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Make My Day: States Dare Servicers to Foreclose

States are not waiting around for the federal government to bail out Main Street. Congress has enacted an ambitious agenda for both the U.S. Department of Treasury to purchase distressed mortgage loans under the Troubled Asset Relief Program TARP and the Federal Housing Administration to refinance distressed mortgage loans with insured loans under the HOPE for Homeowners Program. To date, Treasury has not purchased a single loan under TARP, and HUD has not insured many, if any, loans under the HOPE Program. Yet approximately 7.3 million American homeowners are expected to default on their mortgages between 2008 and 2010, with 4.3 million of those expected to lose their homes.¹

States are doing what they can to stop foreclosures in their tracks or make it so burdensome to foreclose that generous loan modifications look better and better. Of course, the Constitution sharply limits states' ability to enact laws that retroactively modify existing contracts between private parties, but that has not stopped states from getting as close to the line as possible.² Below we provide a brief overview of recent types of measures that jurisdictions have enacted to demonstrate how each may impact the residential mortgage servicing business.³

Notice of Intent to Foreclose

Statistics show that a substantial number of borrowers have no contact with their lenders, because borrowers often try to avoid such communications. A number of states have enacted measures to facilitate greater communication between borrowers and lenders by requiring mortgage servicers to provide certain notices to defaulted borrowers prior to commencing a foreclosure action. The measures serve a dual purpose, providing more meaningful notice to borrowers of the status of their loans and slowing down the rate of foreclosures within these states. For instance, the North Carolina legislature enacted a pair of bills (House Bill 2463 and House Bill 2623⁴) that require a mortgage servicer to mail a homeowner a notice of intent to foreclose at least 45 days before initiating a foreclosure action on a loan. The notice must be in writing, and must detail all amounts that are past due and any itemized charges that must be paid to bring the loan current, inform the homeowner that he or she may have options as an alternative to foreclosure, and provide contact information of the servicer, HUD-approved foreclosure counseling agencies, and the state Office of the Commissioner of Banks.

The equivalent laws in some other states present an even greater compliance challenge for servicers. Under Maryland S.B. 216/H.B. 365, a secured party may not file an action to foreclose a mortgage or deed of trust on residential property until the later of: (1) 90 days after default, or (2) 45 days after sending a Notice of Intent to Foreclose to the mortgagor or grantor and to the record owner with a copy to the Commissioner of Financial Regulation. The Commissioner of Financial Regulation has promulgated emergency regulations stipulating the form that the Notice of Intent to Foreclose must take.⁵ With the emergency regulations set to expire on November 19, the Commissioner published proposed final regulations, which are open for public comment until November 10. Similarly, under New Jersey Assembly Bill 2780 (the "Save New Jersey Homes Act of 2008"), which applies to certain adjustable rate mortgages,⁶ a creditor issuing a notice of intent to foreclose must provide the borrower with a series of written notices that include information prescribed by the statute. The creditor must send each notice in an envelope printed with a lengthy

disclosure, including the statement: “The New Jersey Legislature has enacted the Save New Jersey Homes Act of 2008, which may help you save your home from foreclosure.” While the intent of this requirement is to encourage borrowers to read the notice, it raises issues under the federal Fair Debt Collection Practices Act (FDCPA) regarding loans subject to the statute.⁷

In some cases, states have imposed not only requirements regarding the provision of a notice of intent to foreclose, but also additional measures that a mortgage lender or servicer must undertake in connection with commencing foreclosure proceedings. For instance, California Senate Bill 1137 sets forth extensive due diligence efforts that a lender must undertake to contact a borrower at least 30 days before providing the borrower with a notice of default.⁸ These measures frequently extend the timeline for foreclosure, some by 30 or 45 days. Other states permit even greater extensions of the foreclosure, from six months in Michigan (for active duty members of the armed services)⁹ to three years in New Jersey for certain adjustable rate mortgages (discussed further below).

Proof of Ownership

Last October, a judge on the U.S. District Court for the Northern District of Ohio dismissed fourteen cases in which plaintiffs sought to foreclose mortgages held in securitization trusts by ruling that those plaintiffs lacked standing to sue.¹⁰ In each case, the judge found that the plaintiff was not the owner of the note and mortgage on the date the foreclosure complaint was filed in court. While it has been common practice in residential mortgage transactions for assignments to be completed in blank with technicalities completed later, that may be changing. Legislatures are now instituting stringent proof of ownership requirements that a servicer must satisfy before commencing a foreclosure action.

