

The Plain & Simple

October 2008

Business Law

Volume VII

This publication has been produced by Duval & Stachenfeld's
[Distressed Real Estate Practice Group](#).

Our rule of thumb for our Plain & Simple newsletters is that we like to keep them to a single page. Given the momentous events that have been occurring in the economy in recent weeks, we have decided to break our rule and take a little more space than usual to provide you with a thumbnail sketch of what everyone has been calling the "bailout bill" - actually, the "Emergency Economic Stabilization Act of 2008," and the Troubled Asset Relief Program that is established under it.

The Emergency Economic Stabilization Act

On October 3, 2008, President Bush signed the Emergency Economic Stabilization Act of 2008 (the "Act"), which, among other things, establishes a program to be administered by the United States Department of the Treasury to purchase failing and troubled assets from financial institutions. The following provides a very brief overview of the more pertinent provisions of the Act.

Purposes of the Act

The stated purposes of the Act are (1) to immediately provide authority and facilities that the Secretary of the Treasury (the "Secretary") can use to restore liquidity and stability to the financial system of the United States; and (2) to ensure that such authority and such facilities are used in a manner that: (A) protects home values, college funds, retirement accounts, and life savings; (B) preserves homeownership and promotes jobs and economic growth; (C) maximizes overall returns to the taxpayers of the United States; and (D) provides public accountability for the exercise of such authority.

Summary of the Act

A. Troubled Asset Relief Program (the "TARP")

(1) Authority to Purchase Troubled Assets

Probably the most publicized portion of the Act is the part that authorizes the Secretary to establish the TARP to purchase troubled assets from financial institutions having significant operations in the United States and, in some instances, from foreign financial authorities and banks. The details of what will qualify as a "financial institution" have not yet been fully specified. This authority terminates on December 31, 2009, but may be extended to a date no later than two years from the enactment of the Act if the Secretary submits to Congress a written certification of need.

The troubled assets that are specifically targeted by the TARP are (i) any residential or commercial mortgages and any other securities, obligations, or instruments that are based on or related to such mortgages, that in each case was originated or issued on or before March 14, 2008, the purchase of which the Secretary determines promotes financial market stability, and (ii) after consultation with the Chairman of the Board of Governors of the Federal Reserve System, any other financial instruments that the Secretary concludes will promote financial market stability if purchased.

The Act contemplates providing the Secretary with access to funds in stages to purchase the troubled assets (the "Purchase Funds"). The Act immediately provides access to \$250 billion. Upon submission by the President to Congress of a written certification of need, an additional \$100 billion will be made available. Thereafter, the final \$350 billion will be accessible if the President submits to Congress a written report detailing the Secretary's plan and a joint resolution of disapproval is not passed within 15 calendar days of receiving such report.

(2) Purchase and Management of Troubled Assets

Generally, the Secretary is required to receive warrants for common stock or preferred stock (or senior debt instruments in some cases) from any financial institution selling its troubled assets. The purpose is to protect taxpayers from losses arising from the sale of the assets by the Secretary, cover administrative expenses of the TARP and also allow taxpayers to benefit from equity appreciation. The Secretary is to create a de minimis exception to these rules regarding stock warrants, based the aggregate amount of purchases from a particular financial institution (but the threshold for the exception cannot exceed \$100,000,000).

Although the Act encourages market pricing for assets, e.g., through an auction or reverse auction process, the Secretary has the flexibility to enter into direct purchases with a financial institution if a market mechanism is not feasible or appropriate (but in such instances the Secretary is to pursue additional measures to ensure that prices paid are reasonable and reflect the underlying value).

In making purchases, the Secretary is required to take all steps necessary to prevent the unjust enrichment of financial institutions participating in the TARP - specifically, the Secretary must ensure that a financial institution does not sell its troubled assets for a higher price than it paid to purchase those assets. The foregoing, however, does not apply to troubled assets acquired in a merger or acquisition, or a purchase of assets from a financial institution in conservatorship/receivership or that has initiated bankruptcy proceedings.

The Secretary has the authority to manage troubled assets it purchases and/or sells or engage in any other financial transactions relating to such troubled assets. Revenues and proceeds received by the Secretary in the selling of troubled assets or the surrender of warrants (or senior debt instruments) shall be paid into the general fund of the Treasury to pay down the national debt.

