ALERT:

Treasury Designates Its First "Financial Agent"

STEPTOE & JOHNSON LLP

The Emergency Economic Stabilization Act of 2008 ("Act") authorizes the Secretary of the Treasury ("Secretary") to appoint certain financial institutions as "financial agents" in implementing the authorities provided by the Act. On October 6, the Treasury issued notices pursuant to that authority to financial institutions seeking "financial agents" to provide various asset management services and entered into its first financial agency agreement today, October 14, with The Bank of New York Mellon. Treasury has also indicated that it plans to issue additional solicitations for financial agents, including opportunities for small, veteran, minority and women owned businesses.

This advisory summarizes a number of the key statutory provisions relating to financial agents and provides an overview of the Treasury's first financial agency agreement. It also identifies a number of issues relating to the use of "financial agents" that financial institutions interested in becoming "financial agents" and other organizations interested in contracting with "financial agents" should consider.

Summary of Statutory Provisions

Section 101(a) of the Act establishes the Troubled Asset Relief Program ("TARP"), under which the Secretary, acting through a newly established Office of Financial Stability, is authorized to purchase certain "troubled assets" and to do so "on such terms and conditions" as the Secretary determines "in accordance with this Act and the policies and procedures developed and published by the Secretary." § 101(a)(1). The Act also authorizes the Secretary to manage and sell the troubled assets. See § 106(b) &(c).

The Act generally authorizes the Secretary to take any actions necessary to carry out the authority granted under the Act, including "establishing vehicles...to purchase, hold, and sell troubled assets and issue obligations," § 101(c)(4); entering into contracts, see id. (c)(2); and designating certain "financial institutions" as "financial agents." See id. (c)(3). Section 101(c)(3) goes on to provide that financial institutions designated as financial agents "shall perform all such reasonable duties related to this Act as financial agents of the Federal Government as may be required." The Act also contemplates that the Secretary will retain or procure the services of, among others, asset managers, property managers, servicers, and consultants, to assist in dealing with troubled assets. See id. § (d)(3); § 107(b).

As noted above, the Act authorizes designations of financial institutions as financial agents and defines "financial institutions" as "any institution, including, but not limited to, any bank, savings association, credit union, security broker or dealer, or insurance company, established and regulated under the laws of the United States or any State, territory, or possession of the United States, [or] the District of Columbia...and having significant operations in the United States, but excluding any central bank of, or institution owned by, a foreign government."

The Treasury's Authority to designate financial institutions as financial agents dates back to the National Bank Act of 1864 and today there are a number of statutes providing for financial agents. See, e.g., 12 U.S.C. § 90 (authorizing designation of national banks as depositaries and providing that they "may also be employed as financial agents of the Government"); see also 31 C.F.R. Part 202.

Other sections of the Act potentially relevant to financial agents include §§ 108, 118 and 119. Section 108 specifically requires the Secretary to "issue regulations or guidelines necessary to address and manage or prohibit conflicts of interest that may arise in connection with the administration and execution of the [Act]." This direction applies to conflicts "in the selection or hiring of contractors or advisors, including asset managers;" the purchase and management of troubled assets; employee post-employment restrictions; and "any other potential conflict of interest as the Secretary deems necessary or appropriate in the public interest." Id. (a). The Treasury issued "Interim Guidelines for Conflicts of Interest" on October 6. The Guidelines indicated that Treasury is concerned with actual or potential (organizational) conflicts of interest in situations where a contractor's performance of a contract could potentially affect its other interests, or where a contractor obtains sensitive, non-public government or private information. The Guidelines also indicated that potential personal conflicts of interest involving individual contractor employees were also a potential concern. According to the Guidelines, Treasury anticipates addressing potential conflicts of interest through non-disclosure agreements, solicitation requirements for pre-award disclosure of actual or potential conflicts of interest, conflict mitigation plans, and, potentially, waivers of such conflicts.

Section 118, Funding, addresses funding of costs of administering the Act, including administrative expenses. It allows the Secretary to use proceeds from the sale of securities for the costs of administering the authority granted under the Act and authorizes issuance of securities for purposes of actions authorized by the Act. It then provides that "[a]ny funds expended or obligated by the Secretary for actions authorized by this Act, including the payment of administrative expenses, shall be deemed appropriated at the time of such expenditures or obligation."

Section 119 confirms that decisions of the Secretary pursuant to the authority of the Act shall be subject to review under the Administrative Procedure Act and provides that final actions may be set aside if arbitrary, capricious or an abuse of discretion, or not in accordance with law. See § 119(a)(1); see also 5 U.S.C. §§ 702, 706. However, it includes prohibitions on injunctive relief for actions of the Secretary under Sections 101, 102, 106 (relating to purchase of troubled assets, insurance, and certain other matters relating to troubled assets, including management and sale) and 109 (relating to foreclosure mitigation efforts), except for constitutional violations.

