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Eleventh Circuit Upholds Graves Amendment

By **Connie Ariagno**
and **David G. Mayer**

Congress enacted the Graves Amendment in August 2005 to bar vicarious liability claims against long-term lease and rental car companies. Often challenged in the courts, the dependability of the Graves Amendment has been undermined by inconsistent court rulings that subject lessors to the liability the Graves Amendment intends to prevent.

The U.S. Court of Appeals for the Eleventh Circuit in *Garcia v. Vanguard Car Rental USA, Inc.*, found Congress had the authority to enact the Graves Amendment under the Commerce Clause of the U.S. Constitution. See 540 F.3d 1242, 1252-53 (11th Cir. 2008). It also found that the Graves Amendment blocks vicarious liability of lessors arising out of motor vehicle accidents involving their lessees. Although *Garcia* does not answer all the questions pertaining to lessor liability in these instances, it represents the first time a federal appellate court has handed down a decision concerning the Graves Amendment that offers some relief for passive lessors against liability created by their lessees.

BACKGROUND

The *Garcia* case arose from a three-car accident involving a rental car. Jose Garcia and Nelson Ruiz died from the accident, and Israel Lopez suffered

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Summary and Analysis of the Troubled Asset Relief Program

By **Erik D. Klingenberg**

The United States is in the midst of the worst financial crisis since the Great Depression. The credit markets are barely functioning, numerous financial institutions are failing, and real estate values are plummeting. What started as a breakdown of the credit markets has spread throughout the entire economy. In an attempt to strike at the heart of the current credit crisis, the Emergency Economic Stabilization Act of 2008 (the "Act") establishing the Troubled Asset Relief Program (the "Program") was enacted on Oct. 3, 2008 in an effort to "restore liquidity and stability to the financial system of the United States." (Act at §2(1)). This article cuts to the substance of the Program, examining the provisions dealing with the actual purchase, management, and sale of troubled assets, with an eye toward the financial community.

PROGRAM OVERVIEW

Under the Program, the Secretary of the Treasury (the "Secretary"), acting through a newly created Office of Financial Stability, is authorized to purchase "troubled assets" from "any financial institution." (Act at §101(a)). Alternatively, the Program permits the Secretary to guaranty troubled assets. (Act at §102). In establishing and running the Program, the Secretary is permitted to designate "financial agents of the Federal Government" and form vehicles "to purchase, hold and sell financial assets and issue obligations." (Act at §101(c)(3) and (4)). The Act gives the Secretary significant authority and discretion to be exercised in a manner to protect the value of personal investments, minimize foreclosures, boost the economy, maximize the return on investments, and provide accountability to the public. (Act at §2).

Eligible Assets

"Troubled assets" are defined broadly as "residential or commercial mortgages and any securities, obligations, or other instruments that are based on or related to such mortgages," originated or issued on or before March 14, 2008, and "any other financial instrument that the Secretary ... determines the purchase of

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Graves Amendment

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severe injuries. The car rental company anticipated a claim for vicarious liability and therefore filed a declaratory judgment action seeking a declaration that the Graves Amendment pre-empts such claims. The estates and surviving spouses of Jose Garcia and Nelson Ruiz then filed wrongful death actions against the car rental company. The U.S. District Court for the Middle District of Florida granted summary judgment in favor of the car rental company. On appeal, estates and spouses of Jose Garcia and Nelson Ruiz presented the court with the issues of: 1) whether the Graves Amendment pre-empts the claims asserted by the estates and spouses of Jose Garcia and Nelson Ruiz; and 2) whether Congress had the authority to enact the Graves Amendment.

DECISION/ANALYSIS

The answer to both issues is "yes." The Eleventh Circuit Court of Appeals affirmed the grant of summary judgment in favor of the car rental company, finding the claims asserted by the estates and spouses of Jose Garcia and Nelson Ruiz are pre-empted by the Graves Amendment and are not within its savings clause. The court also found that Congress had the power to enact the Amendment under the Commerce Clause.

