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SPECIAL SECTION

Financial and Economic Crisis

TARP And The Stimulus – Keeping Them Honest

*The Editor interviews **Christine F. Hesse, Steven Kaufhold and Susan H. Lent,** Akin Gump Strauss Hauer & Feld LLP.*

Christine F. Hesse

Steven Kaufhold

Susan H. Lent

Editor: Because the Akin Gump seminars (co-sponsored by Ernst & Young and this newspaper) in Dallas (June 9) and San Francisco (June 11) were both so successful, we thought it would be of interest to our readers and Internet viewers to capture their flavor by asking three of the Akin Gump participants in the San Francisco session to participate in this roundtable. First, we asked each of them to describe their practices.

Christine F. Hesse: I am a senior policy advisor in Akin Gump's Public Law and Policy, Policy and Regulation and Distressed Real Estate Asset Services practices. My practice consists of working with most of our financial services-related clients who have public policy issues at the state and federal levels.

At the federal level, I work primarily with the committees that have jurisdiction over banking, housing, securities and insurance issues, which are the Senate Banking and House Financial Services Committees as well as the various banking and securities regulatory agencies such as the Federal Reserve, Treasury Department, Federal Deposit Insurance Corporation, Securities and Exchange Commission and Federal Housing Finance Agency. I also work with the House and Senate Appropriations Committees that fund these agencies.

At the state level, I co-manage the firm's stakeholder practice, which consists of hiring and managing local counsel across the country when a client has a legislative or regulatory issue in one or several states.

Steven Kaufhold: I am a partner and my practice areas at Akin Gump include Securities Litigation, Commercial Litigation, Class Action and Investment Funds Litigation. My practice focuses on the representation of companies and their directors and officers in litigation and investigations, with a particular emphasis on securities litigation. In the current economy, I find that an increasing number of executives and companies are concerned with ensuring compliance and being sure that they are meeting their own fiduciary obligations.

I handle a wide variety of investigations. Recently, many have dealt with compliance by companies and their senior management with accounting and disclosure obligations. The common denominator in most of the investigations has been that they relate to a company's financial reporting to the public, to the government, or both.

Susan H. Lent: I am a partner. My practice areas at Akin Gump include Public Law and Policy, Transportation, Public Private Partnerships, Policy and Regulation and Renewable Energy. The majority of my clients are businesses and public-sector entities in the transportation sector with issues before Congress and the U.S. Department of Transportation.

I advise clients on a wide range of issues involving the different transportation modes, including roads, airports, public transportation, ports and rail. I assist clients in securing federal funding for infrastructure projects and advise them on compliance with the federal laws and regulations that apply to projects that receive federal funds, including environmental and procurement laws.

I also advise clients on the emerging U.S. trend of private-sector investment in transportation projects, including innovative contracting and financing opportunities and emerging laws that may impact public-private partnerships. Not only did the recently enacted American Recovery and Reinvestment Act (the "Recovery Act") have a significant amount of funding for infrastructure, but Congress is preparing to reauthorize both the surface transportation and aviation laws. As a result, there is a lot of interest in opportunities for securing federal funding for infrastructure as well as in the laws and regulations that apply to projects that receive such funds.

Before joining Akin Gump in 1998 I spent three and a half years working on Capitol Hill as a counsel to the U.S. House of Representatives Committee on Transportation and Infrastructure. In that capacity I played a key role in drafting transportation legislation, including the Transportation Equity Act for the 21st Century (TEA 21), which authorized funding for surface transportation programs from 1998 through 2003 and established laws governing those programs. Before working on Capitol Hill, I was a government contracts lawyer in private practice for several years.

Editor: Steve, your focus on investigations cuts across the practice areas of both of the other participants. So I will start with you. Do you expect that the increased stimulus spending will impact your practice?

Kaufhold: Yes. Sophisticated companies and their leaders realize that increased oversight will accompany the increased stimulus spending. Many companies are closely following the various investigations and inquiries relating to how TARP funds have been spent by major financial institutions. The real questions going forward will be what sort of rules and regulations will be attached to stimulus funds and what resources will the federal government devote to enforcing those rules and regulations. Most observers expect a large increase in the number of investigations that will occur as a result of the dramatically increased spending. First, there will be government investigations regarding compliance with both new and existing regulations. Second, there will likely be an increase in the number of internal investigations by companies that are recipients of such funds.

