DISCUSSION DRAFT

BLUE SKY REGISTRATION, NOTICE FILING AND OFFERING DOCUMENT REQUIREMENTS APPLICABLE TO MUNICIPAL BONDS

Or

I GET BY WITH A LITTLE HELP FROM THE FEDS

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I. Introduction

A. Purpose of this Paper and Major Findings. The purpose of this paper is to identify the legal bases for municipal bond blue sky law practice, with the goal of protecting underwriters and remarketing agents from (1) state securities commission cease and desist orders and lawsuits for injunctive and other relief and (2) bondholder law suits for refunds. The medium by which this goal is accomplished is the blue sky memorandum, which provides advance warning to underwriters and remarketing agents of actions which need to be taken in certain jurisdictions before the bonds may be offered for sale to the public.

This paper summarizes state securities (or “blue sky”) law registration, notice filing and offering document requirements (and related “exempt security” exemptions from such requirements) applicable to publicly offered bonds, notes and other evidences of indebtedness issued by states, political subdivisions (e.g., cities, counties, towns, etc.) and instrumentalities thereof (collectively, “municipal bonds”).

A major theme of this paper is that blue sky analysis is often hampered by a lack of interpretive state law authority that can be relied upon as precedent by third parties, but

1 An “exempt security” exemption is based upon the nature of the security in question; for example, a security issued or guaranteed by a bank. Exemptions from blue sky requirements that are based on the nature of the purchaser are generally referred to as “exempt transaction” exemptions and are often relied upon when an exempt security is not available. For a discussion of exempt transaction exemptions available in connection with offers and sales to certain financial institutions and institutional investors, see Thomas N. Harding, Everything You Always Wanted to Know About Exempt Transactions But Were Too Bored to Ask, THE BOND LAWYER®, issue dated December 1, 2005 [hereinafter EXEMPT TRANSACTIONS ARTICLE].

2 This paper discusses situations in which registration may be required, but it does not discuss what is needed to carry out a municipal bond blue sky registration, because, in my experience, registrations of municipal bonds are extremely rare. I believe this occurs because the latitude given to securities administrators to determine whether a registration statement meets blue sky law requirements and the inability of a practitioner to predict when a registration will become effective are simply not compatible with the schedule-driven business of underwriters. For these reasons, I do not recommend registration as a method of state blue sky law compliance for municipal bonds.
occasionally a practitioner can find a way to an answer (or get by, if you will) by taking analogous federal securities law authority into account.

This paper is intended in part to update, expand and supersede my paper entitled “The Effects of NSMIA on Blue Sky Requirements Applicable to Municipal Securities” (the “NSMIA Paper”), which was originally published on the web site of the National Association of Bond Lawyers (“NABL”) in 2001 and which has been updated from time to time since then. (“NSMIA” is an acronym for the National Securities Markets Improvement Act of 1996.)

The major findings of this paper are:

(1) Lack of Definitions One of the major problems faced by blue sky practitioners is the lack of definitions of essential terms. Most state blue sky laws are based on either the Uniform Securities Act of 1956 (the “1956 Act”), the Uniform Securities Act of 1985 (with 1988 Amendments) (the “1985 Act”) and the Uniform Securities Act of 2002 (the “2002 Act” and, collectively with the 1956 Act and the 1985 Act, the “Uniform Acts”), all of which were promulgated by the National Conference of Commissioners on Uniform State Laws (“NCCUSL”).

None of the Uniform Acts contains definitions of the terms political subdivision or instrumentality. Except for Colorado, the District of Columbia and South Dakota (which have adopted the federal approach in construing these terms), no blue sky law provides definitions of the terms political subdivision or instrumentality. These terms provide a large portion of the basis on which one concludes whether or not the municipal bonds in question are exempt from registration and notice filings. However, as discussed Section II.A.2.(f), infra, I believe that when the issuer in question is located outside the boundaries of the blue sky jurisdiction in question (hereinafter referred to as an “out-of-state issuer”) and the bonds in question constitute covered securities under NSMIA, then the meanings of the terms political subdivision and instrumentality are determined by federal law, rather than state law, because a federal law, namely, NSMIA, has pre-empted the ability of states to impose registration, notice filing and merit condition requirements on municipal bonds issued by out-of-state issuers.

Another example of the lack of essential definitions is the 1985 Act’s optional exclusion from the municipal bond exemption from registration for bonds payable from revenues to be received from a “nongovernmental industrial or commercial enterprise,” unless payments are insured or guaranteed by a person whose securities are exempt under various other sections or the revenues or the revenues from which the payments are to be made are a direct obligation of such person. The lack of a definition of the term “nongovernmental industrial or commercial enterprise” has resulted in a startling lack of uniformity in states that have enacted the 1985 Act, particularly with respect to conduit 501(c)(3) bonds, student loan bonds and single family mortgage revenue bonds. See Section II.D.1. and Appendix A, Section C., infra.

(2) Separate Securities The separate security approach is still employed, in varying degrees, in eight jurisdictions, namely, Colorado, the District of Columbia, Illinois, Montana, Pennsylvania, Tennessee, Texas and Washington. See Sections II.F.3.(c) and II.F.3(e), infra. Separate security analysis under the Illinois, Montana, Tennessee, Texas and Washington blue
sky laws is based upon an analysis of no action letters and/or policy statements issued by the state in question. Separate security analysis under the blue sky laws of Colorado and the District of Columbia is based on coordination with registration requirements and exemptions from registration under federal law. Separate security analysis under the Pennsylvania blue sky law is based on incorporation of federal law by reference. In each of these jurisdictions, the separate security in question must be scrutinized under both Traditional Blue Sky Analysis and NSMIA Analysis, which are defined in Appendix A, Section E.2., infra.

(3) Bank Letters of Credit Except for the coordination of exemptions provisions of the Colorado and District of Columbia blue sky laws discussed in Section II.F.3.(a), infra, no published state blue sky statute, regulation or policy statement has adopted the federal approach that a properly structured letter of credit (i.e., one that provides for payment in full of all principal and accrued interest and, if applicable, purchase price) and that is issued by the right type of bank (i.e., a state bank, a national bank or a qualifying domestic branch of a foreign bank) can provide an independent exemption from registration as a security guaranteed by a bank. See Section II.D.1.(h), infra. For those states that apply separate security analysis, one must apply NSMIA Analysis and Traditional Blue Sky Analysis not only to the municipal bonds in question but also to the related letter of credit; i.e., the letter of credit either qualifies (a) under a separate exemption from registration as a security issued by a bank or (b) as a covered security under NSMIA (and the notice filing requirement, if any, has been satisfied). See Section II.D.1.(h), infra.

B. Blue Sky Laws and Organization of This Paper

Fifty-four jurisdictions, namely, all 50 states, the Commonwealth of Puerto Rico, the District of Columbia, Guam and the U.S. Virgin Islands (collectively, the “Blue Sky Jurisdictions”), have enacted a securities or “blue sky” law. Blue sky laws regulate the sale of securities (including municipal bonds) in several ways, including, among other things:

(1) unless an exemption is available, by requiring the completion of registration, notice filings or the taking of other action in connection with the offer and sale of municipal bonds, and

(2) by imposing requirements on the content of offering documents for municipal bonds.

The fundamental bases of blue sky requirements applicable to municipal bonds are summarized in Appendix A. A substantial portion of Appendix A is taken from the NSMIA Paper and my article “Political Subdivisions and Instrumentalities under State Blue Sky Laws,” which was originally published in The Bond Lawyer®, issue dated September 1, 2006. Appendix A provides much of the technical background needed for Section II; however, since a substantial portion of Appendix A has been previously published, many readers of this paper may choose to proceed from this Section directly to Section II and to refer to Appendix A as needed. Section II discusses patterns of blue sky registration, notice filing and offering document requirements, as well as the unique requirements of certain states.
C. Disclaimer, Citations and Thanks

To best of my knowledge, this paper is an accurate summary of the matters set forth herein as of the date hereof, but it is not intended as legal advice or an opinion of counsel. NABL and its officers, directors and staff assume no responsibility for the views set forth here. Readers of this paper are encouraged to conduct their own independent research of sources of authority cited and matters discussed herein.

