



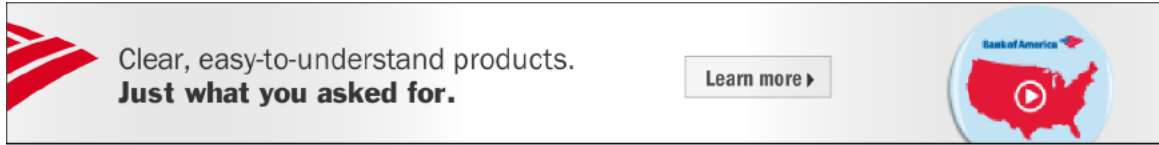
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J.P. Morgan Settles Alabama Bribery Case

By MARY WILLIAMS WALSH
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[J. P. Morgan](#) Securities will forfeit hundreds of millions of dollars in fees on [derivatives](#) contracts that it sold an Alabama county, under a settlement announced Wednesday that could offer hope to other governments staggering under similar deals.

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Dusty Compton/Tuscaloosa News

Larry Langford, a former public official, was convicted in the case.

The [Securities and Exchange Commission](#) charged in a [lawsuit](#) on Wednesday that J. P. Morgan had made unlawful payments to friends of Jefferson County's commissioners in a scheme to win lucrative business from the county to sell bonds and trade in derivatives.

The lawsuit also named two former J. P. Morgan employees. One of those men has already served a short prison term for manipulating similar bond deals in Philadelphia.

To settle the lawsuit, J. P. Morgan will drop its claims for \$647 million in termination fees it had been trying to make Jefferson County pay on the derivatives. The settlement also calls for J. P. Morgan to pay a \$25 million penalty to the commission and \$50 million to the county.

Over the last decade, thousands of governments around the country entered into deals linking bonds with derivatives, forming complex structures that were supposed to hold down borrowing costs. Many of the deals did not work out the way officials expected them to, partly because financial markets froze last fall and partly because interest rates moved sharply in

unexpected directions.

But not every local government can count on relief just because a financial mistake was made. The Jefferson County case involved clear-cut bribes and a criminal conviction, and other governments may be hard pressed to persuade their bankers to change their financial contracts unless they can show laws were broken.

The S.E.C. says the definition of improper activity varies by state, and it is pressing for a uniform federal standard.

Municipalities have another vexing problem as well. If they complain to their bankers about illegal activity in connection with a bond sale, the federal government could find that tax laws were violated, jeopardizing the important tax-exempt status of a town's [municipal bonds](#).

No other place has had problems on the scale of Jefferson County, the most populous county in Alabama. It has been sinking under a \$3 billion debt burden for several years, and the hundreds of millions of dollars in fees it owed J. P. Morgan on the derivatives compounded the problem. The county has made drastic cuts in services and has warned for months that it might have to declare bankruptcy.

The S.E.C. did not point to anything improper about Jefferson County's bonds, its derivatives, or with the once-popular concept of linking the two. Its complaint focused solely on what it called unlawful activity in J. P. Morgan's efforts to win the business.

It said the two former bank employees, Charles [LeCroy](#) and Douglas MacFaddin, had arranged for illegal payments of more than \$8 million to friends of the county commissioners, who then worked to make sure the commissioners voted to give J. P. Morgan contracts to underwrite the county's bonds and provide the derivatives, known as interest-rate swaps.

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A lawyer for Mr. LeCroy, Lisa Mathewson, said the S.E.C. had overstepped its jurisdiction and labeled permissible business practices as fraudulent.

A lawyer for Mr. MacFaddin, Richard F. Lawler, said his client denied violating any securities laws and believed he would be vindicated at trial.

The former County Commission president, Larry Langford, was convicted last week of accepting luxury gifts and cash totaling \$235,000 in connection with the scheme. He was serving as mayor of Birmingham, Ala., Jefferson County's largest city, but was automatically removed when he was convicted. The two former bank employees did not settle with the S.E.C. The suit said that J. P. Morgan passed the cost of the illegal payments to the county by charging above-market prices on the interest-rate swaps.

J. P. Morgan did not admit or deny any of the government's accusations. It said in a statement that it had discontinued its business of trading in derivatives with states and local governments. It also pointed out that the settlement did not impair any of Jefferson County's bonds.

"J. P. Morgan continues to work to achieve a responsible restructuring of Jefferson County's financial affairs," the bank said.

In Jefferson County, word of nearly \$650 million worth of debt forgiveness was not met with universal rejoicing. One former financial adviser to the county, Jim White, said the bank's forfeiture was not nearly enough to end the county's financial troubles.

Dropping the fees "has no practical consequence to Jefferson County, as there was no possible way the county could pay them," he said. As to J. P. Morgan, "I am morally certain that they wrote those termination fees off 18 months ago, since the claim is subordinate to \$3.2 billion of debt."

The county will still have to honor the payment schedule on that debt, which financed a sewer project. The bonds were of the type known as auction-rate securities, whose interest rates reset regularly and shot up during last year's financial turmoil.

Jefferson County embarked on the sewer project after its existing sewer system was condemned by the federal government. It had to raise a lot of money quickly, and was told it could save on the borrowing costs if it sold bonds with a floating rate. The interest-rate swaps were intended to provide a hedge in case interest rates rose. But interest rates fell sharply, making the hedge worthless to the county, despite all the high costs attached to it.

Kyle Whitmire contributed reporting.

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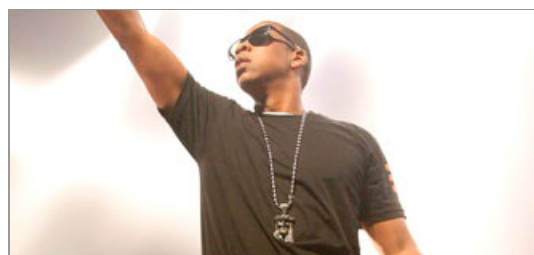
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