware corporation (“Parent”), TTH Acquisition Corp., a Delaware corporation and a wholly owned subsidiary of Parent (“TTH Merger Sub”) and MHI Acquisition Corp., a Delaware corporation and a wholly owned subsidiary of Parent (“MHI Merger Sub” and, together with TTH Merger Sub, the “Merger Subs”). Capitalized terms used in this Agreement and not otherwise defined have the meanings ascribed to them in Section 12.1 of this Agreement.

RECITALS

A. The Company is a holding company which, through the Target Companies, provides end-to-end electronic trading solutions for retail, professional and institutional traders through its family of direct and indirect Subsidiaries including: Momentum Securities, LLC (“Momentum”), a Subsidiary of MHI, which is a provider of onsite brokerage services for professional traders engaged in high-frequency securities trading, largely for their own accounts; Tradescape Securities, LLC (“TSLLC”), also a subsidiary of MHI, which provides active retail customers the same high-speed direct access trading technologies used by institutional and professional traders, as well as competitive commissions, free Level II quotes and superior customer service; Tradescape Technologies, LLC (“TTLLC”), a subsidiary of TTH which distributes products, including Smart Order Routing Technology^{SM} (SORT)^{SM}, Electronic Communications Portal^{SM} (ECP^{SM}) technology, which provides access to all major liquidity pools through high-speed market connections, and LightSpeed^{SM}, a next-generation trading platform for professional traders, domestically and internationally through licensing agreements with the other Company Subsidiaries and through third-party arrangements; and Momentum Securities Partners, LLC (“MSPLLC”), a subsidiary of MHI which serves primarily as an asset holding company for Momentum.

B. On the date of this Agreement and at the Effective Time, respectively, the Company owns and will own, respectively, 100% of the issued and outstanding shares of capital stock of the Target Companies.

C. As a result of the mergers contemplated by this Agreement, pursuant to the terms and on the conditions contained in this Agreement, each Merger Sub will be merged with and into the Target Company specified in this Agreement, resulting in Parent acquiring 100% of the issued and outstanding shares of capital stock of each Target Company.

D. The respective Boards of Directors of each of Parent, the Merger Subs, the Company and the Target Companies have determined that the mergers of the Merger Subs with and into the Target Company specified in this Agreement (hereinafter referred to as the “Mergers”) in accordance with the laws of the State of Delaware, and subject to the terms and conditions of this Agreement, are advisable and in the best interests of Parent, each Merger Sub, the Company and each Target Company, as the case may be, and their respective stockholders and have, where appropriate or required, approved this Agreement and the Mergers.

E. Pursuant to the Mergers, among other things, the outstanding shares of capital stock of each of the Target Companies, as the case may be, shall be converted into the right to receive the consideration specified in this Agreement.

F. Certain officers and employees of the Company have executed and delivered to Parent, Management Retention Agreements (collectively, the "Management Retention Agreements") substantially in the form attached hereto as Exhibit A, that by their terms will take effect as of the Effective Time and supersede any and all prior agreements between such individual and its current employer relating to the employment of such individual, which prior agreements shall have no further force or effect.

G. Parent, each Merger Sub, the Company and each Target Company wish to make certain representations and warranties, covenants and agreements in connection with the Mergers and to set forth the terms and conditions of the Mergers in this Agreement.

H. For U.S. federal income tax purposes it is intended that the Mergers will qualify as a reorganization under Section 368(a)(1)(C) of the Code.

NOW, THEREFORE, in consideration of the foregoing and the mutual representations, warranties, covenants and agreements contained in this Agreement and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties to this Agreement intending to be legally bound do hereby agree as follows:

ARTICLE I

THE TRANSACTION

1.1. The Mergers. At the Effective Time (as defined in Section 1.2), upon the terms and subject to the conditions of this Agreement, TTH Merger Sub shall be merged with and into TTH (the "TTH Merger") and MHI Merger Sub shall be merged with and into MHI (the "MHI Merger") in accordance with the provisions of the Delaware General Corporation Law (the "DGCL"). TTH shall be the surviving corporation in the TTH Merger (the "TTH Surviving Corporation") and MHI shall be the surviving corporation in the MHI Merger (the "MHI Surviving Corporation"). As a result of the Mergers, all of the respective outstanding shares of capital stock of the Target Companies and the Merger Subs shall be converted or cancelled in the manner provided in Section 1.4.

1.2. The Effective Time. At the Closing (as defined in Section 1.17), a certificate of merger shall be duly prepared and executed by each of the TTH Surviving Corporation and the MHI Surviving Corporation (each a "Certificate of Merger" and together, the "Certificates of Merger") and thereafter delivered to the Secretary of State of the State of Delaware (the "Delaware Secretary of State") for filing, as provided in Section 251 of the DGCL, on, or as soon as practicable after, the Closing Date (as defined in Section 1.17). The Mergers shall each become effective at the time (but not prior to the Closing Date) of the filing of the respective Certificate of Merger with the Delaware Secretary of State (the date and time of the filing of the Certificate of Merger for the TTH Merger being referred to as the "TTH Effective Time" and the date and time of the filing of the Certificate of Merger for the MHI Merger being referred to as the "MHI Effective Time" and the TTH Effective Time and the MHI Effective Time are sometimes referred to in this Agreement as the "Effective Time").

1.3. Effects of the Mergers. At the applicable Effective Time, the effects of the Mergers shall be as provided in the applicable provisions of the DGCL.

1.4. Effects on Target Company Capital Stock. At the applicable Effective Time, by virtue of the Mergers and without any action on the part of Parent, the Merger Subs, the Target Companies or the Company:

(a) Capital Stock of the Merger Subs. Each issued and outstanding share of the common stock, par value $.001 per share, of TTH Merger Sub ("TTH Merger Sub Common Stock") shall be converted into and become one fully paid and nonassessable share of common stock, par value $.001 per share, of the TTH Surviving Corporation and each issued and outstanding share of the common stock, par value $.001 per share, of MHI Merger Sub ("MHI Merger Sub Common Stock," and, together with TTH Merger Sub Common Stock, the "Merger Subs Common Stock") shall be converted into and become one fully paid and nonassessable share of common stock, par value $.001 per share of the MHI Surviving Corporation. Each of the TTH Surviving Corporation and the MHI Surviving Corporation shall by operation of law become a wholly owned subsidiary of Parent. Each stock certificate representing shares of Merger Subs Common Stock shall continue to evidence ownership of such shares of TTH Surviving Corporation or MHI Surviving Corporation common stock, as the case may be, without any further action on the part of any party to this Agreement.

(b) Cancellation of Treasury Stock and Target Company Capital Stock Owned by Parent and the Merger Subs. All shares of Target Company Capital Stock that are owned by TTH or MHI as treasury stock and any shares of Target Company Capital Stock owned by Parent or the Merger Subs shall automatically be cancelled and retired and shall cease to exist and no consideration shall be delivered in exchange therefor.

(c) Conversion of Target Company Capital Stock. Each issued and outstanding share of Target Company Capital Stock held by the Company will be converted automatically into the right to receive, upon surrender of the certificates representing such Target Company Capital Stock, (i) a number of shares of common stock, par value $0.01 per share, of Parent (the "Parent Common Stock") equal to the Exchange Ratio and (ii) the non-assignable right to receive the Initial Contingent Amount and the Final Contingent Amount at such times and following the satisfaction or waiver of the conditions set forth in this Agreement, if such amounts are payable. For purposes of this Agreement, the term "Exchange Ratio" means, subject to adjustment in accordance with Section 1.5, the ratio that results from dividing (A) One Hundred Million Dollars ($100,000,000) (the "Initial Consideration") by (B) the product of (1) the Average Pre-Closing Price of Parent Common Stock and (2) the total number of shares of Target Company Capital Stock then outstanding.

All such shares of Target Company Capital Stock shall no longer be outstanding and shall be cancelled and retired automatically and shall cease to exist, and each holder of a certificate representing any such shares of Target Company Capital Stock shall cease to have any rights with respect thereto, except the right to receive the Exchange Ratio per share of Target Company Capital Stock, upon the surrender of such certificate, without interest and the Initial Contingent Amount and Final Contingent Amount, if any.

1.5. Adjustments to Exchange Ratio. The Exchange Ratio shall be appropriately adjusted to reflect the effect of any stock split, reverse split, stock dividend (including any dividend or distribution of securities convertible into Parent Common Stock or such Target Company's shares of Target Company Capital Stock), reorganization, recapitalization or other like change with respect to Parent Common Stock or Target Company Capital Stock occurring after the date of this Agreement and prior to the Effective Time and of any increase in the number of shares of such Target Company Capital Stock outstanding resulting from any failure of the representation and warranty with respect to such Target Company contained in Section 2.2(c) of this Agreement to be correct or any failure of either Target Company to comply with its covenants contained in this Agreement, so as to provide for the same economic effect as contemplated by this Agreement prior to such stock split, reverse split, stock dividend, reorganization, recapitalization, like change or increase.

1.6. Fractional Shares. No fraction of a share of Parent Common Stock will be issued in the Mergers, but in lieu thereof each of the holders of any shares of any Target Company Capital Stock who would

otherwise be entitled to a fraction of a share of Parent Common Stock shall receive from Parent an amount of cash (rounded to the nearest whole cent) equal to the product of (i) such fraction, multiplied by (ii) the Average Pre-Closing Price of Parent Common Stock.

1.7. Certificate of Incorporation, By-Laws and Officers and Directors of the Surviving Corporations. The certificates of incorporation, as the case may be, of each of the Target Companies as in effect immediately prior to their respective Effective Times, shall be the certificates of incorporation, as the case may be, of the relevant Surviving Corporation until thereafter amended as provided by law and such certificates of incorporation. The by-laws of each Merger Sub as in effect immediately prior to their respective Target Company Effective Times shall be the by-laws of the relevant Surviving Corporation until thereafter amended as provided by law, the certificates of incorporation of the relevant Surviving Corporation and such by-laws. From and after the applicable Effective Time, the directors and officers of each Surviving Corporation shall be as set forth on Exhibit B attached hereto until their respective successors are duly elected or appointed and qualified or until their earlier death, resignation or removal in accordance with such Surviving Corporation's certificates of incorporation and by-laws.

1.8. Further Assurances. Each party to this Agreement shall execute such further documents and instruments and take such further actions as may reasonably be requested by one or more of the other parties hereto to consummate the Mergers, to vest each Surviving Corporation with full title to all assets, properties, rights, approvals, immunities and franchises of the applicable Merger Sub and Target Company, to vest the Company with title to the Parent Common Stock it receives and to otherwise effect the purposes of this Agreement.

1.9. Exchange of Certificates. At the Effective Time, Parent shall, subject to Section 1.10, 1.11 and the other provisions of this Agreement, direct Parent's transfer agent to issue to the Company the Parent Common Stock it is entitled to receive pursuant to this Agreement. At the Closing, the Company shall deliver to Parent all share certificates representing TTH Capital Stock and MHI Capital Stock (each a "Certificate") for cancellation, together with a letter of transmittal with respect to such Certificates in form and substance satisfactory to Parent.

1.10. Distributions With Respect to Unexchanged Shares. No dividends or other distributions with respect to shares of Parent Common Stock with a record date on or after the Effective Time will be paid to the holder of any unsurrendered Certificate with respect to the shares of Parent Common Stock represented thereby until the holder of record of such Certificate shall surrender such Certificate. Subject to applicable law, following surrender of any such Certificate, there shall be paid to the record holder of the certificates representing whole shares of Parent Common Stock issued in exchange therefor, without interest, at the time of such surrender, cash in the amount of any such dividends or other distributions with a record date after the Effective Time theretofore payable (but for the provisions of this Section) with respect to such shares of Parent Common Stock.

1.11. Escrow. Notwithstanding the provisions of Article I of this Agreement, Parent will deposit with the Escrow Agent a number of shares of Parent Common Stock equal to the quotient of (a) Twenty Million Dollars ($20,000,000) divided by (b) the Average Pre-Closing Price of Parent Common Stock (the "Escrow Shares") to be held and disbursed by the Escrow Agent in accordance with the Escrow Agreement. The Company will be deemed, without any action on its part, to have received and deposited with the Escrow Agent pursuant to the Escrow Agreement the Escrow Shares. All shares of Parent Common Stock to be received by the Company in connection with the Mergers, other than the Escrow Shares will be distributed to the Company pursuant to Article I of this Agreement. The Escrow Shares will be represented by a certificate registered in the name of the nominee of the Escrow Agent (with the Company being the beneficial owner of the Escrow Shares). To the extent that any dividend or distribution, or other transaction with respect to the Escrow Shares, results in a liability for Tax, such Tax liability will be

that of the Company and not of Parent, TTH Surviving Corporation, MHI Surviving Corporation or any other Subsidiary of Parent. Any and all voting rights with respect to the Escrow Shares will be exercisable by the Company as of the Effective Time. Parent, the Company, the Merger Subs and the Target Companies hereby agree and acknowledge that the Escrow Shares will be treated as transferred to and owned by the Company as of the Effective Time and at all times thereafter for all Tax purposes. The Escrow Shares will be used to satisfy indemnity claims made by Parent pursuant to Section 7.2(e) and Section 9.2(a) of this Agreement.

1.12. No Further Ownership Rights in Target Company Capital Stock. All shares of Parent Common Stock issued (and cash in lieu of fractional shares paid pursuant to Section 1.6 and any dividends or other distributions pursuant to Section 1.10) upon the surrender for exchange of shares of Target Company Capital Stock in accordance with the terms of this Agreement shall be deemed to have been issued in full satisfaction of all rights pertaining to such shares of Target Company Capital Stock, and there shall be no further registration of transfers on the records of any Target Company or any Surviving Corporation of any shares of Target Company Capital Stock and the stock ledger of each of TTH and MHI will be closed. If, after the Effective Time, Certificates are presented to Parent for any reason, they shall be canceled and exchanged as provided in this Agreement.

1.13. Lost, Stolen or Destroyed Certificates. In the event any Certificates shall have been lost, stolen or destroyed, Parent shall direct its transfer agent to issue in exchange for such lost, stolen or destroyed Certificates, upon the making of an affidavit of that fact by the holder thereof, such shares of Parent Common Stock (and cash in lieu of any fractional shares pursuant to Section 1.6) as may be required pursuant to this Agreement; provided, however, that Parent may, in its discretion and as a condition precedent to the issuance thereof, require the owner of such lost, stolen or destroyed Certificates to deliver a bond in such sum as it may reasonably direct as indemnity against any claim that may be made against Parent, the Company, either Surviving Corporation or the transfer agent with respect to the Certificates alleged to have been lost, stolen or destroyed.

1.14. Withholding Rights. Parent, the Merger Subs and each Surviving Corporation shall be entitled to deduct and withhold from any payments made pursuant to this Agreement such amounts as Parent, the Merger Subs or such Surviving Corporation is required to deduct and withhold with respect to any such payment under the Code or any provision of state or local tax law. To the extent that amounts are so withheld, such withheld amounts shall be treated for all purposes of this Agreement as having been paid to the Company.

1.15. Transfer of Ownership. If any certificate for shares of Parent Common Stock is to be issued in a name other than that in which the Certificate surrendered in exchange therefor is registered, it will be a condition of the issuance of the shares of Parent Common Stock that the Certificate so surrendered will be properly endorsed and otherwise in proper form for transfer and that the Person requesting such exchange will have paid to Parent or any agent designated by it any transfer or other taxes required by reason of the issuance of a check in any name other than that of the registered holder of the Certificate surrendered, or established to the satisfaction of Parent or any agent designated by it that such tax has been paid or is not payable.

1.16. Further Action. If, at any time after the Effective Time, any further action is necessary or desirable to carry out the purposes of this Agreement and to vest any Surviving Corporation, as the case may be, with full right, title and possession to all assets, property, rights, privileges, powers and franchises of a Target Company and/or a Merger Sub, as the case may be, the officers and directors of such Surviving Corporation, are fully authorized in the name of and on behalf each of the constituent corporations to the applicable Merger to take, and will take, all such lawful and necessary action, so long as such action is not inconsistent with this Agreement.

1.17. Closing. The closing of the transactions contemplated by this Agreement (the "Closing") shall take place at the offices of Clifford Chance Rogers & Wells LLP, 200 Park Avenue, New York, New York 10166 on a date and at a time to be specified by the parties, which shall in no event be later than the fifth business day following the satisfaction or, if permissible, waiver, of the conditions set forth in Article VIII of this Agreement, or on such other date, time and place as the parties may mutually agree (the "Closing Date"). At the Closing there shall be delivered to Parent, the Merger Subs, the Target Companies and the Company the certificates and other documents and instruments required to be delivered under Article VIII of this Agreement.

1.18. Contingent Payment.

(a) Initial Contingent Amount. If the Initial Period Revenue Target is achieved, as soon as reasonably practicable after December 31, 2002, Parent shall deliver a statement of the Initial Period Net Income (the "Initial Period Net Income Statement") to the Company. Within 60 Business Days after receipt of the Initial Period Net Income Statement, the Company shall, in a written notice to Parent, either accept the Initial Period Net Income Statement or object to the Initial Period Net Income Statement by describing in reasonably specific detail any proposed adjustments to the Initial Period Net Income Statement and the estimated amounts of and reasons for such proposed adjustments. The failure by the Company to object to the Initial Period Net Income Statement within such 60 Business Day period shall be deemed to be an acceptance by the Company of the Initial Period Net Income Statement. If any adjustments to the Initial Period Net Income Statement are proposed by the Company within such 60 Business Day period, the dispute shall be resolved pursuant to the procedures set forth in Section 1.18(d) below. Within 10 Business Days after the later of the acceptance of the Initial Period Net Income Statement by the Company or the resolution of any disputes pursuant to Section 1.18(d) below, as the case may be, Parent shall deliver the Initial Contingent Amount, if any, to the Company.

(b) Final Contingent Amount. If the Final Period Revenue Target is achieved, as soon as reasonably practicable after December 31, 2003, Parent shall deliver a statement of the Final Period Net Income (the "Final Period Net Income Statement") to the Company. Within 60 Business Days after receipt of the Final Period Net Income Statement, the Company shall, in a written notice to Parent, either accept the Final Period Net Income Statement or object to the Final Period Net Income Statement by describing in reasonably specific detail any proposed adjustments to the Final Period Net Income Statement and the estimated amounts of and reasons for such proposed adjustments. The failure by the Company to object to the Final Period Net Income Statement within such 60 Business Day period shall be deemed to be an acceptance by the Company of the Final Period Net Income Statement. If any adjustments to the Final Period Net Income Statement are proposed by the Company within such 60 Business Day period, the dispute shall be resolved pursuant to Section 1.18(d) below. Within 10 Business Days after the later of the acceptance of the Final Period Net Income Statement by the Company or the resolution of any disputes pursuant to Section 1.18(d) below, as the case may be, Parent shall deliver the Final Contingent Amount, if any, to the Company.

(c) Statement of Target Company Revenues. If, pursuant to Parent's calculation of Target Company Revenues the Initial Period Revenue Target and/or the Final Period Revenue Target are not achieved, Parent shall, as soon as reasonably practicable after December 31, 2002 or December 31, 2003, as the case may be, deliver a statement of Target Company Revenues for the period in question (the "Statement of Target Company Revenues") to the Company. Within 60 Business Days after receipt of the Statement of Target Company Revenues, the Company shall, in a written notice to Parent, either accept the Statement of Target Company Revenues or object to the Statement of Target Company Revenues by describing in reasonably specific detail any proposed adjustments to the Statement of Target Company Revenues and the estimated amounts of and reasons for such proposed adjustments. The failure by the Company to object to the Statement of Target Company Revenues within such 60 Business Day period shall be deemed to be an

acceptance by the Company of the Statement of Target Company Revenues. If any adjustments to the Statement of Target Company Revenues are proposed by the Company within such 60 Business Day period, the dispute shall be resolved pursuant to Section 1.18(d) below. If the resolution of any such dispute results in the Initial Period Revenue Target and/or the Final Period Revenue Target being achieved then within 10 Business Days after such resolution, Parent shall deliver the Initial Period Net Income Statement or the Final Period Net Income Statement, as the case may be, to the Company.

(d) Resolution of Disputes.

(i) If any adjustments to the Initial Period Net Income Statement, the Final Period Net Income Statement or the Statement of Target Company Revenues, as the case may be, are proposed by the Company, Parent and the Company shall promptly and in good faith attempt to resolve such objections. In the event the dispute is not resolved within 30 days of such written objection, Parent and the Company shall appoint a major independent accounting firm (the "Auditor") to review the Initial Period Net Income Statement, the Final Period Net Income Statement or the Statement of Target Company Revenues, as the case may be. The review by the Auditor shall be limited to a review of the computations of Net Income or Target Company Revenues, as the case may be, by reference to the procedures and methodologies agreed by Parent and the Company and set forth in the schedules to this Agreement. Parent and the Company shall fully cooperate in connection with the computational review of the preparation of the Initial Period Net Income Statement, the Final Period Net Income Statement and the Statement of Target Company Revenues, as the case may be, provided, however, that in no event shall such review by the Auditor take more than 30 days. The determination of the Auditor shall be final and binding on Parent and the Company.

(ii) In the event that, after the above review process is complete, it is determined that the Initial Period Net Income Statement, the Final Period Net Income Statement or the Statement of Target Company Revenues, as the case may be, was correct as initially calculated, the Company shall pay the costs of the Auditor. In the event that, after the above review process is completed, it is determined that the Initial Period Net Income Statement, the Final Period Net Income Statement or the Statement of Target Company Revenues, as the case may be, was not correct as initially calculated, Parent shall pay the costs of the Auditor. In any event, the costs and expenses of reviewing the Initial Period Net Income Statement, the Final Period Net Income Statement and the Statement of Target Company Revenues (other than those incurred by the Auditor) shall be borne by the party incurring such costs and expense.

(e) Earn-Out Covenants. Until December 31, 2003, unless earlier terminated by their terms, Parent shall and Parent shall cause its Subsidiaries to, comply with the operational covenants with respect to the Target Companies set forth on Schedule 1.18(e).

ARTICLE II

REPRESENTATIONS AND WARRANTIES OF THE COMPANY

Except as disclosed in the schedule to this Agreement provided to Parent by the Company prior to the date of this Agreement (the "Company Disclosure Schedule") and referring to the representations and warranties in this Agreement, any exception so disclosed to specifically identify the Section of this Agreement to which it relates, including through the use of specific cross-references, the Company represents and warrants, to Parent and the applicable Merger Sub with which that Target Company is being merged pursuant to this Agreement as follows:

2.1. General Representations of the Company.

(a) Capacity. The Company is a corporation, duly organized, validly existing and in good standing under the laws of its jurisdiction of organization. The Company has all requisite corporate power and authority to enter into this Agreement and the Collateral Documents to which it is a party and to consummate the transactions contemplated hereby and thereby.

(b) Validity and Execution of Agreements. This Agreement and each of the Collateral Documents to which the Company is a party have been duly executed and delivered by the Company and, assuming due authorization, execution and delivery by Parent and the other parties hereto or thereto, constitute the valid and binding obligation of the Company, enforceable against the Company in accordance with their respective terms, except as such enforcement may be limited by (i) the effect of bankruptcy, insolvency, reorganization, receivership, conservatorship, arrangement, moratorium or other laws affecting or relating to the rights of creditors generally, or (ii) the rules governing the availability of specific performance, injunctive relief or other equitable remedies and general principles of equity, regardless of whether considered in a proceeding in equity or at law.

(c) Ownership of Target Company Capital Stock. The shares of Target Company Capital Stock listed on Schedule 2.1(c) of the Company Disclosure Schedule next to the applicable Target Company (i) are owned on the date of this Agreement legally, beneficially and of record by the Company; (ii) will be owned legally, beneficially and of record immediately prior to the Closing by the Company, free and clear of any Liens; and (iii) constitute all of the Target Company Capital Stock outstanding. The Company has not granted to any Person any rights (including without limitation proxy rights or options with respect to any shares or units of Target Company Capital Stock) and the Company is not a party to any voting trust or other agreement or understanding with respect to such Target Company Capital Stock.