Questions, comments and corrections should be sent to me at the address shown on the preceding cover page.

Citations to the Securities Act of 1933, as amended, are made by Section number only, e.g., Section 3(a)(2). Citations to SEC no action letters list the name of the no action letter followed by the date of availability, e.g., Finney County, Kansas, October 26, 1983. Citations to paragraphs set forth in the Commerce Clearing House Blue Sky Law Reporter are made in the following form, when available: CCH para. 1,234. Citations to state no action letters available through the LexisNexis Total Research System are cited by the title and date of the no action letter, followed by its location on the system, e.g., Minnesota Housing Finance Agency Housing Finance Agency Development Bonds, 1988 Series A, 1988 Mont. Sec. LEXIS 139.

This paper has benefited greatly from the comments and suggestions of Virginia M. Harding, Gould & Ratner LLP, Chicago, Illinois; Dean Hester, Ainsa Hutson, LLP, El Paso, Texas; Andrea McKenna, Ballard Spahr LLP, Philadelphia, Pennsylvania; and David A. Ort, Chicago, Illinois. I owe a special debt of gratitude to Ronald C. Grosser of Hawkins Delafield & Wood LLP, New York, New York, John C. McNally of Hawkins Delafield & Wood LLP, Washington, D.C., and Robert A. Fippinger of Orrick, Herrington & Sutcliffe LLP, New York, New York, for their unfailing willingness to share with me their knowledge of and insights concerning federal and state securities laws. My grateful thanks to all of you.


Blue sky bond registration, notice filing and offering document requirements are important to underwriters and remarketing agents of municipal bonds, because failure to satisfy such requirements can result in state securities commission enforcement actions (including, for example, cease and desist orders), law suits for injunctive or other relief and bondholder law suits for refunds of the purchase price.\(^3\)

Because serious consequences can result from failure to satisfy these requirements, prudent underwriters and remarketing agents require their counsel to provide blue sky memoranda at the commencement of the offering or reoffering of municipal bonds.

Blue sky memoranda typically list:

(1) the jurisdictions in which the municipal bonds in question may be lawfully offered and sold to the public without the need for registration, a notice filing or the taking of other action pursuant to an “exempt security” exemption from registration, provided that the underwriter or remarketing agent is registered as a broker-dealer therein;

(2) the jurisdictions in which registration, a notice filing or the taking of other action must be completed before the securities may be offered to the public by a registered broker-dealer; and

(3) the jurisdictions in which no action need be taken if the securities are offered and sold to specified types of institutional investors in an “exempt transaction,” by a registered broker-dealer or by an unregistered-broker dealer who nonetheless satisfies certain requirements of the jurisdiction in question (e.g., the unregistered broker-dealer has no place of business in the jurisdiction and effects transactions in the jurisdiction exclusively with institutional investors).

The issuer’s offering document (typically, a preliminary official statement) customarily is the main source of facts on which counsel to the underwriter or the remarketing agent relies in carrying out the legal analysis needed for the blue sky memorandum.

Simply put, review by knowledgeable counsel of the offering document while it is still in draft form and preparation by knowledgeable counsel of a blue sky memorandum provides an underwriter or remarketing agent advance warning of the registration, notice filing and offering document requirements applicable to the municipal bonds in question, thereby protecting an underwriter or remarketing agent from -- and enabling an underwriter or a remarketing agent to avoid -- needless enforcement actions and law suits for refunds.

E. CCH Blue Sky Law Reporter

The standard reference work for blue sky matters is the CCH Blue Sky Law Reporter. It is the only publication that attempts to assemble in one place each jurisdiction’s blue sky law, rules and regulations, policy statements and no action letters. The alternative to a subscription to the CCH Blue Sky Law Reporter is to attempt to compile and update these materials online or in a law library, which is an arduous task that probably would not yield access to all the materials found in the CCH Blue Sky Law Reporter.

One of strengths of the CCH Blue Sky Law Reporter is that it is available online, which allows several people in the same office to use it at the same time and allows one to consult it at any place that one has access to broadband Internet service. One of its weaknesses is its relatively sparse collection of state blue sky no action letters. The collection of state no action letters compiled by the LexisNexis Research System is substantially more extensive.

F. State No Action Letters and Informal Telephone Advice by State Securities Commission Staff
State no action letters are not binding as precedent on third parties. Indeed, several jurisdictions expressly counsel against reliance on no action letters by providing that such letters (a) may not be relied upon by third parties as precedent, and/or (b) express only an opinion as to enforcement and are either not binding on the related state securities commission or do not express any legal conclusion as to the questions presented. See Arkansas (Rule 206.01, CCH para. 10,413); California (Rule 250.12(a), CCH para. 11,714); District of Columbia (Rule Section 1947, CCH para.16,546); Hawaii (Release No. 99-2 dated December 2, 1999, CCH para. 20,554); Illinois (Rule Section 130.1520, CCH para. 22,706S); Indiana (Policy Statement dated March 23, 2006, CCH para. 24,706); Iowa (Rule Section 191-50.3(502), CCH para. 25,403); Michigan (Rule 451.2301, CCH para. 32,523); Nevada (Section 90.715.5, Nevada Statutes, CCH para. 38,168A); New Jersey (Statement of Policy dated April 11, 1994, CCH para. 40,632; Oregon (Rule 441-01-040(5), CCH para. 47,405); Pennsylvania (Rule Section 604.023, effective August 10, 2001, CCH para.48,571M); Tennessee (Rule 0780-4-1.05, CCH para. 54,405); and Utah (R164-25-5, CCH para. 57,418). In addition, no action letters often contain such statements.

There are, however, four situations in which no action letters can be useful:

(a) Counsel has independently concluded that the affirmative written authority (for example, a blue sky statute and published blue sky regulations) clearly justifies the conclusion that an exemption from registration, notice filing or offering document requirements is available, so that consistent, favorable no action letters become additional comfort in favor of an exemption.

(b) The pertinent no action letters suggest that an exemption from registration, notice filing or offering document requirements is not available generally or is available subject to certain limitations. In this situation, no action letters function as warnings.

(c) If time permits and the jurisdiction in question has a procedure for obtaining a no action letter, prior no action letters can be used as a basis for requesting a no action letter for the bond issue in question. However, not all states accept requests for no action letters. Ohio stopped providing no action letters approximately 30 years ago. Illinois Securities Law of 1953 Regulation 130.1520(a)(1)(E), CCH para. unavailable, provides that no action requests contain “a representation that the transaction in question has not been commenced and will not commence for at least 30 days,” which, as a practical matter, makes no action letters impossible to obtain in Illinois.

(d) No action letters can provide a general source of guidance when there simply is no authority available on which to base a conclusion. See, for example, the discussion concerning the general lack of definitions of the terms political subdivision, instrumentality, and body corporate and politic in Section II.A.3., infra.

Similar to the situation with respect to no action letters, informal telephone advice from a staff member of a blue sky commission can be useful if counsel has independently concluded that affirmative written authority clearly justifies the conclusion that an exemption from registration, notice filing or offering document requirements is available, so that informal telephone advice becomes additional comfort in favor of an exemption.
However, before making such a call, one should first discuss with the underwriter the need for such a call and ask the underwriter for permission to make the call and, if necessary, to identify the issuer and bonds in question. Staff members usually ask for the names of the issuer and the bonds, and my impression is that staff members are more likely to be helpful if they know who the parties are.

