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Subprime and Credit Crisis Practice

Distress in the U.S. subprime mortgage market is reverberating worldwide and has had an unprecedented impact on the global credit markets. At RK&O, we have seen growing demand from clients seeking legal advice on a range of issues arising from the structuring, distribution and marketing of financial products with an underlying subprime or distressed credit component. Our broad experience in lending, bankruptcy, corporate governance and compliance, litigation, restructuring, derivatives and trading distressed debt puts RK&O in a unique position to help our clients manage risk to minimize losses invest to extract value at this critical time in the credit markets and solve related regulatory and litigation issues which they may face.

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Investment and Arbitrage Opportunities

Distress in the U.S. subprime market has spread to the corporate credit markets and is straining Collateralized Debt Obligation vehicles (“CDOs”) and Collateralized Loan Obligation vehicles (“CLOs”) that have heavily invested in general corporate debt. The current market not only raises issues for investors, both public and private, but also raises issues for audit committees and boards of directors of public companies that hold investments in CDOs and CLOs. Increasing defaults and potential downgrades of the financial guarantors that provided insurance for notes issued by CDOs and CLOs will likely give rise to opportunities for focused investors. Such opportunities can appeal to active investors seeking to replace the collateral manager and manage the underlying portfolio of loans (“Active Investors”), or to opportunistic investors simply taking advantage of pricing dislocations (“Trading Investors”). Finally, the current

environment may cause existing investors in CDOs and CLOs to seek advice regarding their rights and remedies to the extent they believe the collateral manager has acted improperly in managing the portfolio or to the extent there may have been misrepresentations or omissions in the offering documents ("Existing Investors").

Issues for Active Investors

Active Investors should be mindful of the following issues in considering investments in CDOs and CLOs:

- What contractual and other rights are available to remove or replace the collateral manager? These will differ between and/or among the various tranches of debt issued by the CDO or CLO.
- What other rights and remedies are available to holders of each tranche of debt under the CDO/CLO documents?
- How can investors who seek to replace the collateral manager ensure that they step into the rights of the collateral manager without assuming the manager's liabilities?
- What are the optimal tranches of notes in which to invest in order to achieve particular goals and objectives?
- What is the best method of purchasing an entire tranche or blocking position in notes?
- How can public/private information issues be managed during the execution of an activist strategy?
- How can investors accurately assess the value (and potential cost of terminating) any credit default swap or interest rate swap embedded in the CDO or CLO structure?

Issues for Trading Investors

Similarly, Trading Investors should carefully consider the following issues:

- Which tranche of notes provides the optimal value to achieve desired rates of return?
- What are the legal issues that may affect the relative priority of various tranches of debt?
- What are the impediments to recovery inherent in one or more tranches of notes?
- What issues arise in connection with one-off or bulk purchases of notes from either individuals or groups of noteholders?

Issues for Existing Investors

Existing Investors must evaluate their rights, remedies and options in determining whether to continue to hold the notes by considering the following issues:

- What rights do existing holders have to ensure that the collateral manager is a prudent stalwart of capital and is maximizing value?

- What potential claims exist against the collateral manager, underwriter and/or offering agent in a CDO/CLO?
- Who has legal standing to bring those claims or direct that such claims be asserted?
- Are there any conflicts of interest between the financial guarantor, the various tranches of securities and the collateral manager?

Issues Facing Audit Committees and Boards of Directors

Public Companies, Audit Committees, and Boards of Directors should be aware of the following issues:

- What issues are regulators and prosecutors exploring in this area and how should a public company, Board or Audit Committee prepare for and/or respond to governmental inquiries?
- What are the various disclosure obligations of public companies holding investments in CDOs and/or CLOs?
- What type of information should a Board and/or Audit Committee expect and demand regarding exposure to the credit markets?
- What duties are triggered or issues raised with respect to a public company's holdings of CDOs and/or CLOs?

To actively respond to issues arising from the credit and subprime crises, we rely upon the expertise of more than forty attorneys working across multiple practice areas including litigation, derivatives, lending, bankruptcy, corporate restructuring, structured finance, governmental investigations, and white collar crime. Our attorneys work together to respond to clients seeking advice related to a range of complex issues – from credit arbitrage situations and investigations by government authorities to claims involving investors, underwriters, deal sponsors, and directors and officers, to investors seeking to invest in this newly distressed asset class. “Providing this type of coordinated, cross-discipline advice relating to the capital markets is exactly what we do, and have always done, on a day-in and day-out basis,” according to Jon Kibbe, a founding partner of RK&O.

Our Past Work With Clients

We assist our clients in responding to the subprime and credit crisis by continuing to provide counsel to our clients in the following areas:

Litigation

- Representing investors in CDOs asserting claims of securities fraud based upon fraudulent misrepresentations or omissions in the underlying deal documents;
- Representing investors in derivative transactions involving sellers of credit default protection on notes issued by a CDO and secured by residential mortgage-backed securities in connection with claims arising out of the credit default swap transaction;

- Representing bond insurers in connection with government investigations into ratings of municipal and asset-backed bonds; and
- Providing our clients with arbitrage advice regarding broken leveraged buy-outs and merger agreements (involving “material adverse change” provisions and otherwise).

Corporate Governance and Compliance / White Collar / Government Investigations

- Representing a number of individuals and officers/directors relating to their involvement in the subprime securitization process;
- Representing Boards and Audit Committees of public companies holding investments in CDOs/CLOs in advising them regarding disclosure and corporate governance issues;
- Representing public companies holding investments in CDOs/CLOs regarding their disclosure obligations and potential conflicts of interest; and
- Representing members of management in navigating legal issues arising in the current crisis, including departure and separation considerations.

Corporate / Derivatives / Lending / Bankruptcy & Restructuring / Debt Trading

- Representing clients trading credit default swaps;
- Representing purchasers and sellers of loans caught in a “failed” or “hung” syndication;
- Representing clients developing innovative financing for the purchase of distressed assets;
- Representing clients seeking to more efficiently hedge exposure to credit risk;
- Representing market-makers developing more efficient settlement procedures for cash and synthetic exposure to leveraged loans;
- Representing investors in the purchase of interests in subprime lenders;
- Representing purchasers and sellers of portfolios of distressed loans and other debt instruments, through both auction and bilateral sale arrangements;
- Representing CLOs and CDOs and their advisors in connection with the formation, operation and wind-down of such entities;
- Representing secured and unsecured debt holders in connection with both in-court and out-of-court restructurings and reorganizations; and
- Representing investors seeking to acquire blocking or controlling positions in the debt issued by distressed entities in order to be an active participant in the restructurings of such entities.