

Matthew Allen

Continued from page 11

asset backed securities which are then purchased by the CDO manager for his asset pool. And there might be all sorts of cross holdings in terms of directorships and equity holdings.

These were known conflicts within this industry which were recognized and often disclosed. But there are other conflicts which were not disclosed and arguably were misrepresented. The one that keeps coming up is the situation where the CDO manager was an equity noteholder in the deal. This was actually sold in most instances as a deal benefit; the idea being that if the CDO manager has skin in the game, then he ought to be incentivized to perform to the best of his abilities for the benefit of all noteholders.

Unfortunately, because of the way the subordination operates if you are an equity noteholder then clearly you are at greatest risk of losing your capital and you are therefore incentivised to carry out a high correlation low diversification investment strategy. That is to say, it is in your interests to put all of your eggs into one basket because that offers you the best possible chance of you getting your money back. The downside to that is that it also increases the likelihood of investment grade noteholders also losing their money. Their interests are best served by a highly diversified investment strategy, so you have immediate tensions built into these deals as a consequence of the manager being an equity noteholder.

The other aspect to this is, as an equity noteholder, your main interest in the deal is the excess spread, by which I mean that, to the extent the collateral pool can generate income in excess of the liability to pay the coupon on the notes, the excess spread goes to the benefit of the equity noteholders. What that does is to incentivise the manager, as an equity noteholder, to pursue a high yield strategy. The more likely a bond or credit asset is to default the higher the yield or the higher the spread. Increasing the excess spread is in the manager's interest, but from the investment grade noteholders point of view this was not so great because they were looking for more security and overall asset credit quality.

What happens as part of the syndication is a process of subordination with the default risk being concentrated on the equity noteholders. The idea is that they act as a buffer with the result that the deal will have to lose a lot of money before it starts affecting the mezzanine noteholders, let alone the AAA investors. However, with the CDO manager incentivized to put all his eggs in one basket and to pursue a high yield strategy this arguably undermined the whole rationale. The interesting thing about conflicts as a legal concept is that they are internationally viewed as a bad thing and that they need to be properly disclosed. Most jurisdictions would recognize that what you are in fact looking for is full disclosure and the informed consent of all contracting parties and

that without that there is a possibility the deal can be unwound.

Editor: Where were the in-house legal and group risk teams while all this was happening?

Allen: What has emerged from our discussions about these structures is that there is often a surprising lack of knowledge within these teams about the risks. These structures were considered rocket science and were dealt with by the product teams and external counsel and often in-house legal and group risk had a limited role so in some institutions there is now something of a knowledge gap when it comes to unraveling events forensically.

Editor: What was the consequence of the failure to identify the risks involved?

Allen: At the end of the day, the issue was how much capital should be allocated against the potential risks associated with these structures. Everybody thought they were safe in the sense that the structures were rated AAA and it seemed like pretty much all the other institutions were involved and the default risk was therefore negligible. Having said that, I have spoken to a couple of banks that took a more pragmatic view. One, in particular, pulled out of this market about three years ago because one of their risk guys looked at the book and decided that they needed to allocate a level of capital to it which the board just wasn't prepared to support. It was either great foresight or good fortune or both. They are sitting back smiling now, but not many other banks seemed to go through this process.

Editor: What is the background at Eversheds that enables you to serve clients with respect to the outcome of some of these deals?

Allen: We have a very strong financial services and banking practice here and a lot of embedded knowledge. Our work over the last few months has also given us a tremendous insight into how the market is currently behaving. We have been heavily involved over the years in a lot of financial structures that have gone wrong including systemic problems within the industry such as split capital trusts and structured capital at risk products as well as issues around trading, settlement, treasury and counterparty disputes in wholesale markets. We also have an award winning approach to dispute management called RAPID resolution which is all about identifying strategic exit points at the outset of a problem and project managing the issues in a transparent way and with cost certainty wherever possible. Formal litigation is in our experience rarely the right solution and with our multi disciplinary team and commercial focus we can help clients manage their exposures in a pro active way without riding a coach and horses through what might be sensitive commercial or shareholder relationships.