When assessing the value of guidance given in the form of no action letters and informal telephone advice, it is important to remember that for an out-of-state issuer whose bonds qualify as covered securities under Section 3(a)(2), a notice filing can provide a non-registration route to compliance without having to rely on no action letters and informal telephone advice; i.e., compliance with a notice filing requirement necessarily resolves all interpretive issues. The approach can be useful in Nevada, New Hampshire (provided that the offering is made on a “firmly underwritten basis”) and North Dakota, whose notice filing requirements do not include a consent to services of process signed by the issuer, but not in Montana and Washington, whose notice filing requirements do require a consent to service of process. Bond issuers routinely refuse to sign such consents, so when a consent to service of process is required as part of a notice filing the resolution of interpretive issues through satisfying a notice filing requirement is not possible.

In view of the foregoing, sometimes the prudent course is simply to advise the underwriter that because of a lack of clarity in the law of a particular jurisdiction, no offers of the bonds to the public may be made in that jurisdiction (although offers and sales may be made to qualifying institutional investors as part of an exempt transaction).

II. Patterns of Blue Sky Registration, Notice Filing and Offering document Requirements Applicable to Municipal Bonds

A. General Lack of Definitions of the Terms Political Subdivision and Instrumentality

1. Introduction Section 401(a)(1) of the 1956 Act provides an exemption from registration for municipal bonds, namely, “any security (including a revenue obligation) issued or guaranteed by the United States, any state, any political subdivision of a state, or any agency or corporate or other instrumentality of one or more of the foregoing…” [Emphasis added.] Similar exemptions from registration for municipal bonds are found in the 1985 Act and the 2002 Act. See Appendix A, Sections B., C., E. and F.

What do the terms political subdivision and instrumentality mean under blue sky laws?

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4 This result can occur in those jurisdictions which have imposed a notice filing requirement on municipal securities issued by out-of-state issuers because compliance with the blue sky law is stated in the alternative; i.e., it is unlawful to offer securities for sale to the public unless (1) they are registered or (2) they qualify for an exemption from registration or (3) they qualify as covered securities and the notice filing requirement has been satisfied. See, for example, Section 421-B:11.I., New Hampshire Revised Statutes Annotated.
The terms political subdivision and instrumentality are not defined in any state blue sky law or regulations promulgated thereunder, as published in the CCH Blue Sky Law Reporter. As discussed in Section II.A.3.(a), infra, in a handful of jurisdictions the term political subdivision is given meaning through other means (for example, statutory definitions of the term that are meant to be used in construing all statutes of the jurisdiction in question unless the context indicates otherwise). The general failure of state blue sky laws and regulations to contain definitions of the terms political subdivision and instrumentality presents a fundamental, jurisdictional issue for the practitioner: without definitions of these terms, how can one know in any particular case whether the municipal bond exemption from registration for a security issued by a political subdivision or instrumentality is available?

As discussed in Section II.A.2., infra, I believe that when the issuer in question is an out-of-state issuer and the bonds in question constitute covered securities under NSMIA, then the meanings of the terms political subdivision and instrumentality are determined by federal law, rather than state law, because a federal law, namely, NSMIA, has pre-empted the ability of states to impose registration, notice filing and merit condition requirements on municipal bonds issued by out-of-state issuers.

On the other hand, as discussed in Section II.A.3., infra, when the issuer in question is located within the boundaries of the jurisdiction in question (hereinafter an “in-state issuer”), then state law determines the meaning of the terms political subdivision and instrumentality. In addition, for all issuers, regardless of covered security status and the issuer’s location, in using Traditional Blue Sky Analysis one can also rely on state law definitions of these terms. The need to use Traditional Blue Sky Analysis can arise when NSMIA Analysis indicates that a notice filing that includes a consent to service of process signed by the issuer is required. Bond issuers routinely refuse to sign consents to service of process, which makes compliance with such a notice filing requirement impossible.

2. Out-of-State Issuers, Covered Securities and Federal Law

Prior to the enactment of NSMIA, Section 18 provided: “State Control of Securities. Nothing in this title shall affect the jurisdiction of the securities commission (or any agency or office performing like functions) of any State or Territory of the United States, or the District of Columbia, over any security or any person.”

In other words, prior to the enactment of NSMIA, the Securities Act of 1933 did not change the power of states to regulate the sale of securities.

Pursuant to NSMIA, Section 18 was substantially rewritten to provide for a partial federal pre-emption of state blue laws with respect to “covered securities.”

Section 18(a) provides that states and political subdivisions may not impose registration, offering document or merit condition requirements on covered securities. Section 18(b)(4)(C) provides that the term covered security includes a security that is exempt from registration under Section 3(a), except a municipal security that is a covered security under Section 3(a)(2) is not a covered security in the state in which the issuer is located. The significance of Section
18(b)(4)(C) for municipal securities is that a state may impose registration, offering document or merit condition requirements on in-state issuers of municipal securities. On the other hand, municipal securities issued by out-of-state issuers are covered securities under Section 18(b)(4)(C) and, thus, pursuant to Section 18(a), are not subject to registration, offering document or merit condition requirements, but may be subject to a notice filing requirement pursuant to Section 18(c)(2).

The problem is that the Securities Act of 1933 does not contain a definition of the term municipal security.

What is a municipal security under the Securities Act of 1933?

(a) What Is a Municipal Security under the Securities Act of 1933?

The legislative history of NSMIA (including Section 18) indicates that the term municipal security is defined by the exemptions contained in Section 3(a)(2). In discussing the concept of covered security under Section 18(b)(4)(C), House Report No. 104-622, 104th Cong., 2nd Session, page 32, 1996 U.S.C.C.A.N. 3877, at 3894, explained:

“Exempted securities” under section 3(a) of the Securities Act would also be “covered securities” and thus preempted from State registration, with three exceptions: (i) securities of non-profit and similar entities set forth in Section 3(a)(4); (ii) intrastate offerings under section 3(a)(11)(i); and (iii) municipal securities as defined in section 3(a)(2) (which would be preempted in every State but the State in which the issuer of such municipal securities is located). [Emphasis added.]

Of course, Section 3(a)(2) does not contain a definition of municipal securities; it simply lists the types of municipal bonds that qualify for an exemption from registration under Section 5 of the Securities Act of 1933. Section 3(a)(29) of the Securities Exchange Act of 1934 contains a definition of the term municipal security because that Act needs the definition in order to define related terms set forth in that Act (e.g., municipal securities dealer). On the other hand, until the enactment of NSMIA, the Securities Act of 1933 did not need a definition of municipal security, because municipal bonds were the subject of the Securities Act of 1933 in only one section, namely, the Section 3(a)(2) exemption from the registration requirements of Section 5. Thus, the words “as defined in Section 3(a)(2)” should be interpreted to mean “as listed in Section 3(a)(2).”

What types of entities are listed in Section 3(a)(2)?

(b) What Types of Entities Are Listed in Section 3(a)(2)?

Section 3(a)(2) provides an exemption from registration for:

Any security issued or guaranteed by…the District of Columbia, or by any State of the United States, or by any political subdivision of a State or Territory, or by any public instrumentality of one or more States or Territories..[Emphasis added.]
The legislative history of Section 3(a)(2) indicates that an entity’s status as a political subdivision or a public instrumentality is based on its ability to issue tax-exempt obligations.

Specifically, the House Committee Report for the Securities Act of 1933, H.R. Rep. 85, 73rd Cong., 1st Sess. 14 (1933), explained that Section 3(a)(2):

…exempts United States, Territorial, and State obligations, or obligations of any political subdivision of these governmental units. The term “political subdivision” carries with it the exemption of such securities as county, town, or municipal obligations, as well as school district, drainage district, and levee district, and similar bonds. The line drawn by the expression “political subdivision” corresponds generally with the line drawn by the courts as to what obligations of States, their units and instrumentalities created by them are exempted from Federal taxation. By delineation, any constitutional difficulties that might arise with reference to the inclusion of State and municipal obligations are avoided ...A committee amendment makes it clear that there are also exempt securities issued by a public instrumentality of one or more States or Territories exercising an essential governmental function, [hereinafter, the “1933 legislative history”] [Emphasis added.]

