Recent Developments Related to the Emergency Economic Stabilization Act of 2008

On Friday, October 3, 2008 President Bush signed into law legislation known as the Emergency Economic Stabilization Act of 2008 (the "Act"), a bill intended to bring relief to the troubled credit markets. On October 6, 2008, Seyfarth Shaw LLP provided a Management Alert to clients and friends of the firm detailing generally the provisions of the Act (the "Original Alert"). Since such time, there have been a number of developments that have reshaped or clarified the way in which certain provisions of the Act will be implemented. For your convenience, set forth below is a summary of these recent developments and this Alert acts as a supplement to the Original Alert.

Capital Purchase Program

On October 14, 2008, the U.S. Treasury (the "Treasury"), pursuant to Section 101(a) of the Act authorizing the Secretary of the Treasury to "purchase, and to make and fund commitments to purchase, troubled assets from any financial institution, on such terms and conditions as determined by the Secretary," announced the implementation of a voluntary capital purchase program that would allow the U.S. government to purchase preferred shares from a broad array of financial institutions (the "Capital Purchase Program"). Under the Capital Purchase Program, the Treasury will purchase up to $250 billion of senior perpetual preferred shares (the "Senior Preferred Shares") from qualifying U.S. controlled banks, savings associations, and certain bank and savings and loan holding companies engaged only in financial activities ("Qualifying Financial Institutions") that elect to participate on or before 5:00 pm (EDT) on November 14, 2008 (foreign controlled institutions are excluded from participating). The Treasury indicated that it will purchase up to $125 billion of Senior Preferred Shares in nine large financial institutions that initially agreed to participate (JPMorgan Chase & Co., Citigroup, Inc., Wells Fargo & Co., Bank of America Corp. (combined with Merrill Lynch), Goldman Sachs Group, Inc., Morgan Stanley, State Street Corp. and Bank of New York Mellon) and it will determine eligibility and allocations for other interested parties after consultation with the appropriate federal banking agency.

The Senior Preferred Shares will have a liquidation preference of $1,000 per share and the minimum subscription amount available to a participating institution is one (1%) percent of risk-weighted assets (i.e., the assets of the applicable institution, weighted for credit risk according to a formula used by the U.S. Federal Reserve System (the "Federal Reserve")) and the maximum subscription amount is the lesser of (i) $25 billion or (ii) three (3%) percent of risk-weighted assets. The Treasury will fund the Senior Preferred Shares purchased under the program by year-end 2008.

The Senior Preferred Shares will rank senior to common stock and pari passu with existing preferred shares, other than preferred shares which by their terms rank junior to any other existing preferred shares. The Senior Preferred Shares will also (i) pay a cumulative dividend rate in the case of bank holding companies, and non-cumulative in the case of non-bank holding company banks, of five (5%) percent per annum for the first five (5) years and will reset to a rate of nine (9%) percent per annum thereafter, (ii) be non-voting, other than class voting rights on matters that could adversely affect the Senior Preferred Shares and (iii) be callable at par (plus accrued and unpaid dividends) after three (3) years from the date of issuance. Prior to the end of three (3) years, the Senior Preferred Shares may be redeemed with the proceeds from a qualifying equity offering of any Tier 1 (as such term is defined in the Basel I Accord) qualifying perpetual preferred shares or common stock. The Treasury is free to transfer the Senior Preferred Shares to a third party at any time.

For as long as any Senior Preferred Shares are outstanding, no dividends may be declared or paid on junior preferred shares, preferred shares ranking pari passu with the Senior Preferred Shares, or common shares (other than in the case of pari passu preferred shares, dividends on a pro rata basis with the Senior Preferred Shares), nor may the Qualifying Financial Institution repurchase or redeem any junior preferred shares, preferred shares ranking pari passu with the Senior Preferred Shares or common shares, unless (i) in the case of cumulative Senior Preferred Shares all accrued and unpaid dividends for all past dividend periods on the Senior Preferred Shares are fully paid or (ii) in the case of non-cumulative Senior Preferred Shares the full dividend for the latest completed dividend period has been declared and paid in full.