In this case, the suit against the car rental company was based upon

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the dangerous instrumentality doctrine and not upon any negligent or culpable action of the car rental company. Under the dangerous instrumentality doctrine, strict vicarious liability is imposed upon the owner of a motor vehicle who voluntarily entrusts that motor vehicle to an individual whose negligent operation causes damage to another. This doctrine applies to lessors of vehicles like the car rental company involved in the *Garcia* case.

In 1999, the Florida legislature imposed statutory caps on the amount of vicarious liability car rental companies could face under this doctrine. The statute provides, in part, that:

The lessor, under an agreement to rent or lease a motor vehicle for a period of less than 1 year, shall be deemed the owner of the vehicle for the purpose of determining liability for the operation of the vehicle or the acts of the operator in connection therewith only up to \$100,000 per person and up to \$300,000 per incident for bodily injury and up to \$50,000 for property damage. If the lessee or operator of the vehicle is uninsured or has any insurance with limits less than \$500,000 combined property damage and bodily injury liability, the lessor shall be liable for up to an additional \$500,000 in economic damages only arising out of the use of the motor vehicle. See Fla. Stat. §324.021(9)(b)(2).

This statute clearly imposes strict liability against a car rental company for the negligent acts of its lessee while placing a cap on the damages that can be awarded. The estates and spouses of Jose Garcia and Nelson Ruiz rely on this statute to sue the car rental company.

GRAVES AMENDMENT

PRE-EMPTION OF STATE LAW

The first issue questioned is whether or not the Graves Amendment pre-empts this statute and precludes the estates and spouses of Jose Garcia and Nelson Ruiz from bringing wrongful death suits against the car rental company.

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Assignments

Paying Agent Not Liable to Assignee

By Barry A. Graynor

Section 9406(a) of the Uniform Commercial Code provides that once an account debtor receives notification that the account has been assigned, the account debtor may discharge its obligation by paying the assignee and may not discharge the obligation by paying the assignor. This statute is critical to receivables financing, including factoring. In a recent opinion by the U.S. Court of Appeals for the Ninth Circuit, the court held that the account debtor's payment obligations do not extend to its agent. *Nationwide Transport Finance v. Cass Information Systems, Inc.*, 523 F.3d 1051, 65 UCC Rep.2d 709, 2008 U.S. App. LEXIS 9176 (9th Cir. 2008).

Nationwide is a finance company that purchases freight invoices from carriers or truckers who assign their payments under those invoices directly to Nationwide, a typical factoring arrangement. The account debtors are shippers or manufacturers who utilize the carriers to transport their goods across the country. The shippers contract with Cass Information Systems to handle the processing and payment of their freight invoices. The shipper pays Cass the funds needed to pay the invoices, and Cass, in turn, forwards these funds to Nationwide. The business relationship between Nationwide and Cass worked well for

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more than 17 years until one day Cass erroneously misdirected a payment to a carrier. Although Nationwide eventually got paid, Cass asserted its rights under a hold harmless agreement. This induced Nationwide to terminate the agreement. As a result, Cass refused to pay any future invoices to Nationwide.

Nationwide filed an action in the U.S. District Court for the District of Nevada alleging various Nevada state law causes of action, including intentional interference with contractual relationship and intentional interference with prospective economic advantage, based on the theory that Cass was motivated by an intent to get Nationwide's customers to use Cass' expedited payment service, which Nationwide alleged was a competitor. One of the elements of the tort claims was that Cass' conduct was "improper." Conduct specifically in violation of statutory provisions or contrary to established public policy may make interference improper. Accordingly, Nationwide set out to prove that Cass' conduct was improper because it violated or was contrary to Nevada Uniform Commercial Code §9406.

To support this theory, Nationwide sought to introduce the report and testimony of Robert Zadek, an expert on the Uniform Commercial Code. Cass filed a motion to strike Zadek's report and testimony, arguing the report was inadmissible legal opinion. The district court struck the portions of the report that discussed the law and its application but not the sections that discussed industry conditions and standards. This ruling was affirmed.

