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NEW TARP WATCHDOG DEMANDS TRANSPARENCY: RECIPIENTS OF TARP FUNDS SHOULD EXPECT HEIGHTENED FOCUS

Approximately forty-five days have passed since Neil Barofsky, formerly an Assistant United States Attorney in the Southern District of New York, was sworn in as the Special Inspector General for the Troubled Asset Relief Program (the "SIGTARP"), a position created to oversee the bailout program and prevent fraud and waste of taxpayer funds. The SIGTARP post was created by the Emergency Economic Stabilization Act of 2008 ("EESA"), a law enacted on October 3, 2008 in response to the global financial crisis.¹ The Act, as is now well known, authorizes the Secretary of the Treasury to spend up to \$700 billion to purchase troubled assets from banks and other financial institutions through the Troubled Assets Relief Program (the "TARP") so that those institutions can, in turn, extend credit and aid in the nation's economic recovery. The Act has since been interpreted to permit the Secretary to purchase equity and debt of financial institutions.

As SIGTARP, Barofsky is the watchdog of the TARP program, responsible for conducting audits and investigations and vested with broad authority to prevent fraud and waste. Recent events suggest strongly that the SIGTARP, both alone and in conjunction with federal and state regulators, intends to exercise his authority not only over the TARP program, but also over the financial institutions in which the program has invested. This Client Alert explores the directions that Barofsky may take based on his actions and statements in his first 45 days in office.

Barofsky's Background

Barofsky is a former federal prosecutor from the United States Attorney's Office for the Southern District of New York, where he headed the Mortgage Fraud Unit. During the latter portion of his tenure as an Assistant United States Attorney, Barofsky supervised the investigations relating to fraud at Refco. Barofsky was the lead trial lawyer in the US Attorney's Office's successful prosecution of Refco's

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¹ Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat. 3765 (2008).

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former President, Tone N. Grant. Barofsky was associated with Morvillo, Abramowitz, Grand, Iason, Anello & Bohrer, PC, before joining the US Attorney's Office.

Supervision and Authority

The SIGTARP office supplements the numerous statutory Offices of Inspectors General that Congress has established for the various administrative agencies. There is an existing Inspector General for the Treasury Department, but the SIGTARP operates independently of that office. With the addition of the SIGTARP, there are currently only three "special" Inspectors General: SIGTARP; the Special Inspector General for Iraq Reconstruction; and the Special Inspector General for Afghanistan Reconstruction. The SIGTARP, however, has authority broader than both of the other special inspectors general in that he reports not to any agency head or cabinet secretary, but rather directly to Congress.² The SIGTARP serves at the pleasure of the President and, unlike other Inspectors General, is not subject to any statutory provision to be appointed "without regard to political affiliation."³ Special Inspector General Barofsky was appointed during the final days of President Bush's administration (after drawn out confirmation delays by an anonymous Republican senator), but continues to serve under President Obama, who will not replace him.⁴

Compared to other Inspectors General, the SIGTARP powers are far-ranging. The SIGTARP has complete discretion to pursue audits and issue subpoenas, while other Inspectors General are subject to oversight and potential intervention by the agency head to whom they report.⁵ The two other Special Inspectors General are required to coordinate with the Inspectors General for the Departments of State and Defense, but there is no requirement that the SIGTARP coordinate efforts with the Treasury Department's Inspector General.

The SIGTARP, like other Inspectors General, cannot directly prosecute crimes, but can use its subpoena authority to investigate criminal activity and make referrals, as required under the EESA, to the United States Attorney General. Subpoenas issued under Section 6(a)(4) of the Inspector General Act are subject to review and enforcement by "any appropriate United States district court."⁶ The district court, however, will enforce the subpoena if the information sought "is not plainly incompetent or irrelevant to any lawful purpose" of the Inspector General function,⁷ a standard that the SIGTARP can meet easily. Also, courts generally accept an Inspector General's own determination of what information

is necessary to meet its function.⁸ Thus, a motion to quash a SIGTARP subpoena is not likely to succeed.