Editor: Could you give an example of the specific type of investigation that you would expect to see?

Kaufhold: Again, there will be a variety. Taking TARP funds as an example,

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the Special Inspector General of TARP, Neal Barofsky, has described the TARP funding as "inherently vulnerable to fraud, waste and abuse," and his office has already opened 20 separate investigations into the use of TARP funds. The subject matter of these investigations includes potential securities fraud, tax law violations and insider trading, among others. It's reasonable to believe that these issues and others will present themselves as the federal government spends hundreds of billions of dollars more in this troubled economy. Also, existing federal regulators such as the SEC and IRS will carefully scrutinize these issues.

Editor: Do the investigations that you mentioned have civil law implications or are there potential criminal law implications as well?

Kaufhold: Both. In addition to potential civil issues, the latest quarterly report of the Special Inspector General and related testimony revealed the filing of the first criminal charges related to an investigation of the Special Inspector General. The charges were for mail and wire fraud relating to the attempted sale of a fictional "TARP Act securities" investment. Finally, it should be noted that the background of the Special Inspector General himself is as a federal prosecutor in the Southern District of New York.

Editor: Steve expects a large increase in the number of investigations as a result of dramatically increased spending. Christine, how would you describe the mood in Washington, D.C., for our readers across the Country?

Hesse: The mood in D.C. has been quite interesting for the last nine months. As your readers know, the housing crisis has moved the country into a real economic crisis that has the Administration and Congress still grappling with ways to move us out of these problems. We have seen an explosion of federal programs designed to support our banking system and generate liquidity in the capital markets. A year ago no one would have foreseen that we would have this much government intervention and taxpayer dollars involved in entities like AIG, Lehman Brothers, Merrill Lynch, Citigroup, Fannie Mae and Freddie Mac. While most members on the Hill support these programs because they feel that something needs to get our economy on track again, there is real concern about the exit strategy for the government's role in these programs. Members want to ensure that they aren't creating an environment where this support isn't temporary.

Editor: Obviously, a couple of your primary areas of practice, financial services and banking, have been a focus of the Obama Administration. What do you expect to happen next in those areas?

Hesse: I would say that financial services is one of the largest areas that the new Administration and the 111th Congress are focused on for 2009 and 2010. As I mentioned, we have seen an unprecedented number of programs designed to bolster the financial services sector so that credit is available to businesses and consumers. We also know that the financial services industry is expected to be heavily regulated at all levels. The crisis has demonstrated that the financial markets are extremely intricate and complex and that oversight has not kept up with the sophistication of some of these products. We expect a financial regulatory reform package will be passed by this Congress that will likely create a new systemic risk regulator as well as more oversight over the origination and distribution of mortgages, securitizations of those assets and derivatives, to just name a few.

Editor: What is your assessment of current efforts to address mortgage finance and housing issues?

Hesse: Efforts in the mortgage finance and housing area have really been focused to date on the two issues of foreclosure mitigation and creating financing and refinancing opportunities for homeowners. Many consumers initially were approved for financing through exotic mortgages with interest rates that have reset to higher rates that they can't afford to pay. With the current problem of lack of liquidity in the capital markets, homeowners have not had the luxury of being able to refinance into another mortgage product with a lower rate. This has caused thousands of borrowers to fall behind on their loans, leading to defaults and foreclosures that in turn have put downward pressure on home prices. The Administration and Congress have created a number of loan modification programs at the FDIC, with the Indy Mac and other bank portfolios, to the GSEs to the Federal Housing Administration to work with lenders to reduce mortgage payments and incentivize servicers and borrowers to use the programs. One initiative in Congress that has received considerable attention is a proposal to provide for judicial modifications on home mortgages that are in bankruptcy. On the liquidity side, Congress has authorized huge increases to the loan limits for the conforming market and the FHA so that the GSEs and HUD can take on more until the capital markets and the private sector improve. Congress has also provided tax credits for new homeowners.

Editor: Beyond the areas that we've discussed, where do you expect the Administration to focus its recovery efforts going forward?