In 1934, the Section 3(a)(2) was amended to delete the qualifying language (“exercising an essential governmental function”) in order “to extend the scope of the public instrumentality exemption to expanding activities in which governments are engaging.” H.R. Rep. No. 1838, 73rd Cong., 2nd Sess. (1934) 40 (hereinafter the “1934 legislative history”).

Thus, the central concept of the terms political subdivision and public instrumentality under Section 3(a)(2) is the ability of the entity in question to issue debt the interest on which is excludable from gross income.

(c) What Types of Issuers of Are Capable of Issuing Tax-Exempt Debt?

If qualification for the exemption from registration pursuant to Section 3(a)(2) depends on an entity’s ability to issue debt the interest on which is excludable from gross income, what entities are capable of issuing a “State or local bond” the interest on which is excludable from gross income pursuant to Section 103(a) of the Internal Revenue Code of 1986, as amended (the “1986 Code”)?

The following is a summary list of such entities, which is taken mainly from FUNDAMENTALS OF MUNICIPAL BOND LAW 2005⁵, Section 2, pages 13 through 15:

(1) States of the United States. See Section 103(c), 1986 Code.

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(2) Indian tribes (which, pursuant to Section 7871(4) of the 1986 Code, are treated as States for purposes of Section 103 of the 1986 Code).

(3) Possessions, which include the U.S. Virgin Islands, Puerto Rico, American Samoa and Guam. See 103(c)(2), 1986 Code.


(5) Political subdivisions. Treasury Regulation 1.103-1(b) provides that the term “political subdivision” means “any division of any State of local governmental unit which is a municipal corporation or which has been delegated the right to exercise any part of the sovereign power of the unit. In Commissioner v. Shamberg’s Estate, 144 F.2d 998 (2d Cir. 144), cert. denied, the U.S. Court of Appeals for the Second Circuit identified three sovereign powers the presence or absence of which form the basis for determining whether an entity is a political subdivision: the power of eminent domain, the power to tax and the police power. See FUNDAMENTALS OF MUNICIPAL BOND LAW 2005, note 7, supra, Section 2, page 15, for a discussion of these sovereign powers.

(6) Constituted authorities that are specifically authorized pursuant to state law to issue bonds on behalf of a state or political subdivision, in accordance with Internal Revenue Service Revenue Ruling 57-187. Pursuant to Treasury Regulation 1.103-1(b), “Obligations issued by or on behalf of any State or local governmental unit by constituted authorities empowered to issue such obligations are the obligations of such a unit.” [Emphasis added.] Examples of constituted authorities include Alabama Industrial Development Boards (which are the subject of Revenue Ruling 57-187) and New York local development corporations that have been incorporated or reincorporated by one or more counties, cities, towns or villages of the State of New York, or any combination thereof, or the New York Job Development Authority, pursuant to Section 1411 of the New York Not-For-Profit Corporation Law. New York local development corporations and Revenue Ruling 57-187 are discussed in Section II.H.3.(b), infra.

(7) Nonprofit corporations that meet the requirements of Internal Revenue Service Revenue Ruling 63-20 (see Section II.H.3.(a), infra).

(8) Nonprofit corporations that issue Texas Qualified Scholarship Funding Bonds (see Section II.H.3.(c), infra).

(9) The obligor of an underlying tax-exempt obligation (such as a financing lease) for which certificates of participation are issued (see Section II.G, infra).

(d) SEC No Action Letters SEC no action letters⁶ also shed light on the meanings of the terms political subdivision and public instrumentality under Section 3(a)(2).

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⁶ An SEC no-action letter “is one in which an authorized staff official indicates that the staff [of the SEC] will not recommend any enforcement action to the [Securities and Exchange] Commission if the proposed transaction described in the incoming correspondence is consummated. In some instances, the staff will state in response to a no-action request that it is
Several SEC no action letter requests have cited 1933 legislative history as the basis for treating a particular issuer as a political subdivision or a public instrumentality and the 1934 legislative history for the proposition that taxability of interest of a particular bond issue does not affect the issuer’s status as a political subdivision or public instrumentality under Section 3(a)(2). See, for example, Kidder, Peabody & Co., Inc., July 17, 1984; Smith Barney, Harris Upham & Co., Incorporated, July 15, 1985; Arvada Urban Renewal Authority, July 28, 1986; and Newman & Associates, Inc., July 16, 1987.

Usually, however, the issuer’s status as a political subdivision or public instrumentality is dealt with summarily on the basis of counsel’s characterization of the issuer as a political subdivision or instrumentality under the state law of the issuer, because the major thrust of the no action request is not the issuer’s status under Section 3(a)(2) but some other issue – often whether the transaction includes a separate security under Rule 131. Thus, in most no action letters, the issuer’s status under Section 3(a)(2) is deduced from the fact that the major issue of the request was determined favorably and the issuer happened to be a city, town, village, etc. The issuer’s status as an entity described in Section 3(a)(2) comes into focus in connection with certificates of participation, bonds issued in compliance with Revenue Ruling 63-20 (“63-20 Bonds”), bonds issued in compliance with Revenue Ruling 57-187 (“57-187 Bonds”) and Texas Qualified Scholarship Funding Bonds.

The types of issuers found to qualify under Section 3(a)(2) pursuant to SEC no action letters are summarized in Appendix C. Such issuers include counties, cities, villages, state agencies issuing conduit bonds, local authorities and special purpose districts, local boards or agencies issuing conduit bonds and various issuers issuing tax-exempt industrial development bonds in reliance on the IDB Exemption.\footnote{These no action letters and their analysis are taken from Thomas N. Harding, Political Subdivisions and Instrumentalities Under State Blue Sky Laws, THE BOND LAWYER®, issue dated September 1, 2006 [hereinafter POLITICAL SUBDIVISIONS ARTICLE]}

In addition, properly structured certificates of participation are also treated as securities issued by the state or municipal entity that is obligated to make payments on the underlying

\footnote{Unable to assure the writer that it will not recommend enforcement action to the Commission if the transaction occurs in the manner proposed by the writer.” See Procedures Utilized by the Division of Corporation Finance for Rendering Informal Advice, Securities and Exchange Commission Release No. 33-6253 (October 28, 1980), 180 SEC LEXIS 443.}
Properly structured 63-20 Bonds, NYLDC Bonds and Texas Qualified Scholarship Fund Bonds are also treated as exempt from registration under Section 3(a)(2).

However, the binding effect of and ability of third parties to rely upon SEC no action letters is both limited, as discussed below, and helpful, as discussed in the following Section.

The SEC itself has recognized that “The practice of issuing no action and interpretive letters in response to written requests has been singled out in the past as an ‘excellent practice in administrative procedure,’ and many members of the public have come to rely on the informal advice provided in this manner.” Securities Act Release No. 6253, dated October 28, 1980, 1980 SEC LEXIS 443. [Emphasis added.] Footnote 4 at the end of the immediately preceding quoted sentence cautions:

Members of the public are entitled to rely on no-action and interpretive letters as representing the views of the [Division of Corporate Finance]. Such letters, however, set forth staff positions only and do not constitute an official expression of the Commission’s views. See 17 CFR 202.1(d) [Emphasis added.]

17 CFR 202.1(d), cited above, provides:

While opinions expressed by members of the staff do not constitute an official expression of the Commission’s views, they represent the views of the persons who are continuously working with the provisions of the state involved. [Emphasis added.]