By way of example, the New York State Assembly earlier this year amended state law to require that any foreclosure complaint contain an affirmative allegation that the plaintiff is the owner and holder of the note and mortgage at issue or has been delegated the authority to institute the foreclosure action by the owner and holder of the subject mortgage and note.¹¹ The requirement applies to subprime home loans and high-cost home loans, as those terms are

defined in the state’s anti-predatory lending law.¹² The complainant also must certify its compliance with the state’s anti-predatory lending and pre-foreclosure notice requirements; however, the pre-foreclosure notice requirement does not necessarily apply to all New York subprime home loans.¹³ The requirement has left lenders and servicers scratching their heads as to how to certify their compliance with requirements that may not apply (particularly where any mistake could provide a defense to foreclosure).

Rights to Reinstatement

To assist homeowners who are delinquent or in default, states such as Massachusetts and Connecticut have amended their reinstatement laws and other states may be considering similar changes. Massachusetts opted to give borrowers a 90-day right to cure once every five years. By contrast, Connecticut’s new provisions are limited to what is now commonly referred to as toxic “nonprime home loans.”

Massachusetts 90-Day Right to Cure

The Massachusetts law creates a 90-day right to cure for any mortgage on owner-occupied residential real estate within the state.¹⁴ Although the right to cure does not guarantee that a borrower will be able to avoid foreclosure, it does delay the process and provide time for a lender to work with a borrower to modify an existing loan.¹⁵ Under the law a lender or subsequent holder cannot accelerate the unpaid balance of the loan (or take other action to enforce the mortgage as a result of the default) until at least 90 days after giving written notice to the borrower. Local foreclosure counsel have expressed concern that any notice that does not strictly track the statutory language could be deemed deficient, resulting in a further delay of the foreclosure action.

Under the law, a borrower can exercise the right to cure once every five years by paying in full all amounts due. However, the borrower is not liable for any attorney’s fees that the lender incurs prior to or during the cure period. Furthermore, the law prohibits a lender or servicer from charging any fees or penalties attributable to the exercise of the right to cure within the prescribed 90-day period, other than certain charges expressly allowed under Massachusetts law. The statute does not differentiate between charges attributable to the right to cure and other permissible loan charges attributable to the default (even if the borrower did not cure the default), but the Division

of Banks has provided limited additional guidance on this issue.¹⁶

Connecticut's Right to Reinstatement for Nonprime Home Loans

Connecticut is among the states protecting borrowers facing foreclosure in part because of the terms of subprime (or other non-traditional) loans, by providing borrowers with a statutory right to reinstatement. Connecticut House Bill 5577 (codified as Public Act No. 08-176) gives such a right to any borrower with a "nonprime home loan".¹⁷ Before a court may enter judgment in a foreclosure action concerning such a loan, a homeowner has the opportunity to cure any defaults related to the loan. To exercise that right, a homeowner may have to pay any reasonable costs the lender incurred in connection with the defaults. Once the homeowner cures any defaults, he returns to the legal position he would have had had the defaults not occurred. As a result, the mortgagee must terminate the foreclosure proceeding. A Connecticut homeowner may only exercise this right twice in any period of 24 consecutive months.

Mandatory Settlement Conferences and Mediation

As another alternative to foreclosure, some jurisdictions are requiring lenders and troubled borrowers to participate in mandatory settlement conferences. Most recently, New Jersey Chief Justice Stuart Rabner announced a statewide program in which courts will require mediation in any case in which a homeowner contests a foreclosure action.¹⁸ If the homeowner does not contest the foreclosure, participation is voluntary and mediation is available until the time of the sheriff's sale. The program originated in one New Jersey county, but is expected to expand throughout the state in the next several months.

Some states have enacted statutes requiring parties to a foreclosure action to participate in a settlement conference or mediation. Under New York Senate Bill S 8143-A, parties to a foreclosure action involving certain loan types must attend a settlement conference within 60 days of the lender serving the notice of intent to foreclose required under that law. New York legislators intended the conference to: (i) facilitate the parties' discussion of their respective rights and obligations under the mortgage and applicable laws; (ii) assess their potential to agree on an alternative to

foreclosure (such as modification of the loan); and (iii) document and finalize the details of any compromise they reach. Similarly, a recently enacted Ohio bill permits a court to order the parties to any foreclosure action to participate in mediation in person.¹⁹

Even more expansive are the requirements under Connecticut House Bill 5577 (described in part above). That law requires each judicial district in the state to have a foreclosure mediation program available for all residential foreclosure actions filed in the district. Through mediation, parties to a foreclosure action can discuss all issues related to foreclosure (including potential alternatives). The law also prohibits a court from entering a judgment of strict foreclosure unless the lender or servicer has provided notice to the borrower of the availability of the mediation program and until the time period when a party can request foreclosure has elapsed. The requirement applies only to a foreclosure action initiated between the law's effective date and July 1, 2010.