The Treasury's consent will be required for any increase in common dividends per share until the third (3rd) anniversary of the date of the investment unless prior to such third (3rd) anniversary the Senior Preferred Shares are redeemed in whole or the Treasury has transferred all of the Senior Preferred Shares to third parties. The Treasury's consent shall also be required for any share repurchases (other than (i) repurchases of the Senior Preferred Shares and (ii) repurchases of junior preferred shares or common shares in connection with any benefit plan in the ordinary course of business consistent with past practice) until the third (3rd) anniversary of the date of the investment unless prior to such third (3rd) anniversary the Senior Preferred Shares are redeemed in whole or the Treasury has transferred all of the Senior Preferred Shares to third parties.

The Qualifying Financial Institution must file a shelf registration statement covering the resale of the Senior Preferred Shares as promptly as practicable after the date of the investment and take all action required to cause such shelf registration statement to be declared effective as soon as possible. The Qualifying Financial Institution must also grant to the Treasury piggyback registration rights for the Senior Preferred Shares and will take such other steps as may be reasonably requested to facilitate the transfer of the Senior Preferred Shares including, if requested by the Treasury, using reasonable efforts to list the Senior Preferred Shares on a national securities exchange.

Qualifying Financial Institutions participating in the program must also adopt the Treasury's standards for executive compensation and corporate governance for the period during which the Treasury holds equity issued under this program. These standards generally apply to the chief executive officer, chief financial officer, plus the next three most highly compensated executive officers. Qualifying Financial Institutions must meet certain standards, including: (i) ensuring that incentive compensation for senior executives does not encourage unnecessary and excessive risks that threaten the value of the financial institution; (ii) required clawback of any bonus or incentive compensation paid to a senior executive based on statements of earnings, gains or other criteria that are later proven to be materially inaccurate; (iii) prohibition on the financial institution from making any golden parachute payment to a senior executive based on the Internal Revenue Code provision; and (iv) agreement not to deduct for tax purposes executive compensation in excess of $500,000 for each senior executive. See Section IV of this Alert for further details.

In conjunction with the purchase of Senior Preferred Shares, the Treasury will receive ten-year warrants to purchase common stock, exercisable at my time, with an aggregate market price equal to fifteen (15%) percent of the senior preferred investment. The initial exercise price on the warrants and the market price for determining the amount of warrants will be the market price of the participating institution's common stock at the time of issuance, calculated on a 20-trading day trailing average.

Temporary Liquidity Guarantee Program

On October 14, 2008, the Treasury also announced that the Federal Deposit Insurance Corporation ("FDIC") would temporarily guarantee certain senior debt of all FDIC-insured institutions and their holding companies, as well as deposits in non-interest bearing deposit transaction accounts (the "Temporary Liquidity Guarantee Program"). To implement the program, the FDIC Board approved the use of its statutory authority to prevent systemic risk under the FDIC Improvement Act of 1991.

Under the Temporary Liquidity Guarantee Program, the FDIC will guarantee certain newly-issued senior unsecured debt of banks, thrifts and certain holding companies that is issued between October 14, 2008 and June 30, 2009, in the event the issuing institution subsequently fails, or its holding company files for bankruptcy. This includes promissory notes, commercial paper and inter-bank funding. The amount of debt covered by the guarantee may not exceed 125% of debt outstanding as of September 30, 2008 that was scheduled to mature before June 30, 2009. For eligible debt issued on or before June 30, 2009, coverage would only be provided for three (3) years beyond that date, even if the debt in question has not matured.

In addition, any participating depository institution will be able to provide unlimited deposit insurance coverage for non-interest bearing deposit transaction accounts, regardless of the amount. Examples of these include payment-processing accounts, such as payroll accounts used by businesses. The current maximum guarantee limit is $250,000 and this new, temporary guarantee will expire on December 31, 2009.

