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Troubled Asset Relief Program - Understanding the Opportunities and Risks

Today Congress passed, and the President signed into law, the Emergency Economic Stabilization Act, a significant part of which includes the Troubled Asset Relief Program (the "TARP"). The TARP presents unique opportunities for many participants in the real estate and financial services industries, including banks, thrifts, credit unions and other regulated institutions, non-regulated finance companies, asset managers, master servicers, special servicers, hedge funds, private equity investors, distressed-debt funds, insurance companies, certain foreign investors, securitization trustees, administrative agents, "B-piece" investors and others.

The opportunities presented by the TARP are, however, coupled with uncertainties and risks that the attorneys of Locke Lord Bissell & Liddell LLP and the government relations specialists of Locke Lord Strategies are uniquely positioned to assess, mitigate and resolve on behalf of our clients. The experience of LLB&L attorneys in banking, financial, real estate, securities, litigation corporate and bankruptcy law, when coupled with the timely political intelligence, access and guidance offered by the Strategies professionals, will afford significant opportunities and support for those affected by the TARP.

Some commentators have said that, with the TARP, "Wall Street has moved to DC." LLB&L and Strategies have the attorneys and professionals in Washington, DC to monitor and influence the rapidly evolving details regarding the implementation of the TARP and identify any changes that result from its implementation. Strategies professionals and regulatory attorneys have extensive relationships with the members and staff of all the financial services committees in Congress as well as top officials in the federal departments and agencies that will be designing and implementing the TARP. Based on this access and experience, Strategies will be able to offer very timely political intelligence and guidance to potential TARP participants regarding the structure, rules and process that will ensure a

competitive advantage for LLB&L clients who are seeking involvement in the TARP. By combining this DC strategic advice with LLB&L's national breadth and depth, we are uniquely qualified to effectively address the issues that arise from the TARP for clients and assets throughout the country.

Sales to Treasury

Under the TARP, certain holders of "troubled assets" will be eligible to transfer those assets to the Treasury. There are many uncertainties under the TARP which must be clarified by the Treasury as to what types of holders will be eligible to sell assets, the types of assets eligible to be sold and the methodologies that will be used to price those assets. US banks, thrifts and other regulated institutions will be allowed to transfer troubled assets; however it is not clear whether other holders of these assets will be permitted to participate in the TARP. The troubled assets covered by the TARP include a broad range of distressed real estate related assets, including subprime, Alt-A, option ARMs, and other whole-loan residential mortgages, whole-loan commercial floating-rate and fixed-rate mortgages secured by all asset types, commercial mortgage backed securities (CMBS) investments, residential mortgage backed securities (RMBS), and investments in real estate collateralized debt obligation (CDO) bonds that are themselves comprised of investments in various real estate loans, mezzanine loans, CMBS, RMBS, and other real estate interests.

Before selling, potential participants in the TARP will have to seriously weigh the restrictions and requirements which will eventually be imposed on them by the Treasury and the resulting consequences on their ability to operate in the private market. There are, for example, significant executive compensation restrictions, claw back provisions and tax restrictions imposed on all selling entities where assets are purchased directly from the company and on those that sell through the auction process if the amount sold exceeds

\$300 million. Regardless of whether the assets are purchased directly or through the auction process, companies that sell more than \$300 million under the TARP will be subject to a \$500,000 limitation on the deductibility of compensation paid to any executive officer and will be subject to excise taxes with respect to the payment of any severance. In addition, in return for accepting troubled assets in excess of \$100 million, Treasury will receive warrants from a seller whose securities are traded on a national securities exchange, convertible to common or preferred stock or, in the case of a seller whose securities are not traded on a national securities exchange, senior debt. Structuring such warrants and complying with the seller's existing corporate, securities and regulatory requirements and covenants could prove difficult if not properly managed, particularly with respect to public companies since shareholder approval may be required.