Partners Notes

Kramer Levin Honored For Pro Bono Work

Kramer Levin Naftalis & Frankel LLP will be honored for its commitment to pro bono work by the Northside Center for Child Development. Founded in 1946 by Drs. Kenneth and Mamie Clark, the first and second African-Americans to receive doctorates in psychology from Columbia University, the Northside Center provides a full range of hands-on services to more than 1,800 at-

risk children and their families in east and central Harlem.

Kramer Levin has had a long-standing relationship with the Center, including serving as legal counsel in a variety of real estate, employment, and litigation matters, on a pro bono and reduced fee basis. Partner Gregory Horowitz has been a member of its Board of Directors since 2006.

Kelley Drye Wins Motion For Summary Judgment In Patent Case

In a major, legal victory in an action, *Tafas v. USPTO and Dudas*, brought by plaintiffs, independent inventor Dr. Triantafyllos Tafas and Glaxo Smithkline Beecham (GSK), the U.S. District Court for the Eastern District of Virginia on April 1, 2008 ruled that the U.S. Patent and Trademark Office ("USPTO") new claims and continuations rules are invalid.

The court held, "Because the USPTO's rulemaking authority under 35 U.S.C. section 2(b)(2) does not extend to substantive rules, and because the Final Rules are substantive in nature, the Court finds the Final Rules are void as 'otherwise not in accordance with law' and 'in excess of statutory jurisdiction and authority.' 5. U.S.C. section 706(2)."

Kelley Drye represented Dr. Tafas in obtaining this ruling that will have far reaching positive implications in promoting innovation and advances in sciences and technology for all technology

companies, whether large or small.

The patent office, in an effort to deal with a backlog attributable mainly due to business method and software patent applications, had enacted highly controversial new practice rules that would have imposed numerous arbitrary numerical limitations on the number of continuations and claims per patent application.

However, after extensive briefing and oral argument, Judge James C. Cacheris granted Tafas' and GSK's motions for summary judgment finding the USPTO's proposed limitations were an improper extension of its authority.

Kelley Drye partners William R. Golden Jr., Steven J. Moore and James E. Nealon represented Triantafyllos Tafas in this matter.

To get the advisory or for more information about this advisory, please contact William MacLeod at wmacleod@kelleydrye.com.

Charles Welch Tiedermann Elected To Holland Directors Committee

Holland & Knight LLP has announced that Charles Welch Tiedermann, a real estate partner in the firm's Washington, DC, office, has been elected to its Directors Committee for a three-year term.

The Directors Committee, made up of 24 Holland & Knight partners located in offices throughout the country, is the policy-making body of the firm. The election occurred at the firm's annual conference, held recently in Orlando, FL.

Mr. Tiedermann is Holland & Knight's immediate past Real Estate Section Leader. He has more than 25 years of commercial real estate finance, development and leasing experience representing institutional clients. The complex transactions Mr. Tiedermann handles include acquisitions, sales, joint venture formations, construction, permanent and mezzanine loans, ground leases, re-capitalizations and sale-leasebacks. He also has extensive experience with workouts and foreclosures.

Holland & Knight has announced that John Rowley, partner in the firm's Northern Virginia and Washington, DC offices, has been named co-chair of the firm's national White Collar Defense Team. He will lead a team of more than 50 lawyers and professionals who are

experienced in corporate compliance programs, internal investigations, anti-money laundering laws and compliance and white collar defense.

Mr. Rowley devotes a significant part of his practice to representing government contractors in procurement fraud investigations and False Claims Act cases. He also regularly represents companies in trade secret litigation and in cases involving the protection of intellectual property rights. Prior to joining Holland & Knight in 1997, Mr. Rowley was a federal prosecutor with the United States Attorney's Office in Alexandria, Virginia.

Holland & Knight LLP has announced that Bryan T.D. Jung has joined the Chicago office as a senior counsel in the Financial Services and Structured Finance and Securitization Practice Groups.

Mr. Jung focuses his practice primarily on structured and corporate finance transactions, including asset securitization, equipment leasing, and bank, finance company, and other institutional lending transactions.

Holland & Knight has announced that Brian Larkin has joined the firm's New York office as a senior counsel in the Real Estate Section.

Please email the interviewee at mallen@eversheds.com with questions about this interview.