Loan Modification

Expanding on the potential for alternative dispute resolution, some state laws provide for the modification of loans in default. For instance, under the Save New Jersey Homes Act of 2008 (described in part above), a creditor must grant an eligible borrower a three-year extension period, during which time any foreclosure proceedings are suspended and the borrower continues to make payments of principal and interest at the introductory rate at which the mortgage loan was originated. To obtain the extension, the borrower must complete a certification of extension within 90 days of receiving notice that the creditor has applied for entry of final judgment of the foreclosure. Submitting a certification requires the borrower to agree to continue to make monthly payments, to pay any interest deferred because of the extension when he or she repays the mortgage in full, and to accept a modification of the mortgage. The creditor can rescind the modification if the borrower falls 60 or more days past due at any time during the extension period. A court cannot enter a final judgment in a foreclosure proceeding unless it has evidence that the borrower received notice of the availability of the period of extension.

Foreclosure Counseling

States are promoting the use of foreclosure counseling services to assist homeowners facing the loss of

their homes. Under California Senate Bill 1137, a mortgagee may not record a notice of default without contacting a borrower (or satisfying certain due diligence requirements) and providing the borrower with toll-free contact information for a HUD-certified housing counseling agency. In Minnesota, a lender or other mortgage holder foreclosing on a property not only must send the borrower a notice of its intent to foreclose, but also must include information on the availability of foreclosure counseling prevention services.²⁰ In that notice, the lender must state that it will provide the borrower's name and contact information to an approved foreclosure prevention agency, which may raise privacy concerns. At the same time that states are encouraging the use of these foreclosure counseling services, they are increasing their regulation of foreclosure consultants and warning their residents about the work of those consultants. For instance, Nebraska earlier this year enacted the Foreclosure Protection Act,²¹ which regulates contracts between foreclosure consultants and homeowners. Other states now actively regulate the conduct of foreclosure consultants and/or provide a borrower with the right to rescind a contract with a foreclosure consultant.

Expansion of Mortgage Assistance Programs

To provide interim assistance to borrowers facing foreclosure or dealing with related issues, some states have expanded emergency mortgage assistance programs (EMAP). Earlier this year, Connecticut amended its laws to make its EMAP program mandatory. To be eligible for assistance under the Connecticut EMAP, a borrower must meet certain requirements established by the Connecticut Housing Finance Authority (CHFA). A lender or other mortgage holder may not foreclose on certain types of mortgages without giving the borrower notice of the opportunity to have a meeting to discuss the delinquency. During the 60-day period when the parties may meet, a court cannot enter a final order of foreclosure on the borrower's property. If the parties cannot resolve the issue, the borrower may work with the CHFA to discuss the possibility of receiving assistance with mortgage payments under EMAP. The lender may proceed with the foreclosure only if the borrower fails to meet certain deadlines or if the CHFA does not approve the borrower's application for assistance within 30 days of receiving it.

Tenant's Rights

Tenants, like homeowners, have become victims of the foreclosure crisis in large numbers. A handful of states have passed measures to extend protections to tenants living in properties from which they may be evicted as a result of foreclosure proceedings. Illinois has been at the forefront of efforts to protect tenants' rights. In August Governor Rod Blagojevich signed a measure expanding a tenant's right to remain in a mortgaged residential property during the foreclosure process.²² Under previous Illinois law, a tenant could remain in possession for the lesser of 120 days or the remainder of his or her lease. The new measure gives a tenant the right to remain in possession of a property in foreclosure if he or she has made a "good faith effort" to pay rent on the property. California enacted a similar law, under which a person or entity foreclosing on a property must provide any tenant or subtenant living in a rental unit at the property 60 days written notice prior to eviction. Previously, only 30 days notice was required.²³ Servicers should recognize that these measures extending the eviction process will result in lower third party bids at a foreclosure sale when the property is tenant-occupied because the purchaser may either have to pay more in a "cash for keys" arrangement or see further diminution in value.

