

Securities Litigation and Enforcement

The Emergency Economic Stabilization Act of 2008 (the “Act”) does not directly address civil securities litigation or securities enforcement issues. However, as discussed below, it is likely to impact those areas in a number of ways.

1. Civil Litigation

Pursuant to Section 101, the Act authorizes the U.S. Department of the Treasury (the “Treasury”) to purchase “troubled assets” from a “financial institution.” Because the latter term is defined broadly, it may be interpreted by the Treasury to include investors not traditionally thought of as financial institutions. The reach of the Act is also impacted by Section 103(8) which, under the heading “Considerations,” appears to authorize the Secretary of the Treasury to purchase “troubled assets held by or on behalf of an eligible retirement plan described in clause (iii), (iv), (v), or (vi) of section 402(c)(8)(B) of the Internal Revenue Code of 1986.” To the extent that investors in “troubled assets” may believe that they have been damaged as a result of their investment, but are not compensated pursuant to the Act, they may seek redress for their losses by instituting litigation under applicable federal and state laws. Recently, a number of such actions have been brought in both federal and state courts. Such cases are likely to be brought in increasing numbers in the coming months.

2. Reports, Enforcement, and Regulatory Cooperation

The Act requires several reports to be submitted to Congress, including (i) a Special Report on Regulatory Reform, to be submitted by January 20, 2009, analyzing the current state of the regulatory system and its effectiveness at overseeing the participants in the financial system and protecting consumers, making recommendations concerning whether unregulated entities should be subject to regulation, and identifying any gaps in consumer protection (ii) a Regulatory Modernization Report, to be submitted by April 30, 2009, addressing the state of the financial markets, the effectiveness of the financial regulatory system, and recommendations on topics including whether unregulated entities should be subject to regulation, and (iii) a Study and Report on Margin Authority, to be submitted by June 1, 2009, addressing whether leverage and sudden deleveraging of financial institutions were a factor behind the current financial crisis, with analyses and recommendations on margin, leverage usage, and regulation.

While these reports, mandated in Sections 105, 117 and 125, will allow Congress to study the current regulatory environment, the Act leaves untouched the existing federal, state, and self-regulatory scheme. The Act does not alter the Securities Act of 1933, the Securities Exchange Act of 1934, or the rules and regulations thereunder, does not affect the enforcement powers of the Securities and Exchange Commission, and does not modify the investigative and enforcement powers of FINRA and the states.

Further, Section 127 potentially will increase cooperation among federal and state agencies in the investigation of securities sales practices, providing that “[a]ny Federal financial regulatory agency shall cooperate with the Federal Bureau of Investigation and other law enforcement agencies investigating fraud, misrepresentation, and malfeasance with respect to development, advertising, and sale of financial products.” We anticipate that this affirmative information-sharing obligation will tend to increase the overall emphasis on criminal investigation and prosecution. Indeed, as the crisis unfolded over the past several weeks, news agencies reported that the FBI was investigating several large financial institutions at the center of recent events.

3. Recoupment Provisions

Section 134 is one of the more ill-defined but potentially significant provisions of the Act. It provides that after five years, Congress will receive a report “on the net amount within” the Troubled Asset Relief Program (TARP). “In any case where there is a shortfall, the President shall submit a legislative proposal that recoups from the financial industry an amount equal to the shortfall in order to ensure that the Troubled Asset Relief Program does not add to the deficit or national debt.”

Putting aside that the Act does not define what is meant by “shortfall,” the provision anticipates that the “financial industry” may be called upon to provide a backstop for TARP. Significantly, this recoupment provision does not appear to be limited to those entities that contributed to the current financial crisis or to those that participate in TARP. Rather, Section 134 leaves open the door that “the financial industry” as a whole may be called upon to pay for some or all of TARP at a later date without attempting to address any of the potential constitutional roadblocks that may await such legislation.

If you have any questions or would like more details concerning any of the points mentioned in this discussion briefing, please contact the Morgan Lewis attorney with whom you normally communicate or any of the Morgan Lewis attorneys in our Financial Crisis Working Group:

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