(d) No Conflicts. Neither the execution and delivery of this Agreement nor any of the Collateral Documents to which the Company is a party, nor the performance by the Company of the transactions contemplated hereby or thereby, will (i) violate the certificate of incorporation or by-laws of the Company; (ii) violate or constitute a default, or require notice and/or consent under, any mortgage, indenture, deed of trust, lease, contract, agreement, license or other instrument, permit, concession, franchise, judgment, order, decree or ruling to which the Company is a party or by which the Company's assets or properties are bound; (iii) violate any Laws and Regulations applicable to the Company; or (iv) result in the creation of any Lien upon any Target Company Capital Stock.

(e) Investment Representations. The Company understands and acknowledges that the shares of Parent Common Stock being issued to the Company pursuant to this Agreement are not registered under the Securities Act of 1933, as amended, and the rules and regulations promulgated thereunder (the "Securities Act"), or any applicable state securities law, and that such shares of Parent Common Stock may not be transferred or sold except pursuant to the registration provisions of the Securities Act or pursuant to an applicable exemption therefrom and pursuant to applicable state securities laws and regulations, and that the shares of Parent Common Stock being issued to the Company pursuant to this Agreement and in connection with the transactions contemplated hereby will bear appropriate legends to that effect.

(f) Investment Purpose. The shares of Parent Common Stock being received by the Company pursuant to this Agreement and in connection with the transactions contemplated hereby are being acquired for the Company's own account, for the purpose of investment and without a view to the distribution or resale of such shares of Parent Common Stock or any interest therein to the public in violation of the Securities Act. The Company has such knowledge and experience in financial and business matters so as to be capable of evaluating the merits and risks of its investment in shares of Parent Common Stock and is capable of bearing the economic risk of such investment. The Company has been provided, to its satisfaction, the opportunity to ask questions concerning the terms and conditions of the offering and sale

of the shares of Parent Common Stock and issuance of the Parent Common Stock pursuant to this Agreement, has had all such questions answered to its satisfaction and has been supplied all additional information deemed necessary by it to verify the accuracy of the information furnished to the Company.

(g) Government Consents. Assuming the Company Approvals (as defined in Section 2.3(b)) are made or obtained, the execution, delivery and performance of this Agreement by the Company does not require any consent from, action by or in respect of, or filing with, any court or Governmental Entity (as defined in Section 2.3(c)).

2.2. Organization, Standing and Authority; Subsidiaries.

(a) Schedule 2.2(a) of the Company Disclosure Schedule sets forth a true and complete list of the Subsidiaries of each Target Company. Neither Target Company nor any of their respective Subsidiaries directly or indirectly owns any equity or similar interest in, or any interest convertible into or exchangeable or exercisable for, any equity or similar interest in, any corporation, partnership, limited liability company, joint venture or other business association or entity. Each Target Company and each of its Subsidiaries is a corporation or limited liability company, as the case may be, duly organized or formed, as the case may be, validly existing and in good standing under the laws of its jurisdiction of organization or formation. Each Target Company and each of its Subsidiaries has the corporate or limited liability company power, as the case may be, to own, use and lease its assets and properties and to carry on its business as now being conducted and is duly qualified or licensed as a foreign corporation or limited liability company, as the case may be, to do business and is in good standing in each jurisdiction where the nature of its business or the ownership, leasing or operation of its assets and properties render such qualification, license or good standing necessary, except in such jurisdictions where the failure to be so qualified or licensed as a foreign corporation or limited liability company, as the case may be, and in good standing would not have a Material Adverse Effect on such Target Company or such Subsidiary. Schedule 2.2(a) of the Company Disclosure Schedule lists all of the states or other jurisdictions where each Target Company or any of their respective Subsidiaries are qualified or licensed as a foreign corporation or limited liability company, as the case may be.

(b) The member interests and other equity interests in each Target Company Subsidiary listed on Schedule 2.2(b) of the Company Disclosure Schedule opposite such Subsidiary's name (i) are owned on the date of this Agreement legally, beneficially and of record by the Target Company listed thereon; (ii) will be owned legally, beneficially and of record immediately prior to the Closing by such Target Company, free and clear of any Liens; and (iii) except as otherwise listed on Schedule 2.1(c) of the Company Disclosure Schedule with respect to Momentum, constitute all of the member interests, voting and equity securities of each such Subsidiary. Neither the Company, any Target Company nor any of their respective Subsidiaries has granted to any Person any rights (including without limitation proxy rights or options with respect to any member interests or other equity securities, as the case may be, of the Company, either Target Company or any of their respective Subsidiaries) and neither the Company, any Target Company or any of their respective Subsidiaries is a party to any voting trust or other agreement or understanding with respect to such member interests or other equity securities, as the case may be, of any such Target Company or any of their respective Subsidiaries. Neither the Company nor any Target Company has any claim against any of their respective Subsidiaries and the Company does not have any claim against either Target Company, or, in each case, any of its officers, directors or other members, equity security holders or other Person with respect to the issuance of any member interests or other equity securities of any such Target Company or any such Subsidiary, as the case may be.

(c) Capital Structure. The capitalization of each Target Company and each of their respective Subsidiaries is set forth on Schedule 2.1(c) of the Company Disclosure Schedule. There are no other authorized or outstanding shares or classes of capital stock, member interests or voting or equity

securities carrying voting rights or economic interests with respect to either Target Company or any of their respective Subsidiaries and no outstanding commitments to issue any shares of capital stock, member interests or other voting or equity securities. All outstanding shares or other voting or equity securities, as the case may be, of each Target Company and each of their respective Subsidiaries are duly authorized, validly issued, fully paid, non-assessable and are free and clear of any Liens, and are not subject to preemptive rights or rights of first refusal or any agreement to which the Company, any Target Company or any such Subsidiary is a party or by which it is bound. Except as set forth on Schedule 2.1(c) of the Company Disclosure Schedule, neither Target Company nor any such Subsidiary has authorized or issued, and does not have, any options, warrants, calls, rights, commitments or agreements of any character to which the Target Company or such Subsidiary is a party or by which it is bound obligating the Target Company or any such Subsidiary to issue, deliver, sell, repurchase or redeem, or cause to be issued, delivered, sold, repurchased or redeemed, any shares of capital stock or any member interests or other voting or equity securities, as the case may be, of such Target Company or any such Subsidiary or obligating the Target Company or any such Subsidiary to grant, extend, accelerate the vesting of, change the price of, or otherwise amend or enter into any such option, warrant, call, right, commitment or agreement. Except for this Agreement, there are no contracts, commitments or agreements relating to voting, purchase or sale of any Target Company's or any of their respective Subsidiaries' capital stock, member interests, or other voting or equity securities between or among any Target Company or any such Subsidiary and any of their respective stockholders or members, as the case may be. All outstanding shares and other voting or equity securities of each Target Company constituting Target Company Capital Stock and all equity, member or other interests in each Subsidiary of the Target Companies were issued in compliance with all applicable federal and state securities laws.

2.3. Binding Effect; No Conflicts.

(a) The Target Companies have all requisite corporate power and authority to enter into this Agreement and to consummate the transactions contemplated hereby. The execution and delivery of this Agreement and the consummation of the transactions contemplated hereby have been duly authorized by all necessary corporate action on the part of each Target Company. This Agreement has been duly executed and delivered by each Target Company and constitutes the legal, valid and binding obligation of each Target Company, enforceable against it in accordance with its terms, except as such enforcement may be limited by (i) the effect of bankruptcy, insolvency, reorganization, receivership, conservatorship, arrangement, moratorium or other laws affecting or relating to the rights of creditors generally, or (ii) the rules governing the availability of specific performance, injunctive relief or other equitable remedies and general principles of equity, regardless of whether considered in a proceeding in equity or at law.

(b) Assuming the filings and approvals described in clauses (i) through (vi) of Section 2.3(c) (collectively, the "Company Approvals") are made or obtained (as the case may be), the execution, delivery and performance of this Agreement by the Target Companies does not, and the consummation of the transactions contemplated hereby do not and will not, conflict with, or result in any violation of, or default under (with or without notice or lapse of time, or both), or give rise to a right of termination, cancellation or acceleration of any obligation or loss of any benefit under, (i) any provision of the certificate or articles of incorporation, by-laws or any other comparable organizational documents, each as amended, of the Target Companies or any of their respective Subsidiaries; (ii) any mortgage, indenture, deed of trust, lease, contract, agreement, license or other instrument, permit, concession, franchise, judgment, order, decree or ruling to which either Target Company or any of their respective Subsidiaries is a party or by which either Target Company's or any of their respective Subsidiaries' assets or properties are bound; or (iii) any Laws and Regulations applicable to either Target Company or any of their respective Subsidiaries or any of their respective properties or assets.

(c) No consent, approval, order or authorization of, or registration, declaration or filing with, any court, administrative agency or commission, self-regulatory organization ("SRO") or other regulatory body or other foreign or domestic governmental or quasi-governmental authority or instrumentality, including, without limitation, the Securities and Exchange Commission (the "SEC"), the National Association of Securities Dealers, Inc. or its wholly owned subsidiary NASD Regulation, Inc. (together, the "NASD") (each of the foregoing, a "Governmental Entity"), is required by or with respect to either Target Company or any of their respective Subsidiaries in connection with the execution and delivery of this Agreement, the performance of either Target Company's obligations hereunder or the consummation of the transactions contemplated hereby, except for (i) the filing of the Certificates of Merger; (ii) such notices, applications, consents, approvals, orders, authorizations, registrations, declarations and filings as may be required under applicable federal or state securities laws or the applicable securities laws or SRO rules and regulations of any foreign country in connection with the Mergers; (iii) the notification requirements of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (the "HSR Act"); (iv) the notification requirements of Rule 1017 of the NASD; (v) the consents, approvals, orders, authorizations, registrations, declarations and filings set forth on Schedule 2.3(c) of the Company Disclosure Schedule; and (vi) such other consents, authorizations, filings, approvals and registrations which, if not obtained or made would not prevent, or materially alter or delay, any of the transactions contemplated by this Agreement.

2.4. Financial Statements.

(a) The Company has furnished to Parent true and complete copies of the following consolidated financial statements of each Target Company and their Subsidiaries (the "Financial Statements"):

(i) Audited combined financial statements of Momentum and TSLLC as of and for the years ended December 31, 2001 and 2000 (the "Audited Momentum Financial Statements");

(ii) Audited separate financial statements of TTLLC as of and for the year ended December 31, 2001 (the "Audited TTLLC Financial Statements" and, together with the Audited Momentum Financial Statements, the "Audited Financial Statements");

(iii) Unaudited combined financial statements, including balance sheets of Momentum, TSLLC and TTLLC (pro forma) as of and for the eleven months ended November 30, 2001;

(iv) Unaudited combined financial statements, including balance sheets, of Momentum, TSLLC and TTLLC (pro forma) as of and for the two months ended February 28, 2002 (the "Unaudited Financial Statements");

(v) Audited separate financial statements of Momentum for calendar years 1999, 2000 and 2001; and

(vi) Audited separate financial statements of TSLLC for the 15 month period ended December 31, 2001.

(b) The Financial Statements were prepared in accordance with GAAP applied on a basis consistent with that of preceding accounting periods except that the unaudited Financial Statements do not include notes and are subject to normal year-end adjustments. All of the Financial Statements (i) were prepared in accordance with the books of account and other financial records of the Company and its Subsidiaries and (ii) fairly present in all material respects the financial condition of each company represented in such statements as of the respective dates thereof.

2.5. Absence of Certain Changes. Since December 31, 2001, each Target Company and their respective Subsidiaries have conducted their respective businesses in the ordinary course consistent with past practice and there has not occurred: (i) a Material Adverse Effect with respect to either Target Company or any of their respective Subsidiaries; (ii) any acquisition, sale or transfer of any asset or property of either Target Company or any of their respective Subsidiaries, other than in the ordinary course of business and consistent with past practice or any impairment, damage, destruction, loss or claim not covered by insurance, or condemnation or other taking adversely in any respect either Target Company's or any of their respective Subsidiaries' assets; (iii) any change in accounting methods or practices (including any change in depreciation or amortization policies or rates) by either Target Company or any of their respective Subsidiaries or any revaluation by either Target Company or any of their respective Subsidiaries of any of its or their respective Subsidiaries' assets; (iv) any election with respect to Taxes or changes in Tax accounting methods; (v) any declaration, setting aside, or payment of a dividend or other distribution with respect to the shares or member interests, as the case may be, of either Target Company or any of their respective Subsidiaries, or any direct or indirect redemption, purchase or other acquisition by the Target Company or any of their respective Subsidiaries of any of its shares of capital stock, any member interests or other voting or equity securities, as the case may be; (vi) any contract entered into by either Target Company or any of their respective Subsidiaries, other than in the ordinary course of business and as made available to Parent, or any amendment or termination of, or default under, any contract to which either Target Company or any of their respective Subsidiaries is a party or by which it or any of its respective assets or properties is bound; (vii) any amendment or change to the articles or certificate of incorporation or bylaws or other comparable organizational documents of either Target Company or any of their respective Subsidiaries; (viii) any increase in or modification of the compensation or benefits payable or to become payable by either Target Company or any of their respective Subsidiaries to any of their respective directors, officers or employees, other than (in the case of non-executive officer employees) in the ordinary course of business consistent with past practice; (ix) any change in the risk management and hedging policies, procedures or practices of either Target Company or any of their respective Subsidiaries, or any failure to comply with such policies, procedures and practices; or (x) any negotiation or agreement by either Target Company or any of their respective Subsidiaries to do any of the things described in the preceding clauses (i) through (ix) (other than negotiations with Parent and its Representatives regarding the transactions contemplated by this Agreement).

2.6. Undisclosed Liabilities. There are no Liabilities against, relating to or affecting the Target Companies, any of their respective Subsidiaries or any of their respective assets and properties other than (i) those reflected or reserved against on the Audited Financial Statements, or (ii) those incurred in the ordinary course of business consistent with past practice since the date of the last balance sheets for the applicable Target Company included in the Audited Financial Statements and which have not had nor could be reasonably expected to have a Material Adverse Effect on either Target Company or any of their respective Subsidiaries.

2.7. Litigation; Government Proceedings.

(a) Except as set forth on Schedule 2.7 of the Company Disclosure Schedule, there are no private or governmental actions, suits, proceedings, arbitrations, claims, inquiries, examinations, inspections or investigations pending by or before any Governmental Entity, agency, SRO, court or tribunal, foreign or domestic or, to the knowledge of the Company and the Target Companies, threatened against either Target Company or any of their respective Subsidiaries or any of their respective properties or assets or any of their respective officers or directors (in their capacities as such). There are no judgments, decrees or orders against either Target Company or any of their respective Subsidiaries, or any of their respective directors or officers (in their capacities as such). Neither Target Company nor any of their respective Subsidiaries is the plaintiff in any such material proceeding and neither Target Company nor any of their respective Subsidiaries is contemplating commencing legal action against any other Person.

(b) Except as set forth on Schedule 2.7(b) of the Company Disclosure Schedule, during the past ten years, none of the Company, the Target Companies or any of their respective Subsidiaries have been the subject of any governmental proceeding, or material investigation or inquiry involving any Governmental Entity including, without limitation, the SEC, the NASD, or any other federal or state regulatory authority having jurisdiction over the business activities of the Company, the Target Companies or any of their respective Subsidiaries. None of the Company, the Target Companies, or any of their respective Subsidiaries have been the subject of any order, judgment, or decree of any court of competent jurisdiction, permanently or temporarily enjoining, or otherwise limiting any of their participation in, the following activities: (i) acting as an investment adviser, underwriter, broker or dealer in securities, or engaging in or continuing any conduct or practice in connection with such activity; (ii) engaging in any type of business practice; or (iii) engaging in any activity in connection with the purchase or sale of any security or in connection with any violation of federal or state securities laws.

2.8. Business Restrictions. There is no agreement, judgment, injunction, order, ruling or decree binding upon or, to the knowledge of the Company and the Target Companies, threatened with respect to either Target Company or any of their respective Subsidiaries which has or will have the effect of prohibiting or impairing the current business practices of either Target Company or any of their respective Subsidiaries, the acquisition of property or assets by either Target Company or any of their respective Subsidiaries or the conduct of business by either Target Company or any of their respective Subsidiaries as currently conducted or the properties or assets used in their respective businesses or as currently proposed to be conducted by either Target Company or any of their respective Subsidiaries. Neither Target Company currently engages in any activities other than holding member interests or other equity securities of their respective Subsidiaries in each case as set forth on Schedule 2.2(b) of the Company Disclosure Schedule.

2.9. Laws and Regulations.

(a) Except as set forth on Schedule 2.9(a) of the Company Disclosure Schedule, each Target Company and each of their respective Subsidiaries has complied in all material respects with all applicable Laws and Regulations, and is not in violation in any material respect of, and has not received any notices of violation with respect to, any Laws and Regulations in connection with the conduct of its business or the ownership or operation of its business, assets and properties.

(b) Each Target Company and each of their respective Subsidiaries has obtained and currently holds all licenses, permits, certificates, franchises and other authorizations (collectively the "Authorizations") necessary for the ownership or use of its assets and properties and the conduct of its business. Each Target Company and each of their respective Subsidiaries has complied in all material respects with, and is not in violation in any material respect of, any Authorization.

(c) Schedule 2.9(c) of the Company Disclosure Schedule sets forth a description of each Governmental Order applicable to the Company, either Target Company or any of their respective Subsidiaries and no such Governmental Order has had or to the knowledge of the Company would have a Material Adverse Effect on the Company, either Target Company or any of their respective Subsidiaries.

2.10. Properties.

(a) Schedule 2.10(a) of the Company Disclosure Schedule contains a true, complete and correct list (designating the relevant owners, lessors, sublessors, sublessees and lessees, as applicable) of (i) all real property and improvements owned, leased or subleased by each Target Company and its Subsidiaries or otherwise made available for their use, including pursuant to facilities and services agreements or otherwise; (ii) all real and personal property, leases, subleases, occupancy, or other similar agreements to which any Target Company or Subsidiary is a party (the "Leases"); and (iii) all material equipment, fixtures, and other personal property owned, leased, subleased or managed by or otherwise made available for use to either Target Company and any of their respective Subsidiaries. A copy of all Leases and deeds of either Target Company and any of their respective Subsidiaries have been delivered or otherwise made available to Parent by the Company.

(b) With respect to real property leased by each Target Company and their Subsidiaries or otherwise made available to each Target Company or their respective Subsidiaries for their use, such Target Company and their respective Subsidiaries have the right to quiet enjoyment of such real property for the full term of each Lease (and any renewal option related thereto), and the leasehold or other interest of each Target Company or their respective Subsidiaries in such real property is not subject or subordinate to any Lien (or if subordinate, a non-disturbance agreement has been obtained by the Target Company or their respective Subsidiaries from the holder of the Lien). Each Target Company and their respective Subsidiaries are in compliance with all material terms of each Lease, if any, and, to the knowledge of the Company and their respective Subsidiaries, the other party or parties thereto are not in default of its or their obligations thereunder nor does any such party have the right to terminate prior to its scheduled expiration the term of any Lease.

(c) Neither the whole nor any part of any real property leased, used or occupied by each Target Company or their respective Subsidiaries is subject to any pending suit for condemnation or other taking by any public authority, or any other matter materially or adversely affecting the current use, occupancy or value thereof and, to the knowledge of the Company, no such condemnation, taking or other matter is currently threatened or contemplated. The properties leased or subleased by each Target Company and their respective Subsidiaries are sufficient to conduct the operations of such Target Company and their respective Subsidiaries as currently conducted, and the foregoing personal properties are in sound operating condition and repair, normal wear and tear excepted. There has not been any interruption of the operations of the Target Company or their respective Subsidiaries due to inadequate maintenance of any such properties.

(d) Each Target Company and its respective Subsidiaries have good and marketable fee or leasehold title to all of their respective assets and properties, in each case free and clear of any Lien. Each Target Company and their respective Subsidiaries have all necessary assets, equipment and properties to engage in the business as currently conducted by each Target Company and their respective Subsidiaries.

(e) All real property listed on Schedule 2.10(a) of the Company Disclosure Schedule complies in all material respects with all Laws and Regulations applicable to the operations of each Target Company and its Subsidiaries or their use or occupancy of such real property; and none of the Target Companies or their Subsidiaries have received notice of any violation of any such Laws or Regulations.

(f) Other than lessee and sublessees disclosed on Schedule 2.10(a) of the Company Disclosure Schedule no other party or parties have the right to use or occupy all or any portion of the real property set forth on Schedule 2.10(a) of the Company Disclosure Schedule.

(g) Neither of the Target Companies nor any of their respective Subsidiaries have assigned, transferred, conveyed, mortgaged, deeded in trust, or otherwise encumbered any interest in real property set forth on Schedule 2.10(a) of the Company Disclosure Schedule.

2.11. Intellectual Property.

(a) Schedule 2.11(a) of the Company Disclosure Schedule sets forth a list of all Intellectual Property owned by either Target Company or any of their respective Subsidiaries (other than trade secrets, know-how and goodwill attendant to the Intellectual Property and other intellectual property rights not reducible to schedule form). The Target Companies and/or their respective Subsidiaries have all right, title and interest in all such Intellectual Property, free and clear of all claims and/or rights of other Persons, and all such Intellectual Property is valid and in good standing.

(b) Schedule 2.11(b) of the Company Disclosure Schedule sets forth a list of all Intellectual Property licensed from third parties by either Target Company or any of their respective Subsidiaries. The Target Companies and/or their respective Subsidiaries have a valid and binding license to use all such Intellectual Property, free and clear of all claims and/or rights of other Persons, and all such Intellectual Property is valid and in good standing.

(c) Except for the Intellectual Property listed on Schedule 2.11(a) and Schedule 2.12(b) of the Company Disclosure Schedule, and trade secrets, know-how and goodwill attendant to such Intellectual Property and other intellectual property rights not reducible to schedule form, no other Intellectual Property is used or is proposed to be used by either Target Company or any of their respective Subsidiaries in their respective businesses as currently conducted or as currently proposed to be conducted nor is any other Intellectual Property necessary for the conduct of such business.

(d) Each Target Company and its respective Subsidiaries have taken all reasonable precautions to protect the secrecy, confidentiality and value of all know-how included in the Intellectual Property.

(e) Neither of the Target Companies nor any of their respective Subsidiaries have (i) licensed any of their Intellectual Property in source code form to any party; (ii) entered into any exclusive agreements relating to their Intellectual Property; or (iii) entered into any arrangements or agreements that could cause an encumbrance or impairment of their Intellectual Property rights.

(f) The Intellectual Property of the Target Companies and their respective Subsidiaries does not infringe, and is not based on a misappropriation of, any Intellectual Property of any other Person. No proceeding charging either Target Company or any of their respective Subsidiaries with, or an allegation of, infringement or misappropriation of the Intellectual Property has been filed or, to the knowledge of the Company, is threatened to be filed, by any Person. Neither of the Target Companies nor any of their respective Subsidiaries are making any unauthorized use of any confidential information or trade secrets of any other Person in connection with the conduct of their business.

(g) Neither of the Target Companies nor any of their respective Subsidiaries have received any opinion of counsel (outside or inside) relating to the patentability, infringement, validity or enforceability of any Intellectual Property.

(h) There is and has been no unauthorized use, disclosure, infringement or misappropriation of any Intellectual Property rights of either Target Company or any of their respective Subsidiaries, or any Intellectual Property of any third party to the extent licensed by or through either Target Company or any of their respective Subsidiaries, by any third party, including any employee or former employee of either Target Company or any of their respective Subsidiaries.

(i) Each Target Company's and its respective Subsidiaries' rights in and to their Intellectual Property are freely transferable and assignable, and no approval or consent of any Person is needed so that the interest of the Merger Subs in the Intellectual Property shall continue to be in full force and effect and enforceable by the Merger Subs following the transactions contemplated by this Agreement.

(j) Neither of the Target Companies or any of their respective Subsidiaries is, nor will any of them be, as a result of the execution and delivery of this Agreement or the performance of its obligations under this Agreement, in breach of any license, sublicense or other agreement relating to any of its Intellectual Property or the Intellectual Property of a third party.