Nationwide also sought to put David Carney, Nationwide's credit administrator and co-owner, on the stand to testify regarding how the UCC is applied in the factoring industry. Cass again filed a motion to limit Carney's testimony on similar grounds. This ruling too was affirmed.

No one disputed the fact that the shippers were the account debtors, as defined in UCC §9102(a)(3), and that Cass was not an account debtor. The issue in this case was whether §9406 imposed legal obligations on the payment agent of the account debtor. The court held that it did not.

Nationwide made two arguments that §9406 was applicable to Cass: 1) under general principles of agency law, and 2) as a matter of industry conditions, standards, and practices.

GENERAL PRINCIPLES OF AGENCY LAW

The court first examined §9406 and noted that nothing in the plain language of the statute, nor any judicial decisions, supported Nationwide's theory that a payment agent of the account debtor has the same obligations to make payments as the account debtor. The court pointed to other sections of the Uniform Commercial Code which expressly impose duties on agents (*e.g.*, §8407) and concluded that §9406 was not intended to extend the duties of the account debtor to the account debtor's agents.

The court then turned to general principles of agency law, as enunciated in the Restatement (Third) of Agency. First, Nationwide pointed to the general rule that an agent is subject to liability to a third party harmed by the agent's tortious conduct. The court rejected this argument. An agent can be held liable for its own torts where the agent's conduct is independently wrongful; however, this begs the question as to whether Cass' conduct was independently wrongful. Nationwide hadn't proven that Cass had engaged in wrongful conduct. The Restatement does not set forth a rule that a principal's duties are imputed to its agent, such that an agent can be held liable if its acts violate a statute that only a principal is obligated to follow. Second, Nationwide pointed to the general principle of agency law that a principal may be bound by the actions of its agent toward a third party. But this argument was unavailing as well because here Cass was the agent, not the principal. The shippers may be bound by Cass' actions, but this does not mean that Cass has the statutory obligations of the shippers.

INDUSTRY CONDITIONS, STANDARDS, AND PRACTICES

The court then considered whether Cass' conduct did not comport with industry conditions, standards, and practices. Nationwide argued that Article 9 establishes "the

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rules of the game” for factoring transactions; Cass’ insistence on obtaining a hold harmless agreement as a condition of paying its factors was improper conduct because it violated “the rules of the game.” The court rejected this argument on the basis that Nationwide failed to introduce any evidence in support. In fact, one of Nationwide’s witnesses conceded that he was aware that many other factors had signed hold harmless agreements with Cass.

So in the face of the court’s holding, are factors such as Nationwide out of luck if the account debtor’s payment agent fails to pay the invoice? No, since the factor may still bring a legal action against the shipper (the account debtor). And if the payment agent’s failure to pay the factor breached the payment agent’s contract with the shipper, the shipper can also bring a legal action against the payment agent for breach of contract. As the court concluded, even though §9406 does not impose any obligations on the payment agent, neither the factor nor the shipper is without recourse if the payment agent fails in its duties.

THE DISSENT

Judge John T. Noonan, Jr. issued an interesting dissent. As he succinctly put it:

The majority says that there is no principle of agency that required the paying agent to pay. The principle is that an agent to make a payment is bound by its acceptance of the agency. If the obligation of the principal to pay is absolute under an applicable statute, as it was here, the agent has an absolute duty to make the payment. For the agent to hold up payment in order to obtain a benefit for itself is improper and, when it results in injury to the payee, is an actionable interference with a business relationship between the payee and its clients. 2008 U.S. App. LEXIS 9176 [*37]

The dissenting judge then described the context of the case: The economy of the United States runs on credit; factoring is a critical component. Nationwide is a factor, advancing cash to carriers, who are typically small trucking companies. Cass is a large company that processes more than 25 million freight invoices per year. When Cass stopped paying invoices assigned to Nationwide, the impact on Nationwide was “profound.” There was evidence that Cass was trying to compete with Nationwide.