Treasury Notices Regarding Financial Agents

On October 6, 2008, the Treasury issued three Notices (solicitations) to financial institutions seeking financial agents to provide services for implementation of the Act. One was for a single organization to provide custodian, accounting, auction management and other infrastructure services; another was for multiple entities to provide securities asset management services; and the third was for one or more organizations to provide whole loan asset management services. The Notices set out minimum qualifications for each type of asset manager and outlined the process for selection, including eligibility requirements, minimum qualifications, and evaluation (selection) criteria. The Notices also required those responding to agree to disclose all potential conflicts of interest and to avoid, mitigate or neutralize, to the extent feasible and to Treasury's satisfaction, personal or organizational conflicts of interest. In addition, the Notices indicated that the designation of financial agents was "contingent on and subject to availability of funding."

The transmittal accompanying the Notices indicated that they were being issued pursuant to the Treasury's "authority [under the Act] to retain financial agents to provide services on its behalf." The Notices stated that the financial institutions would be financial agents, not contractors, and that neither the Notices nor the services being sought were procurements under the Federal Acquisition Regulations. In addition, the Notices provided that in submitting a response, a financial institution understood and agreed that the Treasury would select a financial institution "in its sole discretion...based on its determination of what is in the best interests of the United States." The solicitation also required the selected institution(s) to enter into a Financial Agency

Agreement that would include "established terms and conditions currently applied to financial agents of the United States." In related notices issued on October 6, Treasury stated that its "financial agent authority will be used when a firm is needed to conduct transactions on Treasury's behalf, for example, where Treasury needs the services of an asset manager." It also stated that '[a]s financial agents, asset mangers will have a fiduciary agent-principal relationship with the Treasury with a responsibility for protecting the interests of the United States."

The Treasury announced the hiring of its first financial agent, The Bank of New York Mellon, on October 14, http://www.treasury.gov/press/releases/hp1211.htm, and Interim Assistant Secretary for Financial Stability Neel Kashkari has said that it plans to announce the selection of the two other asset managers within the next few days and to seek additional assistance. http://www.ustreas.gov/press/releases/hp1199.htm

Overview of the Bank of New York Mellon Financial Agency Agreement

The Treasury's first financial agency agreement ("Agreement") is for custodian, accounting, auction management and other infrastructure services with Bank of New York Mellon ("Bank"). http://www.treasury.gov/press/releases/reports/custodiancontract.pdf. The Bank was one of 70 entities submitting responses to the Treasury's October 6 Notice and one of 10 that met the eligibility and minimum qualification requirements. Interim Assistant Secretary Kashkari has described this as the agreement for the "prime contractor of the [asset] purchase program."

Key provisions of the Agreement include:

- Three year term, with four one-year options.
- Services to be provided "in accordance with the highest practices and professional standards of care, with a degree of attention used in a well -managed operation and no less than that which the Financial Agent exercises for itself and others receiving comparable services."
- With certain limited exceptions, employees of the Bank and its contractors must be US citizens or lawful permanent residents and perform work in the United States.
- The Bank has a "fiduciary duty of loyalty and fair dealing to the United States" while acting as a financial agent, and agrees "to act at all times in the best interests of the United States."
- The Bank has a duty to safeguard and protect various categories of "confidential information," is required to have its employees and contractors execute a confidentiality agreement included as an Exhibit to the Agreement, and is potentially liable for breaches involving "sensitive data."
- The Bank is required to have a Code of Conduct and Code of Ethics.
- The Agreement includes a number of representations and warranties, including a covenant to disclose any actual or potential conflicts of interest and to avoid, mitigate, or neutralize any organizational or personal conflicts to the satisfaction of the Treasury. (The Agreement does not indicate whether any actual or potential conflicts were disclosed or if any actions were taken to avoid, etc., any such conflicts.) The Bank must make an annual certification of compliance regarding the various representations and warranties.
- The Bank is permitted to use certain designated affiliates in performing services under the Agreement. It may also, with the prior written consent of the Treasury, retain contractors to perform such services. Those contracts must be in the Bank's name and not on behalf of the Government; those contractors do not become subcontractors, agents or subagents of the Treasury; and the Treasury "shall not be deemed [to be] a party" to any agreement entered into by the Bank to perform services under its Agreement. The Agreement also provides that Treasury is not liable for payment to any entity other than the Bank.
- The Government Accountability Office and other (currently unidentified) entities authorized by Treasury have broad rights of access and audit.