(k) Each Target Company and its respective Subsidiaries has secured valid written assignments, from all consultants and employees who contributed to the creation or development of Intellectual Property, of the rights to such contributions that such Target Company or Subsidiary does not already own by operation of law and each Target Company and their respective Subsidiaries have obtained waivers of any moral rights existing in such contributions.

(l) Each Target Company and their respective Subsidiaries have taken reasonable steps consistent with prevailing industry practice to protect and preserve the confidentiality of all of their Intellectual Property not otherwise protected by patents or copyrights ("Confidential Information"). All use, disclosure or appropriation of Confidential Information owned by either of the Target Companies or any of their respective Subsidiaries by or to a third party has been pursuant to the terms of a written agreement between such Target Company or Subsidiary and such third party. All use, disclosure or appropriation by each Target Company and their respective Subsidiaries of Confidential Information not owned by such Target Company or such Subsidiary has been pursuant to and in accordance with the terms of a written agreement between such Target Company or Subsidiary and the owner of such Confidential Information, or is otherwise lawful.

2.12. Taxes.

(a) Each of the Company and its Subsidiaries has timely filed all Tax Returns required to be filed and all such Tax Returns were true, correct and complete in all material respects. All material Taxes owed by any of the Company and its Subsidiaries (whether or not shown on any Tax Return) have been paid within the time and in the manner prescribed by law. Except as set forth on Schedule 2.12(a) of the Company Disclosure Schedule, none of the Company or its Subsidiaries currently is the beneficiary of any extension of time within which to file any Tax Return. No claim has ever been made by an authority in a jurisdiction where any of the Company and its Subsidiaries does not file Tax Returns that it is or may be subject to taxation by that jurisdiction. There are no liens or security interests on any of the assets of any of the Company and its Subsidiaries that arose in connection with any failure (or alleged failure) to pay any Tax.

(b) Each of the Company and its Subsidiaries has timely withheld and paid all Taxes required to have been withheld and paid in connection with amounts paid or owing to any employee, independent contractor, creditor, stockholder, or other third party.

(c) Neither the Company nor a director or officer (or employee responsible for Tax matters) of any of the Company and its Subsidiaries expects any authority to assess any additional Taxes for any period for which Tax Returns have been filed. There is no dispute or claim concerning any Tax liability of any of the Company and its Subsidiaries either (i) claimed or raised by any authority in writing or (ii) as to which any of the Company and the directors and officers (and employees responsible for Tax matters) of the Company and its Subsidiaries has knowledge. Schedule 2.12(c) of the Company Disclosure Schedule lists all jurisdiction in which Tax Returns are filed with respect to any of the Company and its Subsidiaries and indicates those Tax Returns that have been audited or that are currently the subject of audit. The Company has delivered or otherwise made available to the Parent correct and complete copies of all income and franchise Tax Returns, examination reports, and statements of deficiencies assessed against or agreed to by any of the Company and its Subsidiaries (and their predecessors) since January 1, 1998.

(d) Schedule 2.12(d) of the Company Disclosure Schedule accurately sets forth, as of December 31, 2001, the tax basis of the Company in the shares of the Target Companies, and the tax basis and capital account of each Target Company and its Subsidiaries.

(e) No power of attorney currently in force has been granted by the Company or any of its Subsidiaries with respect to any Tax matter.

(f) Neither the Company nor any of its Subsidiaries has waived any statute of limitations in respect of Taxes or agreed to any extension of time with respect to a Tax assessment or deficiency.

(g) Neither the Company nor any of its Subsidiaries has filed a consent under Code Section 341(f) concerning collapsible corporations. Neither the Company nor any of its Subsidiaries is required to include in income any adjustment pursuant to Code Section 481(a) by reason of a change in accounting method. Each of the Company and its Subsidiaries has disclosed on its Tax Returns all positions taken therein that could give rise to a substantial understatement of Tax within the meaning of Code Section 6662 (or its equivalent under state or local law). Neither the Company nor any of its Subsidiaries is a party to any Tax allocation, Tax sharing or Tax indemnity agreement. Except as set forth on Schedule 2.12(g) of the Company Disclosure Schedule, neither the Company nor any of its Subsidiaries (i) has been a member of an affiliated group within the meaning of Code Section 1504, or any similar provision of state or local law, filing a consolidated tax return (other than an affiliated group the common parent of which is the Company), or (ii) has any liability for Taxes of any Person (other than any of the Target Companies and their Subsidiaries) under Treasury Regulation § 1.1502-6 (or any similar provision of state or local law), as a transferee or successor, by contract, or otherwise.

(h) None of the Company and its Subsidiaries has a material item of income or gain reported for financial reporting purposes in a pre-Closing period which is required to be included in taxable income for a post-Closing period. None of the Company and its Subsidiaries has made any payments, is obligated to make any payments, or is a party to any agreement that under certain circumstances could obligate it to make any payments that will not be deductible under Code Section 162(m) or Code Section 280G.

(i) Schedule 2.12(i) of the Company Disclosure Schedule sets forth a list of all Tax rulings and closing agreements applied for, received or entered into by the Company and its Subsidiaries the existence, approval or denial of which may adversely affect the Company or any of its Subsidiaries after the Closing Date.

(j) The Company and its Subsidiaries have established (and, until the Closing Date will maintain) on their respective books and records accruals adequate to pay all Taxes not yet due and payable in accordance with generally accepted accounting principles.

(k) Each of the Company's Subsidiaries which is a partnership, joint venture or limited liability company has since its formation and continues to be treated for federal, state and local income tax purposes as a partnership or as an entity that is disregarded for tax purposes and not as an association taxable as a corporation or a publicly traded partnership.

2.13. Employee Benefit Plans.

(a) Schedule 2.13(a) of the Company Disclosure Schedule lists, with respect to the Company, each Subsidiary of the Company and any trade or business (whether or not incorporated) which is treated as a single employer with the Company (a "Company ERISA Affiliate") within the meaning of Section 414(b), (c), (m) or (o) of the Code or Section 4001 of ERISA, (i) all employee benefit plans (as defined in Section 3(3) of ERISA, whether or not subject to ERISA), maintained by, contributed to, or sponsored by the Company or any Company ERISA Affiliate, (ii) any other supplemental retirement, severance, sabbatical, employee relocation, cafeteria benefit (Code Section 125) or dependent care (Code Section 129), life insurance or accident insurance plans, programs or arrangements maintained by, contributed to, or sponsored by the Company or any Company ERISA Affiliate, (iii) all other bonus, pension, profit sharing, savings, deferred compensation, equity-based compensation or incentive plans, programs or arrangements maintained by, contributed to, or sponsored by the Company or any Company ERISA Affiliate, (iv) other fringe or employee benefit plans, programs or arrangements that apply to employees or former employees of the Company or any Company ERISA Affiliate, and (v) any current or former employment or executive compensation or severance agreements (including, without limitation, any agreement providing for salary reductions), written or otherwise, of the Company or any Company ERISA Affiliate, or relating to, any present or former employee, consultant or director of the Company or any of its Subsidiaries (together, the "Company Employee Plans").

(b) The Company has provided or made available to Parent a copy of each of the Company Employee Plans and related plan documents (including trust documents, insurance policies or contracts, employee booklets, summary plan descriptions, amendments and other authorizing documents, and any material employee communications relating thereto, if applicable) and has, with respect to each of the Company Employee Plans which is subject to ERISA reporting requirements, provided copies of the Form 5500 reports, financial statements and actuarial reports filed for the last three plan years. Any of the Company Employee Plans intended to be qualified under Section 401(a) of the Code has obtained from the Internal Revenue Service a favorable determination letter as to its qualified status under the Code (which has not been revoked, modified or limited). The Company has also furnished Parent with a copy of the most recent Internal Revenue Service determination letter issued with respect to each such Company Employee Plan, and nothing has occurred since the issuance of each such letter which could reasonably be expected to adversely affect the tax-qualified status of any of the Company Employee Plans subject to Code Section 401(a).

(c) Each of the Company Employee Plans is, and its administration (including without limitation, with respect to reporting and disclosure) is and has been, in compliance with its terms and with ERISA, the Code (including, without limitation, all tax rules compliance with which is required for any intended favorable tax treatment is intended) and any and all other applicable law.

(d) All contributions, premiums and other payments required by law or otherwise to have been made under any Company Employee Plan have been made; and any and all contributions, premiums and other payments with respect to compensation or service before and through the Closing, or otherwise with respect to periods before and through the Closing, due from any of the Company or its affiliates to, under or on account of each Company Employee Plan sponsored solely by a Target Company shall have been paid prior to Closing.

(e) Neither the Company nor any Company ERISA Affiliate currently sponsors, contributes to, maintains or has any liability (whether contingent or otherwise) under (i) a “multiemployer plan” (as defined in Section 4001(a)(3) of ERISA) or (ii) an employee benefit plan that is or was subject to Part 3 of Subtitle B of Title I of ERISA, or Section 412 of the Code, or Title IV of ERISA, nor have any of them ever done so.

(f) With respect to each Company Employee Plan, the Company and each of its Subsidiaries have complied (except to the extent that any such failure to comply would not, in the aggregate, have a Material Adverse Effect on the Company or any of its Subsidiaries) with (i) the applicable health care continuation and notice provisions of COBRA and the regulations thereunder, (ii) the applicable requirements of the Family Medical and Leave Act of 1993 and the regulations thereunder, and (iii) the applicable requirements of the Health Insurance Portability and Accountability Act of 1996.

(g) There is no suit, action, dispute, claim, arbitration or legal, administrative or other proceeding or governmental investigation pending, or threatened, alleging any breach of the terms of Company Employee Plan or of any fiduciary duties thereunder or violation of any applicable law with respect to any such plan.

(h) None of the Company or any Subsidiary, or any “party in interest” (as defined in Section 3(14) of ERISA) or any “disqualified person” (as defined in Section 4975 of the Code) with respect to any such plan, has engaged in a non-exempt “prohibited transaction” within the meaning of Section 4975 of the Code or Section 406 of ERISA.

(i) (A) No Company Employee Plan that is a “welfare benefit plan” as defined in Section 3(1) of ERISA provides for continuing benefits or coverage for any participant or beneficiary or covered dependent of a participant after such participant’s termination of employment, except to the extent required by law; (B) there has been no violation of Section 4980B of the Code or Sections 601 through 608 of ERISA with respect to any such plan that could result in any material liability; (C) no such plans are “multiple employer welfare arrangements” within the meaning of Section 3(40) of ERISA; (D) all Company Employee Plans which provide medical, dental health or long-term disability benefits are fully insured and claims with respect to any participant or covered dependent under such Company Employee Plan could not result in any uninsured liability to the Company, any Subsidiary or Parent.

(j) Neither the Company nor any Subsidiary has agreed or otherwise committed to, whether in writing or otherwise, to increase or improve the compensation, benefits or terms and conditions of employment or service of any director, officer, employee or consultant.

(k) The Company and each Subsidiary has properly classified for all purposes (including, without limitation, for all Tax purposes and for purposes of determining eligibility to participate in any employee benefit plan) all employees, leased employees, consultants and independent contractors.

(l) On and after the Closing, no Company Employee Plan in which the Company or any Subsidiary participates after Closing shall cover or otherwise benefit any individuals other than current or former employees of the Company and its Subsidiaries (and their dependents and beneficiaries), and neither Parent nor any affiliate thereof (including the Target Companies and the Merger Subs) shall have any liability or obligations under or in connection with any Company equity plan (including, without limitation, the Tradescape Technologies Holdings 2000 Stock Incentive Plan and the Tradescape Corp. 2001 Stock Incentive Plan), or with respect to any grant or award under any such plan.

(m) The Company does not (A) maintain any “group trust” within the meaning of Revenue Ruling 81-100, collective investment funds or similar account, on behalf of any “employee benefit plan” as defined in Section 3(3) of ERISA or “plan” as defined in Section 4975 of the Code (or any person acting on behalf of such “employee benefit plan” or “plan”), (B) sponsor any master or prototype plans or individual retirement accounts, or (C) have any prohibited transaction individual exemptions from the U.S. Department of Labor.

Without limiting any other provision of this Section 2.13, no event has occurred and no condition exists, with respect to any employee benefit plan that has subjected or could subject the Company or any Subsidiary, or any Company Employee Plan or any successor thereto, to any tax, fine, penalty or other liability. No event has occurred and no condition exists, with respect to any Company Employee Plan that could subject Parent or any of its affiliates, or any employee benefit plan maintained by Parent or any affiliate thereof, to any tax, fine, penalty or other liability, that would not have been incurred by Parent or any of its affiliates, or any such plan, but for the transactions contemplated hereby. No Company Employee Plan is or will be directly or indirectly binding on Parent by virtue of the transactions contemplated hereby. Parent, and its affiliates, including on and after the Closing, the Company and any Subsidiary, shall have no liability for, under, with respect to or otherwise in connection with any employee benefit plan, which liability arises under ERISA or the Code, by virtue of the Company or any Subsidiary being aggregated, with any other person in a controlled group or affiliated service group for purposes of ERISA or the Code at any relevant time prior to the Closing. No Company Employee Plan exists which could result in the payment of money or any other property or rights, or accelerate or provide any other rights or benefits, to any current or former employee of the Company or any Subsidiary (or other current or former service provider thereto) that would not have been required but for the transactions provided for herein, and none of the Company or any Subsidiary, nor any of their respective affiliates, is a party to any plan, program, agreement, arrangement, practice, policy or understanding that would result, separately or in the aggregate, in the payment (whether in connection with any termination of employment or otherwise) of any “excess parachute payment” within the meaning of Section 280G of the Code with respect to a current or former employee of, or current or former independent contractor to, any of the Company or any Subsidiary. None of the Company or any Subsidiary maintains any Plan which provides severance benefits to current or former employees or other service providers. Each Company Employee Plan may be amended and terminated in accordance with its terms, and, each such Plan provides for the unrestricted right of the Company or any Subsidiary (as applicable) to amend or terminate such Plan. Neither the Company, any Subsidiary or Parent will have any liability under the Workers Adjustment and Retraining Notification Act, as amended, with respect to any events occurring or conditions existing on or prior to Closing.

2.14. Employee Matters. Each Target Company and their respective Subsidiaries are in compliance in all material respects with all currently applicable laws and regulations respecting employment, discrimination in employment, affirmative action, terms and conditions of employment, wages, hours and occupational safety and health, workers’ compensation and employment practices, and are not engaged in any unfair labor practice. The Company, each Target Company and each of their respective Subsidiaries (a) have withheld all material amounts required by law or by agreement to be withheld from the wages, salaries and other payments to employees, leased employees, consultants and independent contractors; (b) are not liable for any material arrears of wages or any material Taxes or any material penalty for failure to comply with any of the foregoing; and (c) have made all appropriate filings in connection with services provided by such Persons to the Company and any Subsidiary. Neither the Company nor any of its Subsidiaries is liable for any material payment to any trust or other fund or to any Governmental Entity, with respect to unemployment compensation benefits, social security or other benefits or obligations for employees (other than ordinary course payments to be made consistent with past practice). There are no

pending claims against either Target Company or any of their respective Subsidiaries under any workers compensation plan or policy or for long-term disability other than routine claims for benefits. There are no controversies pending or, to the knowledge of the Company, threatened between a Target Company or any of their respective Subsidiaries, on the one hand, and any of their respective employees or former employees, on the other hand, which controversies have or could reasonably be expected to result in an action, suit, proceeding, claim, arbitration or investigation before any agency, court or tribunal, foreign or domestic. Neither Target Company nor any of their respective Subsidiaries is a party to any collective bargaining agreement or other labor union contract; nor does the Company know of any activities or proceedings of any labor union to organize any such employees. To the knowledge of the Company, the Target Companies and their Subsidiaries, no employees of the Target Companies or their Subsidiaries are in violation in any respect of any term of any employment contract, patent disclosure agreement, noncompetition agreement, or any restrictive covenant to a former employer relating to the right of any such employee to be employed by the Target Companies or their Subsidiaries because of the nature of the business conducted or presently proposed to be conducted by the Target Companies or their Subsidiaries or to the use of trade secrets or proprietary information of others. Neither the Target Companies nor their Subsidiaries have any employment agreement with any of their respective officers or other employees. As of the date hereof, no employees (other than clerical or solely administrative employees) of the Target Companies or their Subsidiaries have given notice to the Target Companies or their Subsidiaries, nor are the Company, Target Companies or their Subsidiaries otherwise aware, that any such employee intends to terminate his or her employment with the Target Companies or their Subsidiaries. Schedule 2.14 of the Company Disclosure Schedule sets forth a true and correct list of all full and part-time employees of the Target Companies and their Subsidiaries, including the position held by such employee, the date such employee was hired, and the total compensation, including any bonuses (including, without limitation, incentive schemes and benefits) received by such employee per annum.

2.15. Interested Party Transactions. Except for transactions for compensation of employees, every transaction between the Target Companies and their Subsidiaries and any of their "Affiliates" or their "Associates" (as such terms are defined in the rules and regulations of the SEC), which is currently in effect or was consummated since the inception of the Target Companies and their Subsidiaries and which involved the payment, or receipt, of money, benefits or other compensation is set forth on Schedule 2.15 of the Company Disclosure Schedule. Schedule 2.15 of the Company Disclosure Schedule also lists any business arrangement, relationship or transaction (including, without limitation, any loan) between the Target Companies or their Subsidiaries and any stockholder, director or officer of the Target Companies or their Subsidiaries or between the Target Companies or their Subsidiaries and any company, partnership, business trust, association or similar organization in which a stockholder, director or officer of the Target Companies or their Subsidiaries has a controlling interest (each stockholder, director and officer and any entity controlled by such person referred to as a "Company Regulatory Affiliate"). For purposes of determining who is a Company Regulatory Affiliate, control means the power to vote twenty-five percent (25%) or more of any class of voting securities or other evidence of ownership interests in such corporation, partnership, business trust, association or similar organization, or the control of the election of a majority of the directors or trustees (or individuals holding similar positions) of such other entity.

2.16. Insurance. The Company previously has delivered or otherwise made available to Parent a complete and accurate list of all liability, property, workers' compensation, directors' and officers' liability, "key man" life and other insurance policies in effect that are owned by either Target Company or any of their respective Subsidiaries, or under which either Target Company or any of their respective Subsidiaries is a named insured. Except as set forth on Schedule 2.16 of the Company Disclosure Schedule, there is no claim pending under any such policies or bonds as to which coverage has been questioned, denied or disputed by the underwriters of such policies or bonds. All premiums due and payable under all such policies and bonds have been paid and each Target Company and their respective Subsidiaries are otherwise in compliance in all material respects with the terms of such policies and bonds and such policies and bonds and the coverages thereunder are in full force and effect. The Company has no knowledge of any threatened termination of, or premium increase with respect to, any of such policies.

2.17. Regulatory Matters.

(a) Neither Target Company nor any of their Subsidiaries is subject to registration as an investment company under the 1940 Act, or similar laws of any foreign Governmental Entity. Each Target Company and their Subsidiaries and each of its employees, agents, associated persons or contractors who are required to be registered as a broker-dealer, investment adviser, a registered representative or other applicable regulatory category with the SEC, the securities commission of any state or foreign jurisdiction or any SRO are duly registered as such and such registrations are in full force and effect. All material federal, state and foreign registration requirements have been complied with and such registrations as currently filed, and all periodic reports required to be filed with respect thereto, are accurate and complete in all material respects.

(b) The Company is not aware of any facts or circumstances that would (i) cause the NASD not to approve the transfer of control and ownership of the Target Companies from the Company to Parent; (ii) cause the NASD or any federal or state regulatory agency or other Governmental Entity or SRO to revoke or restrict a Target Company's Authorizations to operate as a broker-dealer after the change in ownership and control of the Target Companies contemplated by this Agreement.

(c) Neither Target Company nor any of their Subsidiaries is subject to any cease-and-desist or other order or enforcement action issued by, or party to any written agreement, consent agreement or memorandum of understanding with, or a party to any commitment letter or similar undertaking to, or is subject to any order or directive by, or has been ordered to pay any civil penalty by, or is a recipient of any supervisory letter from, or has adopted any board or member resolutions at the request or suggestion of, any regulatory authority or other Governmental Entity that restricts the conduct of its business or that in any manner relates to its capital adequacy, its ability to pay dividends, its credit or risk management policies, its management, its trading privileges or its business (each, a "Regulatory Agreement"), nor has either Target Company or any of their Subsidiaries been advised in any other manner by any regulatory authority or Governmental Entity that it is considering issuing or requesting such a Regulatory Agreement nor is there any pending or, to the knowledge of the Company and Target Company or any of their Subsidiaries, threatened regulatory investigation. None of the Target Company, any of its Subsidiaries or any of their respective associated persons (as defined in Section 3(a)(21) of the Securities Exchange Act of 1934, as amended (the "1934 Act")) has been convicted within the past ten years of any felony or misdemeanor described in Section 15(b)(4) of the 1934 Act, or is, by reason of any misconduct, permanently or temporarily enjoined from acting in the capacities, or engaging in the activities, described in Section 15(b)(4)(C) of the 1934 Act.

2.18. Material Contracts.

(a) Neither Target Company nor any of their respective Subsidiaries is a party to or bound by any of the following (collectively, the "Target Company Material Contracts"):

(i) any contract or agreement entered into other than in the ordinary course of business consistent with past practice for the acquisition of the securities of or any material portion of the assets of any other Person or entity;

(ii) any contract or agreement for the purchase of materials, supplies, equipment or services in excess of $75,000 which cannot be cancelled by either Target Company or any of their respective Subsidiaries without penalty or further payment and without more than 45 days' notice;

(iii) any contract, agreement or instrument in excess of $75,000 that expires or may be renewed at the option of any Person other than either Target Company or any of their respective Subsidiaries so as to expire more than one year after the date of this Agreement;

(iv) any employment contract or other arrangement with employees, management contracts and contracts with independent contractors or consultants (or similar arrangements) which, in any case, is not cancelable without penalty or further payment and without more than 30 days' notice;

(v) any trust indenture, mortgage, promissory note, loan agreement or other contract, agreement or instrument for the borrowing of money, any currency exchange, commodities or other hedging arrangement or any leasing transaction of the type required to be capitalized in accordance with GAAP, in each case, where any Target Company or any of their respective Subsidiaries is a lender, borrower or guarantor;

(vi) any contracts and agreements with any Governmental Entity;

(vii) any contract or agreement for capital expenditures in excess of $75,000;

(viii) any contract or agreement limiting the freedom of either Target Company or any of their respective Subsidiaries or any of their respective employees to engage in any line of business or to compete with any other Person, or under the constitution, laws, rules or regulations of any SRO, or any confidentiality, secrecy or non-disclosure contract or agreement;

(ix) any contract or agreement in excess of $75,000 pursuant to which either Target Company or any of their respective Subsidiaries is a lessor of any machinery, equipment, motor vehicles, office furniture, fixtures or other personal property;

(x) any contract or agreement with any Person with whom either Target Company or any of their respective Subsidiaries does not deal at arm's length;

(xi) any agreement of guarantee, support, indemnification, assumption or endorsement of, or any similar commitment with respect to, the obligations, liabilities (whether accrued, absolute, contingent or otherwise) or indebtedness of any other Person other than those entered into in the ordinary course of operating a broker-dealer business;

(xii) any material agreement which would be terminable other than by a Target Company or its respective Subsidiaries as a result of the consummation of the transactions contemplated by this Agreement;

(xiii) any alliance, cooperation, joint venture, stockholders' partnership or similar agreement;

(xiv) any broker, distributor, dealer, agency, sales promotion, market research, market consulting or advertising agreement;

(xv) any research, development, sales representative, marketing or reseller agreement, or any service, support or maintenance agreement related to the business or technology of either Target Company or any of their respective Subsidiaries;

(xvi) any agreement, option or commitment or right with, or held by, any third party to acquire, use or have access to any assets or properties, or any interest therein, of either Target Company or any of their respective Subsidiaries;

(xvii) any license, sublicense or development agreement or other agreement that affects the Intellectual Property used in or necessary for the conduct of the business of the Target Companies or any of their respective Subsidiaries;

(xviii) any agreement relating to its member interests or other voting or equity securities;

(xix) any contract or agreement which would require any consent or approval of a counterparty as a result of the consummation of the transactions contemplated by this Agreement; or

(xx) any other contract whether or not made in the ordinary course of business, which is material to either Target Company, any of their respective Subsidiaries or the conduct or operation of their respective businesses or the absence of which would have a Material Adverse Effect on such Target Company or any of their respective Subsidiaries.