Hesse: The Administration still will need to deal with the main issue that brought us into this housing and economic crisis in the first place. It is the issue of the banks still having bad assets on their books. The TARP program was initially authorized last fall to buy these bad assets but the program quickly turned into a capital injection program for the banking industry. The FDIC and the Treasury Department have recently launched dual programs under PPIP to buy back legacy loans and legacy securities from the banks. Many of the particulars of the programs are still being worked out but the hope is that these programs will allow banks to sell their troubled assets while creating a market for these assets with investors.

Editor: What advice would you have for an in-house counsel or other executive outside of Washington, D.C., who believes that stimulus spending or other legislation might impact his or her company?

Hesse: One of the most important pieces of advice that I can offer to an in-house counsel or executive outside of D.C. is that legislation can be very difficult to monitor let alone have any input on when someone is situated outside of Washington. By the time you read about it in the paper, the legislation usually has gone through several iterations and members and interest groups may be locked into their positions on it. It is important to have a firm in D.C. like Akin Gump, which has a group of lawyers and staff who work full-time in the legislative and regulatory arenas. They not only can help guide a company through the process but they will know the politics around the issues from both the members' perspective and interested groups downtown. By being involved in the process, companies can help ensure that as little harm is done to them as possible while hopefully creating some opportunities for them as well.

Editor: Susan, Steve has mentioned that the number of investigations will grow with increases in the amounts that government is investing in the stimulus. Your focus has been on government investments in infrastructure. Building and rebuilding America's infrastructure is a key goal of the Obama Administration — are there any particular types of projects that seem to be receiving particular emphasis?

Lent: President Obama made infrastructure a priority in the Recovery Act because he recognized the need to rebuild aging infrastructure, alleviate congestion, provide better public transportation options and facilitate goods movement and understood that investment in infrastructure would stimulate the economy by creating short-and long-term jobs. While most of the funding under the Recovery Act has been distributed under existing formulas and programs, with states and metropolitan planning organizations having flexibility to select projects that meet their priorities (provided the projects are shovel-ready), the Stimulus Act did include an $8 billion competitive program for high-speed rail projects and a $1.5 billion competitive program for surface transportation projects, reflecting Congress and the Obama Administration's priorities.

The President and Transportation Secretary Ray LaHood have touted the $8 billion high-speed rail program as a priority. The Department of Transportation will determine how to distribute the funds through a competitive process. There is significant interest across the country in the program, although some have questioned whether the technology for high-speed rail is fully developed to warrant such a large investment, particularly as part of the Recovery Act.

The Recovery Act also includes a $1.5 billion competitive grant program for surface transportation projects. DOT published its notice of funding availability in the May 18 *Federal Register* and is seeking applications for projects of regional and national significance, with grants ranging from $20 to $300 million. Eligible projects include highway, bridge, public transit, freight rail and port. DOT has set forth evaluation criteria that favor projects that already have a portion of their financing in place, including projects with private-sector investment. DOT also will favor projects that utilize innovative contracting approaches. As part of this program, DOT may award loans and loan guarantees under its existing Transportation Infrastructure Finance and Innovation Act (TIFIA) program to projects with revenue streams, including toll roads and port/intermodal projects.

Another area of interest is tax incentives and tax credit bonds. The Recovery Act created Build America Bonds, which give state and local governments the option of issuing tax credit bonds and receiving a direct payment from the Internal Revenue Service equal to the subsidy that otherwise would have been delivered through the tax credit. The Recovery Act also established Recovery Zone bonds, another category of tax credit bond that encourages investment in economically depressed areas, increases the availability of new market tax credits, and excludes the interest on private activity bonds from the Alternative Minimum Tax.

The Recovery Act also includes a number of grant programs for renewable energy infrastructure and tax incentives for investment in various types of renewable energy projects.

Editor: Is it your sense that more federal funds will be available for transportation projects?

Lent: There historically has been reliable and sustained federal funding for transportation projects. Most of the funding is distributed by formula to states, transit agencies and airport authorities although some funding is earmarked for projects in legislation. Highway, transit and intermodal projects are largely funded by federal gas tax revenues and airport projects are largely funded by aviation fuel taxes. The current surface transportation and aviation legislation expires at the end of this fiscal year. Congress will attempt to pass new authorizing legislation. Reauthorization of the aviation program is mired in issues related to development of a new air traffic control system. Reauthorization of the surface transportation programs is complicated by the fact that the 18.4 cent federal gas tax is not adequate to sustain the surface transportation program let alone grow it, as many in Congress would like. Congress is looking at different options, including indexing the gas tax to inflation, raising the tax, transitioning to a vehicle miles traveled fee, encouraging more toll roads and congestion pricing and supplementing the program with general funds. While Congress will attempt to pass a bill this year,

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it is more likely that its members will extend the current legislation – possibly with a general fund supplement to continue the program at current levels — for some period of time while they identify a funding solution.