(3) Guidelines and Oversight

The guidelines for the TARP are not delineated in the Act. They are left to be established by the Secretary within the earlier to occur of (x) two business days after the first purchase of any troubled assets or (y) the date that is forty-five days after the enactment of the Act. Therefore - importantly - the Secretary has yet to establish mechanisms for purchasing troubled assets, methods for pricing and valuing troubled assets, procedures for selecting asset managers and criteria for selecting troubled assets for purchase. The Secretary must also issue any necessary regulations or guidelines with the aim of avoiding conflicts of interest in the administration of the TARP (e.g., conflicts arising in the hiring of asset managers and advisors) as soon as practicable.

It goes without saying that pricing is going to be absolutely key to the success of the program – if the government is too aggressive in keeping prices low then the volume of sellers will likely not be adequate for the TARP to achieve its goals, but if the government is too generous with pricing, the program runs a significant risk of being attacked for squandering taxpayers’ money. This is a particularly tricky issue now for reasons that reflect the problem that the Act is intended to cure – paying “over market” runs the risk of attack, but if market pricing is sought and the definition of “market” takes into account the lack of access to credit that many buyers face, the Treasury is no more attractive a buyer to a seller than other private entities (and, indeed, the various oversights, disclosures and limitations that come with doing business with the Treasury through the TARP may further discourage a seller).

Although many of the details of the TARP’s operation are not yet specified, it is clear that there will be market transparency for its operations – the acquisitions, prices and pricing mechanisms and other financial aspects of the deals will all be made public.

There are also several oversight bodies created under the Act. Among them are (1) the Financial Stability Oversight Board, which is responsible for reviewing the exercise of authority by the Secretary under the Act, making recommendations to the Secretary and reporting any suspected fraud; (2) the Office of the Special Inspector General for the Troubled Asset Relief Program, which will conduct audits and investigations of the Secretary’s actions; and (3) the Congressional Oversight Panel, which will review the state of the financial markets, the regulatory system and the use of authority under the TARP and report back to Congress every thirty days.

On the fifth anniversary of the enactment of the Act, the Director of the Office of Management and Budget is required to report to Congress on the net amount within the TARP. If there is any shortfall, the Act provides that the President shall submit to Congress a proposal that recoups from the “financial industry” (presently undefined) such shortfall amount. This is intended to ensure that the TARP does not add to the national debt or deficit. No details or guidelines regarding how this recoupment would occur are provided.

B. Authority to Insure Troubled Assets

Following the establishment of the TARP, the Secretary is required to set up a program for financial institutions who wish to insure their troubled assets. Under this insurance program, the Secretary may guarantee the timely payment of principal and interest, on such terms and conditions determined by the Secretary. The authority to provide such guarantees terminates on December 31, 2009, but may be extended as mentioned above.

Participating financial institutions must pay a premium to the Secretary (such amount to be set by the Secretary in accordance with certain minimum requirements). Premiums collected by the Secretary shall be deposited into the Troubled Assets Insurance Financing Fund (the “Insurance Fund”) established by the Secretary and such Insurance Fund shall be used to fulfill the guaranteed obligations under the insurance program.

The Purchase Funds available to the Secretary shall be reduced by an amount equal to the difference between the total amount of outstanding guaranteed obligations and the balance of the Insurance Fund.

C. Foreclosure Mitigation Efforts / Assistance to Homeowners

The Act requires that the Secretary and the Federal Housing Finance Agency, the FDIC and the Federal Reserve Board (collectively, the “Federal Property Manager”) undertake certain foreclosure mitigation efforts, to the extent any of them acquires any mortgages, mortgage-backed securities and other assets secured by residential real estate.