To determine whether Cass acted improperly, the real question, according to the Restatement (Second)

of Torts, is whether Cass’ conduct was fair and reasonable under the circumstances. Did Cass abide by “the rules of the game”? According to the dissent, the jury could have found that it had not:

Properly instructed, the jury could have found that the shipper clients of Cass had an absolute duty under the U.C.C. to pay the carriers which shipped their goods; that Nationwide had been assigned all the rights of such carriers; that Cass had no right to demand a payment or any agreement as a condition for discharging a debt it was being paid to discharge and had agreed to discharge; and that Cass had acted unjustifiably to injure Nationwide as its competitor. 2008 U.S. App. LEXIS 9176 [*48]

As the dissent points out, Cass does not step into the shipper’s shoes in the sense that it must make payment if the shipper defaults; Cass is in the shipper’s shoes in the sense that it cannot insert conditions of its own before making payment.

The dissent warns that the majority position may put a severe crimp in the credit functioning of factors. It remains to be seen if this prediction comes true.



Graves Amendment

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The Graves Amendment has two operative provisions, a pre-emption clause and a savings clause. The pre-emption clause provides:

An owner of a motor vehicle that rents or leases the vehicle to a person (or an affiliate of the owner) shall not be liable under the law of any State or political subdivision thereof by reason of being the owner of the vehicle (or an affiliate of the owner) for harm to persons or property that results or arises out of the use, operation, or possession of the vehicle during the period of the rental or lease, if (1) the owner (or an affiliate of the owner) is engaged in the

trade or business of renting or leasing motor vehicles, and (2) there is no negligence or criminal wrongdoing on the part of the owner (or an affiliate of the owner). 49 U.S.C. §30106(a).

The claims the estates and spouses of Jose Garcia and Nelson Ruiz assert against the car rental company are clearly within the scope of this provision. Therefore, the Graves Amendment pre-empts these claims unless they fall within the statute’s savings clause.

The savings clause provides:

Nothing in this section supersedes the law of any state or political subdivision thereof – (1) imposing financial responsibility or insurance standards on the owner of a motor vehicle for the privilege of registering

and operating a motor vehicle; or — (2) imposing liability on business entities engaged in the trade or business of renting or leasing motor vehicles for failure to meet the financial responsibility or liability insurance requirements under state law. *See* 49 U.S.C. §30106(b).

The savings clause exempts from pre-emption laws that impose financial responsibility or insurance standards, or laws that penalize the failure to meet the financial responsibility or liability insurance requirements under state law. Therefore,
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which is necessary to promote financial market stability. ...” (Act at §3(9)(A) and (B)).

A wide range of financial assets are eligible for purchase under the Program. Almost all real estate related instruments are generally contemplated. Treasury has also interpreted troubled assets to include direct equity investments in banks. The voluntary Capital Purchase Program was enacted to encourage financial institutions to build capital to increase the flow of financing to support the economy.

Under the Capital Purchase Program, the Secretary is authorized to purchase up to \$250 billion of senior preferred shares in qualifying U.S. controlled banks, savings associations, and certain bank holding companies. The Secretary will determine specific eligibility and allocations for an interested financial institution after consultation with the appropriate federal agency that regulates such financial institution. Both the warrant provisions and executive compensation limits discussed later are applicable to the Capital Purchase Program. The deadline for election to participate in the program is Nov. 14, 2008.

Eligible Sellers

The Secretary may purchase troubled assets from any “financial institution” defined as “any institution ... established and regulated under the laws of the United States or any State ... and having significant operations in the United States, but excluding any central bank of, or institution owned by, a foreign government.” (Act at §3(5)).

To be eligible to sell troubled assets, a financial institution must not only be

established in the United States, but also must be regulated here. Federal and state chartered banks, insurance companies, broker-dealers, mutual funds, registered investment companies, and employee retirement plans are all eligible sellers. Any such institution may be owned by a non-U.S. entity other than a foreign government. The voluntary Capital Purchase Program has its own requirements for institutions which qualify under that program.