All eligible FDIC-insured institutions will be covered under the Temporary Liquidity Guarantee Program for the first 30 days without incurring any costs. After that initial 30-day period, however, institutions wishing to no longer participate must opt out or be assessed for future participation (the FDIC will maintain and post on its website a list of those eligible entities that have elected to opt out and each eligible entity must make clear to relevant parties whether or not it has chosen to participate). Participants will be charged a 75-basis point annual fee (multiplied by the amount of debt covered by this program), and a 10-basis point surcharge will be added to a participating institution's current insurance assessment in order to fully cover the non-interest bearing deposit transaction accounts. If an institution opts out, the guarantees are good only for the first 30 days. Eligible financial institutions availing themselves of the guarantee program will be subject to enhanced supervisory oversight to prevent rapid growth or excessive risk-taking. The FDIC will determine eligibility in consultation with the institution's primary federal regulator.

Commercial Paper Funding Facility

The Federal Reserve announced on October 7, 2008 that it would establish a Commercial Paper Funding Facility (the "CPFF") program to provide liquidity to commercial paper issuers that might otherwise not be able to currently obtain funding through the issuance of commercial paper in the capital markets. On October 14, 2008, the Federal Reserve announced further details of its CPFF program, which provides a broad backstop for the commercial paper market. The CPFF will be structured as a credit facility to a newly-formed special purpose vehicle ("SPV") authorized under section 13(3) of the Federal Reserve Act and will serve as a funding backstop to facilitate the issuance of term commercial paper by eligible issuers.

The Federal Reserve Bank of New York (the "New York Fed") will commit to lend to the SPV on a recourse basis, with the loan being secured by all the assets of the SPV. Eligible issuers are U.S. issuers of commercial paper, including U.S. issuers with a foreign parent company.

The SPV will purchase from eligible issuers three-month U.S. dollar-denominated commercial paper through the New York Fed's primary dealers (including asset-backed commercial paper that is rated at least A-1/P-1/F1 by a major nationally recognized statistical rating organization ("NRSRO"), and, if rated by multiple major NRSROs, rated at least A-1/P-1/F1 by two or more major NRSROs.

The maximum amount of a single issuer's commercial paper the SPV may own at any time will be the greatest amount of U.S. dollar-denominated commercial paper the issuer had outstanding on any day between January 1 and August 31, 2008. The SPV will not purchase additional commercial paper from an issuer whose total commercial paper outstanding to all investors (including the SPV) equals or exceeds the issuer's limit.

Pricing will be based on the then-current 3-month overnight index swap rate plus fixed spreads at the time of its registration to use the CPFF and each issuer must pay a facility fee equal to 10 basis points of the maximum amount of its commercial paper the SPV may own. The SPV will cease purchasing commercial paper on April 30, 2009, unless the Federal Reserve extends the facility. The New York Fed will continue to fund the SPV after such date until the SPV's underlying assets mature.

Pacific Investment Management Co., or Pimco, will serve as asset manager for the Commercial Paper Funding Facility and State Street Bank and Trust Co. will serve as custodian.

Executive Compensation Issues

Guidance on Executive Compensation Limits

Both the Treasury and the Internal Revenue Service ("IRS") have issued preliminary guidance on the limits on executive compensation paid by financial institutions that participate in the Troubled Asset Relief Program ("TARP") under the Act. The preliminary guidance answers some basic questions about the limitations, but there are still many issues that need to be resolved.

As described in the Original Alert, the Act contains two sets of executive compensation limitations. Section 111 requires the Treasury to impose limits on the compensation paid by any financial institution that agrees to participate in one of the TARP programs. Section 303 modifies two provisions of the Internal Revenue Code to impose tax penalties on certain types of executive compensation paid by participating institutions. Thus, Section 111, which is under the jurisdiction of the Treasury, is contractual in nature and requires participating institutions to agree not to pay certain types of compensation, and Section 302, which is under the jurisdiction of the IRS, imposes automatic tax penalties on the actual payment of compensation.