The Secretary shall implement a plan that maximizes assistance to homeowners and encourages the servicers of the underlying mortgages to take advantage of the existing HOPE for Homeowners Program or other similar programs guarding against foreclosures (the HOPE for Homeowners Program is a program Congress created to help certain homeowners at risk of default and foreclosure refinance into more affordable, sustainable loans). The Federal Property Manager shall also develop a similar plan within sixty days of the enactment of the Act. In addition, the Federal Property Manager shall encourage servicers to offer modifications to residential mortgage loans (such as reducing interest rates and loan principal) to prevent foreclosures. With respect to existing investment contracts, the Secretary is required to consent (when appropriate) to reasonable requests for loss mitigation measures (such as term extensions, rate reductions, principal write downs and increases in the proportion of loans within a trust allowed to be modified). The Secretary may also use loan guarantees and credit enhancements to facilitate loan modifications to prevent avoidable foreclosures.

D. Executive Compensation

Some financial institutions participating in the TARP shall be subject to new standards with respect to executive compensation and corporate governance.

If the Secretary purchases troubled assets directly from a financial institution where no bidding process or market prices are available and consequently receives a “meaningful debt or equity position” (presently undefined) in such institution, then such institution shall be required to comply with the Secretary’s standards for the executive compensation of its senior executive officers. For example, during any period of time that the Secretary holds a debt or equity position in the financial institution, (1) the institution must adopt limits on compensation that exclude incentives for senior executives to take unnecessary risks that threaten the value of the institution, (2) the institution must recover paid bonuses paid to senior executives which were based on earnings that are later proven to be materially inaccurate, and (3) the institution is prohibited from making any golden parachute payments to its senior executives.

The restrictions on financial institutions that are selling pursuant to an auction process are distinct from those applicable to financial institutions selling to the Secretary pursuant to “direct” purchases as described above. If a financial institution has sold to the Secretary exclusively pursuant to an auction process, the three limitations referenced above would not apply, but if the Secretary acquires troubled assets from a financial institution through an auction and such purchases are greater than \$300,000,000 in the aggregate (including any direct purchases from such institution), then such institution shall be prohibited from entering into any new employment contract with an executive that provides a golden parachute triggered by involuntary termination, bankruptcy, insolvency or receivership. The Secretary shall issue guidelines to carry out the foregoing within two months of the enactment of the Act.

There are additional tax implications for such companies that are detailed in the Act, including a limitation on the ability of a company to take a tax deduction for certain senior employees in excess of \$500,000 a year if the Treasury has acquired more than \$300,000,000 in assets (and such acquisitions were not exclusively direct purchases) from such company over all taxable years. Note that the \$500,000 threshold applies to all compensation, and performance-based compensation is not excepted.

E. Authority to Suspend Mark-to-Market Accounting

Interestingly, the Act gives the Securities and Exchange Commission (the "SEC") the authority to suspend the rules requiring "mark-to-market" accounting for any issuer or with respect to any class or category of transaction if the SEC determines that it is necessary or appropriate in the public interest and is consistent with the protection of investors. The Act also requires that the SEC, in consultation with the Financial Accounting Standards Board ("FASB") and the Secretary, conduct within ninety days a study on mark-to-market accounting standards, as applicable to financial institutions, to consider, at minimum, the following: (1) the effects of such accounting standards on a financial institution's balance sheet, (2) the impacts of such accounting standards on bank failures in 2008, (3) the impact of such standards on the quality of financial information available to investors, (4) the process used by FASB in developing accounting standards, (5) the advisability and feasibility of modifications to such standards, and (6) alternative accounting standards. Some commentators and industry insiders are of the view that the mark-to-market rules have been a leading cause of, or at minimum have exacerbated, the current economic situation; many will be watching to see (a) if the SEC takes the opportunity the Act grants it to suspend such rules (b) the scope of any such suspensions, and (c) the results of the SEC study.

Distressed Real Estate Practice Group

Duval & Stachenfeld has for the past decade positioned itself to be ready for the inevitable downturn in real estate by acquiring and training knowledgeable and talented lawyers in the critical areas for distressed real estate; namely, **real estate**, **bankruptcy** and **litigation**. In that regard, the Firm has established its Distressed Real Estate Practice Group to provide coordinated expertise in these legal areas and to provide advice and guidance regarding workouts, debt and equity restructurings and recapitalizations, bankruptcies, distressed debt and distressed property acquisitions and dispositions, and related litigation.

If you would like additional information regarding the substance of this Plain & Simple newsletter, please contact one of Duval & Stachenfeld LLP's [Distressed Real Estate Practice Group](#) chairs.

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