Program Limit and Term

The aggregate purchase price of troubled assets “outstanding at any one time” under the Program (the “Program Limit”) may not exceed \$250 billion, which may be raised by Presidential certification to \$350 billion and, unless rejected within 15 days after notice by Congress, further raised to \$700 billion. (Act at §115). The Secretary’s authority to purchase, commit to purchase or insure troubled assets (the “Program Term”) expires on Dec. 31, 2009, provided that the Secretary may extend such date to not later than Oct. 3, 2010. (Act at §120(a) and (b)).

For the duration of the Program Term, the Program will consist of a revolving fund (the “Fund”) that may be increased as assets are removed from the Fund. Sales or liquidations of troubled assets by the Fund will reduce the amount considered “outstanding.” After the Program Term, the Secretary will no longer be authorized to make commitments to purchase new assets or issue new guarantees; however, the Program will continue until all purchased assets have been sold or liquidated (and all guarantees have expired). During this time, the assets will continue to be serviced and managed for the Fund. It is probable that most sales and other financial transactions involving purchased assets will take place after the Program Term, when markets have, it is hoped, stabilized and losses are more determinable.

ASSET ACQUISITION AND INSURANCE

Purchases of Troubled Assets

The centerpiece of the Program is the Secretary’s ability to purchase troubled assets from ailing financial institutions in an attempt to stem the

write-downs and losses being taken by such institutions. By establishing “market” prices for troubled assets and providing liquidity to the market, the Program also seeks to encourage private participants to begin purchasing mortgage-related and other structured products as well. In furtherance of these goals, Treasury will publish program guidelines within the earlier of two days after the first asset purchase or 45 days after enactment of the Act. (Act at §101(d)). Given the breadth of affected assets and institutions, we expect the program guidelines to be general, ensuring broad discretion and flexibility in their implementation.

Process and Pricing

In making purchases under the Program, the Secretary has broad discretion to purchase assets subject to the requirement that the Program “minimize any potential long-term negative impact on the taxpayer.” (Act at §113(a)(1)). In that regard, the Secretary must purchase assets at the lowest price consistent with the Act’s purposes and is encouraged to use market mechanisms, such as auctions and reverse auctions, to accomplish that goal. (Act at §113(b)(2)).

Purchases may be made directly from an institution or through an open market auction process. In cases where the Secretary determines it is necessary to purchase directly from an institution, the Fund must obtain “meaningful” equity or debt interest in the selling institution, and significant executive compensation limits will be imposed on such institution. (Act at §111(b)). Furthermore, the Capital Purchase Program lays out detailed warrant provisions and requirements for when Treasury will make a direct investment in the equity of a qualifying financial institution.

Establishing the price at which the Fund will purchase troubled assets will be the key to its success. There are billions of dollars of private funds available to purchase distressed assets. For the most part, these funds have not been activated yet because potential sellers are unwilling to take the losses that would result from the prices that potential purchasers are seeking. There will be significant

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pressure to balance the demand to maximize the return to taxpayers and the need to minimize losses to selling institutions.

Indications to date, including testimony by Federal Reserve Chairman Ben S. Bernanke, indicate that prices will give greater consideration to expected losses and future cash flows than current distressed market prices. However, more distressed institutions or institutions with less exposure to certain asset types may be willing to sell at lower prices. Once prices have been established for a particular class of assets, there will be pressure on other institutions to mark (or sell) their similar assets at similar prices. In addition, not all assets of the same type are created equal.

The Act expressly permits financial institutions to make a profit on the sale of assets acquired in a merger or acquisition (such as the Merrill, Wamum, and Wachovia transactions) or from an institution in bankruptcy, conservatorship, or receivership (such as IndyMac or Lehman). This provision should make it easier for troubled institutions to find willing merger partners, by not only reducing the risk associated with troubled assets held by such institutions but also making it possible to profit from troubled assets acquired in such transactions.

Purchase Conditions

Congress required that certain punitive conditions be imposed on all but the smallest sellers of troubled assets and authorized the Secretary to impose any other conditions deemed appropriate.