The TARP provides that the Secretary must provide program guidelines which relate to mechanisms for purchasing troubled assets, methods for pricing and valuing troubled assets, procedures for selecting asset managers and criteria for identifying troubled assets for purchase; consequently, there will be significant opportunity for participants to influence the methods and procedures Treasury eventually adopts. The banking and government relations specialists of LLB&L and Strategies will be particularly helpful in this process to potential asset sellers given the many contacts we have with key Administration officials, Congressional members of both parties, Treasury and the FDIC.

Insurance of Troubled Assets

Under the TARP, the Secretary is mandated to establish a program to guarantee troubled assets originated or issued prior to March 14, 2008. The guarantee program will have a premium structure based on the credit risk associated with the particular troubled asset that is being guaranteed. Under this provision, the Secretary may guarantee 100 percent of

the principal and interest of the troubled asset on such terms and conditions as the Secretary determines. The proper classification for premium purposes is an issue which may have profound effect on institutions seeking assistance. Our attorneys have decades of experience relating to government classifications for purposes of insurance (for example risk weightings under Basel I and II) and can assist you in determining the premium structure that may apply to your particular assets.

Asset Management

After acquiring the distressed assets, Treasury will manage those assets, on behalf of U.S. taxpayers, in a cost effective manner pending ultimate resale to the private sector after the credit markets have stabilized. This asset management is a substantial function that will be largely handled by multiple contractors and asset managers hired by the government, which may include government agencies and private sector firms. Some of the asset management functions will be akin to those required of asset managers under the Resolution Trust Corporation (RTC) in the late 1980s. Indeed, there have been some discussions that the Treasury will rely on the FDIC for the management of assets. But whereas many of those assets under the RTC involved whole commercial or residential real estate loans and loan portfolios, the distressed assets under the TARP will include assets that are part CMBS, part RMBS, part CDO, part whole loan, as well as a mixture of other real estate related assets.

LLB&L attorneys have significant experience in dealing with these distressed assets. LLB&L's broad experience includes representing asset managers, securitization master servicers, special servicers, trustees, collateral managers and investors in connection with CMBS and CDO securities, pooling and servicing agreements for CMBS, CDO indentures, REMIC and other tax issues, Cayman SPV's, AMBAC/MBIA wrappers, GIC's, hedge and swap counter-

party exposures, credit default swaps, servicing and sub-servicing arrangements and asset sales, foreclosures and other dispositions throughout the United States. This experience will greatly assist asset managers and servicers in structuring their bids for this work, and after selection, in fully understanding their distressed asset portfolios, assessing their legal rights and benefits under the applicable documents governing those assets, managing those assets in the near term in a cost-efficient manner, and achieving ultimate resolution of those assets as soon as is commercially feasible.

Strategies professionals and LLB&L regulatory attorneys will assist in analyzing the regulations governing the submission of bids and proposals by potential asset managers to be chosen for such work. Strategies professionals will also assist in clarifying the rules governing the relationship between Treasury and the independent Financial Stability Oversight Board established under the TARP and the disclosures that must be made to that board, in order to confirm that all servicers and asset managers comply with the TARP's strict conflict of interest rules so as to ensure fair and impartial asset sales and dispositions.

Acquisition of Distressed Assets

Just as there were many opportunities for private investors in acquiring RTC-era assets, so too will there be substantial opportunities for investors interested in acquiring from Treasury troubled assets accumulated pursuant to the TARP, particularly those investors willing to act early in the process. Properly pricing such acquisitions requires detailed due diligence regarding control features, mandatory protective advance features, transfer provisions and other key provisions of the financial securities documentation, as well as a sophisticated understanding of the underlying real estate assets themselves, the legal rights relating thereto under state law as well as the legal impact on these assets from having been owned by the Treasury under the TARP. LLB&L attorneys have

substantial experience in creating, documenting and analyzing multiple CMBS and CDO transactions, in representing master servicers, trustees and special servicers in administering those assets, and in assisting government sector and private sector participants in sales and acquisitions of complex real estate related loans, assets and securities.