(b) Each Target Company and their respective Subsidiaries has performed in all material respects the obligations required to be performed by it and is entitled to all accrued benefits under, and is not in default in any material respect of, each Target Company Material Contract to which it is a party or by which it is bound. Each of the Target Company Material Contracts is in full force and effect, unamended, and there exists no material default or event of default or event, occurrence, condition or act, with respect to either Target Company or any of their respective Subsidiaries or, to the knowledge of the Company, with respect to any other contracting party, which, with the giving of notice, the lapse of the time or the happening of any other event or condition, would become a material default or event of default under any Target Company Material Contract. True, correct and complete copies of all Target Company Material Contracts have been delivered or made available to Parent.

(c) Without limiting the generality of the foregoing, each of the contracts and other agreements and arrangements listed on Schedule 8.1(o)(i) and Schedule 8.1(d)(i) shall be legal, valid and binding agreements of a Target Company or one of their respective Subsidiaries following the Closing and shall be enforceable in accordance with the terms set forth in such contracts, agreements and arrangements as of the date of this Agreement.

(d) Schedule 2.18(d) of the Company Disclosure Schedule sets forth a true, correct and complete list of all employment agreements and similar arrangements between the Company and any employee, consultant and independent contractor who performs services for either Target Company or any of its Subsidiaries.

2.19. Assets.

(a) Each of the Target Companies and their respective Subsidiaries owns, leases or has the right to use all the material properties and assets necessary for or used or held for use in the conduct of the business of each such Target Company and/or such Subsidiary or otherwise owned, leased or used by each such Target Company or any such Subsidiary (all such properties and assets being referred to as the "Assets"). Each of the Target Companies and their respective Subsidiaries has good title to, or in the case of leased or subleased Assets, valid and subsisting leasehold interests in, all of the Assets, free and clear of all Liens.

(b) The Assets, together with the Intellectual Property constitute all the properties, assets and rights necessary for, forming a part of, used, held or intended to be used in, and all such properties, assets and rights are necessary in, the conduct of the business and operations of the Target Companies and their respective Subsidiaries. The Assets, together with the Intellectual Property, are sufficient to enable Parent and its Subsidiaries to operate the business of the Target Companies immediately after Closing as they are being operated on the date of this Agreement.

(c) Immediately following the Closing, the Target Companies and their respective Subsidiaries shall own and possess all documents, books, records, agreements and financial data of any sort used by them in the conduct of their business or otherwise.

2.20. Bank Accounts, Letters of Credit and Powers of Attorney. Schedule 2.20 of the Company Disclosure Schedule contains a complete and accurate list of (a) all bank accounts, lock boxes and safe deposit boxes relating to the business and operations of the Target Companies and/or any of their respective Subsidiaries (including the name of the bank or other institution where such account or box is located and the name of each authorized signatory thereto), (b) all outstanding letters of credit issued by financial institutions for the account of the Target Companies and/or any of their respective Subsidiaries (setting forth, in each case, the financial institution issuing such letter of credit, the maximum amount available under such letter of credit, the terms (including the expiration date) of such letter of credit and the party or parties in whose favor such letter of credit was issued), and (c) the name and address of each Person who has a power of attorney to act on behalf of either of the Target Companies and/or any of their respective Subsidiaries. The Company has heretofore delivered or made available to Parent true, correct and complete copies of each letter of credit and each power of attorney described on Schedule 2.20 of the Company Disclosure Schedule.

2.21. Brokers' and Finders' Fees. None of the Company, the Target Companies, nor any of their respective Subsidiaries have incurred, nor will they incur, directly or indirectly, any liability for brokerage or finders' fees or agents' commissions or investment bankers' fees or any similar charges in connection with this Agreement or any transaction contemplated hereby, except for Financial Technology Partners LLC and Appleby Capital, Inc., whose fees and expenses are the sole responsibility of the Company.

2.22. Books and Records. The minute books and other similar records of the Target Companies and their respective Subsidiaries as made available to Parent prior to the execution of this Agreement contain a true and complete record, in all material respects, of all actions taken at all meetings and by all written consents in lieu of meetings of the stockholders, members, the boards of directors or other governing body and committees of the boards of directors or other governing body of the Target Companies and their respective Subsidiaries. The stock transfer ledgers and other similar records of the Target Companies and their respective Subsidiaries as made available to Parent prior to the execution of this Agreement contain true and complete records, in all material respects, of all transfers related to the member interests and other equity securities of the Target Companies and their respective Subsidiaries, as the case may be. The Company has made available to Parent a true and correct copy of the certificate or articles of incorporation or other comparable organizational documents, as amended, and bylaws, as amended, and any other charter or organizational documents, each as amended, of the Target Companies and each of their respective Subsidiaries. Neither of the Target Companies nor any of their respective Subsidiaries is in violation of any of the provisions of their operating agreement, certificate or articles of incorporation or bylaws or other comparable organizational documents, each as amended.

2.23. Representations Complete. None of the representations or warranties made by the Company herein or in any schedule hereto, including the Company Disclosure Schedule, or certificate furnished by the Company or any of the Target Companies pursuant to this Agreement, contains or will

contain at the Effective Time any untrue statement of a material fact, or omits or will omit at the Effective Time to state any material fact necessary in order to make the statements contained herein or therein, in the light of the circumstances under which made, not misleading in any material respect.

2.24. TRK Obligation. The Company represents and warrants that the liability of Parent and its Subsidiaries at or subsequent to the Effective Time under the Put and Call Agreement, the Put Exercise Agreement, the Put Termination Agreement and the Agreement dated April 8, 2002 among Momentum, the Company, the TRK Executives and TRK is expressly limited to (i) the payment of one-half of the Net Profits Amount (as defined in the Put Exercise Agreement) and (ii) to the extent that Parent or its Subsidiaries elect to exercise the Second TRK Call Option, the payment of the exercise price of such call as determined under the Put and Call Agreement (the matters referred to in the preceding subclauses (i), (ii) and (iii) are sometimes referred to as the "Parent TRK Obligations).

ARTICLE III

REPRESENTATIONS AND WARRANTIES OF PARENT

Except as disclosed in the Parent SEC Documents (as defined in Section 3.4) or the Parent schedules to this Agreement (the "Parent Disclosure Schedules"), Parent represents and warrants to the Company and the Target Companies as follows:

3.1. Organization, Standing and Authority. Parent and each of the Merger Subs is a corporation duly organized, validly existing and in good standing under the laws of its jurisdiction of organization. Parent and each of the Merger Subs have all requisite corporate power and authority to enter into this Agreement and the Collateral Documents to which they are a party and to consummate the transactions contemplated hereby and thereby.

3.2. Capital Structure. The authorized capital stock of Parent consists of 600,000,000 shares of Parent Common Stock and 1,000,000 shares of Parent's preferred stock, ("Parent Preferred Stock"), of which there were issued and outstanding as of the close of business on April 8, 2002, 354,198,052 shares of Parent Common Stock and one share of Parent Preferred Stock. There are no other outstanding shares of capital stock or voting securities, and there are a sufficient number of authorized shares of Parent Common Stock available to satisfy all outstanding commitments to issue any shares of Parent Common Stock pursuant to (i) the exercise of options outstanding as of such date under Parent's 1993 Stock Option Plan and 1996 Stock Incentive Plan (collectively, the "Parent Stock Option Plans"), (ii) Parent's Associate Stock Purchase Plan; (iii) the terms of this Agreement, and (iv) all other outstanding capital stock issuance obligations. All outstanding shares of Parent Common Stock are duly authorized, validly issued, fully paid and non-assessable and are free and clear of any Liens other than any Liens created by or imposed upon the holders thereof, and are not subject to preemptive rights or rights of first refusal created by statute, the Certificate of Incorporation or By-laws, each as amended, of Parent or any agreement to which Parent is a party or by which it is bound. Parent has not issued or granted any stock appreciation rights or performance units under the Parent Stock Option Plans or otherwise. There are no contracts, commitments or agreements relating to voting, purchase or sale of Parent's capital stock between or among Parent and any of its stockholders. True and complete copies of all material agreements and instruments relating to or issued under the Parent Stock Option Plans have been provided or made available to the Company (including through the SEC's EDGAR Database) and such agreements and instruments have not been amended, modified or supplemented, and there are no agreements to amend, modify or supplement such agreements or instruments in any case from the form provided or made available to the Company. All outstanding shares of Parent Common Stock and all options to purchase Parent Common Stock were issued in compliance with all applicable federal and state securities laws. The shares of Parent Common Stock to be issued pursuant to this Agreement, when issued in accordance with this Agreement, will be duly authorized, validly issued, fully paid and non-assessable, and free and clear of any Liens other than Liens created by or imposed upon the holders thereof.

3.3. Binding Effect; No Conflicts.

(a) Assuming the filings and approvals described in clauses (i) through (vi) of Section 3.3(c) (collectively, the "Parent Approvals") are made or obtained (as the case may be), the execution and delivery of this Agreement and the Collateral Documents and the consummation of the transactions contemplated hereby and thereby have been duly authorized by all necessary corporate action on the part of Parent and each Merger Sub. This Agreement and each Collateral Agreement to which Parent is a party has been duly executed and delivered by Parent and constitutes the legal, valid and binding obligation of Parent and each Merger Sub, enforceable against them in accordance with its terms, except as such enforcement may be limited by (i) the effect of bankruptcy, insolvency, reorganization, receivership, conservatorship, arrangement, moratorium or other laws affecting or relating to the rights of creditors generally, or (ii) the rules governing the availability of specific performance, injunctive relief or other equitable remedies and general principles of equity, regardless of whether considered in a proceeding in equity or at law.

(b) Assuming the Parent Approvals are made or obtained (as the case may be), the execution and delivery of this Agreement and the Collateral Documents does not, and the consummation of the transactions contemplated hereby and thereby will not, conflict with, or result in any violation of, or default under (with or without notice or lapse of time, or both), or give rise to a right of termination, cancellation or acceleration of any obligation or loss of a benefit under, (i) any provision of the certificate or articles of incorporation or by-laws or other charter or comparable organizational documents of Parent or any of its Subsidiaries, each as amended; (ii) any mortgage, indenture, deed of trust, lease, contract, agreement, license or other instrument, permit, concession, franchise, judgment, order, decree or ruling to which Parent or any of its Subsidiaries, is a party or by which Parent's or any of its Subsidiaries' assets or properties are bound; or (iii) any Laws and Regulations applicable to Parent or any of its Subsidiaries.

(c) No consent, approval, order or authorization of, or registration, declaration or filing with, any court, administrative agency or commission, SRO or other Governmental Entity, is required by or with respect to Parent or any of its Subsidiaries in connection with the execution and delivery of this Agreement or any Collateral Document, the performance of Parent's or each Merger Sub's obligations hereunder or thereunder or the consummation of the transactions contemplated hereby or thereby, except for (i) the filing of Certificates of Merger; (ii) such notices, applications, consents, approvals, orders, authorizations, registrations, declarations and filings as may be required under applicable federal or state securities laws or the securities laws of any foreign country in connection with the Mergers; (iii) the notification requirements of the HSR Act; (iv) the notification requirement of Rule 1017 of the NASD; (v) the consents, approvals, orders, authorizations, registrations, declarations and filings set forth on Schedule 3.3(c) of the Parent Disclosure Schedule; and (vi) such other consents, authorizations, filings, approvals and registrations which, if not obtained or made would not prevent, or alter or delay, any of the transactions contemplated by this Agreement.

3.4. SEC Documents; Financial Statements. Parent has made available (including through the SEC's EDGAR Database) to the Company each statement, report, registration statement, definitive proxy statement, and other filings (including exhibits, supplements and schedules thereto) filed with the SEC by Parent since December 31, 1999 (collectively, the "Parent SEC Documents"). As of their respective filing dates, the Parent SEC Documents complied in all material respects with the requirements of the 1934 Act and the Securities Act, and none of the Parent SEC Documents contained any untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements made therein, in light of the circumstances in which they were made, not misleading, except to

the extent corrected by a subsequently filed Parent SEC Document. The financial statements of Parent, including the notes thereto, included in the Parent SEC Documents (the "Parent Financial Statements") were complete and correct in all material respects as of their respective dates (except to the extent corrected by a subsequently filed Parent SEC Document), complied as to form in all material respects with applicable accounting requirements and with the published rules and regulations of the SEC with respect thereto as of their respective dates, and have been prepared in accordance with generally accepted accounting principles applied on a basis consistent throughout the periods indicated (except as may be indicated in the notes thereto or, in the case of unaudited statements included in Quarterly Reports on Form 10-Q, as permitted by Form 10-Q of the SEC). The Parent Financial Statements fairly present the consolidated financial condition and operating results of Parent and its Subsidiaries at the dates and during the periods indicated therein (subject, in the case of unaudited statements, to normal and recurring year-end adjustments).

3.5. Litigation. Except as set forth in the Parent SEC Documents, there is no private or governmental action, suit, proceeding, claim, arbitration, inquiry, examination, inspection or, to the knowledge of Parent, investigation pending by or before any Governmental Entity, agency, court or tribunal, foreign or domestic or, to the knowledge of Parent, threatened, against Parent or any of its Subsidiaries or any of their properties or of their officers or directors (in their capacities as such) that, individually or in the aggregate, could reasonably be expected to prevent, enjoin, alter or materially delay any of the transactions hereby or could reasonably be expected to have a Material Adverse Effect. There is no judgment, decree or order against Parent or any of its Subsidiaries, or, to the knowledge of Parent, any of their directors or officers (in their capacities as such) that, individually or in the aggregate, could reasonably be expected to prevent, enjoin, alter or materially delay any of the transactions hereby or could reasonably be expected to have a Material Adverse Effect on Parent.

3.6. Broker's and Finders' Fees. Parent has not incurred, nor will it incur, directly or indirectly, any liability for brokerage or finders' fees or agents' commissions or investment bankers' fees or any similar charges in connection with this Agreement or any transaction contemplated hereby, except for Robertson Stephens, Inc., whose fees and expenses are the sole responsibility of Parent.

3.7. Operations of the Merger Subs. Each Merger Sub was formed solely for the purpose of engaging in the transactions contemplated by this Agreement and has not engaged in any business or activity (or conducted any operations) of any kind, entered into any agreement or arrangement with any Person, or incurred, directly or indirectly, any material liabilities or obligations, in each case except in connection with its organization or formation, the negotiation of this Agreement, the Mergers and the transactions contemplated by this Agreement.

3.8. Form S-3 Eligibility. Parent is eligible to register the resale of Parent Common Stock on a registration statement on Form S-3 under the Securities Act.

ARTICLE IV

COVENANTS

4.1. Conduct of Business of the Target Companies and their respective Subsidiaries.

(a) At all times during the period from the date of this Agreement and continuing until the earlier of termination of this Agreement or the Effective Time, each of the Company and the Target Companies shall and the Company and the Target Companies shall cause their respective Subsidiaries (except to the extent expressly contemplated by this Agreement or as consented to in writing by Parent), to carry on their business only in, and not to take any action except in, the ordinary course in substantially the same manner as heretofore conducted. Without limiting the generality of the foregoing, each of the Target

Companies shall, and the Company and each Target Company shall cause each of their respective Subsidiaries to (i) pay and to cause its Subsidiaries to pay debts and Taxes when due subject to good faith disputes over such debts or Taxes; (ii) preserve intact its and its Subsidiaries' present business organizations and reputation; (iii) use commercially reasonable efforts to keep available the services of its and its Subsidiaries' present executive officers and key employees; (iv) use commercially reasonable efforts to preserve its and its Subsidiaries' relationships with customers, suppliers, distributors, licensors, licensees, and others having business dealings with it or its Subsidiaries; (v) maintain its and its Subsidiaries' assets and properties in good working order and condition, ordinary wear and tear excepted; (vi) comply in all material respects with Laws and Regulations, self-regulatory law, ordinance, rule or regulation applicable to the conduct of its business, or the ownership or operation of its business, to the end that its and its Subsidiaries' goodwill and ongoing businesses shall be unimpaired at the Effective Time; (vii) not take any action or engage in any practice or fail to take any action or engage in any practice or enter into any transaction which would cause any representation or warranty contained in this Agreement with respect to such Target Company or its Subsidiaries to be untrue in any material respect (if not qualified by materiality) or in any respect (if qualified by materiality) or result in a breach in any material respect (if not qualified by materiality) or in any respect (if qualified by materiality) of any covenant made by or on behalf of such Target Company or any of its Subsidiaries in this Agreement; or (viii) take any action or engage in any practice or fail to take any action or engage in any practice or enter into any transaction that would be required to be disclosed pursuant to Section 2.5 of this Agreement.

(b) Without limiting the generality of the foregoing, at all times during the period from the date of this Agreement and continuing until the earlier of the termination of this Agreement or the Effective Time, except as expressly contemplated by this Agreement, each Target Company shall not do, cause or permit any of the following, and the Company and the Target Companies shall not allow, cause or permit any of their respective Subsidiaries to do, cause or permit any of the following, in each case without the prior written consent of Parent:

(i) Charter Documents. Cause or permit any amendment, modification, alteration or rescission of its operating agreement, certificate or articles of incorporation, bylaws or other comparable organizational documents;

(ii) Dividends; Changes in Capital Stock. (w) declare, set aside or pay any dividends on or make any other distributions (whether in cash, stock or property) in respect of any of its voting or equity securities, other than in the ordinary course of business consistent with past practice; (x) split, combine or reclassify or take any action with respect to any of its voting or equity securities, issue or authorize the issuance or propose the issuance of any other securities in respect of, in lieu of or in substitution for member interests or other voting or equity securities, as the case may be; (y) adopt a plan of complete or partial liquidation or resolutions providing for or authorizing such liquidation or a merger, consolidation, restructuring, recapitalization or other reorganization; or (z) redeem, repurchase or otherwise acquire, directly or indirectly, any of its voting or equity securities or any option with respect thereto except from former employees, directors and consultants in accordance with agreements providing for the repurchase of securities in connection with any termination of service to it or its Subsidiaries;

(iii) Options. Grant any options, appreciation rights, phantom rights, profit participation rights or other rights to acquire securities or accelerate, amend or change the period of exercisability or vesting of options or other rights granted under its unit or stock plans or authorize cash payments in exchange for any options or other rights granted under any of such plans;

(iv) Material Contracts. (A) Enter into any material contract or commitment, or violate, amend or otherwise modify or waive any of the terms of any of its contracts, other than in the ordinary course of business consistent with past practice, or engage in any new transaction outside the ordinary

course of business and not consistent with past practice, and in no event shall such contract, commitment, amendment, modification or waiver involve payments by the Target Companies or any of their Subsidiaries of amounts in excess of fifty thousand dollars ($50,000) or (B) enter into any material contract or agreement which would require the consent of the other party thereto as a result of a change of control of, or merger or consolidation involving, a Target Companies or any of its Subsidiaries;

(v) Issuance of Securities. Issue, deliver or sell or authorize or propose the issuance, delivery or sale of, or purchase or propose the purchase of, any member interests, any other voting or equity securities or securities convertible into, or subscriptions, rights, warrants or options to acquire, or other agreements or commitments of any character obligating it to issue any such securities or other convertible securities;

(vi) Intellectual Property. Transfer or license to any Person any rights to Intellectual Property other than the license of non-exclusive rights to Intellectual Property in the ordinary course of business consistent with past practice or fail to renew or pay any fees relating to any patent, trademark, service marks or any of the Intellectual Property;

(vii) Exclusive Rights. Enter into or amend any agreements pursuant to which any other party is granted exclusive marketing or other exclusive rights of any type or scope with respect to any of its products or technology;

(viii) Dispositions. Sell, lease, license, grant any security interest in or otherwise dispose of or encumber any of its properties or assets, except in the ordinary course of business consistent with past practice;

(ix) Indebtedness. Except in the ordinary course of business consistent with past practice, (A) incur any indebtedness for borrowed money or assume, guarantee, endorse or otherwise as an accommodation become responsible for the obligations of any other Person in excess of fifty thousand dollars ($50,000) in the aggregate or (B) voluntarily purchase, cancel, prepay or otherwise provide for a complete or partial discharge in advance of a scheduled repayment date with respect to, or waive any right under, any indebtedness for borrowed money;

(x) Payment of Obligations. Pay, discharge or satisfy in an amount in excess of fifty thousand dollars ($50,000) in the aggregate, any claim, liability or obligation (absolute, accrued, asserted or unasserted, contingent or otherwise) arising other than in the ordinary course of business, other than the payment, discharge or satisfaction of liabilities reflected or reserved against in the Financial Statements;

(xi) Capital Expenditures. Make any individual capital expenditure, capital addition or capital improvement in excess of fifty thousand dollars ($50,000) except pursuant to existing commitments under Company Material Contracts;

(xii) Insurance. Reduce the amount of any insurance coverage provided by existing insurance policies;

(xiii) Employee Benefit Plans; New Hires; Pay Increases. (A) Adopt or amend any employee benefit or unit based or stock purchase or option plan (except as required by law), or (B) hire any new director or vice-president level (or the functional equivalent in the Company's and its Subsidiaries' organizational structure) or executive officer level employee, pay any special bonus or special remuneration to any employee or director or increase the salaries or wages of its employees;

(xiv) Severance Arrangements. Grant any severance or termination pay (A) to any director or officer or (B) to any other employee except payments made pursuant to written plans or agreements outstanding, or written in policies of the Company, the Target Companies or any of their respective Subsidiaries in effect, on the date hereof (in each case furnished to Parent prior to the date of this Agreement);

(xv) Lawsuits. Commence any action, suit or proceeding other than (A) in the ordinary course of business; (B) in such cases where it in good faith determines that failure to commence suit would result in the material impairment of a valuable aspect of its business, provided that it consults with Parent prior to the filing of such a suit; or (C) in respect of a breach of this Agreement;

(xvi) Acquisitions. Acquire or agree to acquire by merging or consolidating with, or by purchasing a substantial portion of the assets of, or by any other manner, any business or any corporation, partnership, association or other business organization or division thereof, or otherwise acquire or agree to acquire any assets or acquire or agree to acquire any equity securities of any corporation, partnership, limited liability company, association or business organization;

(xvii) Transactions with Company Regulatory Affiliates. Enter into any arrangement, relationship or transaction with a Company Regulatory Affiliate, any stockholder, director or officer of the Company, any Target Company or any of their Subsidiaries or between the Company, any Target Company or any of their Subsidiaries and any company, partnership, business trust, association or similar organization in which a stockholder, director or officer of the Company, any Target Company or any of their Subsidiaries has a controlling interest. For purposes of determining who is a Company Regulatory Affiliate, control means the power to vote twenty-five percent (25%) or more of any class of voting securities or other evidence of ownership interests in such corporation, partnership, business trust, association or similar organization, or the control of the election of a majority of the directors or trustees (or individuals holding similar positions) of such other entity;

(xviii) Other. Take or agree in writing or otherwise to take (A) any of the actions described in this Section 4.1; (B) any action that will result in any of the conditions to the Mergers as set forth in Article VIII of this Agreement not being satisfied or in violation of any provision of this Agreement, except, in every case, as may be required by any applicable Laws and Regulations; or (C) any other action that would materially adversely delay or materially adversely impair the ability of the Target Companies or any of their respective Subsidiaries to consummate the Merger.

4.2. Conduct of Parent. During the period from the date of this Agreement and continuing until the Effective Time, except as expressly contemplated or permitted by this Agreement or with the Company's prior written consent, Parent shall not, and shall cause its Subsidiaries to not: (a) take any action that will result in any of the conditions to the transactions contemplated by this Agreement set forth in Article VIII of this Agreement not being satisfied or in a violation of any provision of this Agreement or (b) take any other action that would materially adversely delay or materially adversely impair the ability of Parent or any of its Subsidiaries to consummate the transactions contemplated by this Agreement, except, in every case, as may be required by applicable law.