1. Warrants/Senior Debt

In any purchase (other than de minimis purchases of not more than \$100 million), the Secretary must receive, in the case of an exchange traded institution, warrants to purchase nonvoting common or preferred stock and, in the case of all other institutions, either warrants or senior debt instruments. (Act at §113(d)). The warrants or debt obtained must be designed to ensure reasonable participation in the ap-

preciation in value of the institution or a reasonable rate of return in the case of debt instruments. (Act at §113(d)(2)(A)(i) and (ii)). Any warrants must contain appropriate market standard anti-dilution provisions. (Act at §113(d)(2)(D)).

2. Executive Compensation

If the Fund purchases assets directly from an institution, the Secretary must also require the institution to "meet appropriate standards for executive compensation and corporate governance." (Act at §111(b)(1)). Such standards must exclude incentives for senior executive officers of a financial institution to take unnecessary and excessive risks, provide for the recovery of any bonus or incentive compensation paid to a senior executive officer based on earnings or other criteria that are later proven to be materially inaccurate, and prohibit golden parachute payments to its senior executive officer during the period that the Secretary holds an equity or debt position in the financial institution. (Act at §111).

If the Fund purchases any assets through an auction process, and the aggregate purchases from the selling institution exceed \$300 million (including direct purchases), the institution will be required to adopt less severe restrictions on executive compensation. (Act at §302(a); *see also* 26 U.S.C. §162(m)).

3. Market Conditions and Criteria

A variety of market conditions and criteria will be imposed upon the purchase of troubled assets. Standardized purchase agreements presumably will be created for the Program, which will vary depending on the type of assets being purchased and whether the assets are acquired directly or through an auction. Each agreement will need to address delivery and custody issues (including required documentation), due diligence, representations and warranties, and servicing issues. For securities, diligence regarding control rights and other legal priorities and remedies may be crucial.

Due Diligence. It is expected that the Fund will perform some level of due diligence with respect to troubled assets that it purchases under

the Program. Any such diligence would be potentially more extensive for residential or commercial whole loans, REO properties and participation interests (collectively, "Real Estate Assets") than for securities. Items which should be explored include property value, legal compliance, borrower credit files, borrower credit, including updated credit scores and other customary borrower and collateral due diligence.

Representations and Warranties.

There is a significant difference in sellers' representations and warranties in the market today compared with a year ago. Sellers are making fewer representations, and, as noted above, purchasers must rely more on due diligence. However, it is unclear the extent to which the Fund will require representations and warranties on Real Estate Assets that it acquires. At a minimum, it is expected that sellers will be required to warrant good title; however, whether the Fund will insist on market standard "whole loan" representations and warranties is unclear. The Fund should weigh the value of representations and warranties against the creditworthiness of the particular seller.

Servicing and Control Issues.

Servicing and control issues will be a significant factor in determining which assets the Fund purchases and how it prices them. Real Estate Assets will command a higher price if sold "servicing released," in which case, the Fund will be able to sell the servicing rights to a servicer selected by the Fund. Given the modification and homeowner protection requirements of the Act, it is likely that the Fund will attempt to control the appointment of servicers to the greatest extent possible.

The Fund may also acquire subordinate tranches of residential and commercial mortgage-backed securities and other securities ("Real Estate Securities"), which may include the "first loss" or "B-piece" or pieces. By purchasing such positions, the Fund may be able to acquire control over the servicing or obtain some form of special servicing rights for

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servicing delinquent mortgage loans or REO, which may be particularly appealing to the Fund with respect to its foreclosure mitigation directive. Through these rights, the Fund could control the servicing of the mortgage loans with generally the same financial impact as if the Fund owned the mortgage loans directly.

Acquisition Vehicles

The Act permits the Secretary to establish vehicles “to purchase, hold, and sell troubled assets and issue obligations.” (Act at §101(c)(4)). Subject to the general purposes of the Program, there is no restriction on the type or number of vehicles that the Secretary may establish.

The Secretary will not have to consider the tax, limitation of liability, and bankruptcy issues that private institutions must consider when forming entities to hold assets. As a result, the form of vehicle used will likely relate more to convenience, flexibility, and suitability for the assets being held and the types of obligations that may be issued.