Affected Executives

Both sets of restrictions apply to the same group of "senior executive officers" (individually an "SEO" and collectively, "SEOs"). The tax provisions under Section 302 use the term "covered executive" rather than SEO, but the definition is virtually identical and the term SEO will be used in this discussion. The SEOs include the participating institution's CEO, CFO, and three other most highly compensated executive officers. This is the same group of officers whose compensation must be disclosed in a public company's annual proxy, but there are a number of significant differences between the U.S. Securities and Exchange Commission's (the "SEC") proxy disclosure rules and the definition of SEO:

1. Most importantly, the limitations in the Act apply to both public and private companies. In order to identify the SEOs of a private company, the SEC rules are to be applied by analogy.
2. The SEC proxy rules identify the three (3) most highly compensated officers based on compensation earned during the preceding year. The tax rules under Section 303 use compensation earned during the same year that the tax penalties apply to. The Treasury rules under Section 111 are not clear as to which year's compensation is used, but the rules state that an institution must use its "best efforts" to identify the most highly compensated officers until the final compensation data are available. In some cases, this may require the institution to defer making payments to an executive until it is determined whether the executive is an SEO.
3. Both sets of rules apply not only to the participating financial institution itself, but to all members of its "controlled group", defined as a common parent company and all 80% owned subsidiaries. The rules apply to the CEO and the CFO of the parent company, but the other three officers may be employed by any member of the group. Thus, an SEO does not necessarily need to be employed directly by the institution participating in TARP to be affected.
4. The SEC proxy rules only apply to the person who is the CEO or CFO on the last day of the year. Both sets of rules in the Act apply to anyone who serves as CEO or CFO at any time during the year.
5. The Treasury rules under Section 111 of the Act, like the SEC proxy rules, apply on a year by year basis. However, under the tax rules, a person who is an SEO during any year in which the institution participates in TARP is "tainted" as long as TARP remains in effect, or for some purposes as long as any deferred compensation remains payable.
6. Both sets of rules provide that if an institution that is participating in TARP is acquired by an institution that is not participating, the SEOs of the acquirer do not become subject to the compensation rules solely by reason of the acquisition, but the SEOs of the target remain subject to the rules (even if not one of the most highly compensated officers of the new controlled group) for twelve (12) months for purposes of Section 111 of the Act, and as long as TARP remains in effect or deferred compensation is payable for purposes of Section 302 of the Act. The rules do not, however, address the opposite situation, in which an institution participating in TARP acquires an institution that is not participating. This situation has already arisen in the announced acquisition of National City Bank by PNC Financial Services, and it appears that the golden parachute payments to National City Bank officers will not be limited even though PNC Financial Services is participating in the Capital Purchase Program.

Limits on "Risky" Incentive Programs

An institution that participates in the Capital Purchase Program or in the program for the purchase of assets directly from a "potential failing systemically significant institution" (the "Direct Purchase Program") must limit the incentive compensation paid to its SEOs so that the incentive programs do not encourage the SEOs to take unnecessary and excessive risks. This rule does not apply to institutions that participate solely in the "troubled assets auction purchase" program (the "Auction Program"). Unlike the Capital Purchase Program, the Direct Purchase Program and Auction Program have been announced but not yet implemented.

In order to comply with this requirement, the participating institution's compensation committee, together with the institution's senior risk officers, must conduct an initial review of the institution's incentive compensation arrangements not later than 90 days after the institution begins participating in the program, and at least annually thereafter as long as the Treasury holds a debt or equity stake in the institution. The committee must also make modify incentive programs to eliminate unreasonable risks, and must certify to the Treasury that it has performed both the initial and each annual review.

Limits on Golden Parachute Payments

All three programs limit a financial institution's ability to make "golden parachute" payments to SEOs. For all purposes, a golden parachute payment includes any payment made to an SEO by reason of an involuntary termination, or in connection with the institution's bankruptcy or insolvency. An involuntary termination includes a resignation for good reason and a termination that is characterized by the parties as voluntary, if the facts indicate that the SEO would have been terminated had he not resigned.