(e) Political Subdivisions and Public Instrumentalities Under Section 3(a)(2) I think that political subdivision or public instrumentality status under Section 3(a)(2) is determined by the entity’s ability to issue debt the interest on which is excludable from gross income, as corroborated by SEC pronouncements, including no action letters (which covers most issuers of municipal bonds) or as limited by additional requirements enunciated by the SEC, including requirements set forth in SEC no action letters. Examples of such additional requirements appear in no action letters concerning certificates of participation, as discussed in Section II.G. infra; 63-20 Bonds, as discussed in Section II.H.3(a), infra; and Texas Qualified Scholarship Funding Bonds, as discussed in Section II.H.3.(b), infra.

What is striking is the degree of congruence between the type of entity that is qualified to issue tax-exempt debt for purposes of the Internal Revenue Code and the type of entity that qualifies for an exemption from registration pursuant to SEC pronouncements, including SEC no action letters. The only incongruence that I have found between federal tax treatment and securities law treatment of these entities is that while interest on properly issued obligations of

8 See II.G., infra.
9 See II.H.3.(a), infra.
10 See II.H..3.(b), infra.
11 See II.H.3.(c), infra.
Indian tribes is excludable from gross income for federal income tax purposes, such obligations are not exempt from registration under Section 3(a)(2). See E.F. Hutton & Co., September 27, 1985. In that no action request, tax-exempt Indian tribe bonds were being offered to institutional investors in the minimum denomination of $200,000 and increments of $100,000 above that amount (i.e., in a private placement); the SEC’s response made it clear that no action would be taken because the bonds qualified under the Bank Exemption. An Indian tribe may be treated as a State for federal tax law purposes, but it is not treated as a State under Section 3(a)(2).

(f) Summary of Argument and Conclusion Section 18(a) prohibits states from imposing registration, offering document and merit condition requirements on covered securities. Pursuant to Section 18(b)(4)(C), a covered security includes any security described in Section 3(a)(2), except that a municipal security is not a covered security in the state in which the issuer is located. The significance of Section 18(b)(4)(C) for municipal securities is that states may continue to impose registration, offering document and merit condition requirements on municipal securities issued by in-state issuers but may not impose such requirements on municipal securities issued by out-of-state issuers. Pursuant to Section 18(c)(2)(A), states may, however, impose notice filing requirements on municipal securities issued by out-of-state issuers.

The legislative history of NSMIA indicates that the term covered security under Section 18 includes securities that are exempt from registration under Section 3(a), subject to three exceptions. One of the exceptions to covered security status under Section 3(a) is municipal securities, as defined or listed in Section 3(a)(2). Municipal securities listed in Section 3(a)(2) include securities issued or guaranteed by political subdivisions and public instrumentalities. The terms political subdivision and public instrumentality, as used in Section 3(a)(2), must necessarily take their meanings from federal law, rather than state law, because Section 3(a)(2) is part of a federal statute. Since the Securities Act of 1933 does not define the terms political subdivision and public instrumentality, the meanings of these terms under the Securities Act of 1933 should be based upon the legislative history of Section 3(a)(2) (i.e., those entities that have the power to issue obligations the interest on which is excludable from gross income), as corroborated or limited by federal securities law concepts, including SEC no action letters.

However, NSMIA did not completely federalize the meanings of the terms political subdivision and instrumentality under state blue sky laws, because the federal pre-emption under Section 18(b)(4)(C) does not apply to in-state issuers. In addition, for all issuers, regardless of covered security status and the issuer’s location, in using Traditional Blue Sky Analysis one can also rely on state law definitions of these terms. The need to use Traditional Blue Sky Analysis can arise when NSMIA Analysis indicates that a notice filing that includes a consent to service of process signed by the issuer is required. Bond issuers routinely refuse to sign consents to service of process, which makes compliance with such a notice filing requirement impossible.

3. All Issuers and State Law

(a) Issuers Characterized as Political Subdivisions
(1) **Summary** There is some state case law that attempts to define the term political subdivision in a general manner that might be used as a basis for construing the meaning of this term under a blue sky law. Florida and Pennsylvania provide statutory definitions of the term political subdivision that are of general applicability to all statutes, unless the context indicates otherwise. State no action letters can provide guidance as to the meaning of this term not because of the analysis of the meaning of the term contained in the no action letters (which is generally absent), but because of the apparent willingness of state securities commissions to treat the issuer’s status favorably and summarily, as a prelude to moving on to the issue that is the real focus of the no action request.

(2) **Case Law** There is some case law that attempts to set forth a general definition of the term political subdivision. *Lydecker v. Englewood*, discussed below, appears to be the leading case.

In striking down a real estate tax levied by a sewage and drainage district whose governing commissioners were elected by property owners rather than the voters in general, the 1879 decision of the New Jersey Supreme Court in *Lydecker v. Englewood*, 41 N.J.L. 154, 156 ("*Lydecker*”) discussed the history and meaning of the term political subdivision as follows:

> The political divisions of the state are those which are formed for the more effectual or convenient exercise of political power within the particular localities. Originally, counties and townships, in which a uniform state policy is observable, composed this class almost or quite exclusively. Then, as population became denser in certain places, and there was added to this common design a special necessity for local government different from that proper to more rural districts, villages, towns and cities were constituted, and, as these were separated by their charters of incorporation from the townships of which they had before been part, and absorbed their functions, they also became political divisions. In these institutions, therefore, must be discovered the essential characteristics of their class, and they will be such common and prominent features as have co-existed with these organizations throughout their history, and are not possessed by other bodies of legislative creation which stand outside of the same category. These distinctive marks are, I think, that they embrace a certain territory and its inhabitants, organized for the public advantage, and not in the interest of particular individuals or classes; that their chief design is the exercise of governmental functions, and that to the electors residing within each is, to some extent, committed the power of local government, to be wielded either mediately or immediately, within their territory, for the peculiar benefit of the people there residing. Bodies so constituted are not merely creatures of the state, but parts of it, exerting the powers with which it is vested for the promotion of those leading purposes which it was intended to accomplish, and according to the spirit which actuates our republican system. [Emphasis added.]

See also the 1897 New Jersey Supreme Court decision in *Smith v. Howell*, 60 N.J.L. 384, 386, which cited the above, underlined text in *Lydecker* in upholding the constitutionality of an act providing for the formation of street lighting districts and the 1902 decision of the Court of Errors and Appeals of New Jersey in *Allison v. Corker*, 67 N.J.L. 596, 606, which cited the
above, underlined text in Lydecker in upholding the constitutionality of an act providing for the formation of road districts.

In 1927, the Supreme Court of Arizona in Sorenson v. Arizona, 31 Ariz. 421 at 425, 254 P. 234 at 231 (“Sorenson”), cited the above, underlined text in Lydecker in holding that a school district was a political subdivision under a statute providing for election contests involving a county, city or political subdivision of either. In 1975, the Court of Appeals of Arizona, Division Two, in McClanahan v. Cochise College, 540 P.2d 744 at 747, 25 Ariz. App. 13 at 17, quoted Sorenson’s citation of Lydecker in holding that a junior college district was a political subdivision under an exemption from a statute providing for judicial review of administrative actions.

(3) Statutory Definitions: Florida and Pennsylvania Section 1.01, Florida Statutes, provides: “In construing these statutes and each and every word, phrase, or part hereof, where the context will permit...(8) The words “public body,” “body politic,” or “political subdivision” include counties, cities, town, villages, special tax school districts, special road and bridge districts, bridge districts, and all other districts in this state.”

Title 1, Section 1991, Pennsylvania Consolidated Statutes provides: “The following words and phrases, when used in any statute finally enacted on or after September 1, 1937, unless the context clearly indicates otherwise, shall have the meanings given to them in this section...Political Subdivision. Any county, city, borough, incorporated town, township, school district, vocational school district and county institution district.”