Troubled Asset Insurance

As an alternative to selling assets to the Secretary, financial institutions may request that the Secretary guarantee the timely payment of principal of, and interest on, troubled assets, including mortgage-backed securities. (Act at §102). The limit on the Secretary’s spending authority for the Program will be reduced by the excess of the “total outstanding guaranteed obligations [over] the balance in the Troubled Assets Insurance Fund.” (Act at §102(c)(4)).

The insurance program seems most appropriate for senior/super-senior securities that have little risk of loss but are nonetheless depressed in value given the general lack of liquidity. These securities are highly illiquid in the current environment and given the low risk, premiums should be low, and, with a TARP guaranty, these otherwise distressed securities would have the benefit of the equivalent of the full-faith and credit of the U.S. government, increasing their value and liquidity. On the other hand, the

high premiums required to cover expected losses are likely to discourage the use of the insurance program for riskier assets. Targeted use of the insurance program, however, could result in a very efficient use of amounts available under the Program Limit.

Management and Servicing

The basic provisions related to the Secretary’s general authority to manage assets purchased under the program are straightforward and extremely broad. (Act at §106(a), 106(b) and 101(c)(4)). This broad authority is qualified with respect to residential products by the requirement that the Secretary “encourage the servicers of the underlying mortgages ... to minimize foreclosures [and] to facilitate loan modifications to prevent avoidable foreclosures.” (Act at §109(a)).

The Act further provides that, except as established in any contract, a servicer of pooled residential mortgages will be deemed to act in the best interests of all investors if the servicer implements a workout plan involving reasonable loss-mitigation measures, including partial payments. This further broadens protections which were granted to servicers pursuant to §1403 of the Housing and Economic Recovery Act. This provision, along with §109(b), effectively opens up the safe harbor to situations where the loan is not in default and to non-owner occupied residences.

In addition, the Secretary may use loan guarantees and credit enhancements to facilitate loan modifications to prevent avoidable foreclosures. (Act at §109(a)). If the Secretary were to make available credit enhancement that covered specific loans that had been modified, this could alter the equation of the servicer’s net present value determination. If credit enhancements were added that eliminated re-default risk, the servicer would effectively be able to offer more favorable modification terms to the borrower while still complying with its contractual duties under the securitization documents.

Thus, under the Program, the Secretary has a very meaningful

opportunity to bring market pressure to bear on servicers to adopt specific approaches to loan modifications and workouts, not only for whole loan pools purchased under the Program but also for mortgage-backed securities.

SALE AND FINANCING OF PURCHASED ASSETS

The provisions regarding the sale of assets purchased under the Program are brief and to the point. (Act at §106(c) and 113(a)(2)). It is unlikely that troubled assets purchased under the Program will be resold quickly. The primary purpose of the Act is to “restore liquidity and stability. ... ” (Act at §2(1)). Actual losses on most troubled assets are expected to be significantly less than the decline in market value on those assets. Thus, by removing troubled assets from the market and the balance sheets of financial institutions, the Secretary can hold assets until the market stabilizes and the actual losses become more certain.

When assets are resold, it is expected that in many cases new securities will be created, taking into account then-current assumptions about losses and required spreads. In such cases, existing securities would be repackaged into new securities. Due to the Program Limit, it is also possible that some assets may be repackaged to increase credit enhancement (reducing or eliminating expected losses) and resold fairly quickly, thereby increasing the number of troubled assets that the Program can purchase.

CONCLUSION

The Secretary has significant authority to provide stability and liquidity to the capital markets through the Program. There will be many opportunities for financial institutions to participate in the process, as sellers managers, servicers, advisers, or investors. We are confident that the financial community will bring its collective knowledge, experience and, of course, capital, to bear on rebuilding the capital markets and providing (rational) financing for individuals and businesses around the world.