Acquisition/Sale and Merger of Banks and Financial Companies

As the Treasury begins to buy troubled assets under the TARP, the market will make necessary adjustments and as a result, some banks and financial institution participants will be able to survive and thrive, some will need to become a part of a larger company and others will ultimately fail. This scenario is similar to the savings and loan bailout of the early 1990's and is reminiscent of the Government's actions by the FDIC and the RTC in resolving failures during that crisis. As banks fail, the FDIC will try to resolve them as whole banks, or as recently done, take the bank as receiver and seek a resolution through the sale of the whole bank, bank assets or the assumption of deposit liabilities. Many times buyers will be searching for the best deals, which will most likely include some form of government assistance. The details of these forms of assistance will be worked out over time; however most of the terms will likely be negotiated on a case by case basis. Attorneys at LLB&L have significant experience in working with the FDIC and other bank regulatory agencies with regard to deals involving government assistance, including government assisted mergers, whole bank assistance, purchase and deposit liability assumption transactions, government forbearances and capital certificates.

Buyers will be very active in this market as troubled banks begin to seek resolutions through mergers, acquisitions and purchase and deposit assumption transactions. LLB&L attorneys have the breadth and depth to counsel both buyers and sellers of banking companies. Our attorneys have counseled

some of the largest to medium and small banks in mergers and acquisitions. We are experienced in performing legal due diligence, structuring transactions, and drafting necessary applications and securities documents, if required.

Regulatory/Corporate Matters

The TARP requires companies that sell troubled assets into the TARP to meet certain minimum corporate governance standards and limit compensation of executive officers. The TARP also limits the tax deductibility of compensation paid to executive officers of participating companies in excess of \$500,000. LLB&L is expert in advising clients on a host of regulatory matters, including corporate governance and compensation. We will be able to advise clients of the best methods to structure compensation and create corporate governance policies and procedures that meet the requirements of the TARP.

In addition, our attorneys are experts in advising clients on the impact that selling troubled assets into the TARP will have on the public perception of the company. Some commenters have speculated that companies selling trouble assets to the Treasury may be perceived as failing, regardless of whether that perception is correct. It is imperative then that participating companies work with knowledgeable counsel in structuring a sale that best limits the potential for negative feedback from the public.

Bankruptcy and Dispute Resolution

The TARP presents novel applications of the bankruptcy code. For instance, under the TARP, banks, insurance companies, investment firms and other companies designated by the Secretary of the Treasury will be permitted to sell troubled assets into the TARP. In the event of failure, only with respect to banks does the federal government have the ability to be appointed as receiver. All of the other institutions participating in the TARP will be required to file for bankruptcy in the

event of failure. This raises a multitude of issues when creditors are competing with the federal government over the remains of a failed company, including the prior right of the Federal government on senior debt and the elevation of shareholder claims from securities fraud. LLB&L has a first-rate national team of bankruptcy and restructuring attorneys in offices across the United States, providing experience and depth in virtually every aspect of corporate bankruptcy matters. We represent a vast array of creditors, including banks, other lenders, insurance companies, creditors' committees, investment funds, indenture trustees, corporations and government agencies.

With the government assuming the status of a company's major creditor, inevitably, disputes will arise among all the parties involved with TARP. Multiple issues are likely to arise in the event of the failure of an institution involved in the TARP. Therefore, companies that are doing business with an institution involved in the TARP must take preventative action in the event of failure and make appropriate contingency plans and assess its exposure. LLB&L Attorneys are experienced in working with clients to identify early on those assets over which litigation is likely to arise and to formulate a plan to quickly and efficiently resolve disputes through settlement discussions and mediation wherever possible. In the event a pre-litigation settlement or agreement cannot be obtained, and litigation is commenced, LLB&L has vast experience in the litigation over troubled assets, including, securities, real estate and banking litigation.

Additional Complexities

The TARP includes many additional provisions which are not highlighted here but that, nonetheless, can greatly impact a particular investor's legal and economic position including provisions that present significant tax and tax related issues. While each aspect of the TARP must be assessed in light of each client's unique circumstances, none of

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these issues alters the fundamental economic opportunities raised by the TARP.

For additional information as to how the attorneys of Locke Lord Bissell & Liddell and the government relations professionals of Locke Lord Strategies may assist you in connection with the TARP, you are invited to contact any of the members of the Troubled Asset Relief Practice Group listed below.

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