(4) Colorado, District of Columbia and South Dakota Under the blue sky laws of Colorado, the District of Columbia, and South Dakota, the terms political subdivision and instrumentality are defined by federal law rather than state law because of the express coordination of federal and state exemptions from registration under the Colorado and District of Columbia blue sky laws and because of a South Dakota policy statement that expressly adopts the federal definitions of the terms political subdivision and instrumentality.

Section 11-51-311, Colorado Revised Statutes, provides:

In furtherance of the policy stated in section 11-51-101(3), the exemptions under sections 11-51-307 to 11-51-309 shall be coordinated with exemptions for securities and transactions under the federal “Securities Act of 1933” so that an offering registered under the federal “Securities Act of 1933” shall be subject to registration by filing under this article in the absence of an exemption under this article and so that an offering exempt from registration under the federal “Securities Act of 1933”, other than pursuant to the exemption for intrastate offerings, shall also be exempt from registration under this article. The securities commissioner shall make, amend, and rescind rules in order to effectuate such policy. Nothing in this section shall limit the powers or actions of the securities commissioner to make, amend, and rescind rules with regard to exemptions provided by sections 11-51-307 and 11-51-308 or added by section 11-51-309 but not contained in the federal “Securities Act of 1933” or rules and regulations thereunder. [Emphasis added.]
Similarly, Section 31-5604.06(a) of the District of Columbia Code [Section 406(a) of the District of Columbia Securities Act] provides:

(a) In furtherance of the policy stated in section 102(b), the exemptions under sections 401, 402 and 403 shall be coordinated with exemptions for securities and transactions under the Securities Act of 1933 so that an offering registered under the Securities Act of 1933 shall be subject to registration by filing under this act in the absence of an exemption under this act, and an offering exempt from registration under the Securities Act of 1933, other than under the exemption for intrastate offerings, shall be exempt from registration under this act. [Emphasis added.]

South Dakota Policy Statement dated October 20, 2006, CCH para. 52,584, provides:

The primary reason for the South Dakota enactment of the Uniform Act of 2002 (the "Act") was to coordinate state and federal law wherever possible in order to alleviate some of the burdens and confusion that can be associated with interstate transactions. In those instances in which the Act and the rules thereunder have not defined a particular term and there is a federal definition, no-action letter or federal interpretive opinion with respect to that term, the Division accepts the federal definition, no-action letter or interpretive opinion of the term. Therefore, the Division will interpret the terms "political subdivision" and "instrumentality" in the same manner as the Securities and Exchange Commission interprets those terms under Section 3(a)(2) of the Securities Act of 1933, as amended.

(5) State No Action Letters State no action letters published online by LexisNexis at www.LexisNexis.com/State Securities Administrative Decisions, No Action Letters provide guidance as to the meaning of the term political subdivision. I use the term “guidance,” because, as discussed in Section I.F., state no action letters are not meant to be binding as precedent. However, in most cases, state no action letters involving the issuer’s status as a political subdivision are the only written guidance available.

Determination of political subdivision status pursuant to state no action letters usually parallels the list of qualifying entities listed in Lydecker (i.e., counties, townships, villages, towns and cities) and the 1933 legislative history of Section 3(a)(2) (i.e., “county, town, or municipal obligations, as well as school district, drainage district, and levee district, and similar bonds”).

Like SEC no action letters, except in situations where the structure of the financing is integral to the conclusion that the obligations are being issued by a political subdivision (e.g., certificates of participation, discussed in Section II.G), in state no action letters the question of whether the bonds in question are being issued by a political subdivision within the meaning of the blue sky law in question is dealt with summarily, because some other issue (for example, whether a separate security is part of the financing or whether the bonds are payable from payments to be made by a nongovernmental industrial or commercial enterprise) is the focus of the no action letter.
Thus, in many instances, the simple assertion in the no action request that the issuer in question constitutes a political subdivision under the law in the jurisdiction in which the issuer is located is sufficient for the securities commission staff to conclude that the issuer is the type of entity that qualifies under the jurisdiction’s municipal bond exemption from registration. In such no action requests, the assertion is usually made without any supporting citation. See, for example, Round Rock Independent School District, 1991 Ala. Sec. LEXIS 40; Shawnee County, Kansas, 1994 Ariz. Sec. LEXIS 7; and Salt Lake City Utah and Unita County, Wyoming, 1985 Conn. Sec. LEXIS 54.

Often, the assertion in the no action request of the issuer’s legal status under the laws of the issuer’s jurisdiction is sufficient to justify the conclusion that the issuer is a political subdivision. See, for example, the three bond issues that were the subject of City of Naperville, Illinois, 1983 Ala. Sec. No-Act LEXIS 3 (the issuers of which were the City of Wichita, Kansas, “a municipality organized under the laws of the State of Kansas”; the City of Naperville, Illinois, “a city organized under the laws of the State of Illinois”; and the Village of Glendale Heights, “a village organized under the laws of the State of Illinois”).

There are also several instances of favorable no action letters that involved issuers whose legal status is based upon words and concepts not found in blue sky laws (i.e., the issuer’s legal status is based on home rule concepts). See, for example, City of St. Cloud, Minnesota, 1985 Tex. Sec. LEXIS 49 (in which the city was described as “a home rule charter city”); City of Chicago, Illinois, 1984 Conn. Sec. No-Act. LEXIS 113, and City of Chicago, Illinois, 1984 Md. Sec. No-Act. LEXIS 172 (in both no action requests the City of Chicago was described as “a municipal corporation and home rule unit of local government”); and Municipality of Anchorage, Alaska, 1991 Wa. Sec. LEXIS 106 (in which the municipality was described as “a municipal corporation organized under the Constitution and laws of the State of Alaska and its home rule charter”).

(b) Issuers Characterized as Instrumentalities What constitutes an instrumentality under state blue sky laws?

As discussed in Section II.A.3.(a)(4), supra, Colorado and the District of Columbia have adopted the federal meaning of the term instrumentality because their blue sky laws expressly coordinate their exemptions from registration with the federal exemptions from registration, and South Dakota has expressly adopted the federal meaning of the term pursuant to a policy statement.

The California Commissioner of Corporations has announced a list of factors to be considered in determining whether a nonprofit corporation qualifies as an instrumentality of a political subdivision under the California municipal bond exemption from registration (for example, whether the political subdivision has approved the formation, articles of incorporation bylaws and officers and directors of the corporation and must approve changes in the articles of incorporation, bylaws and officers and directors or that it reserves a right of disapproval). See, for example, Commissioner’s Opinion No. 74/98C, 1974 Cal. Sec. LEXIS 5, and Commissioner’s Opinion 76/22C, 1976 Cal. Sec. LEXIS 3.
In Clay County Medical Corporation, 1984 Wis. Sec. LEXIS 185, the Wisconsin Office of the Commissioner of Securities (the “Office”) announced that the status of a nonprofit corporation as an instrumentality under the Wisconsin municipal bond exemption was a legal opinion that the Office was not authorized to render and that the determination of such status must either be made by an opinion of private attorneys on behalf of the nonprofit corporation or by an opinion from an appropriate governmental agency empowered to determine the status of the nonprofit corporation under applicable state law. In Los Angeles County Asset Leasing Corporation, 1984 Wis. Sec. LEXIS 170, the Office granted the no action request based on requesting counsel’s opinion that the nonprofit corporation issuer was a political subdivision of the State of California. In County of Shasta Public Facilities Corporation, 1984 Wisc. Sec. LEXIS 187, the Office granted the no action request based on an opinion from the California Department of Corporations that the nonprofit corporation was an instrumentality of the County of Shasta, California.

The Wisconsin approach of looking to the law of the issuer’s state to determine instrumentality status has been widely used by state securities commissions in no action letters.