4.3. No Solicitations. None of the Company, the Target Companies nor any of their respective Subsidiaries or any of their respective Affiliates shall, nor shall they authorize or permit any officer, director, employee, investment banker, financial advisor, attorney, accountant or other agent or representative (each, a "Representative") retained by or acting for or on behalf of the Company, either of the Target Companies or any of their respective Subsidiaries or any of their respective Affiliates to, directly or indirectly, initiate, solicit, encourage, or participate in any negotiations regarding, furnish any confidential information in connection with, endorse or otherwise cooperate with, assist, participate in or facilitate the

making of any proposal or offer for, or which may reasonably be expected to lead to, an Acquisition Transaction (as defined below), by any Person or group. The Company and the Target Companies shall promptly inform Parent, orally and in writing, of the material terms and conditions of any proposal or offer for, or which may reasonably be expected to lead to, an Acquisition Transaction that it receives. The Company and the Target Companies will immediately cease and cause to be terminated any existing activities, discussions or negotiations with any parties conducted on or prior to the date of this Agreement heretofore with respect to any Acquisition Transaction. As used in this Agreement, "Acquisition Transaction" means any merger, consolidation or other business combination involving any of the Target Companies or any of their respective Subsidiaries or Affiliates, or any acquisition in any manner of all or a substantial portion of the equity of, or all or a substantial portion of the assets of any of the Target Companies or any of their respective Subsidiaries or Affiliates, whether for cash, securities or any other consideration or combination thereof, other than pursuant to the transactions contemplated by this Agreement.

4.4. Access to Information; Confidentiality.

(a) The Company and the Target Companies shall, and the Company and the Target Companies shall cause their respective Subsidiaries to, throughout the period from the date hereof to the Effective Time, (i) provide Parent and its Affiliates and their respective Representatives with full access, upon reasonable prior notice, during normal business hours to all officers, employees, agents and accountants of the Target Companies and their respective Subsidiaries, and their respective assets, properties, books and records, but only to the extent that such access does not unreasonably interfere with the business and operations of the Target Companies and their respective Subsidiaries, and (ii) furnish promptly to such persons (x) a copy of each report, statement, schedule and other document filed or received by such Target Company or any of their respective Subsidiaries pursuant to the requirements of federal or state securities laws or filed with any other governmental or regulatory authority, and (y) all other information and data (including, without limitation, copies of contracts, Benefit Plans and other books and records) concerning the business and operations of the Target Companies and their respective Subsidiaries as Parent or any of such other persons reasonably may request. No investigation pursuant to this paragraph or otherwise shall affect any representation or warranty contained in this Agreement or any condition to the obligations of the parties hereto. Parent shall use its commercially reasonable efforts to make its key personnel available to the Company upon reasonable prior notice during normal business hours to answer relevant diligence inquiries from the Company but only to the extent that such diligence activities do not unreasonably interfere with the business activities of such key personnel.

(b) Parent will hold, and shall cause its Affiliates and their respective Representatives to hold, in strict confidence, unless (i) compelled to disclose by judicial or administrative process or by other requirements of applicable laws of governmental or regulatory authorities (including, without limitation, in connection with obtaining the necessary approvals of this Agreement or the transactions contemplated hereby of governmental or regulatory authorities); provided that to the extent reasonably practicable Parent shall provide the Company with reasonable notice of such compelled disclosure, or (ii) disclosed in an action or proceeding brought by a party hereto in pursuit of its rights or in the exercise of its remedies hereunder, all documents and information concerning the Target Companies and their respective Subsidiaries furnished to it by such entities or their respective Representatives in connection with this Agreement or the transactions contemplated hereby, except to the extent that such documents or information can be shown to have been (w) known by Parent, any of its Affiliates or any of their respective Representatives prior to disclosure by the Company, the Target Companies or their Subsidiaries or their respective Representatives, as the case may be, (x) in the public domain (either prior to or after the furnishing of such documents or information hereunder) through no fault of Parent, its Affiliates and its Representatives, (y) later acquired by Parent, any of its Affiliates or any of their respective Representatives from another source if Parent, such Affiliate or such Representative is not aware, after due inquiry, that such

source is under an obligation to the Company and of its Subsidiaries, the Target Companies or their Subsidiaries to keep such documents and information confidential or (z) independently developed by Parent or any of its Affiliates. In the event that this Agreement is terminated without the transactions contemplated hereby having been consummated, upon the request of the Company, Parent will, and will cause its Representatives to, promptly redeliver or cause to be redelivered all copies of documents and information furnished by the Target Companies, their Subsidiaries, the Company or their respective Representatives to Parent, its Affiliates and their Representatives in connection with this Agreement or the transactions contemplated hereby and destroy or cause to be destroyed all notes, memoranda, summaries, analyses, compilations and other writings related thereto or based thereon prepared by Parent or its Representatives.

4.5. Regulatory and Other Approvals.

(a) Subject to the terms and conditions of this Agreement, each of the Target Companies, their Subsidiaries and the Company and Parent will proceed diligently and in good faith and will use all commercially reasonable efforts to do, or cause to be done, all things necessary, proper or advisable to, as promptly as practicable, (i) obtain all consents, approvals or actions of, make all filings with and give all notices to Governmental Entities or any other public or private third parties required of Parent, the Merger Subs, the Target Companies, their Subsidiaries, or the Company to consummate the Mergers and the other transactions contemplated hereby and (ii) provide such other information and communications to such Governmental Entity or other public or private third parties as the other party or such Governmental Entity or other public or private third parties may reasonably request. In addition to and not in limitation of the foregoing, each of the parties will (x) take promptly all actions necessary to make the filings required of Parent, the Target Companies, their Subsidiaries and the Company or their Affiliates under the HSR Act, NASD membership rules and other applicable federal and state securities laws; (y) comply at the earliest practicable date with any request for additional information received by such party or its Affiliates from the Federal Trade Commission (the "FTC") or the Antitrust Division of the Department of Justice (the "Antitrust Division") pursuant to the HSR Act or the SEC or NASD under applicable federal and state securities laws and regulations; and (z) cooperate with the other party in connection with such party's filings under the HSR Act and applicable federal and state securities laws and regulations and SRO rules and regulations and in connection with resolving any investigation or other inquiry concerning the Mergers or the other matters contemplated by this Agreement commenced by the FTC, the Antitrust Division, state attorneys general or the SEC or NASD.

(b) If the Company does not obtain any of the consents, approvals, waivers or assignments set forth on Schedule 8.1(d)(ii) or Schedule 8.1(o)(ii), the Company and Parent shall cooperate in any reasonable arrangements designed to provide Parent and its Subsidiaries with the benefits of the subject contracts and agreements, including enforcement for the benefit of Parent and its Subsidiaries of any and all rights of any Person under such contracts or agreements against any third party arising out of the cancellation of any such contract or agreement by such third party.

4.6. Notice and Cure. Each of Parent, on the one hand, and the Target Companies, their Subsidiaries and the Company, on the other hand, will notify the other promptly in writing of, and contemporaneously will provide the other with true and complete copies of any and all information or documents relating to, and will use commercially reasonable efforts to cure before the Closing, any event, transaction or circumstance occurring after the date of this Agreement that causes or will cause any covenant or agreement of Parent, the Target Companies, their Subsidiaries or the Company, as the case may be, under this Agreement to be breached or that renders or will render untrue any representation or warranty of Parent, the Target Companies, their Subsidiaries or the Company, as the case may be, contained in this Agreement as if the same were made on or as of the date of such event, transaction or circumstance. Each of Parent, on the one hand, and the Target Companies, their Subsidiaries and the Company, on the other hand, also will notify the other promptly in writing of, and will use commercially reasonable efforts to cure, before

the Closing, any violation or breach of any representation, warranty, covenant or agreement made by Parent, the Target Companies, their Subsidiaries or the Company, as the case may be, in this Agreement, whether occurring or arising prior to, on or after the date of this Agreement. No notice given pursuant to this Section 4.6 shall have any effect on the representations, warranties, covenants or agreements contained in this Agreement for purposes of determining satisfaction of any condition contained herein. Notwithstanding anything to the contrary contained in this Agreement, nothing in this Agreement shall require Parent or any of its Affiliates to divest or hold separate, or to agree to any material conditions or restrictions with respect to the operation of, any business, division or operating unit of Parent or any of its Affiliates or the operation of the business of the Target Companies and their respective Subsidiaries following the Closing.

4.7. Fulfillment of Conditions. Subject to the terms and conditions of this Agreement, each of Parent, the Company and the Target Companies will take or cause to be taken all commercially reasonable steps necessary or desirable and proceed diligently and in good faith to satisfy each condition to the other's obligations contained in this Agreement and to consummate and make effective the transactions contemplated by this Agreement, and neither the Company or the Target Companies, on the one hand, nor Parent, on the other hand, will, nor will they permit any of their respective Subsidiaries to, take or fail to take any action that could be reasonably expected to result in the nonfulfillment of any such condition.

4.8. Real Property Matters. The Target Companies agree to (i) procure all consents regarding the transfer of the Leases to Parent as may be required under the Leases, in the form, manner and in compliance with any timing requirements set forth in the Leases and (ii) notify each landlord and sublandlord under the Leases regarding the transfer of the Leases to Parent, to the extent, and in the manner required under the Leases. Each Target Company that is a party to a Lease shall, and each Target Company covenants to cause each of their Subsidiaries that is a party to a Lease to, execute and deliver at Closing, an agreement assigning to Parent all right, title and interest of the subject Target Companies and/or their respective Subsidiaries in and to the Leases.

4.9. Existing Stockholders' Agreements. Each of the Company and the Target Companies shall cause any member or stockholder agreements, as the case may be, or other agreements or arrangements whereby the applicable Target Company, any of its Subsidiaries or the Company or any employee, member or stockholder of either Target Company or the Company have any right of first refusal or other contractual rights pursuant to which the applicable Target Company, Subsidiary or the Company or such employees, members or stockholders may have a right to participate in or otherwise impede the transactions contemplated by this Agreement to be terminated or modified such that any such rights shall not exist as an impediment to the Mergers or the other transactions contemplated by this Agreement.

4.10. Voting. The Company agrees that, during the period from the Closing Date to the fifth anniversary of the Closing Date, so long as it continues to own (beneficially or of record) shares of Parent Common Stock, in connection with any matter submitted to a vote of the stockholders of Parent it will vote all of its shares of Parent Common Stock in the manner recommended by the Board of Directors of Parent. The Company will obtain, on behalf of Parent, an identical covenant to the one set forth in this Section 4.10 in favor of Parent from each of its stockholders or any other Person to whom it intends to distribute any shares of Parent Common Stock received pursuant to this Agreement unless such transfer or distribution is made after compliance with Sections 5.4 and 5.5 of this Agreement.

4.11. Company Consolidations. Following the Closing, the Company shall not consolidate with or merge into any other Person or convey, distribute, transfer or lease all or any portion of its properties and assets (other than in the ordinary course of business consistent with past practice) to any Person, and the Company shall not permit any Person to consolidate with or merge into the Company or convey, transfer or lease its properties and assets substantially as an entirety to the Company, unless: (a) in case the Company shall consolidate with or merge into another Person or convey, distribute, transfer or lease

all or any portion of its properties and assets (other than in the ordinary course of business consistent with past practice) to any Person, the Person formed by such consolidation or into which the Company is merged or the Person which acquires by conveyance, distribution or transfer, or which leases, such properties and assets of the Company shall be a partnership or limited liability company organized and validly existing under the laws of the United States of America, any State thereof or the District of Columbia and shall expressly assume, by an agreement in form and substance satisfactory to Parent in its sole discretion, the performance or observance of every covenant and agreement of the Company in this Agreement and each Collateral Document, including for the avoidance of doubt, the Company's obligation to indemnify any Person under Article VII or Article IX of this Agreement and (b) the Company delivers to Parent an officers' certificate and an opinion of counsel, each stating that such consolidation, merger, conveyance, distribution, transfer or lease and the terms of any such agreement comply with this Section 4.11. For purposes of this Section 4.11, Parent agrees that the assignment or conveyance of all or any portion of the Companies properties and assets to a newly formed limited liability company will not violate this Section provided that such limited liability company expressly assumes all of the obligations of the Company pursuant to this Agreement in writing.

ARTICLE V

ADDITIONAL AGREEMENTS

5.1. Registration Requirements.

(a) Obligations of Parent.

(i) As soon as reasonably practicable after the Effective Time, Parent shall file a registration statement (the "Registration Statement") with the SEC to effect the registration under the Securities Act of the shares of Parent Common Stock issuable in the Mergers as Initial Consideration (together with any shares of Parent Common Stock issued in connection with any stock dividend, split, combination or recapitalization on, of or with respect to shares of Parent Common Stock issuable in the Mergers as Initial Consideration, collectively, the "Registrable Shares"), for sale by the Company. Parent shall use its commercially reasonable efforts to file the Registration Statement as soon as practicable after the Effective Time, but in no event later than 120 days after the Effective Time. After the Registration Statement is filed, Parent shall respond reasonably promptly to any and all comments made by the staff of the SEC to such Registration Statement.

(ii) Such Registration Statement shall comply in all material respects with the requirements of the Securities Act and the rules and regulations of the SEC promulgated thereunder and shall not contain any untrue statement of a material fact or omit to state a material fact required to be stated therein, or necessary to make the statements therein not misleading. The financial statements of Parent included in the Registration Statement or incorporated by reference therein will comply as to form in all material respects with the applicable accounting requirements and the published rules and regulations of the SEC applicable with respect thereto. Such financial statements will be prepared in accordance with GAAP consistently applied during the periods involved (except as may be otherwise indicated in the financial statements or the notes thereto or, in the case of unaudited interim statements, as permitted by the SEC) and fairly present the financial position of Parent at the dates thereof and the results of operations and cash flows for the periods then ended (subject, in the case of unaudited interim statements, to immaterial year-end adjustments).

(iii) Parent shall not be required to conduct an underwritten offering.

(iv) Parent shall have no obligation to include the Registrable Shares owned by the Company in a Registration Statement unless and until the Company has furnished Parent with all information and statements about or pertaining to the Company in such reasonable detail and on such timely basis as is reasonably deemed by Parent to be necessary or appropriate for the preparation of the Registration Statement.

(v) Parent will keep the Registration Statement effective to sell Registrable Shares, until the earlier of (A) such date as all of the Registrable Shares have been resold or (B) two years from the date such Registration Statement is declared effective by the SEC (the "Registration Period").

(vi) Parent shall prepare and file with the SEC, as promptly as is reasonably practicable, such amendments (including post-effective amendments) and supplements to the Registration Statement and the prospectus used in connection with the Registration Statement as may be necessary to keep the Registration Statement effective during the Registration Period, and, during such period, to comply with the provisions of the Securities Act with respect to the disposition of all Registrable Shares covered by the Registration Statement.

(vii) Parent shall furnish to the Company (A) promptly after the same is prepared and filed with the SEC, one copy of the Registration Statement and any amendment thereto and each preliminary prospectus and each amendment or supplement thereto; (B) on the date of effectiveness of the Registration Statement or any amendment thereto, a notice stating that the Registration Statement or amendment has been declared effective; and (C) such number of copies of a prospectus, including a preliminary prospectus, and all amendments and supplements thereto and such other documents as the Company may reasonably request in order to facilitate the disposition of the Registrable Shares owned by the Company.

(viii) Parent shall use its best efforts to cause all Registrable Shares to be listed on each national securities exchange or quotation service on which securities of the same class or series issued by Parent are then listed.

(ix) With a view to making available to the Company the benefits of Rule 144 and any other rule or regulation of the SEC that may at any time permit the Company to sell Registrable Shares to the public without registration or pursuant to registration, Parent covenants and agrees to: (A) make and keep public information available, as those terms are understood and defined in Rule 144, until such date as all of the Registrable Shares shall have been resold and (B) file with the SEC in a timely manner all reports and other documents required of Parent under the Exchange Act.

(x) As promptly as practicable after becoming aware of such event, Parent shall notify the Company of the happening of any event, of which Parent has knowledge, as a result of which the prospectus included in the Registration Statement, as then in effect, includes an untrue statement of a material fact or omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, and use commercially reasonable efforts to promptly prepare a supplement or amendment to the Registration Statement to correct such untrue statement or omission, and deliver such number of copies of such supplement or amendment to the Company as the Company may reasonably request.

(xi) Parent shall use commercially reasonable efforts to prevent the issuance of any stop order or other suspension of effectiveness of the Registration Statement, and, if such an order is issued, to obtain the withdrawal of such order as soon as practicable (including in each case by amending or supplementing the Registration Statement) and to notify the Company of the issuance of such order and the resolution thereof, and if the Registration Statement is supplemented or amended, deliver such number of copies of such supplement or amendment to the Company as the Company may reasonably request.

(xii) Without limiting the generality of subsections (x) and (xi) above, Parent may refuse to permit the Company to resell any Registrable Shares pursuant to the Registration Statement at any time; provided, however, that in order to exercise this right at any time, Parent must notify the Company to the effect that suspension of the sale of shares under the Registration Statement is necessary because either (A) Parent has determined in good faith that such a sale would be in violation of the requirements of the Securities Act and the regulations promulgated by the SEC thereunder or (B) there exists at the time material non-public information relating to Parent which, in the reasonable opinion of Parent, should not be disclosed. Notwithstanding the foregoing, Parent shall not under any circumstances be entitled to exercise its right to suspend sales under this subsection until Parent has provided the Company with a certificate executed by an authorized officer of Parent stating that such suspension is necessary in light of such potential violation or non-public information. Parent shall not under any circumstances be entitled to exercise its right to suspend sales under this subsection more than two times in any twelve (12)-month period, and the period during which the Registration Statement under this subsection may be withdrawn shall not exceed 60 days each such time.

(b) Obligations of the Company.

(i) The Company will provide Parent all information necessary from the Company to register such shares and shall execute such documents in connection with such registration as Parent may reasonably request. The Company further agrees to furnish promptly to Parent in writing all information required from time to time to be disclosed in order to make the information previously furnished to Parent by the Company not misleading.

(ii) The Company, by the Company's acceptance of the Registrable Shares, agrees to cooperate with Parent as reasonably requested by Parent in connection with the preparation and filing of the Registration Statement hereunder, unless the Company has notified Parent in writing of the Company's election to exclude all of the Company's Registrable Shares from such Registration Statement.

(iii) The Company agrees that, upon receipt of any notice from Parent of the happening of any event of the kind described in Sections 5.1(a)(x) and 5.1(a)(xii), the Company will immediately discontinue disposition of the Registrable Shares pursuant to the Registration Statement covering such Registrable Shares until the Company's receipt of the copies of the supplemented or amended prospectus contemplated by Section 5.1(a)(x) or written notice from Parent as contemplated by Section 5.1(a)(xii) and, if so directed by Parent, the Company shall deliver to Parent (at the expense of Parent) or destroy (and deliver to Parent a certificate of destruction) all copies in the Company's possession, of the prospectus covering such Registrable Shares current at the time of receipt of such notice.

(iv) The Company agrees that, during the period from the Closing Date to the second anniversary of the Closing Date, so long as it continues to own (beneficially or of record) shares of Parent Common Stock issued in connection with the transactions contemplated by this Agreement, it will comply with Parent's internal written trading policies in effect as of the date of this Agreement and attached hereto as Exhibit C together with any amendments thereof (the "Parent's Internal Trading Policies"), as if it was specifically named in such policies, with respect to the resale of Parent Common Stock.

(c) Expenses of Registration. Parent shall pay all Registration Expenses (as defined below) in connection with any registration, qualification or compliance hereunder, and the Company shall pay all Selling Expenses (as defined below) and other expenses that are not Registration Expenses relating to the Registrable Shares to be resold by the Company. "Registration Expenses" shall mean all expenses, except for Selling Expenses, incurred by Parent in complying with the registration provisions set forth herein, including, without limitation, all registration, qualification and filing fees, printing expenses, escrow fees, fees and disbursements of counsel for Parent, blue sky fees and expenses and the expense of

any special audits incident to or required in connection with any such registration. “Selling Expenses” shall mean selling commissions, underwriting fees, expenses of counsel to the Company and stock transfer taxes applicable to the Registrable Shares.

5.2. Blue Sky Filings. Parent shall take such steps as may be necessary to comply with the securities and blue sky laws of all jurisdictions which are applicable to the issuance of the shares of Parent Common Stock in connection with the Mergers. The Company shall use its best efforts to assist Parent as may be necessary to comply with the securities and blue sky laws of all jurisdictions which are applicable in connection with the issuance of the shares of Parent Common Stock in connection with the Mergers.

5.3. Resale of Shares of Parent Common Stock. The Company covenants and agrees that any sale of shares of Parent Common Stock issued to the Company in connection with the transactions contemplated by this Agreement shall be conducted through Parent or an Affiliate of Parent which is a registered broker-dealer; provided, however, that in conducting such sales, the costs and terms of performance offered by Parent or an affiliate of Parent shall be the costs and terms of performance offered by Parent or an affiliate of Parent to other institutional investors for similar transactions; provided such costs and terms of performance are competitive with the costs and terms of performance offered by agency broker-dealers unaffiliated with the Company and any of its shareholders. If, at the time of such proposed sale, neither Parent nor any of its Affiliates are registered broker-dealers or they do not, at the time of such proposed sale, offer competitive costs and terms of performance as other agency broker-dealers, then Parent shall have the right to approve the broker-dealer through which such sales are to be made, which approval shall not be unreasonably withheld or delayed.

5.4. Parent Right of First Refusal. In addition to and not in limitation of any other restrictions on sales of Parent Common Stock contained in this Agreement or any Collateral Document, for the period from the Closing Date to the fifth anniversary of the Closing Date, any sale or transfer by the Company of an aggregate of 25,000 or more shares of Parent Common Stock issued to the Company in connection with the transactions contemplated by this Agreement in any 30-day period shall be solely for cash consideration and shall be consummated only in accordance with the following procedures:

(a) The Company shall first deliver to Parent a written notice (a “Notice of Sale”), which shall: (i) state the Company’s intention to sell shares of Parent Common Stock to one or more Persons; if available, the name or names of such Person or Persons, the number of shares of Parent Common Stock; if a proposed privately negotiated sale, the purchase price to be paid therefor and a summary of the other material terms of the proposed sale and (ii) offer Parent the option to acquire all or a portion of such shares of Parent Common Stock upon the terms and subject to the conditions of the proposed sale as set forth in the Notice of Sale. Any such offer shall remain open and irrevocable for the period set forth below (and, to the extent such offer is accepted during such period, until the consummation of the sale contemplated thereby). Parent shall have the right and option for a period ending on the earlier of (i) Parent’s express written rejection of the offer by written notice to the Company or (ii) five (5) days after delivery of the Notice of Sale (the “Acceptance Period”) to accept all or any part of such shares of Parent Common Stock at the purchase price and on the terms stated in the Notice of Sale; provided, however, that if the proposed sale is a public sale, the purchase price shall be the Closing Price of Parent Common Stock on the date of such Notice of Sale or, if the date of such Notice of Sale is not a Trading Day, the next Trading Day. Such acceptance shall be made by delivering a written notice to the Company within the Acceptance Period.

(b) If effective acceptance shall not have been received during the Acceptance Period, the Company may sell all, but not less than all, of the shares of Parent Common Stock so offered for sale and not so accepted by Parent, if a privately negotiated sale, at the purchase price to the proposed purchaser or purchasers or, if a public sale, at the current market price for such shares at the time of such

sale and on the other terms stated in the Notice of Sale, at any time within ninety (90) days after the expiration of the Acceptance Period (the "Open Sale Period"); provided, however, that, if required, the proposed purchaser or purchasers have been approved by Parent in accordance with Section 5.5 of this Agreement. To the extent the Company sells the shares of Parent Common Stock so offered for sale during the Open Sale Period, the Company shall promptly notify Parent as to (i) the number of shares of Parent Common Stock, if any, that the Company then owns, (ii) the number of shares of Parent Common Stock that the Company has sold, (iii) the terms of such sale and (iv) if known, the name of the owner(s) of any shares of Parent Common Stock sold. If all of the offered shares of Parent Common Stock are not sold by the Company during the Open Sale Period, the right of the Company to sell such shares of Parent Common Stock shall expire and the obligations set forth in this Section 5.4 shall be reinstated; provided, however, that at any time during the Open Sale Period, the Company may terminate the offer and reinstate the procedure provided in this Section 5.5 without waiting for the expiration of the Open Sale Period.