Registration and/or Maintenance of Abandoned Foreclosed Properties

As the number of abandoned properties has increased, many jurisdictions have enacted laws creating an obligation for servicers to maintain abandoned foreclosed properties. Sellers of whole loans increasingly are unwilling to provide representations that the real estate securing the loans does not contain any environmental contamination or other hazards. Their reluctance to provide representations may be a result of their unwillingness to assume the risk of liability for those properties. This risk may be heightened in states that grant borrowers a right to redeem residential real property for a period of time after the property is sold pursuant to foreclosure.²⁴ As of September 2008, more than 40 municipalities had enacted such regulations.²⁵ Many of these measures impose liability on mortgage holders for the failure to maintain properties acquired as the result of foreclosure or loan default. For instance, city officials in Buffalo, New York have taken advantage of a provision in the state's property maintenance code that permits the imposition of liability for the failure to maintain abandoned property on any individual

who has “control” over the premises.²⁶ In their view, a lender who sends a letter to a homeowner in default, in which the lender threatens to take action against the homeowner, is considered to be in “control” of the property and is therefore liable for its maintenance.²⁷

Similarly, Chula Vista, California now requires the registration and maintenance of abandoned residential property. Under the city’s municipal code, a lender or servicer of mortgaged property has 10 days after the homeowner defaults on his or her mortgage to inspect the property.²⁸ If the property is vacant, the lender must register the property with the city and pay an annual registration fee. The registration and maintenance obligations fall on the “owner” of abandoned residential property, who under the municipal code may be any person with “legal or equitable title or any interest” in the property. Any owner who fails to register and maintain a property may be held strictly liable, and may be subject to prosecution and to the imposition of administrative penalties.²⁹ Alternatively, penalties may be available under the state’s law, which specifically does not preempt local nuisance abatement ordinances of this type.³⁰

Conclusion

The challenge that mortgage lenders and servicers face in the wake of the national foreclosure crisis has been magnified by state – and even local – laws responding to the crisis. The laws described above require lenders and servicers not only to keep up to date on legislative changes, but also (in many cases) to adjust their business practices to comply with new statutory requirements. At a minimum, many of these measures effectively extend the timeframe for bringing a foreclosure action; they may also add procedural requirements to the process. Lenders and servicers may support efforts to increase home retention, but related legislative efforts significantly increase the compliance burden to effect that result. Furthermore, a number of cities have become involved in responding to the foreclosure crisis, further complicating the regulatory scheme into which lenders and servicers must fit their business practices. Although the success of these new measures has yet to be seen, their impact on mortgage lenders and servicers is already evident.

Endnotes

- 1 Monica Hatcher, *FDIC boss urges help for homeowners*, MIAMI HERALD, Oct. 24, 2008, available at <http://www.miamiherald.com/business/nation/story/739241.html>.
- 2 See Laurence E. Platt, Nanci L. Weissgold, and David L. Beam, *Hurricane Subprime: Will Congress Provide Disaster Relief from Home Foreclosure?*, BNA’s Banking Report, April 2, 2007.
- 3 See also Kristie D. Kully and Kerri Smith, *Minding the Gap – Servicers Subject to Regulatory Scrutiny*, K&L Gates Mortgage Banking Alert, Aug. 26, 2008.
- 4 North Carolina House Bill 2463, effective January 1, 2009, amends the state’s Mortgage Lending Act. For a more extensive discussion of that bill’s provisions, see *id.* North Carolina House Bill 2623 became effective November 1, 2008 and is scheduled to expire on October 31, 2010. It applies only to a “subprime loan,” defined as a loan originated between January 1, 2005 and December 31, 2007, that would qualify as a “rate spread home loan” under Section 24-1.1(F)(a)(7) of the North Carolina General Statutes (if that definition had been in effect when the loan was originated).
- 5 Foreclosure Procedures for Residential Property, 2008 Md. Reg. 11513 (proposed Oct. 10, 2008) (to be codified at Md. Code Regs. 09.03.12.02).
- 6 The Save New Jersey Homes Act of 2008 applies to an “introductory rate mortgage,” which it defines as a loan secured by real estate on which there is a one-to-four family dwelling that the borrower occupies as his or her principal residence. An “introductory rate mortgage” provides for either: (1) an introductory payment rate option set at least 3 percent below the “fully indexed rate” at the time the loan was originated, with payments that may adjust by more than 3 percent at the reset date (regardless of whether the variable rate index has increased); or (2) an interest rate that may adjust by more than 2 percent at the end of the initial fixed rate period of the loan, an interest rate at origination of more than 200 basis points over the Freddie Mac 30-year conventional interest rate (regardless of the payment rate in effect), and an introductory interest rate set below the “fully indexed rate” at the time the loan was originated that may adjust at the reset date regardless of whether the variable rate index has increased. The term does not include a loan that provides for: (1) a fixed rate of interest for the first five or more years of the loan term; or (2) an introductory interest rate that is set below the “fully indexed rate” at the time the loan was originated only because of the borrower’s payment of bona fide discount points.
- 7 Section 808 of the FDCPA prohibits a debt collector from using any “unfair or unconscionable” collection tactics. 15 U.S.C. § 1692f.