Issuers that are characterized simply as an instrumentality under the law of the jurisdiction that provides for their formation have been found to be an instrumentality under state blue sky laws. See, for example, The Health, Educational and Housing Facilities Board of the County of Knox, Tennessee, 1985 Conn. Sec. No-Act. LEXIS 16, in which the issuer was characterized as a “public instrumentality of the County of Knox,” Travis County Health Facilities Development Corporation, 1993 S.D. Sec. No-Act. LEXIS 99, in which the issuer was characterized as an “instrumentality of Travis County, Texas, itself a political subdivision of the State of Texas,” and Guam Airport Authority, 1993 S. D. Sec. No-Act. LEXIS 1, in which the issuer was characterized as an “instrumentality of the Government of Guam, a territory of the United States.”

Some issuers’ state law status as an instrumentality is coupled with its status as a political subdivision under state law. See, for example: Industrial Development Authority of Russell County (Virginia), 1982 Ala. Sec. LEXIS 12, in which the issuer was described as a “public body corporate and politic and a political subdivision of the Commonwealth of Virginia”; Request for Interpretive Opinion, 1986 Mass. Sec. LEXIS 34, and Request for Interpretive Opinion, 1986 N. Dak. Sec. LEXIS 71, both of which described the Bordentown Sewerage Authority as “a public body corporate and politic constituting a political subdivision of the State of New Jersey”; and Hermantown Economic Development Authority, 1996 Minn. Sec LEXIS 29, in which the issuer was described as a “public body corporate and politic and a ‘political subdivision’ of a state”.

Far more frequently, the issuer’s status as an instrumentality under state law is coupled with its status as a body corporate and politic. See, for example: Maine Health and Educational Facilities Authority, 1992 Ariz. Sec. LEXIS 20, in which the issuer was described as a “public body corporate and politic and an instrumentality of the State of Maine”; The Illinois Health Facilities Authority, 1985 Conn. Sec. LEXIS 386, in which the issuer was described as “a body politic and corporate and an instrumentality of the State of Illinois”; Missouri Higher Education
Loan Authority, 1988 N.J. Sec. LEXIS 234, in which the issuer was described as an “instrumentality and body corporate and politic of the State of Missouri”; Maryland Health and Higher Education Facilities Authority, 1989 N. Dak. Sec. LEXIS 55, in which the issuer was described as a “body politic and corporate constituting a public instrumentality organized and existing under the laws of the State of Maryland”; and The Health, Educational and Housing Facility Board of the City of Jackson (Tennessee), 1985 Pa. Sec. LEXIS 249, in which the issuer was described as a “public body corporate and politic and an instrumentality of the City of Jackson”.

Since status of an issuer as an instrumentality is so often coupled with status as a body corporate and politic, what is a body corporate and politic under state blue sky laws?

Like the terms political subdivision and instrumentality, the term body corporate and politic is not defined in any state blue sky statute or regulation. There are numerous examples of court decisions that attempt to define this term in the context of a statute that does not relate to municipal bonds (for example, a tort claims act that attempts to limit tort liability of the state in question and its political subdivisions or a statute providing for judicial review of administrative actions), and, thus, their applicability to the blue sky law of the state in question is uncertain at best.

Whatever its literal meaning may be, the term body corporate and politic appears to be an unspoken qualifying category under municipal bond blue sky law exemptions from registration, because state securities commissions readily declare the availability of the municipal bond exemption for issuers that are characterized simply as a body corporate and politic under the law of the issuer’s jurisdiction. See, for example, Allegheny County Hospital Authority, 1985 Ky. Sec. LEXIS 13, in which the issuer was described as a “body corporate and politic created under Act 164 of the General Assembly of the Commonwealth of Pennsylvania”; Development Authority of Burke County, 1989 Mass. Sec. LEXIS 64, in which the issuer was described as a “public body corporate and politic of the State of Georgia”; Housing and Redevelopment Authority of Virginia, Minnesota, 1998 Minn. Sec. LEXIS 14, in which the issuer was described as a “public body, corporate and politic of the State of Minnesota”; University of Illinois, 1991 Minn. Sec. LEXIS 16, in which The Board of Trustees of the University of Illinois was described as a “body corporate and politic of the State of Illinois”; South Carolina Jobs – Economic Development Authority, 1995 N.J. Sec. LEXIS 28, in which the issuer was described as a “public body corporate and politic of the State of South Carolina”; and Housing Finance Authority of Pinellas County, 1987 Wyo. No-Act. LEXIS 40, in which the issuer was described

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12 See, for example, Hamilton County Board of Mental Retardation and Developmental Disabilities et al. v. Professionals Guild of Ohio (1989), Supreme Court of Ohio, 46, Ohio St. 3d 147, 150, 545 N.E.2d 1260, 1262: “A body corporate and politic is a governmental body or public corporation having powers and duties of government…Black’s Law Dictionary (5 Ed. 1979), defines ‘public corporation’ as …one created by the state for political purposes and to act as an agency in the administration of civil government, generally within a particular territory or subdivision of the state, and usually invested, for that purpose, with subordinate and local powers of legislation; such as a county, city, town, or school district.”
as a “public body corporate and politic created in accordance with the Florida Housing Finance Authority Law”.

B. Definitions and the District of Columbia, Guam, Puerto Rico and the U.S. Virgin Islands

1. **Introduction** Municipal bonds issued by the District of Columbia, Puerto Rico, Guam and the U.S. Virgin Islands and their respective instrumentalities are exempt from registration under Section 3(a)(2) and state blue sky laws, but the path to these exemptions is not always straightforward.

2. **Section 3(a)(2)** Section 3(a)(2) provides an exemption from registration for “Any security issued or guaranteed by the United States or any territory thereof, or by the District of Columbia…or by any public instrumentality of one or more States or territories...” [Emphasis added.] Section 3(a)(6) provides that the term territory “means Puerto Rico, the Virgin Islands, and the insular possessions of the United States.” The Securities Act of 1933 and SEC no action letters appear to be silent as to the status of Guam, but the Office of Insular Affairs of the U.S. Department of the Interior treats Guam as a territory.\(^{13}\) Thus, the foregoing provisions provide an exemption from registration for securities issued by the District of Columbia, Puerto Rico, the U.S. Virgin Islands and Guam, as well as instrumentalities of the foregoing, except instrumentalities of the District of Columbia. However, in District of Columbia Housing, April 26, 1982, the SEC recognized that bonds issued by the District of

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\(^{13}\) The Office of Insular Affairs of the U.S. Department of the Interior also treats Puerto Rico and the U.S. Virgin Islands as territories. See the definition of the term territory on the web site of the U.S. Department of Interior, Office of Insular Affairs, [www.doi.gov/oia](http://www.doi.gov/oia).
Columbia Housing Finance Agency are exempt as securities issued by a public instrumentality under Section 3(a)(2).

Thus, securities issued by (1) the District of Columbia, Puerto Rico, Guam and the U.S. Virgin Islands, (2) the District of Columbia Housing Finance Agency, and (3) instrumentalities of Puerto Rico, Guam and the U.S. Virgin Islands are exempt from registration under Section 3(a)(2) and, therefore, are covered securities under Section 18(b)(4)(C), except in the jurisdiction in which the issuer is located.

3. **State Blue Sky Laws**  
Section 402(a)(1) of the 1956 Act provides an exemption from registration for “any security (including a revenue obligation) issued or guaranteed by the United States, any state, any political subdivision of a state, or any agency or corporate or other instrumentality of one or more of the foregoing.” [Emphasis added.] Section 401(m) of the 1956 Act provides that state “means a state, commonwealth, territory, or possession of the United States, the District of Columbia, and Puerto Rico.” As discussed in Section II.B.2., supra, Guam, Puerto Rico and the U.S. Virgin Islands are treated as U.S. territories by the United States Department of the Interior.