5.5. Parent Approval of Sales. Notwithstanding anything to the contrary contained in this Agreement, for the period from the Closing Date through the date that is the fifth anniversary of the Closing Date, any privately negotiated sale or transfer by the Company to a Person and its Affiliates of (i) an aggregate of 1,000,000 or more shares of Parent Common Stock issued to the Company in connection with the transactions contemplated by this Agreement or (ii) a number of shares of Parent Common Stock issued to the Company in connection with the transactions contemplated by this Agreement to any Person and its Affiliates in one or a related series of transactions occurring within any 90 day period that together is equal to or greater than 1,000,000 shares of Parent Common Stock shall be subject to the prior written approval of Parent. Parent shall have five (5) days after receipt of a Notice of Sale subject to the approval requirement of this Section 5.5 to approve or disapprove the proposed sale or transfer in writing. If Parent does not approve or disapprove the sale or transfer specified in the Notice of Sale by the fifth day after receipt of the Notice of Sale, the Company seeking Parent's approval pursuant to this Section 5.5 shall deliver an additional notice (the "Final Sale Notice") to Parent stating that the Company has not received a response from Parent pursuant to this Section 5.5. Parent's failure to approve or disapprove the proposed sale or transfer in writing within one day following its receipt of the Final Sale Notice shall constitute approval by Parent of the proposed sale or transfer. Any transfer of shares of Parent Common Stock in violation of this Section 5.5 shall be void and of no force or effect. Notwithstanding anything to the contrary contained in this Agreement, the Company may withdraw a Notice of Sale delivered pursuant to Sections 5.4 or 5.5 at any time prior to completion of the sale or transfer of shares of Parent Common Stock specified in such notice.

5.6. Subsequent Transferees. In addition to the restrictions on Company consolidations and other matters contained in Section 4.11 of this Agreement, the Company shall not be permitted to distribute, dividend or otherwise transfer any shares of Parent Common Stock received by the Company pursuant to this Agreement to any of its stockholders, members or other equity holders without obtaining the prior written consent of Parent, which consent shall not be unreasonably withheld and delivering to Parent an acknowledgment from such proposed transferee to become bound by the restrictions on resales and other covenants contained in Section 5.1(b)(iv), Section 5.4 and Section 5.5 of this Agreement. Any transfer of shares of Parent Common Stock in violation of this Section 5.6 shall be void and of no force or effect. For purposes of clarification, this Section 5.6 shall not apply to any transfer that is subject to and made in compliance with Section 5.4 and Section 5.5 of this Agreement.

5.7. Operating Committee. The Company and Parent shall establish a two person committee (the "Operating Committee") comprised initially of Omar Amanat and an executive designated by Parent (the "Parent Appointee"). The successor to Omar Amanat shall be appointed by Omar Amanat or any of his successors and the successor to the Parent Appointee shall be appointed by Parent, respectively. The Operating Committee shall resolve any post-closing management and integration matters between Parent and the Target Companies. In the event that the Operating Committee shall be unable to resolve any such

matter, such matter shall be submitted to a senior executive of Parent for review and consideration. Unless otherwise agreed in writing between Parent and Omar Amanat or his successor, as the case may be, the Operating Committee shall dissolve and have no further effect on the date that is 24 months from the date of this Agreement.

5.8. Post-Closing Litigation Assistance. The Company and each of its Subsidiaries will use their commercially reasonable efforts to take all acts reasonably requested to be taken by Parent in connection will the legal, administrative or other proceedings set forth on Schedule 5.8 attached hereto, including but not limited to testifying in, and assisting in Parent's preparation for, all such legal, administrative or other proceedings.

5.9. TRK Post-Closing Matters. Following the Closing, the Company shall (a) satisfy its obligation pursuant to Section 1(a) of the New TRK Agreement when due, and (b) if the TRK Executives withdraw all or any portion of their capital in Momentum prior to January 1, 2004, the Company will promptly and in any event not more than two Trading Days following such withdrawal replace such capital in full.

ARTICLE VI

EMPLOYMENT MATTERS

6.1. Employees; Employee Benefit Matters.

(a) To the extent permissible under the applicable provisions of the Code and ERISA and the terms of any applicable employee benefit plans sponsored or maintained by Parent or its Subsidiaries other than any Company Employee Plan sponsored solely by the Target Companies, (i) for purposes of crediting periods of service for eligibility to participate and vesting (but not with respect to accruals), employees of each Target Company and their Subsidiaries shall receive credit as if such service had been with Parent and (ii) as of the Closing, individuals who are employees of a Target Company or any of their respective Subsidiaries at the Effective Time and who become employees of Parent or any Subsidiary of Parent shall be eligible to participate in employee benefit plans (within the meaning of ERISA Section 3(3)) maintained by Parent or any Subsidiary thereof on substantially the same terms and conditions as apply generally to other similarly situated employees of Parent or any of its Subsidiaries.

(b) The Company shall cause the account of each employee of the Company or a Target Company or any of their respective Subsidiaries at the Effective Time who become employees of Parent or any Subsidiary of Parent (a "Continuing Employee") under the Tradescape.com 401k plan (the "401k Plan") (i) to be fully vested as of the Effective Time, and (ii) to receive any employer contributions (matching and profit sharing) for the plan year in which the Effective Time occurs on a pro-rata basis (based on compensation earned prior to the Effective Time) without regard to any requirement under the 401k Plan that the employee be employed on any particular date or complete any period of service in order to receive such contribution. The Company will cause the 401k Plan to permit each Continuing Employees to elect at any time after the Effective Time to receive distributions (including direct rollovers) of their accounts under the 401k Plan.

ARTICLE VII

TAX MATTERS

7.1. Company Covenants.

(a) Preparation and Filing of Pre-Closing Tax Returns; Payment of Pre-Closing Taxes. Between the date of this Agreement and the Closing Date, the Company shall cause each Target Company and their Subsidiaries to prepare and file on or before the due date therefor all Tax Returns required to be filed by such Target Company and their Subsidiaries (except for any Tax Return for which an extension has been granted as permitted hereunder), on or before the Closing Date, and shall pay all Taxes (including estimated Taxes) due on such Tax Returns (or due with respect to Tax Returns for which an extension has been granted as permitted hereunder) or which are otherwise required to be paid at any time prior to or during such period. Such Tax Returns shall be prepared in accordance with the most recent Tax practices as to elections and accounting methods, subject to Parent's consent, which shall not be unreasonably withheld or delayed.

(b) Notification of Tax Proceedings. Between the date of this Agreement and the Closing Date, the Company, to the extent the Company or a director or officer (or employee responsible for Tax matters) of any of the Company and its Subsidiaries has knowledge of the commencement or scheduling of any Tax audit, the assessment of any Tax, the issuance of any notice of Tax due or any bill for collection of any Tax due or the commencement or scheduling of any other administrative or judicial proceeding with respect to the determination, assessment, or collection of any Tax of the Company or its Subsidiaries, shall provide prompt notice to Parent of such matter, setting forth information (to the extent known) describing any asserted Tax liability in reasonable detail and including copies of any notice or other documentation received from the applicable Tax authority with respect to such matter.

(c) Tax Elections, Waivers, and Settlements. The Company shall not, and shall cause each Target Company and its Subsidiaries not to, take any of the following actions with respect to a Target Company or its Subsidiaries without Parent's consent:

(i) make, revoke or amend any Tax election;

(ii) execute any waiver of restrictions on assessment or collection of any Tax; or

(iii) enter into or amend any agreement or settlement with any Tax authority.

(d) Termination of Existing Tax-Sharing Agreements. All Tax-sharing agreements or similar arrangements with respect to or involving a Target Company and its Subsidiaries shall be terminated with respect to the Target Company and its Subsidiaries on the Closing Date, and, after the Closing Date, neither Parent and its Affiliates, on the one hand, nor the Target Company or its Subsidiaries, on the other, shall be bound thereby or have any liability thereunder to the other party for amounts due in respect of such agreements and arrangements.

7.2. Post-Closing Tax Covenants; Indemnity.

(a) Tax Return Filing and Payment of Pre-Closing/Post-Closing Taxes.

(i) Parent shall prepare and timely file all Tax Returns of each Target Company and their Subsidiaries for the Straddle Period (as defined in Section 7.2(b)). Parent shall pay and discharge all Taxes shown to be due on such Tax Returns. No later than ten Business Days prior to the due date of a

Straddle Period Tax Return for a Target Company or its Subsidiaries, the Company shall pay to Parent the amount of Taxes shown due which is attributable to the pre-Closing portion of the Straddle Period less estimated Tax payments made prior to the Closing Date. The Company shall prepare, and with Parent's cooperation, timely file all Tax Returns of such Target Company and their Subsidiaries for all pre-Closing periods for which Tax Returns have not been filed as of the Closing Date. The Company shall pay and discharge all Taxes shown to be due on the pre-Closing Tax Returns before the same shall become delinquent and before penalties accrue thereon except to the extent estimated Tax payments have previously been made with respect to such Taxes.

(ii) The Tax Returns referred to in the preceding paragraph shall be prepared in a manner consistent with past practice, unless a contrary treatment is required by an intervening change in the applicable law. Parent or the Company shall cause a copy of any Tax Return that is required to be filed by it, under the preceding paragraph, together with all relevant workpapers and other information, to be made available to the other party for review and approval no later than 20 Business Days prior to the due date for the filing of such Tax Return (taking into account proper extensions) and such approval not to be unreasonably withheld. An exact copy of any such Tax Return filed by Parent or the Company and evidence of payment of such Taxes shall be provided to the other party no later than 10 Business Days after such Tax Return is filed.

(iii) Notwithstanding anything to the contrary in this Agreement, neither Parent nor the Company shall, nor shall they permit any of the Target Companies and their Subsidiaries to, file any amended Tax Return relating to a Target Company or a Subsidiary (or otherwise modify any such Tax Return) with respect to taxable periods ending on or prior to the Closing Date without the written consent of the other party if such amendment adversely affects the other party or such Target Company or any of its Subsidiaries, unless required to do so by law. If any of the Parent, the Company, a Target Company or a Subsidiary is required by law to file an amended Tax Return for a Target Company or a Subsidiary with respect to taxable periods ending on or prior to the Closing Date, and such amended Tax Return adversely affects a Target Company or a Subsidiary or the Parent or its Subsidiaries' tax attributes or its position in a post-Closing period, the Company and the Parent shall have joint control over the filing of such amended Tax Return.

(b) Allocation for Straddle Period. For purposes of this Agreement, the amount of Taxes of a Target Company and its Subsidiaries attributable to the pre-Closing portion of any taxable period beginning before and ending after the Closing Date (the "Straddle Period") shall be determined based upon a hypothetical closing of the taxable year on such Closing Date with the Closing Date being included in the pre-Closing portion of such Straddle Period; provided, however, real and personal property Taxes (which are not based on income) shall be determined by reference to the relative number of days in the pre-Closing and post-Closing portions of such Straddle Period.

(c) Representations and Covenants of Parent Related to Tax Treatment of the Mergers. Parent represents, warrants and covenants as follows: (i) except as otherwise contemplated by the terms of this Agreement, Parent has no plan or intention to reacquire any of the shares of Parent Common Stock issued in the Mergers; (ii) Parent has no current plan or intention to sell or otherwise dispose of or to cause any Target Company to dispose of any of the assets of any Target Company, except for dispositions made in the ordinary course of business or transfers described in Code Section 368(a)(2)(C) and other transfers among members of Partner's affiliated group; (iii) following the Mergers, Parent will continue each Target Company's historic business or use a significant portion of each Target Company's historic business assets in a business (for purposes of this representation, continuation of the historic business of the Company and its Subsidiaries shall be considered continuation of the historic business of each Target Company); (iv) Parent shall treat the Mergers as a tax-free reorganization as defined in Section 368(a) of the Code for all tax purposes until there has been a determination (as defined in Section 1313 of the Code) requiring an

alternative characterization of such transactions or unless otherwise required by law; and (v) the payment of cash in lieu of fractional shares of Parent common stock is solely for the purpose of avoiding the expense and inconvenience to Parent of issuing fractional shares and does not represent separately bargained for consideration.

(d) Representations and Covenants of Company Related to Tax Treatment of the Mergers. The Company represents, warrants and covenants as follows: (i) the Company has adopted a valid plan of reorganization with respect to the transactions contemplated herein; (ii) the stock of the Target Companies represents and at the Effective Time will represent at least 90 percent of the fair market value of the net assets and at least 70 percent of the fair market value of the gross assets held by the Company and the Company has received or shall receive prior to Closing an opinion from its investment banker to this effect, which the Company will make available to Parent; (iii) the Company will distribute to its shareholders the Parent Common Stock and other property it receives pursuant to the Mergers, as well as its cash and other property, in pursuance of its plan of reorganization; (iv) the Company is not an investment company as defined in Section 368(a)(2)(F) of the Code; and (v) the transactions contemplated by this Agreement would have qualified as a tax-free reorganization under Section 368(a)(1)(C) of the Code if they had been completed immediately prior to the formation of the Target Companies. For purposes of the covenant contained in clause (ii) of this subparagraph, amounts used by the Company to pay its reorganization expenses, amounts paid by the Company to its shareholders who receive cash or other property, and all redemptions and distributions (except for regular, normal dividends) made by the Company immediately before the Effective Time will be included as assets of the Company.

(e) Indemnification.

(i) Notwithstanding anything to the contrary in Article IX, the Company agrees to indemnify and hold harmless the Indemnified Parties (as defined in Section 9.2) (including following the Closing, the Target Companies, their Subsidiaries and the successors to the foregoing and their respective stockholders, officers, directors, employees and agents) from and against any and all Losses (as defined in Section 9.2(a)), asserted against, or paid, suffered or incurred by any Indemnified Party which, directly or indirectly, arise out of, result from, are based upon or relate to: (A) the inaccuracy, untruth or incompleteness, as of the date of this Agreement or the Closing Date, of any of the representations or warranties made in Section 2.12; (B) any Taxes imposed on the Company and its Subsidiaries or asserted against the properties, income, or operations of the Company and its Subsidiaries for any taxable period of the Company and its Subsidiaries ending on or prior to the Closing Date, including the pre-Closing portion (as allocable pursuant to Section 7.2(b)) of any Straddle Period and any Taxes imposed on Parent, any Target Company or its Subsidiaries as a result of the failure of the Mergers to qualify as a tax-free reorganization under Section 368 of the Code (or any similar provision of state, local or foreign law), other than Taxes imposed on Parent, any Target Company or any of their respective Subsidiaries as a result of its non-succession to the net operating loss carryovers of the Company under Section 381 of the Code or any similar provision of state or local law by reason of such failure; (C) Taxes of another Person claimed from a Target Company and its Subsidiaries as a result of any Target Company or their Subsidiaries or their predecessors being included prior to the Closing Date in a combined, consolidated or unitary tax group under Treasury Regulations Section 1.1502-6 (or any similar provision of state, local or foreign law) or, as a transferee or successor, by contract or otherwise; and (D) the Company's obligations for any Transfer Taxes pursuant to Section 7.2(i) hereof;

(ii) Parent agrees to indemnify and hold harmless the Company (and its successors and stockholders, officers, directors, employees and agents, if any, as the case may be), from and against any and all Losses asserted against, or paid, suffered or incurred by any of them which, directly or indirectly, arise out of, result from, are based upon or relate to: (x) any Taxes imposed on or in respect of the operations of the Target Companies or their Subsidiaries for any taxable periods commencing after the Closing Date,

including the post-Closing portion (as allocable pursuant to Section 7.2(b)) of any Straddle Period or (y) any breach of Parent's representations and covenants contained in Section 7.2(c).

(f) Tax Contest.

(i) Parent or the applicable Indemnified Party shall notify the Company in writing within 30 calendar days of receipt of written notice of any pending or threatened Tax examination, audit or other administrative or judicial proceeding (a "Tax Contest") that could reasonably be expected to result in an indemnification obligation under Section 7.2(e); provided, however, that a failure to give such notice shall not affect Parent's or such Indemnified Party's right to indemnification pursuant to Section 7.2(e) unless such failure or delay shall have materially and adversely affected the indemnifying party's ability to defend against, settle, or satisfy any action, suit or proceeding against it, or any damage, loss, claim or demand for which Parent or the applicable Indemnified Party is entitled to indemnification hereunder.

(ii) If a Tax Contest relates to any pre-Closing taxable period, the Company shall at its expense control the defense and settlement of such Tax Contest. To the extent the Company does not assume the defense and settlement of any Tax Contest referred to in the preceding sentence, Parent may defend such Tax Contest in the manner it deems appropriate including, but not limited to, settling such Tax Contest after giving the Company 5 calendar days' prior written notice setting forth the terms and conditions of such settlement. Notwithstanding the foregoing, the Company shall not agree to any settlement concerning Taxes for a pre-Closing taxable period which may adversely impact Parent, a Target Company or any Subsidiary for a post-Closing period or the Tax attributes of Parent, a Target Company or any Subsidiary without the prior written consent of Parent.

(iii) If a Tax Contest relates to any Straddle Period, Parent and the Company shall jointly control the defense and settlement of such Tax Contest, and all fees and expenses related to such joint representation shall be paid equally by Parent, on the one hand, and the Company, on the other hand.

(g) Cooperation. The Company and Parent agree to furnish or cause to be furnished to each other, and upon request, as promptly as practicable, such information and assistance (including access to books and records) as is reasonably necessary for preparation of any Tax Return, claim for refund or audit, and the prosecution or defense of any claim, suit or proceeding relating to any Target Company's or their Subsidiaries' Tax liability. The requesting party shall bear all out-of-pocket costs and expenses reasonably incurred by the other party hereto in providing such assistance.

(h) Disputes. In the event that a dispute arises between the Company and Parent as to the amount of Taxes or indemnification or any matter relating to Taxes attributable to a Target Company and their Subsidiaries, the parties shall attempt in good faith to resolve such dispute, and any agreed upon amount shall be paid to the appropriate party. If such dispute is not resolved 30 calendar days thereafter, the parties shall submit the dispute to an independent accounting firm mutually chosen by Parent and the Company for resolution, which resolution shall be final, conclusive and binding on the parties. Notwithstanding anything in the Agreement to the contrary, the fees and expenses of the independent accounting firm in resolving this dispute shall be borne equally by the Company and Parent.

(i) Transfer Taxes. The Company shall be responsible for the filing of Tax Returns (including any documentation) with respect to all transfer, documentation, sales, use, stamp, registration, and similar Taxes incurred in connection with this Agreement or any transaction contemplated thereby and the payment of any such Taxes.

(j) Character of Payments. To the extent permitted by applicable law, the parties agree that any indemnification payments (and/or payments or adjustments) made with respect to this Agreement shall be treated for all Tax purposes as an adjustment to the purchase price.

(k) Survival. The representations and warranties contained in Section 2.12 and the obligations of the parties set forth in this Article VII shall survive until the 90th day after the expiration of the applicable statute of limitations with respect to the Taxes in question including all periods of extension, whether automatic or permissive.

(l) Extension Following Delivery of Claim Notice. Notwithstanding anything herein to the contrary, any representation, warranty, covenant and agreement relating to any Tax matter, which is the subject of a claim asserted in writing prior to the expiration of the applicable survival period, shall survive with respect to such claim or any dispute with respect thereto until the final resolution thereof.

(m) Exclusive Tax Remedy. Notwithstanding anything to the contrary in this Agreement, absent fraud, the parties to this Agreement acknowledge and agree that the sole and exclusive remedy with respect to any and all claims relating to Taxes shall be pursuant to the provisions set forth in this Article VII including any claim resulting from a breach or inaccuracy of representations and warranties relating to Taxes, and to the extent there is any conflict between provisions of Article VII and provisions of other Sections of this Agreement with respect to issues or claims relating to Taxes, the provisions of this Article VII shall control.

ARTICLE VIII

CONDITIONS TO CLOSING

8.1. Conditions to the Obligations of Parent and the Merger Subs. The obligation of Parent and the Merger Subs to effect the Mergers and the other transactions contemplated by this Agreement is subject to the fulfillment on or prior to the Closing of each of the following conditions (all or any of which may be waived by Parent in its sole discretion):

(a) Performance of Obligations; Representations and Warranties. The Company and each of the Target Companies shall have performed and complied with all covenants and agreements contained in this Agreement that are required to be performed or complied with by them prior to or at the Closing, and each of the Company's representations and warranties contained in this Agreement shall be true and correct in all material respects (if not qualified by materiality or by reference to a Material Adverse Effect) and in all respects (if qualified by materiality or by reference to a Material Adverse Effect) as of the Closing Date as though made on and as of the Closing Date, or in the case of representations and warranties made as of a specified date earlier than the Closing Date, shall be true and correct in all material respects (if not qualified by materiality or by reference to a Material Adverse Effect) and in all respects (if qualified by materiality or by reference to a Material Adverse Effect) on and as of such date and the Company shall have delivered to Parent a certificate, dated as of the Closing Date to such effect, substantially in the form attached hereto as Exhibit D.

(b) Opinions of Counsel. Parent shall have received the favorable written opinions each dated the Closing Date from the Company's outside counsel as to the matters set forth on the attachment to Exhibit E in a form reasonably satisfactory to counsel for Parent.

(c) Resignations. Parent shall have received the written resignation of the individuals set forth on Exhibit F, each effective at the Effective Time.

(d) Consents. Parent shall have been furnished with evidence satisfactory to it of the consent, approval or waiver of those Persons listed on Schedule 8.1(d)(i) attached hereto and the Company shall use its best efforts to obtain the consent, approval or waiver of the Persons listed on Schedule 8.1(d)(ii) attached hereto and all other Persons whose consent, approval or waiver shall be required in connection with the Mergers and the other transactions contemplated by this Agreement under any Target Company Material Contract. Each of such consents, approvals and waivers (i) shall be in form and substance reasonably satisfactory to Parent, (ii) shall not be subject to the satisfaction of any condition that has not been satisfied or waived and (iii) shall be in full force and effect.

(e) Governmental Approvals. Each of Parent, the Company, the Target Companies, the Merger Subs and their respective Subsidiaries shall have timely obtained from each Governmental Entity all approvals, non-objections, waivers and consents, if any, necessary for consummation of or in connection with the Mergers and the other transactions contemplated by this Agreement and no such approval, non-objection, waiver or consent shall contain any condition that Parent reasonably determines to be unduly burdensome or otherwise alters the benefits for which Parent bargained in this Agreement.

(f) Injunctions, Etc. No temporary restraining order, preliminary or permanent injunction or other order issued, enacted, promulgated, enforced or entered by any court of competent jurisdiction or other legal or regulatory restraint or prohibition preventing the consummation of either of the Mergers or the other transactions contemplated by this Agreement shall be in effect, nor shall any proceeding brought by an administrative agency or commission or other Governmental Entity, domestic or foreign, seeking any of the foregoing be pending; nor shall there be any action taken, or Laws and Regulations or orders enacted, entered, enforced or deemed applicable to any of the Mergers or the other transactions contemplated by this Agreement, which prevents or prohibits the consummation of either of the Mergers or the other transactions contemplated by this Agreement.

(g) Good Standing Certificates. The Company and each Target Company shall have delivered to Parent for each Target Company and their respective Subsidiaries (a) copies of the certificates or articles of incorporation (or other comparable corporate organizational documents), including all amendments thereto, of such company certified by the appropriate official of the jurisdiction of incorporation or formation, (b) certificates from the appropriate official of the respective jurisdictions of incorporation or formation to the effect that each such Company is in good standing or subsisting in such jurisdiction, listing all charter documents of such Company on file and attesting to its payment of all franchise or similar Taxes, and (c) a certificate from the secretary of state or other appropriate official in each jurisdiction in which such Company is qualified or admitted to do business to the effect that the applicable company, is duly qualified or admitted and in good standing in such jurisdiction.