1. An institution that participates in the Direct Purchase Program may not pay any golden parachute payment in any amount to an SEO as long as the Treasury maintains its debt or equity stake in the institution. It appears that an institution that already has in place agreements providing for golden parachute payments will need to renegotiate those agreements as a condition to participation.
2. An institution that participates in the Capital Purchase Program may not pay any golden parachute to an SEO, but only to the extent the total amount paid to the SEO exceeds three times the SEO's average annual compensation. The determination of whether parachute payments exceed the three times threshold is basically the same as under current §280G of the Internal Revenue Code, except that the restriction only apply to amounts that exceed the three times threshold. (Under §280G, once the three times threshold is exceeded, the tax penalties apply to all payments that exceed one times average annual compensation.)
3. An institution that participates in the Auction Program and that sells at least $300,000,000 of troubled assets to the Treasury (counting amounts sold under the Direct Purchase Program and the Capital Purchase Program) may not enter into any new agreements providing for golden parachute payments to any SEO that exceed the three times threshold. An employee's status as an SEO is determined when the agreement is entered into, rather than when the severance is paid. Renewals and material modifications are considered new agreements. Golden parachute payments under existing agreements are not prohibited, but under §280G as modified by Section 302 of the Act, if parachute payments to an SEO under an existing agreement exceed the three times threshold the tax penalties of §280G (including the 20% excise tax) will apply.

Mandatory Clawbacks

An institution that participates in the Capital Purchase Program or the Direct Purchase Program must include a clawback provision in its incentive plans that requires SEOs to repay any type of bonus or incentive payment that is based on materially inaccurate financial statements or other performance metrics. This rule does not apply to institutions that participate solely in the Auction Program.

The Treasury guidance notes that, unlike the clawback provision of the Sarbanes-Oxley Act of 2002, the clawback required by the Act is not limited to bonuses based on inaccurate financial statements but applies to any materially inaccurate performance metrics. The guidance does not elaborate on how the institution is to implement the clawback, but presumably participating institutions will be required to agree to modify their incentive programs as necessary to comply as a condition of participation. Renegotiation of existing employment agreements may also be necessary.

Overall Limits on Deductible Compensation

Finally, institutions that participate in any of the three programs (subject to the $300,000,000 threshold for institutions participating solely in the Auction Program) may not deduct more than $500,000 paid to any SEO in any year during which TARP is in effect, with no exemption for incentive-based compensation. Although the Act itself applied this rule only to institutions participating in Auction Program, the Treasury is requiring institutions that participate in the Capital Purchase Program or the Direct Purchase Program to agree not to deduct compensation paid in excess of the limit as long as the Treasury maintains its investment in the institution, with the limit prorated if the Treasury only has a stake in the institution for a portion of the year. This proration rule may have the perverse result that if an institution recovers sufficiently to repay the Treasury's investment its deduction limit will be further reduced in the year of repayment.

If an SEO earns deferred compensation while the institution is participating in one of the TARP programs, the portion of the deferred compensation that would have been nondeductible if paid currently continues to be nondeductible when paid, even if the officer is no longer an SEO or the institution is no longer participating in TARP. The IRS guidance provides fairly detailed examples illustrating how the $500,000 limit is applied in various deferred compensation situations.

Accounting Changes

On September 30, 2008, the SEC and the Financial Accounting Standards Board (the "FASB") issued joint guidance intended to give companies more flexibility in valuing financial assets in inactive markets under FASB Statement No. 157, Fair Value Measurements. On October 10, 2008, the FASB published FASB Staff Position No. 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active, which expanded on the guidance provided in the joint SEC/FASB release and provided a series of illustrative examples. The SEC and FASB guidance clarifies the application of FAS No. 157 as follows:

A. In determining fair value for a financial asset, the use of a reporting entity's own assumptions about future cash flows and appropriately risk-adjusted discount rates is acceptable when relevant observable inputs are not available. Regardless of the valuation technique used, an entity must include appropriate risk adjustments that market participants would make for nonperformance and liquidity risks.

B. The nature of market quotes from brokers should be weighed when considering the mix of available market information to determine fair value and less reliance should be placed on broker quotes in less active markets that do not reflect the results of market transactions. In cases where the volume and level of trading activity in the asset have declined significantly, the available prices vary significantly over time or among market participants, or the prices are not current, the observable inputs might not be relevant and could require significant adjustment.

