

Message from Our Boston Office

As the third quarter draws to a turbulent end, this issue offers vital information:

Mr. Ames' article on middle-market transactions notes that investors are increasingly interested in them due to the tightening credit markets. He illustrates three factors driving deals and four issues that make the deals unique. His article is a must-read.

Mr. London and Mr. Walsh's article on "The Greening of Government Contractors" notes that bidders and contractors can anticipate and adapt to proposed sustainability initiatives or other "green" criteria.

In cyberspace, our recent webinar looked ahead to what the financial services industry might expect from either a McCain or an Obama administration. And bankruptcy partner Francis Lawall's Peppercast spotlights the importance of thoroughness regarding Section 328 success fees.

Back in the brick-and-mortar world, we note two local events in the business community in which Pepper plays major roles, and we welcome to our Boston office Litigation and Dispute Resolution partner Roger A. Lane, Commercial Litigation associates Andrew DeVoogd and Courtney Worcester, Intellectual Property and Life Sciences associate Anne M. Shyjan and Intellectual Property associate Gregory D. Len.

As always, we welcome your comments and suggestions.

in this issue

- 1 Middle-Market Memo on M&A
- 2 Obama and McCain: What Would They Do For (Or To) You Webinar
- 3 The Greening of Government Contractors
- 3 Peppercast: Success Fees Under Section 328; Be Reasonable and Be Specific
- 4 Upcoming Events

Middle-Market Memo on M&A

This article first appeared in The Deal on August 5, 2008. It is reprinted here with permission.

The tightening of the credit markets and the resulting sharp decline in high-leverage megadeals has generated strong interest in middle-market transactions — a trend that is expected to continue at least throughout 2008.

Middle-market transactions are projected to remain in focus because they do not depend on syndicated debt, according to PricewaterhouseCoopers' transaction services group's midyear mergers and acquisitions forecast for 2008.

In addition, according to the forecast, three regulatory factors may drive an increase in middle-market deals — and possibly all deals — before year's end:

- the possible increase in the capital gains tax, which may motivate private equity firms to cash out wholly or in part by fourth quarter
- the new business combination accounting standard, FAS 141(R) — Business Combinations, which will no longer allow certain transaction costs to be capitalized into the purchase price, instead requiring them to be expensed
- changes in how companies account for noncontrolling interests or minority investments, FAS 160 — noncontrolling interests in consolidated financial statements, which may cause firms to take control of their minority interests before being required to record them in equity and lose gain and loss recognition for transactions with a parent.

As private equity firms deploy more capital in the midmarket, and because middle-market deals are unique, getting the right fit and the right experience can be critical to success. Four basic issues make these deals unique.

Social issues. Midmarket deals frequently involve founders or family operators who are key to a private equity target's success and growth. It's important to match the financial expertise of the investor with the operating expertise of the owner-operator with sensitivity, whether it involves the in-

roduction of a new finance officer, the addition of debt to the target's balance sheet or the creation of incentive-based compensation plans where there were none.

Changes in senior management also require a sensitive touch. These changes are often characteristic of the mid-market deal, and implementing any of them suddenly and without a clear understanding of the benefits could spell disaster.

Structure issues. Middle-market targets may be organized in a way that is not tax-efficient for investors. Therefore, understanding the use of creative and flexible flow-through structures for making an investment, such as LLCs, is important. Experience matters when it comes to understanding the alternatives these structures offer for the allocation of profits, losses and distributions to target owners and investors alike, and for creating critical incentives for management to drive growth.

Special skill also is required to address and balance the economic and tax concerns of the target owner's rollover equity — such as maintaining a single-level of tax and maximizing capital gains — and the investor's goals — such as qualifying for consolidated return filing, or a step-up in tax basis and amortization of the investment.

Capitalization issues. Growth through add-on transactions often drives returns in midmarket investments, while high leverage drives the megadeals. In fact, many midmarket deals are initially funded entirely with equity, sometimes later refinanced.

The result is that the post-money capitalization of a mid-market target follows its own pattern, and creates its own dynamic — all with a profound effect on valuations and returns — and all requiring a different approach to financial modeling.

Most important, because add-on transactions are so crucial in the middle market, the ability to complete them quickly and in a cost-efficient manner with positive effects on the target's balance sheet and P&L statement takes deft handling.

Supporting players. The accounting firms, lenders, investment bankers, lawyers and others that source midmarket opportunities for investors are all cast from a special group focused on the middle market. Dealing with any one of these advisers will put all the necessary experience and resources of the other advisers within the reach of investors,

Obama and McCain: What Would They Do For (Or To) You Webinar

Whatever choice the voters make in November, it's likely that the current federal regulatory approach to the financial services industry will change, perhaps dramatically. We've all heard the campaign rhetoric, but few have probed deeply into the specifics of both candidates' positions on matters affecting the financial services business.

What would Sen. Barack Obama's proposal for a foreclosure prevention fund mean for mortgage lenders already struggling for survival? What would Sen. John McCain do to address the financial issues at Fannie Mae and Freddie Mac, or other aspects of the ongoing credit crisis?

Listen as we examine the policies of both candidates regarding financial services regulation and related issues.

Visit Pepper's webinar section at www.pepperlaw.com to view the webinar recording and download the PowerPoint slides from this online event.

enabling them to close the deal quickly. This special group also is best suited to stay ahead of market trends and solutions that can create commercial efficiencies.

It is worth noting that this "fit" is as important to cost control as it is to overall success. Successful midmarket deals demand advisers who staff their deals with lean-and-mean teams, and provide the same partner and team from deal to deal.

