

message from partner in charge

As the third quarter draws to a turbulent end, this issue offers timely, relevant information to you and your clients.

First, we spotlight federal receiverships. Ms. Kress and Ms. Kistler show how several statutes govern this quick, cost-effective method for a secured creditor to gain control over a borrower's collateral upon default.

Mr. Ames' article discusses middle-market transactions and investors' increasing interest in them due to the tightening of the credit markets. He illustrates three regulatory factors driving the deals and four issues that make them unique.

Finally, we look to Pepper in cyberspace, for a timely online event. We recently presented a webinar in which we looked ahead to what the financial services industry might expect from either a McCain or an Obama administration.

Also, we point you to Mr. Gorland's appearance at ACI's Automotive Product Liability Seminar, where he'll speak on testing plaintiffs on crashworthiness claims.

As always, thanks for reading and please tell us your comments or suggestions.

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Bankruptcy Alternatives: Receiverships and Assignment

This is an excerpt of this article. The complete article is available on our web site at http://www.pepperlaw.com/pepper/publications_update.cfm?rid=1445.0

For secured creditors, a federal receivership can offer the quickest and most cost-effective method of gaining control over a borrower's collateral upon default. A federal receivership maintains the value of the collateral by allowing the business to continue to operate. The receiver will preserve and protect the collateral as well as the financial integrity of the business as a going concern. In addition, the receiver may be able to stabilize the operations to mitigate further potential losses.

Foreclosure actions are generally brought in the county in which the property is located, while state receivership actions are brought in the state in which the property is located. These remedies present logistical issues when the collateral is located in multiple counties or states. Federal receivership actions commence in the federal district of the state where the property is located or in the state of the borrower's principal place of business.

Although federal receiverships are grounded in federal common law, several federal statutes govern such receiverships.

Appointment of a Receiver *Federal Jurisdiction*

To initiate an action in the federal court, the federal court must have jurisdiction. Because a secured party's enforcement of its rights is not usually based upon a federal question (although federal district courts may appoint receivers in cases initiated by governmental entities for violation of federal laws), diversity and the minimum amount in controversy under § 1332 of Title 28 of the U.S. Code must exist to invoke the jurisdiction of a federal district court. Once jurisdiction is established, the court has ancil-

lary jurisdiction to appoint a receiver, as well as ancillary subject matter jurisdiction over every suit the receiver may subsequently initiate.

Procedurally, to have a receiver appointed, the secured creditor will first file suit against the borrower for breach of contract. Once the suit is filed, the secured creditor will then file a motion to appoint a receiver, supported by an affidavit alleging the basis for the relief requested. In many states, including Michigan, a suit for breach of contract cannot be combined with a count for foreclosure; the secured party must decide whether to initiate the suit or begin foreclosure.

The act of appointing a receiver is analogous to the entry of an injunction; it is an extraordinary remedy that lies in the discretion of the court and should be employed with the utmost caution and granted only in cases of clear necessity to protect a plaintiff's interest in property.

The following factors are usually weighed by the court to determine whether a receiver should be appointed:

- the existence of a valid claim by the moving party
- fraudulent conduct on the part of the defendant
- imminent danger that property may be lost, concealed, injured, diminished in value, or squandered
- an inadequacy of the available legal remedies
- the probability that harm to plaintiff by denial of the appointment is greater than the injury to the parties opposing appointment
- plaintiff's probable success in the action
- possibility of irreparable injury to plaintiff's interest in the property.

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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.

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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 introduction 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, 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.

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Upcoming Events

Scott Gorland Speaking at ACI's Automotive Product Liability Seminar - October 29-30, 2008

Pepper partner **Scott L. Gorland** will speak at the American Conference Institute's “Defending and Managing Automotive Product Liability” seminar on October 29-30, at Sutton Place Hotel in Chicago, IL.

Mr. Gorland will speak at the 3:20 p.m. session on October 29 on “Crashworthiness: Putting Plaintiffs to the Test When They Advance Theories to See What Sticks — Roof Crush, Air Bags, Seat Belts, Glass Glazing & Beyond.”

For more information and to register, visit www.americanconference.com/automotive.

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