C. The concept of a fair value measurement assumes an orderly transaction between market participants and thus distressed or forced liquidation sale scenarios should be weighed when determining fair value. Even in times of market dislocation, it is not appropriate to conclude that all market activity represents forced liquidations or distressed sales. However, it is also not appropriate to automatically conclude that any transaction price is determinative of fair value. Determining fair value in a dislocated market depends on the facts and circumstances and may require the use of significant judgment about whether individual transactions are forced liquidations or distressed sales.

D. A quoted market price in an active market for the identical asset is most representative of fair value and thus is required to be used (generally without adjustment). Transactions in inactive markets may be inputs when measuring fair value and should be considered by management if they are orderly, but would likely not be determinative.

E. A significant increase in the spread between the amount sellers are "asking" and the price that buyers are "bidding," or the presence of a relatively small number of "bidding" parties, are indicators that should be considered in determining whether a market is inactive.

F. In general, the greater the decline in value, the greater the period of time until anticipated recovery, and the longer the period of time that a decline has existed, the greater the level of evidence necessary to reach a conclusion that an other-than-temporary decline has not occurred with respect to the value of an asset. Factors to consider include the following:

1. The length of the time and the extent to which the market value has been less than cost;
2. The financial condition and near-term prospects of the issuer, including any specific events, which may influence the operations of the issuer such as changes in technology that impair the earnings potential of the investment or the discontinuation of a segment of the business that may affect the future earnings potential; or
3. The intent and ability of the holder to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in market value.

While this guidance may be helpful in certain circumstances, it fails to address the principal criticism of mark-to-market accounting: if liquidity risk, which is often substantial with respect to distressed assets, must be considered when gauging the cash flow of the distressed assets for purposes of determining their value under FAS No. 157, then the discretion and assumptions permitted by the new guidance will not provide any relief to reporting entities with respect to how they value the distressed assets.

Tax Changes

Current Recognition of the Tax Changes in Section 301 of the Act

On October 17, 2008, the federal banking and thrift regulatory agencies announced that they will allow banks, bank holding companies, and thrifts (collectively, "Banking Organizations") to realize the benefits of the tax change enacted in Section 301 of the Act in their third quarter 2008 regulatory capital calculations.

Section 301 of the Act allows Banking Organizations to treat any gain or loss from the sale or exchange of any "applicable preferred stock" as ordinary income or loss for federal income tax purposes. "Applicable preferred stock" is defined as preferred stock in Fannie Mae or Freddie Mac that was held by the applicable financial institution on or after January 1, 2008 and before September 7, 2008. Because the Act was passed in October of 2008, the Banking Organizations would otherwise not have been able to recognize the tax benefits of Section 301 until the fourth quarter of 2008. As a result of this decision, Banking Organizations may now realize the economic benefits of the change in the third quarter of 2008.

§382 Changes

Notice 2008-100 provides that if the Treasury purchases equity in a bank, that purchase will not be considered to contribute to an ownership change under §382 (which limits the use of net operating loss carryforwards and certain built-in losses following ownership changes). Share purchases, option exercises, and redemptions will be considered nonexistent and warrants will be treated as not exercised.

§597 Changes

The IRS also stated in Notice 2008-101 that cash assistance given to banks under the Act would not constitute taxable federal financial assistance under § 597 (which sets forth rules concerning the treatment of transactions in which federal financial assistance is provided). The notice has a statement saying that no inference should be drawn about the treatment of any other payments to banks.

Notice 2008-91

In Notice 2008-91, Treasury announced it will issue regulations providing that a "controlled foreign corporation" (a "CFC") may choose to exclude from the definition of the term "obligation" an obligation held by a CFC that would constitute an investment in U.S. property if the obligation is collected within 60 days of when it is incurred. The guidance is designed to facilitate liquidity for companies that are having trouble funding their operations in light of the United States' recent economic turmoil. The guidance supplements Notice 88-108, which provided that some 30-day obligations held by a CFC at the end of the year will not be treated as an investment in U.S. property under §956. According to the IRS, a CFC may apply Notice 2008-91 or Notice 88-108, but not both. The Treasury and the IRS plan to issue regulations under §956(e) following the issuance of the notice.