- Treasury gets "exclusive Unlimited Rights" for use within the Government in any "Business Methods" created by the Bank or its affiliates and contractors expressly for the purpose of providing services and may use them "for any purpose within the Federal Government's authority." It has non-exclusive unlimited rights to such Business Methods for use outside of the Government and "may use them for any purpose within the Treasury's authority." It also generally gets non-exclusive unlimited rights in other data produced, developed, or obtained by the Bank or its affiliates or contractors for the purpose of providing services under the Agreement. There is also an "authorization and consent" clause regarding use of patented or copyrighted inventions, works or products.
- The Agreement specifies various events of default (e.g., breach of fiduciary duty or if the Bank's representations or warranties are or become false, incorrect or incomplete), as well as remedies for default, including termination or reduction in the scope of services. The Agreement also sets out several other matters for which the Bank may be liable, including delay in processing or transferring funds; losses due to fraud, willful misconduct, negligence, etc., or breaches of fiduciary duty by the Bank, its affiliates or contractors.
- Treasury also has a right to terminate the Agreement or reduce the scope of work when, in its sole discretion, it is "necessary to protect the interest of the United States Government," even in the absence of a default (i.e. terminate the Agreement for convenience.)
- The Agreement provides for internal resolution of disputes through "mutual agreement" at the "lowest possible level," with escalation up the "chain of command." However, both parties "reserve the right to pursue other legal or equitable rights they may have concerning any dispute."
- The Agreement is to be interpreted under "Federal law," or New York law if there is no applicable federal law.
- The Agreement states that it is not a federal procurement contract and therefore is not subject to the Federal Property & Administrative Services Act or the Federal Acquisition Regulations, or any other federal procurement law.
- The Agreement includes a statement of work setting out the services that the Bank is to perform, at Exhibit A, and gives Treasury the right, in its sole discretion, to make changes in the scope of work, subject to negotiation of an equitable adjustment in the price or other terms.
- The Agreement includes an Exhibit B, Compensation, however details of the compensation and pricing have been redacted.

Some Open Issues Regarding Financial Agents

The Treasury's use of its financial agent authority for infrastructure and asset management services in implementing the Act raises several potential issues:

- Whether decisions of the Treasury regarding the solicitation and selection of financial agents are subject to judicial review and if so, where and what relief may be available?
- What are the elements of a financial agent's "fiduciary agent-principal relationship" with the Government; are the rights and obligations arising from that status limited to those set out in a financial agent agreement; and does the Government's status as sovereign affect the rights and obligations of the parties, and if so, how? For example, what is the nature and extent of a financial agent's "fiduciary duty of loyalty and fair dealing to the United States" and to what extent, if any, can the Government be held liable for the actions of its (financial) agents?
- What legal standards will be used in identifying and resolving organizational and personal conflicts of interest? See, e.g., FAR Subpart 9.5.
- What are the other parameters of the Treasury's "unlimited rights" in Business Methods or other data?
- Whether the compensation provisions of the Agreement are legally exempt from disclosure or, as a practical/transparency matter, will otherwise be disclosed?
- What other "legal or equitable" rights and remedies are available to a financial agent and in what forum?

Steptoe's new Troubled Asset Task Force has been considering these questions and is ready to advise financial institutions, asset managers, and others regarding these and other issues relating to the economic stabilization legislation recently passed by the U.S. Congress.

Leadership of the Task Force is provided by Washington, D.C.-based partners Scott A. Sinder, chair of Steptoe's Government Affairs & Public Policy practice and General Counsel to the Commercial Mortgage Securities Association; John T. Collins, a member of the firm's Corporate, Securities and Finance practice and its Regulatory & Industry Affairs Department, who was formerly General Counsel to the US Senate Banking Committee, a Senior Attorney at the Washington D.C. Federal Reserve Board and a Staff Attorney with the SEC; and Scott H. Katzman, head of Steptoe's Corporate, Securities and Finance practice.

For additional information please contact your Steptoe & Johnson LLP relationship partner or Scott Sinder, John Collins, or Scott Katzman

Scott A. Sinder
ssinder@steptoe.com
202.429.6289

John T. Collins
jcollins@steptoe.com
202.429.8047

Scott H. Katzman
skatzman@steptoe.com
202.429.8025

For questions regarding financial agent or government contracts issues, please contact:

Thomas P. Barletta
tbarletta@steptoe.com
202.429.8058

Peter L. Wellington
pwellington@steptoe.com
202.429.8115