So getting the right fit and the right experience can make the difference between closing the deal and losing it.

Author:

*Mitchell S. Ames
212.808.2723
amesm@pepperlaw.com*

The Greening of Government Contractors

This article was originally published in Mass High Tech on September 12, 2008. It is reprinted here with permission.

Recent developments have thrust federal and state agencies, as well as government contractors, to the forefront of the “green” movement. Proposed policy changes will soon place significant new obligations on government contractors and agencies. However, since all bidders must meet these criteria, those who adapt more quickly to these green standards may have a competitive advantage.

In recent years, federal, state and local governments encouraged the private sector to adopt more environmentally friendly (or sustainable) technologies and processes, even where there is no enforceable requirement.

In late 2007, the Office of Federal Procurement Policy proposed the Acquisition of Green Products and Services Policy. The policy requires federal agencies to give preference to green products and services, including alternative fuels; bio-based products; non-ozone depleting substances; recycled content and/or remanufactured products; and renewable energy.

The scope of this policy is broad. As long as it is life-cycle cost-effective to do so, the proposed policy requires agencies to first consider mandatory and preferred sources to obtain green products and services before approaching other sources. Exemptions from these purchase requirements require written justifications that such items are not reasonably available within the time required, the items are only available at an unreasonable price (based on

life-cycle cost), the items are not available from a sufficient number of sources to maintain a satisfactory level of competition, or the items are not reasonably available to meet the functional requirement of the agency.

Green Regulation of Federal Buildings

Buildings account nationwide for 30 percent of the raw materials used, 30 percent of the waste output, and 12 percent of the potable water consumption. At least 12 federal agencies specifically require new construction of federal buildings and other federally funded construction to meet LEED certification. The Department of Energy now requires, at the design stage, that new federal commercial and multifamily buildings achieve at least 30 percent greater energy efficiency over prevailing building codes, if not unduly costly.

Over the next 10 years, these DOE regulations are estimated to save taxpayers \$776 million and more than 40 trillion British Thermal Units (BTUs) of energy, while reducing about 2 million metric tons of carbon dioxide.

Similarly, at least 15 states and 90 local governments specifically require that new state or local buildings or buildings constructed with state or local funding meet LEED certification. In 2010, the California Building Code will require all new buildings to use at least 15 percent less energy.



Peppercast: Success Fees Under Section 328; Be Reasonable and Be Specific

In complex business reorganizations, debtors and other major parties-in-interest, such as trustees, examiners and creditors’ committees, will typically retain a small army of professionals – attorneys, financial advisors, accountants – to assist in the case. Not surprisingly, these professionals are entitled to compensation from the bankruptcy estate.

This podcast with **Francis J. Lawall**, a partner in Pepper’s Corporate Restructuring and Bankruptcy Practice Group, discusses the importance of thoroughness regarding Section 328 success fees and the Northwest Airlines case.

Listen today by visiting the Corporate Restructuring and Bankruptcy section of Pepper’s podcenter at www.pepperpodcasts.com.

As this guidance changes over time and a federal climate change bill is enacted, government contractors will face more stringent requirements.

What Should Government Contractors Do?

Individual government contractors or pre-existing/ad hoc groups of government contractors can take several proactive steps.

Initially, contractors can comment on proposals, particularly the proposed green products and services acquisition policy. Some key issues likely to arise during the commenting period include the meaning of terms such as the definition of environmentally preferable, the level of risk that requires use of products not containing so-called toxic chemicals, the meanings of the “maximum extent practicable” and “not reasonably available to meet the functional requirement.” Comments should seek to clarify the meaning of these terms.

If this guidance is adopted, contractors should implement an environmental audit to determine what, if any, additional environmental measures or documentation is needed to comply with the green products and services acquisition policy.

Government contractors with other divisions also need to decide whether to have one company-wide green policy or to adopt a separate policy for its government contracting group. As a practical matter, it may be more cost-effective to have one policy.

Finally, other companies also should consider employing these “green criteria,” because this guidance is likely to become de facto voluntary standards for all of the private sector, not just federal contractors.

Authors:

Steven R. London
617.204.5107
londons@pepperlaw.com

William J. Walsh
202.220.1424
walshw@pepperlaw.com

Upcoming Events

Babson College Rocket Pitch

October 24, 2008
Babson Park, MA

Babson College entrepreneurs pitch their business ideas to a large audience of students, faculty, entrepreneurs, investors and service providers. Pepper partner **Matthew S. Gilman** will be speaking at this year’s event.

For more information, visit www3.babson.edu/ESHIP/outreach-events/rocketpitch.cfm.

2008 New England Venture Summit

November 25, 2008
The Marriot
Burlington, MA

Pepper Hamilton is the Coaching Sponsor of the Summit.

For more information and to register, visit www.youngstartup.com/newengland08/overview.php.

Pepper Hamilton LLP

Attorneys at Law

The material in this publication is based on laws, court decisions, administrative rulings and congressional materials, and should not be construed as legal advice or legal opinions on specific facts. The information in this publication is not intended to create, and the transmission and receipt of it does not constitute, a lawyer-client relationship.

Please send address corrections to
phinfo@pepperlaw.com.

www.pepperlaw.com

Berwyn | Boston | Detroit | Harrisburg | New York
Orange County | Philadelphia | Pittsburgh
Princeton | Washington, D.C. | Wilmington

© 2008 Pepper Hamilton LLP. All Rights Reserved.
This publication may contain attorney advertising.