According to the IRS, the exclusion described in Notice 2008-91 does not apply if the CFC holds for 180 or more calendar days during its tax year obligations that, without regard to the 60-day rule, would constitute an investment in U.S. property. The notice applies only for a foreign corporation's first two tax years ending after October 3, 2008. However, the IRS clarified that the notice does not apply to a controlled foreign corporation's tax years that begin after December 31, 2009.

Hiring by the U.S. Treasury of Certain Advisers

Custodian

On October 14, 2008, the Treasury announced that Bank of New York Mellon ("BNYM") will serve as its custodian for the implementation of TARP authorized under the Act. The New York-based bank will help the Treasury with custodial, accounting, auction management and other infrastructure services necessary to administer the complex portfolio of troubled assets the Treasury will purchase.

As a custodial bank, BNYM manages twenty-three trillion dollars worth of assets for endowments, mutual funds and pension plans for whom it acts as a corporate trustee. It will play a similar role for the Treasury.

Among other things, BNYM will provide the accounting of record for the portfolio, hold all of its cash and assets, provide pricing and asset valuation services and assist with any other related services. It will also track unique asset attributes required by the Act, such as executive compensation limits and warrants received from selling institutions. Finally, BNYM will facilitate the acquisition of securitized assets by serving as auction manager and conducting reverse auctions for the applicable trouble assets and will provide all related infrastructure needs.

BNYM was one of seventy companies that bid for its three-year contract, and one of 10 that met the Treasury's minimum eligibility requirements to oversee TARP. All candidates were required to have at least $500 billion of U.S. assets under custody.

In addition to its appointment as TARP custodian, BNYM is also one of the nine initial financial institutions receiving capital injections under the Capital Purchase Program described in Section I of this Alert.

Legal Adviser

On October 10, 2008, the Treasury hired Simpson, Thacher & Bartlett LLP ("Simpson") to serve as legal adviser for the implementation of the Act.

Under the terms of its contract with the Treasury, Simpson will help with the "formulation of equity participation documentation including, but not limited to, co-investment accompanying private sector investment, shelf facilities for government investment without private sector investment, warrants or senior notes accompanying mortgage-backed securities or whole loan purchases, and other direct investments."

Simpson was one of six firms solicited by the government to provide legal advice with respect to the massive bank bailout package. Of the six approached by the Treasury, four firms withdrew themselves from consideration citing potential conflicts arising from representing the Treasury and their major banking clients at the same time. These firms were Cleary, Gottlieb, Steen & Hamilton, Davis, Polk & Wardwell, Wachtell, Lipton, Rosen & Katz, and an unnamed firm. Simpson and the undisclosed firm agreed to apply for the position.

Under the contract, which will last for six months, Simpson will be paid a maximum amount of $300,000.00.

Investment Adviser

On October 13, 2008 the Treasury announced that Ennis Knupp and Associates ("Ennis"), a consulting firm based in Chicago, will serve as its investment adviser for the implementation of TARP. The firm began work immediately to help the Treasury administer the complex portfolio of troubled assets it plans to purchase.

The Treasury hired Ennis to assist in evaluating potential asset managers and other vendors. The firm will also be responsible for developing and maintaining investment policies and guidelines and assisting with the oversight of the portfolio's multiple asset managers. This oversight includes determining asset allocations for and evaluating the performance and costs of each asset manager, avoiding conflicts of interest and identifying strategic investment and market issues impacting the overall portfolio.

Ennis will also conduct research on mortgage whole loan asset managers and servicing organizations. Finally, the firm will identify qualified minority- and women-owned businesses to provide services for the portfolio.

Ennis was hired using a procurement contract under the Federal Acquisition Regulation. The Treasury solicited bids from six companies and received bids from three before settling on Ennis.

Accounting Firm

On October 21, 2008 the Treasury announced that PricewaterhouseCoopers LLP and Ernst & Young will assist it in the implementation of TARP. The Treasury hired PricewaterhouseCoopers on Thursday, October 16 and hired Ernst & Young on Saturday, October 18.