Editor: Can state and local governments and private business expect increased oversight of how federal funds are used?

Lent: State and local governments and private businesses can expect increased oversight over federal funds distributed under the Recovery Act. Many of the same laws that apply to recipients of federal funds made available under other laws apply to funds made available under the Recovery Act, including the Buy American Act, the National Environmental Policy Act (NEPA) and the Davis Bacon Act prevailing wage requirements. The Recovery Act, however, has additional requirements that likely will be overseen by the Recovery Accountability and Transparency Board, the various agency Inspector Generals, the Department of Justice and Congress to guard against fraud, waste and abuse.

The following are compliance requirements applicable to Recovery Act funds:

The governor, mayor or other chief executive must certify that for all funds provided to states and local governments for infrastructure investments, the infrastructure investment has been fully reviewed as required by law and is an appropriate use of taxpayer dollars. The certification shall include a description of the investment, the estimated total cost, and the estimated total amount of funds to be used. All certifications must be posted on a government website, and no funds will be made available until an appropriate certification is made. This certification requirement will likely mean that state and local governments will oversee projects more carefully than usual.

All funding recipients must register with the federal government's Central Contractor Registration Database. This requirement applies to both public entities and contractors.

All recipients of funds under the Act must submit reports to the federal agency that provided the funds, whether the recipient is a contractor, grantee, or state or local government. The reports must identify: (1) the total funds received; (2) the amount expended or obligated; (3) a list of projects or activities with details on completion status, the estimated number of jobs created and retained and, for state and local governments, the purpose, total cost, and rationale for the project, and the name of a person to contact if the federal agency has any concerns; and (4) detailed information on subcontracts or subgrants awarded. These reports must be made publicly available. All fund recipients must submit their first report within 180 days of the Act's enactment.

There also are potential False Claims Act implications associated with submitting invoices for payment of Recovery Act funds.

Editor: Do you think there is any concern that federal funding will come with so many restrictions and levels of oversight that certain agencies and companies will decide not to accept the funding?

Lent: State and local governments already must comply with requirements and are subject to oversight when they receive federal funds. While additional requirements apply to Recovery Act funds, state and local governments are for the most part not willing or able to pass up funding in the current economy regardless of the strings attached. They are making strategic decisions about which projects they choose to fund with federal funds, either through the Recovery Act or other sources, so that they do not have to comply with the stringent federal requirements for all of their projects.

As for the private sector, they also are making strategic decisions about the costs and benefits of participating in projects that receive stimulus funds. Companies do not receive Recovery Act or other federal transportation dollars directly, but are beneficiaries either as contractors or investors in public-private partnerships or as the operators of railroads or intermodal or port facilities. As a result, they must evaluate the extent to which requirements apply to them and the potential liability that results from participating in the projects that receive Recovery Act funding. Companies that are in the transportation business must enhance their compliance procedures to ensure that they follow all of the rules associated with the Recovery Act.

Editor: What advice would you have for an in-house counsel or other executive outside of Washington, D.C., who believes that stimulus spending or other legislation might impact his or her company?

Lent: Time is of the essence, as the federal government is in the process of distributing federal funds. Different federal agencies are farther along in the process than others, but many of them have already issued grant announcements and some deadlines for submission of applications have passed. Public-sector entities and businesses interested in either securing federal funding directly or taking advantage of federal funds as a contractor should inventory the various programs under the Recovery Act and determine what programs are of interest and the timeline and process for securing funding. They also should determine the compliance requirements. It is a complicated process, but in the current economy federal funding and financing may offer good opportunities for certain types of businesses. I would recommend that in house counsel and counsel for public entities (1) identify the requirements associated with the Recovery Act; (2) establish a process for compliance; and (3) train those who will apply for funding, receive and administer funding and submit claims for invoices that will be paid with Recovery Act funds on the process for compliance.