- 8 A thorough description and analysis of the provisions of California Senate Bill 1137 is available in Jonathan D. Jaffe and Nanci L. Weissgold, *California's New Foreclosure Legislation – Will Other States Play “Follow the Leader”?*, K&L Gates Mortgage Banking and Consumer Credit Alert, July 22, 2008.
- 9 Senate Bill 749 permits a Michigan court to stay foreclosure proceedings involving a homeowner who is an active duty member of the military for up to 6 months; the measure applies only to mortgages entered into after its May 2008 effective date.
- 10 *In Re Foreclosure Cases*, 2007 WL 3232420 (N.D. Ohio Oct. 31, 2007).
- 11 N.Y. Real Prop. Acts. Law § 1302.
- 12 Codified in Sections 6-l (for high-cost) and 6-m (for subprime) of New York's Banking Law.
- 13 See N.Y. A.B. 10817 adding Section 6-m to the N.Y. Banking Law (which defines and regulates “subprime home loans”) and amending Section 1304 of the Real Actions and Proceedings Law (which separately defines the term “subprime home loans”).
- 14 Chapter 206 of the Acts of 2007, An Act Protecting and Preserving Home Ownership.
- 15 See Press Release, Foreclosure Prevention Efforts Declining and “Disappointing,” State Officials Say (Sept. 29, 2008), available at: http://www.csbs.org/AM/Template.cfm?Section=Press_Releases&TEMPLATE=/CM/ContentDisplay.cfm&CONTENTID=18826.
- 16 Opinion on Loan Modification and Protecting Lien Status, 2008 Op. Mass. Div. of Banks 16 (June 25, 2008).
- 17 Public Act No. 08-176. For purposes of the Act, a “nonprime home loan” is a loan, other than an open-end or reverse mortgage loan: (1) in which the borrower is a natural person; (2) the proceeds of which are for personal, family, or household purposes; (3) which is secured by a one-to-four family residential property located in the state of Connecticut which is, or was when the loan was made, intended to be occupied by the borrower as his or her principal residence; (4) which has a principal loan amount not exceeding (a) \$417,000 for loans originated after July 1, 2008, but before July 1, 2010; or (b) the Fannie Mae conforming loan limit for all loans originated after July 1, 2010; and (5) for which the difference between the loan's annual percentage rate and (a) the yield on U.S. Treasury securities with comparable maturity periods is equal to or greater than three percentage points for a first-lien loan or five percentage points for a subordinate-lien loan, or (b) the conventional mortgage rate is equal to or greater than one and three-quarters percentage points for first-lien loans or three and three-quarters percentage points for subordinate-lien loans.
- 18 Press Release, Judiciary Announces Foreclosure Mediation Program to Assist Homeowners at Risk of Losing Their Homes (Oct. 16, 2008), <http://www.judiciary.state.nj.us/pressrel/pr081016c.htm>.
- 19 Ohio House Bill 138 (effective September 11, 2008).
- 20 Minnesota House File 3420 (effective August 1, 2008); Minn. Stat. §§ 580.021, 588.022.
- 21 Nebraska Legislative Bill 123 (effective July 18, 2008).
- 22 Illinois Senate Bill 2721 (Public Act 095-0933) (effective August 26, 2008).
- 23 See *supra* note viii.
- 24 For example, under Alabama law the debtor, junior lienors, creditors, and other enumerated parties may redeem within one year from the date of foreclosure sale by paying the buyer the purchase price plus interest and costs. Ala. Code § 6-5-248.
- 25 Cities that have enacted and/or proposed this type of measure are located in California, Delaware, the District of Columbia, Florida, Georgia, Illinois, Indiana, Maryland, Massachusetts, Michigan, Minnesota, Missouri, New York, Ohio, Pennsylvania, South Dakota, Vermont, and Wisconsin.
- 26 N.Y. State Prop. Maint. Code § 202. Under the New York code, an “owner” is “[a]ny person, agent, operator, firm, or corporation having a legal or equitable interest in the property; or recorded in the official records of the state, county or municipality as holding title to the property; or otherwise having control of the property, including the guardian of the estate of any such person, and the executor or administrator of the estate of such person if ordered to take possession of real property by a court.” *Id.*
- 27 Michael Orey, *Dirty Deeds*, Bus. Wk., Jan. 3, 2008.
- 28 Chula Vista (Calif.) Mun. Code § 15.60.040.
- 29 *Id.* §§ 15.60.090, 15.60.110.
- 30 See *supra* note viii.

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