(h) Management Retention Agreements. The Management Retention Agreements shall be in full force and effect, and none of the parties thereto (other than Parent) shall have indicated an intention to repudiate, terminate or challenge the enforceability of any of those agreements.

(i) Escrow Agreement. The Escrow Agreement shall have been duly executed and delivered by the parties thereto.

(j) HSR Act. Any waiting period (and any extension thereof) applicable to the consummation of the Mergers or the consummation of the other transactions contemplated by this Agreement under the HSR Act shall have expired or been terminated.

(k) NASD Approval. Each of Parent and the applicable Target Company shall have obtained from the NASD approval to continue to operate as a broker-dealer following the change in ownership and control of such Target Company and its Subsidiaries contemplated by this Agreement.

(l) Orderly Distribution and Lock-Up Agreement. The Company shall have executed and delivered to Parent a copy of the Orderly Distribution and Lock-Up Agreement attached hereto as Exhibit G.

(m) Invoices. Parent shall have received the Invoices required to be delivered pursuant to Section 11.1 of this Agreement.

(n) MarketXT Subscriber Agreement. The MarketXT Subscriber Agreement by and between Parent, or an affiliate thereof and MarketXT, a wholly-owned Subsidiary of the Company, shall be amended and duly executed and delivered by the parties hereto.

(o) Assignments. The Company or its Subsidiary shall have validly assigned to a Target Company or one of its Subsidiaries the contracts, agreements, personal property and other assets listed on Schedule 8.1(o)(i) attached hereto and the Company shall use its best efforts to have validly assigned to a Target Company or one of its Subsidiaries the contracts, agreements, personal property and other assets listed on Schedule 8.1(o)(ii) attached hereto. Each of such assignments shall (i) be in form and substance reasonably satisfactory to Parent and (ii) shall be in full force and effect.

(p) Terminations. Parent shall have been furnished with evidence satisfactory to it of the termination of the contracts and agreements listed on Schedule 8.1(p) attached hereto.

(q) Second TRK Call Option. The Company shall have assigned the Second TRK Call Option to a Target Company or one of its Subsidiaries. The assignment shall (i) be in form and substance reasonably satisfactory to parent and (ii) shall be in full force and effect.

(r) TRK Arrangements. The Company, the Target Companies and their respective Subsidiaries and TRK and the TRK Executives shall have entered into an agreement, in form and substance satisfactory to Parent in its sole discretion, with respect to the ongoing relationship of the business of the Target Companies, their respective Subsidiaries and TRK following the Closing, including resolution of the Second TRK Put Option, the Significant Disposition Payment Amount and the Put Termination Right.

(s) Amended Copyright Assignment Agreement. The Company shall have recorded an amended copyright assignment agreement, in form and substance reasonably satisfactory to Parent, assigning the copyright “ENTIRE QUOTESAVER” (Txu 896-803) to TTLLC.

(t) License Agreement. The License Agreement shall have been duly executed and delivered by the parties thereto.

(u) Clearing Agreement. An agreement relating to joint clearing arrangements among Parent and its Subsidiaries and MarketXT shall have been duly executed and delivered by the parties thereto; which provides that while such joint clearing agreement is in place MarketXT will be charged clearing and execution fees which are equal to those incurred by Momentum. Such agreement will remain in place until there is a sale or change of control of MarketXT by its current owners.

8.2. Conditions to the Obligations of the Company and the Target Companies. The obligation of the Company and the Target Companies to effect the Mergers and the other transactions contemplated by this Agreement is subject to the fulfillment at or prior to the Closing of each of the following conditions (all of which may be waived by the Company in its sole discretion).

(a) Performance of Obligations; Representations and Warranties. Parent and the Merger Subs shall have performed and complied with all covenants and agreements contained in this Agreement that are required to be performed or complied with by them prior to or at the Closing and each of the representations and warranties of Parent contained in this Agreement shall be true and correct, in all material respects (if not qualified by materiality) and in all respects (if qualified by materiality) as of the Closing Date as though made on and as of the Closing Date or, in the case of representations and warranties made as of a specified date earlier than the Closing Date, shall have been true and correct in all material respects (if not qualified by materiality) and in all respects (if qualified by materiality) on and as of such date and Parent shall have delivered to the Company a certificate dated the Closing Date executed on behalf of Parent by an authorized signatory to such effect, substantially in the form attached hereto as Exhibit K.

(b) Opinion of Counsel. The Company shall have received the favorable written opinion, dated the Closing Date, from counsel for Parent, as to the matters set forth on the attachment to Exhibit H in a form reasonably satisfactory to counsel for the Company.

(c) Governmental Approvals. Each of Parent, the Company, the Target Companies, and their respective Subsidiaries shall have timely obtained from each Governmental Entity all approvals, non-objections, waivers and consents, if any, necessary for consummation of or in connection with the Mergers and the other transactions contemplated by this Agreement and no such approval, non-objection, waiver or consent shall contain any condition that the Company reasonably determines to be unduly burdensome or otherwise alters the benefits for which the Company bargained in this Agreement.

(d) Injunctions, Etc. No temporary restraining order, preliminary or permanent injunction or other order issued, enacted, promulgated, enforced or entered by any court of competent jurisdiction or other legal or regulatory restraint or prohibition preventing the consummation of either of the Mergers or the other transactions contemplated by this Agreement shall be in effect, nor shall any proceeding brought by an administrative agency or commission or other Governmental Entity, domestic or foreign, seeking any of the foregoing be pending; nor shall there be any action taken, or Laws and Regulations or orders enacted, entered, enforced or deemed applicable to any of the Mergers or the other transactions contemplated by this Agreement, which prevents or prohibits the consummation of either of the Mergers, the Blair Interest Purchase or the other transactions contemplated by this Agreement.

(e) Escrow Agreement. The Escrow Agreement shall have been duly executed and delivered by the parties thereto.

(f) HSR Act. Any waiting period (and any extension thereof) applicable to the consummation of the Mergers and the other transactions contemplated by this Agreement under the HSR Act shall have expired or been terminated.

(g) NASD Approval. Each of Parent and the applicable, Target Company shall have obtained from the NASD approval to continue to operate as a broker-dealer following the change in ownership and control of such Target Company and its Subsidiaries contemplated by this Agreement.

(h) MarketXT Subscriber Agreement. The MarketXT Subscriber Agreement by and between Parent, or an affiliate thereof and MarketXT, a wholly-owned Subsidiary of the Company, shall be amended and duly executed and delivered by the parties hereto.

(i) Clearing Agreement. An agreement relating to joint clearing arrangements among Parent and its Subsidiaries and MarketXT shall have been duly executed and delivered by the parties thereto; which provides that while such joint clearing agreement is in place MarketXT will be charged clearing and execution fees which are equal to those incurred by Momentum. Such agreement will remain in place until there is a sale or change of control of MarketXT by its current owners.

ARTICLE IX

SURVIVAL; INDEMNIFICATION

9.1. Survival.

(a) Representations and Warranties of Parent and the Company. Subject to the provisions of Section 7.2(k), all of the representations and warranties of Parent and the Company contained in or made pursuant to this Agreement shall survive the Closing and shall remain operative and in full force and effect for a period of two years after the Closing Date (such period being referred to as the "Indemnity Period") with the exception of the representations and warranties contained in Sections 2.1(a), 2.1(b), 2.1(c), 2.2, 2.3(a), 2.21. 3.1 and the last sentence of Section 3.2 which shall survive the Closing and shall remain operative and in full force and effect indefinitely, in each case, regardless of any investigation or statement as to the results thereof made by or on behalf of any Person before or after the Closing.

(b) Covenants and Agreements of the Parties. Each covenant and agreement contained in this Agreement shall survive the Closing until the date which is 90 days following the last date on which such covenant or agreement is to be performed or, if no such date is specified, indefinitely.

(c) Extension following Delivery of a Claim Notice. Notwithstanding anything herein to the contrary, any representation, warranty, covenant or agreement which is the subject of a claim which is asserted in writing prior to the expiration of the applicable survival period shall survive with respect to such claim or any dispute with respect thereto until the final resolution thereof.

9.2. Indemnification.

(a) Subject to the limitations contained in this Article IX, the Company shall indemnify and hold harmless Parent and its Subsidiaries (including, following the Closing, the Target Companies and their respective Subsidiaries) and their respective employees, agents, directors, and Affiliates and the employees, agents, directors, officers and Affiliates (collectively, the "Indemnified Parties") from and against any and all damages, claims, losses (including loss of value), expenses, costs, obligations and liabilities, including without limitation liabilities for all reasonable attorneys', accountants', and experts' fees and expenses including those incurred to enforce the terms of this Agreement or any Collateral Document (collectively, "Losses"), asserted against, or paid, suffered or incurred by any Indemnified Party which, directly or indirectly, arise out of, result from, are based upon or relate to: (i) the inaccuracy, untruth or incompleteness, as of the date of this Agreement or the Effective Time, of any representation or warranty made or deemed to have been made by the Company in this Agreement (other than Section 2.12, which shall be dealt exclusively pursuant to Section 7.2); provided, however, that if any such representation or warranty (other than those contained in Section 2.5(i)) is qualified in any respect by materiality or Material Adverse Effect, for purposes of this paragraph such materiality or Material Adverse Effect qualification will in all respects be ignored; (ii) any failure by the Company or any Target Company (with respect to pre-Closing periods) to perform or fulfill any of its covenants or agreements set forth in this Agreement; (iii) the transactions described on Schedule 9.2(a)(i); and (iv) the items listed on Schedule 9.2(a)(ii).

(b) Parent shall indemnify and hold harmless the Company, its employees, agents, directors, officers, Subsidiaries and its Affiliates and the employees, agents, directors and officers of its Affiliates from and against any and all Losses asserted against, or paid, suffered or incurred by the Company which, directly or indirectly, arise out of, result from, are based upon or relate to: (i) the inaccuracy, untruth or incompleteness, as of the date of this Agreement or the Effective Time, of any representation or warranty made by the Parent in this Agreement or (ii) any failure by Parent to perform or fulfill any of its covenants or agreements set forth in this Agreement.

9.3. Limitation of Liability; Disposition of Escrow Fund.

(a) After the Closing, the Indemnified Parties' rights to indemnification under Section 9.2 shall be subject to the following limitations: (i) in no event shall the aggregate amount to be paid to the Indemnified Parties under Section 9.2(a)(i) or 9.2(a)(ii) exceed the value of the Escrow Shares and any cash or other property held in escrow pursuant to the Escrow Agreement from time to time (the "Indemnity Amount") and (ii) the Indemnified Parties shall be entitled to recover any Loss otherwise recoverable pursuant to Section 9.2(a)(i) or Section 9.2(a)(ii) only to the extent the aggregate of Losses otherwise recoverable pursuant to such Sections exceeds $1,000,000 in the aggregate and then only for the amount of such excess (the "Deductible Amount"). For purposes of clarification, the limitations contained in this Section 9.3(a), including the Indemnity Amount and the Deductible Amount, shall not apply to any claim for indemnification made by the Indemnified Parties pursuant to Section 7.2(e), Section 9.2(a)(iii) or Section 9.2(a)(iv) of this Agreement; provided, however, that Parent agrees that the Indemnified Parties shall first proceed against the Escrow Shares before making any claim pursuant to Section 7.2(e), Section 9.2(a)(iii) or Section 9.2(a)(iv) of this Agreement against any other portion of the Parent Common Stock issued to the Company or any other assets or properties of the Company.

(b) In no event will the Company be required to satisfy any claims made by the Indemnified Parties pursuant to Sections 9.2(a)(i) and 9.2(a)(ii) of this Agreement other than by surrendering Escrow Shares, cash or other property held in escrow pursuant to the terms of the Escrow Agreement for the account of the Company. This Section 9.3(b) shall not apply to any other indemnification claims brought by the Indemnified Parties pursuant to any other provision of this Agreement.

(c) Notwithstanding anything to the contrary contained in this Agreement, the Indemnified Parties shall not be entitled to make a claim for indemnification for any Losses that are otherwise accounted for in the calculation of Net Income.

9.4. Notice of Claims. If any of the Indemnified Parties believes that it has suffered or incurred any Loss, it shall notify the Escrow Agent and the Company promptly in writing (at the addresses set forth herein), and in any event within the applicable time period specified in Section 9.1, describing such Loss, all with reasonable particularity and containing a reference to the provisions of this Agreement in respect of which such Loss shall have occurred. If any legal action is instituted by a third party with respect to which any of the Indemnified Parties intend to claim indemnity under this Article, such Indemnified Party shall promptly give written notice thereof (a "Claim Notice") to notify the Escrow Agent and the Company of such legal action. In any event, a failure or delay in notifying the Company shall not affect the Indemnified Party's right to indemnity, except only to the extent such failure or delay materially and adversely prejudices the ability to defend against any legal action.

9.5. Defense of Third Party Claims. Because the right to indemnity is limited as provided herein, the Indemnified Parties shall have the right to conduct and control, through counsel of their own choosing, reasonably acceptable to the Company, any third party legal action or other claim, but the Company may, at its or their election, participate in the defense thereof at its sole cost and expense; provided, however, that if the Indemnified Parties shall fail to defend any such legal action or other claim, then the Company may defend, through counsel of its own choosing, such legal action or other claim, and so long as it gives the Indemnified Parties at least 15 days' notice of the terms of the proposed settlement thereof and permits the Indemnified Parties to then undertake the defense thereof, except as set forth below, settle such legal action or other claim and recover out of the Indemnity Amount the amount of such settlement or of any judgment and the costs and expenses of such defense. None of the Indemnified Parties, the Company or the Target Companies shall compromise or settle any such legal action or other claim without the prior written consent of the other, which consent shall not be unreasonably withheld, except that under no circumstances shall any Indemnified Party be required to consent to the entry of an order for injunctive or other non-monetary relief. All costs and expenses reasonably incurred in defending any such third party legal action or other claim, including the amount of any settlement or of any judgment, shall be paid out of the Indemnity Amount.

9.6. Payment; Set-Off.

(a) In the event the Company is obligated to make any payment to the Indemnified Parties in respect of the indemnity granted pursuant to Section 7.2 or this Article IX, the Company shall be permitted to satisfy such obligation (i) through the payment of cash; (ii) by delivering from the escrow a number of Escrow Shares or other property of value held therein, in each case, as calculated in accordance with the terms of the Escrow Agreement; or (iii) by delivering other shares of Parent Common Stock.

(b) In addition to Parent's right to proceed against the Escrow Shares for indemnification claims pursuant to Section 7.2(e), 9.2(a)(iii) and 9.2(a)(iv), if the Escrow Shares are not available or have been released to the Company pursuant to the Escrow Agreement, Parent may reduce and withhold a portion of the Contingent Payment in an amount equal to the Losses claimed pursuant to such sections until such time as any dispute with respect to such claims is resolved or paid. If such claims are determined in favor of Parent and the full amount of Losses with respect to such claims are not paid by the Company, Parent may retain and will have no obligation to issue to the Company that portion of the Contingent Payment equal to the amount of such unpaid Losses.

9.7. Exclusive Remedy. Except as provided in Section 7.2(e), the parties hereto agree that the remedies provided by this Article IX shall be the sole and exclusive remedy of Parent following the Closing for the subject matter covered by such indemnification and any claim arising under this Agreement.

ARTICLE X

TERMINATION; EFFECT OF TERMINATION

10.1. Termination. This Agreement may be terminated, and the transactions contemplated hereby may be abandoned, at any time prior to the Effective Time:

(a) by mutual written agreement of the parties hereto;

(b) by either Parent or the Company, if, the Closing shall not have occurred on or before December 31, 2002 or such later date as the parties may agree (provided that the right to terminate this Agreement under this Section 10.1(b) shall not be available to any party whose action or failure to act has been the cause of or resulted in the failure of the Mergers to occur on or before such date and such action or failure to act constitutes a breach of this Agreement);

(c) by Parent, if the Company shall breach any of its representations, warranties or obligations hereunder to an extent that would cause the condition set forth in Section 8.1(a) not to be satisfied and such breach shall not have been cured within ten (10) business days of receipt by such party of written notice of such breach; provided, however, that the right to terminate this Agreement by Parent shall not be available to Parent if Parent is at that time in material breach of this Agreement;

(d) by the Company, if Parent shall breach any of its representations, warranties or obligations hereunder to an extent that would cause the condition set forth in Section 8.2(a) not to be satisfied and such breach shall not have been cured within ten (10) business days following receipt by Parent of written notice of such breach; provided, however, that the right to terminate this Agreement by the Company shall not be available to the Company where the Company or other Target Company is at that time in material breach of this Agreement;

(e) by either the Company or Parent upon written notice to the other party, thirty (30) days after the date on which any application, notice or other request for approval, non-objection or consent required to be filed with a Governmental Entity shall have been denied, objected to or withdrawn at the request or recommendation of the Governmental Entity, unless within the thirty (30) day period following such denial, objection or withdrawal, the parties hereto agree to file, and have filed, with the applicable Governmental Entity, a petition for re-hearing or an amended application, notice or other request for approval, non-objection or consent; provided, however, that no party should have a right to terminate this Agreement, pursuant to this Section 10.1(e) if such denial, objection, or request or recommendation for withdrawal shall be due to the failure of the party seeking to terminate this Agreement to perform or observe the covenants and agreements of such party set forth in this Agreement; and

(f) by either Parent or the Company if any permanent injunction or other order of a court or other competent authority preventing the consummation of any of the Mergers shall have become final and nonappealable.

10.2. Effect of Termination. (a) If this Agreement is validly terminated by either the Company or Parent pursuant to Section 10.1, this Agreement will forthwith become null and void and there will be no liability or obligation on the part of any of the Company, the Target Companies, Parent or the Merger Subs (or any of their respective Representatives or Affiliates), except to the extent that such termination results from the breach by a party hereto of any of its representations, warranties, or covenants or agreements set forth in this Agreement; provided that (a) the provisions of Section 4.4(b) (Confidentiality), Section 11.1 (Expenses), Section 13.1 (Press Releases), Section 13.7 (Governing Law) and this Section 10.2 shall remain in full force and effect and survive any termination of this Agreement and (b) nothing herein shall relieve any party from liability for fraud or willful breach in connection with this Agreement or the transactions contemplated hereby.

ARTICLE XI

FEES AND EXPENSES

11.1. Payment of Expense. Whether or not the transactions contemplated by this Agreement are consummated, all costs and expenses incurred in connection with this Agreement and the transactions contemplated hereby (including, without limitation, the fees and expenses of its advisers, brokers, finders, agents, accountants and legal counsel) shall be paid by the party incurring such expense. In no event shall Parent or any of the Target Companies be liable (before or after the Closing) for any fees and expenses of the Company relating to the transactions contemplated by this Agreement. In addition, the unpaid fees and expenses of all brokers, investment bankers, financial advisors, attorneys and accountants engaged in connection with the preparation and negotiation of this Agreement or the transactions contemplated hereby and whose compensation is payable by any of the Target Companies or the Company shall be reflected on invoices (the “Invoices”) submitted to Parent on or prior to the Closing Date, which Invoices shall include confirmation that no further compensation beyond the amount reflected in the Invoice is or will be payable by the Company (or either of the Target Companies or any of their Subsidiaries).

ARTICLE XII

DEFINITIONS

12.1. Definitions. As used in this Agreement the terms set forth below shall have the following meanings:

“Affiliate” (i) with respect to any specified Person, means such person’s relatives, beneficiaries, spouse or ex-spouse or any other Person that directly, or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with, such specified Person, and (ii) with respect to a legal entity such as a corporation, partnership, or limited liability corporation, has the same meaning as specified under Rule 12b-2 of the Securities Exchange Act of 1934, as amended.

“Average Pre-Closing Price of Parent Common Stock” means the average of the Closing Price of Parent Common Stock for the ten consecutive Trading Days ending on the Trading Day two days immediately prior to the Effective Time; provided, however, that if the Average Pre-Closing Price of Parent Common Stock is equal to or less than the Collar Price, then the Average Pre-Closing Price of Parent Common Stock shall be the Collar Price.

“Business Day” means any day other than a Saturday, a Sunday or any other day on which banks in New York State are required to close.

“Closing Price of Parent Common Stock” means, for any day, the closing sale price per share on that day of Parent Common Stock on the New York Stock Exchange as reported in The Wall Street Journal (or, if not reported in The Wall Street Journal, as reported by another authoritative source designated by Parent).

"Code" shall mean the Internal Revenue Code of 1986, as amended.

"Collar Price" shall mean $8.5106.

"Collateral Documents" shall mean the Management Retention Agreements, the Escrow Agreement, the Orderly Distribution and Lock-Up Agreement, and any other agreement, instrument, certificate, memorandum, schedule or other document delivered by a Person or any of its respective directors, officers, employees or trustees pursuant to this Agreement or in connection with the Mergers or the transactions contemplated by this Agreement.

"Control" means the possession of the power, directly or indirectly, to direct or cause the direction of the management and policies of a Person whether through the ownership of voting securities, by contract or otherwise.

"Environmental and Safety Laws" means any federal, state or local laws, ordinances, codes, regulations, rules, policies and orders that are intended to assure the protection of the environment, or that classify, regulate, call for the remediation of, require reporting with respect to, or list or define air, water, groundwater, solid waste, hazardous or toxic substances, materials, wastes, pollutants or contaminants, or which are intended to assure the safety of employees, workers or other Persons, including the public.

"Escrow Agent" shall mean a national bank or trust company designated by Parent and reasonably acceptable to the Company.

"Escrow Agreement" shall mean an agreement substantially in the form of Exhibit I, executed and delivered at the Closing.

"Final Contingent Amount" shall mean that number of shares of Parent Common Stock equal to the quotient of (i) the Final Period Cash Amount divided by (ii) the Average Pre-Closing Price of Parent Common Stock, provided, however, that in no event shall the Final Contingent Amount exceed fourteen million one hundred thousand (14,100,000) shares of Parent Common Stock.

"Final Period Cash Amount" shall mean the product of (i) ten (10) times (ii) the Final Period Overage, provided, however, that if such product exceeds one hundred and twenty million dollars ($120,000,000) then the Final Period Cash Amount shall equal one hundred and twenty million dollars ($120,000,000).

"Final Period Net Income" shall mean the Net Income of the Target Companies for the period from January 1, 2003 through December 31, 2003.

"Final Period Overage" shall mean that amount by which the Final Period Net Income exceeds ten million dollars ($10,000,000), rounded down to the nearest dollar amount.

"Final Period Revenue Target" shall mean Target Company Revenues for the period January 1, 2003 through December 31, 2003 of at least sixty million dollars ($60,000,000).

"Governmental Order" means any order, writ, judgment, injunction, decree, stipulation, determination or award entered by or with any Governmental Entity.

"GAAP" shall mean generally accepted accounting principles in the United States.

"Initial Contingent Amount" shall mean that number of shares of Parent Common Stock equal to the quotient of (i) the Initial Period Cash Amount divided by (ii) the Average Pre-Closing Price of Parent Common Stock, provided, however, that in no event shall the Initial Contingent Amount exceed seven million fifty thousand (7,050,000) shares of Parent Common Stock.

"Initial Period Cash Amount" shall mean the product of (i) ten (10) times (ii) the Initial Period Overage, provided, however, that if such product exceeds sixty million dollars ($60,000,000) then the Initial Period Cash Amount shall equal sixty million dollars ($60,000,000).

"Initial Period Net Income" shall mean the Net Income of the Target Companies for the period July 1, 2002 through December 31, 2002.

"Initial Period Overage" shall mean that amount by which the Initial Period Net Income exceeds four million five hundred thousand dollars ($4,500,000), rounded down to the nearest dollar amount.

"Initial Period Revenue Target " shall mean Target Company Revenues for the period July 1, 2002 through December 31, 2002 of at least thirty million dollars ($30,000,000).