IN THE MARKETPLACE

Tygris Commercial Finance Group, Inc. of New York has named **Lawrence G. Hund** as its chief financial officer. He will oversee all of Tygris' treasury, accounting, tax,

planning and analysis, and financial operations. In addition, Hund will be a member of the executive committee and report to Frederick E. "Rick" Wolfert, chief executive offi-

cer of Tygris. Previously, Hund was vice president and chief financial officer of Bridge Finance Group.



Graves Amendment

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states may suspend the license and registration of, or otherwise penalize, a car owner who fails to meet the financial responsibility requirement or who fails to pay a judgment resulting from a collision, but they cannot impose judgments against rental car companies based solely on the negligence of their lessees.

The estates and spouses of Jose Garcia and Nelson Ruiz argued their claims were within the savings clause because the Florida statute was a financial responsibility law. The court rejected this argument, interpreting the term "financial responsibility" as referring to "insurance-like requirements" and not vicarious liability provisions. The court concluded that the pre-emption clause would be surplusage if the liability provision of the Florida statute was construed as a "financial responsibility" requirement. Therefore, the Graves Amendment pre-empts the liability claims against the lessor under the Florida statute.

CONGRESSIONAL POWER TO PRE-EMPT STATE LAW

The next issue questioned is whether Congress can enact this pre-emptive legislation under the Commerce Clause. Under the Commerce Clause, Congress may regulate purely intrastate activities when they "substantially affect" or have a "substantial relation to" interstate commerce. The commercial leasing of cars is, in the aggregate, an economic activity with substantial effects on interstate commerce. This categorization stems from the size and national scope of

the industry, and because rental cars are frequently employed as instrumentalities of interstate commerce.

For regulation of intrastate activities to survive review under an aggregation analysis, Congress need only have a rational basis for concluding that the intrastate activity would undermine the lawful Commerce Clause goals of a federal statute if left untouched. Congress could have perceived strict vicarious liability for the acts of lessees as a burden on the commercial leasing of cars industry because the costs of strict vicarious liability against rental car companies are borne by someone, most likely the customers, owners, and creditors of rental car companies. This liability would make rental cars more expensive and thereby inhibit interstate commerce. Additionally, if the costs are passed on to the owners of car rental companies, it could drive less-competitive companies out of the marketplace and inhibit entry into the market, potentially reducing options for consumers. Therefore, Congress had a rational basis for enacting the Graves Amendment, and Congress had the authority to enact same.

CONCLUSION

The *Garcia* case is an important case of first impression. No other federal appellate court has analyzed the pre-emptive scope of the Graves Amendment or its constitutionality. The decision in *Garcia* is binding over federal cases originating in the states of Alabama, Florida, and Georgia. It is not binding upon federal cases originating in other states, but is persuasive authority for district courts in other states and for other U.S. Courts of Appeal.

The *Garcia* case was recently followed in an *en banc* decision by the Fourth District Court of Appeal of Florida in *Vargas v. Enterprise Leasing Co.*, 2008 WL 4756388 (Fla. 4th DCA, Oct. 31, 2008) (not released for publication). The facts of *Vargas* involve a rental car accident where the plaintiff alleged the lessee to be at fault for the accident. The plaintiff also sued the car rental company under the dangerous instrumentality doctrine. The plaintiff relied on the same Florida statute as the plaintiffs in the *Garcia* case. Though the *Vargas* court followed the analysis of *Garcia* without detour, the court certified the pre-emption question to the Florida Supreme Court, as there is a split decision between the Florida District Courts of Appeals.

Unless the U.S. Supreme Court reverses the *Garcia* decision or overrules the *Vargas* decision in another case, the focus in future cases is likely to be whether the statute at issue is a financial responsibility or a strict liability statute. In the ordinary course of business, vehicle lessors should maintain insurance that meets or exceeds the insurance coverage requirements under applicable state law to demonstrate financial responsibility and to avoid the uncertainty of exposure to strict liability for a lessee's accidents.

Although lessors will not be free of disputes under the Graves Amendment, the *Garcia* and *Vargas* decisions give lessors an off ramp from vicarious liability for the lessees' accidents on roads and highways in the United States.



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