The firms will help the Department with accounting and internal control services needed to administer the complex portfolio of troubled assets the Department will purchase, including whole loans and mortgage backed securities. PricewaterhouseCoopers will help the Department establish a sound internal control posture and Ernst & Young will provide general accounting support and expert accounting advice.

The agreements with the two Firms are each good through September 30, 2011. The Treasury issued two requests for quotes from 12 firms on the General Services Administration's Federal Supply Schedules on October 8. The Department received six responses for each request and awarded contracts to PricewaterhouseCoopers and Ernst & Young. The initial contracts are worth $191,469.27 and $492,006.95, respectively.

Approval by the Federal Reserve of the Wells Fargo/Wachovia Transaction

On October 12, 2008 the Board of Governors of the Federal Reserve approved Wells Fargo & Co.'s ("Wells") application to merge with Wachovia Corporation ("Wachovia") and all of its subsidiaries as well as the share exchange agreement previously negotiated between the two. In doing so, it removed the final regulatory hurdle standing in the way of the transaction's consummation. The merger remains, however, subject to the approval of Wachovia's shareholders.

In a controversial move that virtually guarantees Wells will win the eventual shareholder vote, Wachovia issued Wells ten shares of preferred stock in exchange for approximately 15.3 billion dollars. The move gives Wells preferred stock

representing 39.9% of Wachovia voting shares. The rules of the New York Stock Exchange, on which Charlotte, North Carolina-based Wachovia trades, normally require shareholder approval before issuing such preferred stock. Wachovia declined to seek such approval, however, citing an exception that allows a corporation to skip the vote if it determines that a delay in issuing the stock would endanger the company.

In response to the preferred stock issuance, a shareholder suit has been filed in the North Carolina Business Court seeking both a temporary and permanent injunction blocking the deal. The suit contends that the stock issuance is unnecessary and unfair to shareholders because the proposed price is too low and the issuance means any shareholder vote regarding the potential merger will be unfair. Issuing the stock, the plaintiffs claim, also effectively blocks any other potential bidders from offering a better price. The plaintiffs accuse Wachovia of breach of fiduciary duty in the deal and accuse Wells of aiding and abetting that breach.

No hearings have yet been set, but the plaintiffs hope to have hearings before the deal's anticipated closing date at the end of the year. If the deal closes before the case is heard, the suit asks the judge to undo the acquisition or award unspecified monetary damages.

Meanwhile, Citigroup, Inc. ("Citigroup") continued with a separate lawsuit against Wells and Wachovia in Manhattan federal court. Wells announced its agreement to acquire Wachovia just days after the federal government helped negotiate an agreement in principal in which Citigroup would acquire Wachovia's banking business for approximately $2.1 billion. Citigroup claims that the resulting letter agreement with Wachovia restricted Wachovia from entering into merger discussions with any other third party. In its complaint, Citigroup seeks more than $20 billion in compensatory damages and more than $40 billion in punitive damages from Wells for "tortious interference with Citi's contract with Wachovia," along with unspecified relief from Wachovia "for its bad faith breach of that contract." On October 14, 2008 Wells filed its own lawsuit requesting that the court block Citigroup from pursuing liability claims against it.

The resolution of both suits could turn on how the court interprets Section 126 of the Act. Section 126 provides that any agreement that "directly or indirectly affects, restricts or limits the ability of any person to offer to acquire or acquire" an insured depository institution is unenforceable as contrary to public policy. Wachovia and Wells argue that the letter agreement between Citigroup and Wachovia is just such an agreement and is therefore unenforceable under the Act. Citigroup, however, argues that Section 126 only applies to acquirers, in this case Wells, but does not permit the targets of such acquisitions to avoid their obligations under exclusivity agreements. Citigroup also argues that its agreement with Wachovia should be upheld for public policy reasons, insisting that the private sector should play a pivotal role in rescuing distressed financial institutions and that agreements such as this one assist in achieving that goal.

Conclusion

We expect that the implementation of the Act and the initiatives created under it will continue to evolve on a daily basis and we will continue to monitor events related to the Act and keep you apprised of any significant future developments.

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