The SIGTARP is also armed with financial power. The EESA gives him full discretion regarding the use of a \$50 million budget allocated to the SIGTARP.⁹ Ironically, transparency, the very focus of Inspector General Barofsky's office, appears to be the main check on Barofsky's broad discretionary powers. Senate Finance Committee Chairman Max Baucus, the Senator responsible for adding the SIGTARP position to the EESA, has indicated he will hold future oversight hearings on Barofsky's activities.¹⁰

Finally, particularly given the media and public focus on spending at TARP-funded institutions, Special Inspector General Barofsky can easily use his investigative powers to bring to the attention of both the public and Treasury Department officials any discovered expense or policy that might be perceived as wasteful or inappropriate. Such actions could directly affect not only public perception of the institution, but also the institution's relationship with the Treasury Department (including the Treasury Secretary, who has sole discretionary authority to issue TARP funds) and other

² *Id.* § 121 (f)(1).

³ Inspector General Act of 1978, as amended, codified at 5 U.S.C. App § 4(a).

⁴ Paul C. Light, *Senate Confirms N.Y. Prosecutor as Inspector General for Bailout, The Washington Post*, Dec. 9, 2008.

⁵ Congressional Research Service, The Library of Congress, Order Code RS22981, The Special Inspector General for the Troubled Asset Relief Program 2 (2008) [hereinafter *CRS Report*].

⁶ Inspector General Act of 1978 § 6(a)(4).

⁷ *United States v. Aero Mayflower Transit Co., Inc.*, 831 F. 2d 1142 (D.C. Cir 1987).

⁸ *United States v. Westinghouse Elec. Corp.*, 788 F. 2d 164 (3d Cir. 1986).

⁹ Emergency Economic Stabilization Act § 121 (g)(1).

¹⁰ Press Release, Committee on Finance, Baucus Commends Confirmation of Special Inspector General for Financial Rescue Plan (Dec. 8, 2008), <http://finance.senate.gov/press/Bpress/2008press/prb120808.pdf>.

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regulators, and perhaps raise claims under the “clawback” provision of the EESA.

Duties and Responsibilities

The SIGTARP must “conduct, supervise, and coordinate audits and investigations of the purchase, management, and sale of assets by the Secretary of the Treasury . . .”¹¹ Additionally, the SIGTARP must submit an initial report no later than sixty days after his confirmation and every calendar quarter thereafter summarizing his activities and detailing any actions taken by the Secretary of the Treasury with respect to the bailout.¹² The EESA also provides that the SIGTARP must fulfill the duties contained in the Inspector General Act of 1978.¹³ This last requirement is broad, but to date it has been interpreted to mean that the SIGTARP must be prepared to testify at congressional hearings, respond to congressional inquiries, and report criminal violations to the United States Attorney General.¹⁴

Recent events suggest strong ongoing coordination with state and federal regulators in the discharge of those duties. New York State Attorney General Andrew Cuomo recently announced, in connection with his investigation of bonuses paid to Merrill Lynch executives ahead of its merger with Bank of America, a TARP funds recipient, that his:

. . . ongoing inquiry into executive compensation practices at TARP funded institutions . . . will be conducted cooperatively and in coordination with the TARP Special Inspector General Neil Barofsky. Our offices have already begun working together and I look forward to a continuing and productive working relationship with the Special Inspector General. Our cooperative efforts set a perfect example for how federal and state authorities should be working together on behalf of taxpayers.¹⁵

Inspector General Barofsky, for his part, has made similar public statements. In press reports, Barofsky has stated that he “expects [it] will be a long and productive partnership” with Mr. Cuomo’s office.¹⁶

A recent SEC action provides additional insight on the scope and reach of the SIGTARP office. In that matter, the SEC sought emergency injunctive relief against Nashville-based financial planner Gordan B. Grigg and his firm, ProTrust Management, Inc., for securities fraud and misrepresentations involving the sale of commercial paper and bank debt purported to be government backed and issued

by the TARP program. There is, in fact, no program that allows investors to purchase TARP-backed securities, nor have any such securities been issued. Thus, the sole connection between the Griggs case and the TARP program is Griggs’ purported assertions that the subject securities were TARP backed. Notwithstanding the absence of a true relationship with the TARP program, the Special Inspector General is a partner in the SEC’s case. The SEC’s press release provides a public message similar to the one issued by Attorney General Cuomo. In its release, the SEC “acknowledges the assistance of the Special Inspector General of the TARP program and looks forward to continued coordination in this and other matters.”¹⁷

Barofsky’s prosecutorial background suggests that he may measure his success, as do many prosecutorial offices, at least in part, based on his ability to assist in making civil or criminal cases against participants in transactions that come within his jurisdiction. Barofsky’s announced partnership with Attorney General Cuomo evidences that Barofsky will join a crowded field consisting of federal prosecutors, state attorney generals, the SEC, and self-regulatory organizations, all of which may have jurisdiction over some of the transactions that also fall within Barofsky’s.