"Intellectual Property" means (i) all names, including names of all entities owned or product names previously acquired by either Target Company or any of their respective Subsidiaries, brands, and slogans embodying business or product goodwill or indications of origin, all registered and unregistered trademarks, trade names, service marks and applications therefor ("Marks"), in each case as used or useful in the conduct of either Target Company's or any of their respective Subsidiaries' business and all of the goodwill of either Target Company or any of their respective Subsidiaries in conjunction with which such Marks are being used; (ii) all current and future patents, patent applications and inventions to which either Target Company or any of their respective Subsidiaries is or will be an assignee or owner relating to either Target Company's or any of their respective Subsidiaries' business, including, but not limited to, any provisional, utility, continuation, continuation-in-part or divisional applications filed in the U.S. or other jurisdiction and all reissues thereof and all reexamination certificates issuing therefrom; (iii) all ownership rights to any copyrightable works, both published and unpublished relating to either Target Company's or any of their respective Subsidiaries' business, including all copyright registrations; (iv) all computer and electronic data processing programs and software programs (in both source code and object code form) and related documentation, research projects, computer software under development, software concepts owned and proprietary intellectual property, processes, formulae and algorithms, including all intellectual property used in the ownership, marketing, development, maintenance, support and delivery of the software, all as presently owned or licensed by either Target Company or any of their respective Subsidiaries and used or useful in either Target Company's or any of their respective Subsidiaries' business; (vi) all inventions, improvements, developments, modifications and derivative works, know-how and trade secrets owned by either Target Company or any of their respective Subsidiaries or its or their employees and used or useful in either Target Company's or any of their respective Subsidiaries' business, whether or not reduced to practice, which either Target Company or any of their respective Subsidiaries, or any employee or former employee of either Target Company or any their respective Subsidiaries, together or individually, alone or in combination with each other or any other Person, has made which relates to either Target Company's or any their respective Subsidiaries' business; and (vii) the right to sue for and recover damages, assert, settle and/or release any claims or demands and obtain all other remedies and relief at law or equity for any past, present or future infringement or misappropriation of any of the foregoing.

"Laws and Regulations" means all federal, state, local and foreign and SRO laws, rules, regulations and ordinances, including, without limitation, federal, state local, foreign and SRO laws, rules, regulations and ordinances with respect to the business conducted by any Person and Environmental and Safety Laws.

"Liabilities" means, without limitation, (i) all liabilities that would be included on a balance sheet in accordance with GAAP, (ii) all amounts whether fixed or contingent that are or may be payable to terminate all contracts, agreements (written or oral), leases, or to pay all severance payments under any employment agreements, including employees terminated prior to Closing, (iii) all amounts whether fixed or contingent that are or may be payable to discharge or satisfy any Liens, environmental claims, intellectual property claims, litigation claims, Tax claims, employee benefit plans or claims or any damages, whether known or unknown, that may arise out of or are based on any fact, condition, event or circumstance that existed on or prior to the Closing Date, (iv) all costs, expenses or other amounts that have been or may be incurred by the Company to consummate the transactions contemplated by this Agreement, and (v) any indebtedness, guaranty, endorsement, claim, loss, damage, deficiency, cost, expense, obligation or responsibility, either accrued, absolute, contingent, mature, unmature or otherwise and whether known or unknown, fixed or unfixed, choate or inchoate, liquidated or unliquidated, secured or unsecured, that may be asserted against, and/or payable by, any Person based on any contract, agreement (written or oral), fact, condition, event or circumstance that existed on or prior to the Closing Date; provided, however, that for the purposes of determining the aggregate amount of Liabilities pursuant to this Agreement, any Liability that may fall within more than one of the categories set forth in the preceding sentence shall be counted only once.

"License Agreement" shall mean an agreement substantially in the form of Exhibit J, executed and delivered at the Closing.

"Liens" shall mean any mortgage, pledge, lien, security interest, conditional or installment sale agreement, encumbrance, charge or other claims of third parties of any kind, except for (a) liens for Taxes or governmental charges or claims (i) not yet due and payable or (ii) being contested in good faith, if a reserve or other appropriate provision, if any, as shall be required by GAAP shall have been made therefor on the Financial Statements; (b) statutory liens of landlords, lien of carriers, warehousemen's, mechanics and materialmen's and other liens imposed by law incurred in the ordinary course of business for sums (i) not yet due and payable and (ii) being contested in good faith, if a reserve or other appropriate provision, if any, as shall be required by GAAP shall have been made therefor on the Financial Statements; (c) liens incurred or deposits made in connection with workers' compensation, unemployment insurance and other similar types of social security programs in each case in the ordinary course of business consistent with past practice; (d) purchase money security interest incurred in the ordinary course of business, consistent with past practice; and (e) easements, rights-of-way, restrictions and other similar charges or encumbrances, in each case, which do not interfere with the ordinary conduct of the Company's operations and do not or would not materially detract from the value of the property to which such encumbrance relates.

"MarketXT Subscriber Agreement" shall mean an agreement with respect to the provision of ECN services to Parent and certain of its Subsidiaries following the Closing in form and substance reasonably satisfactory to Parent and the Company.

"Material Adverse Effect" shall mean any circumstance, change in or effect on any Person or any of its Subsidiaries that, individually or in the aggregate with any other circumstance, changes in or effects on, such Person or any of its Subsidiaries, is, or would reasonably be expected to be materially adverse to the assets, business, operation, condition (financial or otherwise) or results of operations of such Person and its Subsidiaries taken as a whole; provided, however, that none of the following, to the extent arising after the date of this Agreement, shall constitute a Material Adverse Effect: (i) any circumstance, change or effect affecting generally the United States or world equity markets or any material portion thereof or (ii) any circumstance, change or effect arising out of, resulting from, based upon or relating to the announcement or pendency of the Mergers or compliance with the terms of, or the taking of any action required by, this Agreement.

"MHI Capital Stock" shall mean the Common Stock, $.001 par value per share, of MHI.

"Net Income" shall mean for any fiscal period the consolidated, combined net income of the Target Companies and their respective Subsidiaries after provision for federal and state income taxes determined in accordance with GAAP as applied in the preparation of the financial statements of Parent and its consolidated Subsidiaries for the applicable fiscal period and net of any minority interest of the Class B members and Class C members of Momentum, with the following clarifications and modifications:

(a) Net income for any fiscal period shall be determined by subtracting from the Target Company Revenues from that period all costs, expenses and charges incurred by the Target Companies and their respective Subsidiaries, including without limitation:

(i) the costs of execution of securities trades and all clearing charges associated therewith; provided, however, that such costs and charges shall not exceed those costs and charges incurred by the Target Companies and their respective Subsidiaries under their existing arrangements with SouthWest Securities;

(ii) all royalties and other expenses incurred in connection with the licensing of Intellectual Property by any of the Target Companies or any of their respective Subsidiaries;

(iii) commissions, payments and all other consideration paid or accrued for payment (cash or non-cash) to brokers, traders, employees and any other Person performing services for the Target Companies or any of their respective Subsidiaries;

(iv) any costs, charges or expenses relating directly to and any payments payable, paid or accrued for payment to the holders of Class B member interests or Class C member interests issued by Momentum or any future member interests issued by Momentum as a result of any contractual arrangements with the Target Companies or any of their respective Subsidiaries, including, without limitation for this purpose, all amounts accrued as trader payouts on the consolidated financial statements of either Target Company;

(v) the general corporate and other overhead expenses allocated to the business of the Target Companies and their respective Subsidiaries by Parent in accordance with its practices and policies in effect from time to time as applied to Parent's other Subsidiaries and business units in the categories and for the purposes set forth on Schedule 1.18(a)(v);

(vi) without duplication of the amounts set forth in subclauses (iii) or (v) above or subclause (vii) below, any employment related costs associated with personnel employed by or for the benefit of any of the Target Companies or any of their respective Subsidiaries (including for this purpose those personnel added in Parent's reasonable discretion to improve the risk profile of the business conducted by the Target Companies and their Subsidiaries, including personnel for finance, risk management and compliance) in each case, as set forth on Schedule 1.18(a)(vi);

(vii) without duplication of the amounts set forth in subclauses (iii) or (vi) above, the fees and expenses of legal and accounting advisors, including compliance advisors and personnel, engaged to perform services in the ordinary course for the business of either Target Company or any of its respective Subsidiaries;

(viii) any marketing expenses incurred by either Target Company or any of their respective Subsidiaries;

(ix) except as provided in clause (b)(iii) below, depreciation and amortization charges prior to any purchase price GAAP adjustments;

(x) interest charges incurred by the Target Companies and their respective Subsidiaries in connection with any financing or capital obligations of the Target Companies or any of their respective Subsidiaries;

(xi) appropriate charges (determined by Parent in its reasonable discretion) for any capital or other funding (cash or securities) supplied by Parent to meet the capital requirements of the Target Companies and their respective Subsidiaries imposed by any Governmental Entity or SRO which directly regulates the Target Companies or any of their respective Subsidiaries (and does not relate solely to the Office of Thrift Supervision or other banking regulatory authorities); provided, however, that if any such capital or funding is required as a result of a voluntary action by Parent, including as a result of any withdrawal of regulatory capital from any Target Company or any of their respective Subsidiaries, the aggregate amount of any such capital charge will not in any fiscal period exceed 20% per annum calculated on a monthly basis of the gross amount of the capital or other funding provided by Parent;

(xii) appropriate charges (determined by Parent in its reasonable discretion) for any capital or other funding (cash or securities) supplied by Parent in connection with the acquisition of any Person made by Parent, the Target Companies or any of their respective Subsidiaries that will be consolidated or combined with the business of the Target Companies; provided, however, that the aggregate amount of any such capital charge will not in any fiscal period exceed 20% per annum calculated on a monthly basis of the gross amount of the capital or other funding provided by Parent in connection with any such acquisition; and

(xiii) any employee termination cost or expense or other costs and expenses relating to severance obligations arising out of any contractual or other arrangement entered into or agreed to by either Target Company or any of their respective Subsidiaries at or prior to the Effective Time.

(b) The calculation of Net Income shall exclude the effects of the following items:

(i) any expenses directly incurred by or on behalf of the Target Companies and their respective Subsidiaries in connection with the acquisition of the Target Companies by Parent at or prior to the Effective Time;

(ii) intercompany charges between either Target Company or any of their respective Subsidiaries and Parent other than those charges agreed to by the Operating Committee in writing;

(iii) any additional or reduced depreciation, amortization or other expense resulting from the write-up or write-down of any asset and any amortization of good will or other intangibles relating to the acquisition of the Target Companies by Parent;

(iv) any writeoffs of reserves reflected on the opening consolidated balance sheet of either Target Company, as adjusted by Parent, made pursuant to purchase accounting under GAAP in connection with the acquisition of the Target Companies by Parent;

(v) any writeoffs of overaccruals reflected on the opening consolidated balance sheet of either Target Company, as adjusted by Parent, made in conjunction with the purchase price GAAP adjustment;

(vi) any expenses incurred by or on behalf of Parent in connection with the acquisition of the Target Companies by Parent;

(vii) any portion of trading losses allocable to the holders of Class B member interests or Class C member interests issued by Momentum or any future member interests issued by Momentum, in each case pursuant to contractual arrangements with the Target Companies or any of their respective Subsidiaries;

(viii) except as otherwise specifically provided for in this Agreement, any costs and expenses relating directly to the integration, rationalization and consolidation of the Target Companies and their respective Subsidiaries with Parent or any of its Subsidiaries; and

(ix) any expenses related to the downsizing of the Houston, Texas office of Momentum in an aggregate amount not to exceed $500,000.

(c) The net income of the Target Companies and their respective Subsidiaries shall not include any benefits of the consolidation of services or facilities or other rationalization of the Target Companies and their respective Subsidiaries subsequent to the acquisition by Parent of the Target Companies if such consolidation of services or facilities or other rationalization imposes any material cost or expense on Parent or any of its Subsidiaries unless and to the extent a portion of the costs and expenses of such activities by Parent are borne by the Target Companies and their respective Subsidiaries and the amount of such benefit is agreed upon by the Operating Committee.

"New TRK Agreement" shall mean that certain agreement dated April 8, 2002 by and among Momentum, the Company, TRK and the TRK Executives.

"Person" shall mean any individual, corporation, partnership, limited partnership, limited liability company, other business organization, trust, association or entity or government agency or authority.

"Property" means all real property leased or owned by the applicable Target Company or their Subsidiaries, as the context requires, either currently or in the past.

"Put and Call Agreement" means the Put and Call Agreement, effective as of December 1, 1999 by and among Momentum, the Company, TRK and the TRK Executives, as modified by the Put Exercise Agreement and the Put Termination Agreement.

"Put Exercise Agreement" means the Put Exercise Agreement, dated August 28, 2001, by and among Momentum, the Company, TRK and the TRK Executives, as modified by the Put Termination Agreement.

"Put Termination Agreement" means the agreement, effective as of January 25, 2002, by and among Momentum, the Company, TRK and the TRK Executives.

"Put Termination Right" means the option to terminate the Second TRK Put Option granted by TRK and the TRK Executives to the Company and its Affiliates pursuant to the Put Termination Agreement.

"Second TRK Call Option" means the right to purchase all TRK Interests owned by TRK and the TRK Executives as of the date of exercise of such option granted to the Company pursuant to the Put and Call Agreement.

"Second TRK Put Option" means the right to require the Company to purchase all TRK Interests owned by TRK and the TRK Executives as of the date of exercise of such option granted jointly and severally to TRK and the TRK Executives pursuant to the Put and Call Agreement.

"Significant Disposition Payment Amount" means $10% of the net proceeds to the Company if such net proceeds are less than $120 million or $12 million if such net proceeds are greater than $120 million.

"Subsidiary" of any Person shall mean any corporation, partnership, limited liability company, joint venture or other entity in which such Person (a) owns, directly or indirectly, 50% or more of the outstanding voting securities or equity interests or (b) is a general partner or managing member.

"Surviving Corporation" shall mean each of the TTH Surviving Corporation and the MHI Surviving Corporation.

"Target Company Capital Stock" shall mean the TTH Capital Stock and the MHI Capital Stock.

"Target Company Revenues" shall mean for any fiscal period the combined, consolidated revenues of the Target Companies and their respective Subsidiaries, determined in accordance with GAAP as applied in the preparation of the financial statements of Parent and its consolidated Subsidiaries for the applicable fiscal period, with the following clarifications and modifications:

(a) Revenues shall include, without limitation, all revenues generated by the Target Companies and their respective Subsidiaries from (i) securities brokerage activities, including all commission revenue, net of any rebates paid, the revenues and cost savings generated by the internalization of securities trading activities through the use of technology held by the Target Companies or any of their respective Subsidiaries to the extent such internalization is approved by Parent in its sole discretion, payments for order flow rebates received and all other revenues derived from agency trading; (ii) trading activity by the Class B members or such future classes of member interests created pursuant to the terms and subject to the conditions of clause (d) of Schedule 1.18(e), to the extent such revenues are allocated pursuant to the applicable contractual arrangements to the Target Companies or one of their respective Subsidiaries; and (iii) software and technology licensing activities derived from any technology purchased by Parent from the Target Companies or any of their respective Subsidiaries;

(b) Revenues shall not include any revenues generated from or by Tradescape Online accounts;

(c) Revenues shall not include any increase in revenues occurring as a result of replacing the existing SouthWest or any future clearing arrangements with an arrangement with an existing or after acquired Affiliate of Parent;

(d) Subject to the limitations described in clause (a)(xii) above, Revenues of the Target Companies and their respective Subsidiaries shall include revenues from Persons acquired by Parent, the Target Companies or any of their respective Subsidiaries whose business or businesses will be combined with the business of the Target Companies;

(e) The revenues of each Target Company and its Subsidiaries shall be determined on a consolidated basis, and the revenues as so consolidated of both Target Companies shall then be combined, in each case in accordance with GAAP;

(f) Revenues shall not include any intercompany receivables (and shall not be reduced by any intercompany payables) by and among any of the Target Companies and/or any of their respective Subsidiaries;

(g) For purposes of the Net Income computation, to the extent any Revenues or expenses would not be taxable as a result of the pass-through nature of the Person involved, all Taxes computed with respect to such Revenues and expenses during any applicable fiscal period will be computed using Parent's effective Tax rates as applied by Parent;

(h) Revenues shall include any amounts actually received by Parent and any of its Subsidiaries as a result of the settlement or resolution of any pending or future claims, litigations or arbitral proceedings assigned to Parent or one of its Subsidiaries by the Company, in each case net of any related costs and expenses; and

(i) Revenues shall include any insurance proceeds with respect to any pre-Closing claim for coverage submitted to any insurer by the Company, the Target Companies and any of their respective Subsidiaries that is actually received by Parent or any of its Subsidiaries following the Closing

"Tax" (and, with correlative meaning, "Taxes" and "Taxable") shall mean any and all taxes, fees, levies, duties, tariffs, imposts, and other charges of any kind in the nature thereof (together with any and all interest, penalties, additions to tax and additional amounts imposed with respect thereto) imposed by any government or taxing authority, including, without limitation: taxes or other charges on or with respect to income, franchises, windfall or other profits, gross receipts, property, sales, use, capital stock, payroll, employment, social security, workers' compensation, unemployment compensation, or net worth; taxes or other charges in the nature of excise, withholding, ad valorem, stamp, transfer, value added, or gains taxes; license, registration and documentation fees; and customs duties, tariffs, and similar charges.

"Tax Return" shall mean any return, declaration, report or similar statement required to be filed with respect to any Tax (including any attached schedules), including, without limitation, any information return, claim for refund, amended return or declaration of estimated Tax and all federal, state, local and foreign returns, reports and similar statements.

"Trading Day" means a day on which trading generally takes place on the New York Stock Exchange and on which trading in Parent Common Stock has not been halted or suspended.

"TRK" means Tanzman, Rock and Kaban, LLC, a Delaware limited liability company.

"TRK Executives" means Jonathan Tanzman, Marc Rock and Jared Kaban.

"TRK Interests" means certain rights to payment under the TRK Service Agreement and the limited liability company interests in Momentum owned by TRK and the TRK Executives.

"TRK Service Agreement" means the Service Agreement dated December 1, 1999 among Momentum, the Company, TRK and the TRK Executives.

ARTICLE XIII

MISCELLANEOUS

13.1. Press Releases. Except as required by law, none of the parties to this Agreement shall issue any press release or otherwise make public any information with respect to the subject matter of this Agreement nor the transactions contemplated hereby, without the prior written consent of each of the other parties to this Agreement. In the event that a public release is required to be filed or released by law, the non-releasing party shall, if reasonably practicable be provided with a reasonable opportunity to review and comment on the proposed press release or other information prior to issuance.

13.2. Integration. This Agreement and the agreements expressly referred to or contemplated herein set forth the entire understanding of the parties hereto with respect to the transactions contemplated hereby, and, except as set forth in this Agreement, such other agreements, and the Exhibits hereto, there are no representations or warranties, express or implied, made by any party to this Agreement (or any of their Affiliates) with respect to the subject matter of this Agreement. Any and all previous agreements and understandings between or among the parties regarding the subject matter hereof, whether written or oral, are superseded by this Agreement and the agreements referred to or contemplated herein.

13.3. Assignment and Binding Effect. This Agreement may not be assigned by any party hereto without the prior written consent of the other parties. All the terms and provisions of this Agreement shall be binding upon and inure to the benefit of and be enforceable by the respective successors and assigns of the parties hereto.

13.4. Waiver. Any term or provision of this Agreement may be waived at any time by the party entitled to the benefit thereof only by a written instrument duly executed by such party.

13.5. Notices. Any notice, request, demand, waiver, consent, approval, or other communication which is required or permitted to be given to any party hereunder shall be in writing and shall be deemed given only if delivered to the party personally or sent to the party by facsimile transmission (promptly followed by a hard-copy delivered in accordance with this Section 13.5), by reputable overnight courier service or by registered or certified mail (return receipt requested), with postage and registration or certification fees thereon prepaid, addressed to the party at its address set forth below.

If to Parent or a Merger Sub:

E*TRADE Group, Inc.
4500 Bohannon Drive
Menlo Park, CA 94025
Attention: Russell S. Elmer, Esq.
Facsimile No.: (650) 331-6835
Telephone No.: (650) 331-5408

with a copy to:

Clifford Chance Rogers & Wells LLP
2001 K Street, N.W.
Washington, DC 20005
Attention: John P. Ketels, Esq.
Facsimile No.: (202) 912-6000
Telephone No.: (202) 912-5000

and

Clifford Chance Rogers & Wells LLP
200 Park Avenue
New York, NY 10166
Attention: Karl A. Roessner, Esq.
Facsimile No.: (212) 878-8375
Telephone No.: (212) 878-8000

If to the Company:

Tradescape Corp.
135 East 57th Street
31st Floor
New York, NY 10022
Attn: Chief Executive Officer

with a copy to:

Wollmuth Maher & Deutsch LLP
500 Fifth Avenue, 12th Floor
New York, New York 10110
Attn: Rory M. Deutsch, Esq.

Such notice, request, demand, waiver, consent, approval or other communication will be deemed to have been given as of the date so delivered.

13.6. Amendment. This Agreement shall not be amended, modified, revised, supplemented or terminated orally and no waiver of compliance with any provision hereof and no consent provided for herein shall be effective other than by a written instrument executed by all of the parties hereto. This Agreement may be amended upon the taking of requisite corporate action by all of the parties hereto.

13.7. Governing Law. THIS AGREEMENT SHALL BE GOVERNED BY AND INTERPRETED AND ENFORCED IN ACCORDANCE WITH THE LAWS OF THE STATE OF DELAWARE WITHOUT GIVING EFFECT TO ANY DELAWARE CHOICE OF LAW PRINCIPLES.

13.8. Third Party Beneficiaries. The representations, warranties, covenants and agreements contained in this Agreement are for the sole benefit of the parties hereto, and their respective successors and assigns, and they shall not be construed as conferring, and are not intended to confer, any rights on any other Person.

13.9. Severability. If any term or other provision of this Agreement is determined to be invalid, illegal or incapable of being enforced by any rule of law or public policy, all other terms and provisions of the Agreement shall remain in full force and effect. Upon such determination, the parties hereto shall negotiate in good faith to modify this Agreement so as to give effect to the original intent of the parties to the fullest extent Permitted by applicable law.

13.10. Extensions. At any time prior to the Effective Time, either party may by appropriate action, in writing, extend the time for compliance by or waive performance of any representation, warranty, agreement, condition or obligation of the other party.

13.11. Section Headings; Interpretation. All section headings are for convenience only and shall in no way modify or restrict any of the terms or provisions hereof. In this Agreement, words importing the singular shall include the plural and vice versa.

13.12. Exhibits; Disclosure Schedule. All Exhibits referred to herein and in the Company Disclosure Schedule are intended to be and hereby are specifically made a part of this Agreement. Each exception to a representation or warranty that is set forth in the Company Disclosure Schedule is identified by reference to, or has been grouped under a heading referring to, a specific individual Section of this Agreement and, except as otherwise specifically stated with respect to such exception in such Disclosure Schedule, relates only to such Section.

13.13. Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original.

13.14. Specific Enforcement. Each party expressly agrees that one or more of the other parties will be irreparably damaged if this Agreement is not specifically enforced. Upon a breach or threatened breach of the terms, covenants or conditions of this Agreement, the non-breaching party or parties shall in addition to all other remedies, be entitled to a temporary or permanent injunction, without any showing of any actual damage, or a decree for specific performance, in accordance with the provision hereof.

IN WITNESS WHEREOF, each of the parties hereto has executed, or has caused to be executed by its duly authorized representative, this Agreement as of the date first written above.

E*TRADE GROUP, INC.

/s/ JARRETT LILIEN

Name: Jarrett Lilien
Title: Chief Brokerage Officer

TTH ACQUISITION CORP.

/s/ RUSSELL S. ELMER

Name: Russell S. Elmer
Title: President and Chief Executive Officer

MHI ACQUISITION CORP.

/s/ RUSSELL S. ELMER

Name: Russell S. Elmer
Title: President and Chief Executive Officer

TRADESCAPE CORP.

/s/ OMAR AMANAT

Name: Omar Amanat
Title: Chief Executive Officer

TRADESCAPE TECHNOLOGY HOLDINGS INC.

/s/ OMAR AMANAT

Name: Omar Amanat
Title: President

TRADESCAPE MOMENTUM HOLDINGS INC.

/s/ OMAR AMANAT

Name: Omar Amanat
Title: President