¹¹ Emergency Economic Stabilization Act § 121 (c)(1).

¹² *Id.* § 121 (f)(1).

¹³ *Id.* § 121 (c)(3).

¹⁴ *CRS Report, supra* at 4-5.

¹⁵ Statement from Attorney General Andrew Cuomo Regarding New Developments in Investigation of Merrill Lynch Bonuses and Bank of America (Jan. 27, 2009) (emphasis added), http://www.oag.state.ny.us/media_center/2009/jan/jan27a_09.html.

¹⁶ Chad Bray and Liz Rappaport, *Thain Gets Subpoena in Pay Probe, Wall St. J.*, Jan. 27, 2009, <http://online.wsj.com/article/SB123307302854619913.html>.

¹⁷ Press Release, U.S. Securities and Exchange Commission, SEC Charges Nashville-Based Financial Planner with Fraud Involving Purported Investments in TARP (Jan. 28, 2009) (emphasis added), <http://www.sec.gov/news/press/2009/2009-12.htm>.

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SIGTARP's First Moves

Shortly after taking office, the SIGTARP's first action was to tighten restrictions contained in the agreements between the Treasury Department and recipients of the TARP funds. Specifically, the language in the anticipated TARP contracts with Citigroup, General Motors, GMAC and Chrysler requires each of these institutions to account for its use of TARP funds, set up internal controls over the funds, and report to the government on the implementation of these controls. The report will require a signed certification from a senior officer of each institution.¹⁸ The TARP agreements also apply these standards to the institution's executive compensation and expense policies.

In a letter to Barney Frank, the Chairman of the House Financial Services Committee, dated January 22, 2009, Barofsky indicated that his office currently was preparing requests for each entity that has already received TARP funds asking them to provide, within thirty days of the request:

- a narrative response outlining the institution's use or expected use of TARP funds;

- copies of pertinent supporting documentation (financial or otherwise) to support such response;
- a description of the institution's plans for complying with applicable executive compensation restrictions; and
- a certification by a duly authorized senior executive officer of the institution as to the accuracy of all statements, representations, and supporting information provided.¹⁹

The Special Inspector General had hoped to send the letters "shortly," but the requirements of the Paperwork Reduction Act has slowed that timetable considerably. Just last week, the White House Office of Management and Budget denied the SIGTARP's request to waive the Paperwork Reduction Act's provisions, and it could take up to three months for the required review to occur.²⁰ The delay in requesting and collecting relevant information affects a key strategy of the Special Inspector General to examine the use of TARP proceeds. In his letter to Chairman Frank, Inspector General Barofsky stated, "in the context of a program this large and this important to the Nation's economic recovery, addressing the basic question 'Where did the

money go?' is critical to credible and effective oversight of TARP."²¹

Conclusion

One consequence of receipt of TARP funds will be that recipient entities will find themselves subjected to an additional layer of regulation. SIGTARP Neil Barofsky's background, as well as the steps he has taken in his first 45 days in office, suggest that he will be an aggressive, well-financed, and media-savvy investigator who will be working in tandem with a number of existing regulators and prosecutorial bodies. Moreover, some of his initial actions suggest that he will take the position that an entity's receipt of funds open up many of its internal business operations to his scrutiny. As a result, financial institutions that are already heavily burdened by overlapping, and sometimes competing regulatory requests, will find themselves having to deal with yet another governmental watchdog, and one that may be quite formidable.

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¹⁸ Neil Roland, *Top Cop Ratches Up Restrictions on Rescue Cash*, *Fin. Week*, Jan. 7, 2009, <http://www.financialweek.com/apps/pbcs.dll/article?AID=/20090107/REG/901079973/1005/rss02&rssfeed=rss02>.

¹⁹ Letter from Neil M. Barofsky, Special Inspector General, Troubled Asset Relief Program, to Barney Frank, Chairman, Committee on Financial Services, U.S. House of Representatives (Jan. 22, 2009), http://www.house.gov/apps/list/press/financialsvcs_dem/0542_001.pdf.

²⁰ Amit R. Paley, *Bailout Fund Letters are Held Up*, *The Washington Post*, Jan. 31, 2009, <http://www.washingtonpost.com/wp-dyn/content/article/2009/01/30/AR2009013003771.html>.

²¹ *Id.*

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