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14 In District of Columbia Housing, April 26, 1982, counsel requesting the no-action letter pointed out that even though the enabling act for the District of Columbia Housing Finance Agency (“DCHFA”) expressly designated DCHFA an “instrumentality of the District of Columbia,” securities issued by DCHFA would not enjoy the benefit of the exemption from registration under the General Exemption of the Securities Act of 1933 because under Section 3(a)(2) the benefit of instrumentality status extends only to instrumentalities of states and territories.

Counsel argued that the lack of an express exemption for DCHFA obligations appeared to be attributable to legislative oversight, since the legislative history of the Securities Act of 1933 demonstrated a plain intention to exempt the obligations of all units or corporate bodies that, like DCHFA, could properly be said to be performing “an essential governmental function” and that there was no affirmative indication that Congress intended to treat DCHFA differently than any other state or territory under the Securities Act of 1933 or the other securities laws. Counsel also pointed out that the Securities Exchange Act of 1934 (the “1934 Act”) exempts DCHFA obligations (because under the 1934 Act the definition of “State” includes the District of Columbia), and cited court decisions to the effect that the Securities Act of 1933 and the 1934 Act should be construed as “one comprehensive scheme of regulation.” Thus, to require a literal reading of Section 3(a)(2) would subvert Congressional intent to exempt securities issued by all governmental instrumentalities and would lead to an inequitable and unjustifiable result, and, therefore, obligations of DCHFA “should be considered to be exempt securities pursuant to Section 3(a)(2) of the Act” [emphasis added].

The SEC was persuaded. The response of the SEC Division of Corporate Finance was that the Division would not recommend any enforcement action to the SEC if the DCHFA, “in reliance upon your opinion as counsel that it is an instrumentality whose securities are exempt under Section 3(a)(2) of the Securities Act of 1933, issues and sells its securities without compliance with the registration provisions of that Act.” [Emphasis added.]
Sections 101(18) and 401(b)(1) of the 1985 Act and Sections 102(31) and 201(1) of the 2002 Act contain similar provisions.

Thus, the general pattern of state blue sky laws is that securities issued by the District of Columbia, Puerto Rico, Guam and the U.S. Virgin Islands and their respective agencies and instrumentalities enjoy the benefit of the municipal bond exemption from registration because the term state is defined to include the District of Columbia, Puerto Rico and territories of the United States (which include Guam, Puerto Rico and the U.S. Virgin Islands).

However, there are some exceptions to this general pattern of state blue sky laws:

(a) The Arizona blue sky law does not provide a definition of state, but it includes securities issued by any territory, insular possession and the District of Columbia (as well as any agency or instrumentality thereof) within the municipal bond exemption itself. See Section 44-1843.A.1., Arizona Revised Statutes. The blue sky laws of Florida and Texas take the same approach. See Section 517.051.(1), Florida Statutes and Section 581-5.M., Texas Statutes.

(b) The Oregon municipal bond blue sky law exemption from registration (Section 59.025.(1)(a), Oregon Revised Statutes) follows the 1956 Act exemption from registration, but the definitions section of the Oregon blue sky law does not contain a definition of state, which, as discussed above, is the usual way that state blue sky laws extend the benefit of the municipal bond blue sky law exemption registration to the District of Columbia and U.S. territories. However, the same result is accomplished pursuant to Section 174.100, Oregon Revised Statutes, which provides: “As used in the statute laws of this state, unless the context or a specifically applicable definition requires otherwise…(9) “United States” includes territories, outlying possessions and the District of Columbia.” Similarly, under the Tennessee blue sky law the municipal bond exemption from registration is extended to the District of Columbia and U.S. territories by Section 1-3-105(32), Tennessee Code, which provides: “As used in this code, unless the context otherwise requires…(32) ‘State,’ when applied to the different parts of the United States, includes the District of Columbia and the several territories of the United States.”

(c) The District of Columbia municipal bond exemption follows the 1956 Act municipal bond exemption (Section 31-5604.01(1) of the District of Columbia Code [Section 401 of the District of Columbia Securities Act], CCH para. 16,1210), but the District of Columbia blue sky law does not include the District of Columbia in the definition of State (See Section 31-5601.(33) of the District of Columbia Code [Section 101 of the District of Columbia Securities Act], CCH para. 16,101). However, because of the express coordination of District of Columbia exemptions from registration with exemptions from registration under the Securities Act of 1933, securities issued by the District of Columbia and the District of Columbia Housing Finance Agency are exempt from registration under the District of Columbia municipal bond exemption.

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15 See Section II.B.2., supra, for a discussion of the exemption under Section 3(a)(2) and Section II.F.3.(e), infra, for a discussion of the coordination of District of Columbia and federal exemptions from registration.
C. Anomalous Exemptions from Registration: Arkansas and Nebraska

1. The Arkansas municipal bond exemption applies only to “any security, including a revenue obligation, issued or guaranteed by this state, any political subdivision of this state, or any agency or corporate or other instrumentality of one or more of the foregoing…” Section 23-42-503(a)(1), Arkansas Statutes [Emphasis added]. This anomaly of excluding securities issued by out-of-state issuers from the municipal bond exemption is shared with Nebraska (discussed below).

However, this anomaly is not insurmountable. Because of the enactment of NSMIA, municipal bonds issued by non-Arkansas issuers are covered securities pursuant to Section 18(b)(4)(C). Such covered securities are exempt from the Arkansas notice filing requirement, which applies only to covered securities under Section 18(b)(2) (securities issued by investment companies) and offerings pursuant to Rule 506 of Regulation D. See Arkansas Rule 509.01, CCH para. 10,509.

2. The Nebraska municipal bond exemption also applies only to in-state issuers. See Section 8-1110(1), Nebraska Revised Statutes. As is the case in Arkansas, because of the enactment of NSMIA municipal bonds issued by non-Nebraska issuers are covered securities under Section 18(b)(4)(C). Such covered securities are exempt from the Nebraska notice filing requirement, which applies only to offerings by investment companies, offerings pursuant to Rule 506 of Regulation D and offerings by agricultural cooperatives. See Chapter 20, Nebraska Blue Sky Rules, CCH para. 37,420.

D. Regulation of Conduit and Revenue Bonds

1. Montana, New Mexico, North Dakota, Rhode Island, Washington and Wisconsin – Exclusion of NGICE Bonds from the Municipal Bond Exemption

   (a) General Lack of Uniformity

   Many state blue sky laws exclude from the municipal bond exemption bonds payable from revenues to be received from a nongovernmental industrial or commercial enterprise unless the payments are insured or guaranteed by a person whose securities are exempt from registration under one of several enumerated exemptions or unless the payments are the direct obligation of such a person. This exclusion from the municipal bond exemption is due mainly to the enactment of the Uniform Securities Act (1985) with 1988 Amendments (the “1985 Act”), which was promulgated by NCCUSL. For a discussion of the 1985 Act and its role in the evolution of blue sky laws, see Appendix A, Section C., infra.

   As of the date of this paper, the blue sky laws of the States of Montana, New Mexico, North Dakota, Rhode Island, Washington and Wisconsin (collectively, the “NGICE States”) contain some variation of the 1985 Act’s exclusion from the municipal bond exemption from
registration (the “1985 Act Exclusion”) for bonds payable solely from revenues to be received from a nongovernmental industrial or commercial enterprise (hereinafter, a “NGICE”). See Section 30-10-104(1), Montana Code Annotated - 2007; Section 201.A., New Mexico Uniform Securities Act; Section 7-11-401(1), Rhode Island General Laws; Section 10-04-05.2, North Dakota Century Code; Section 21.20.310.(1), Revised Code of Washington; and Section 551.201.(1)(a), Wisconsin Statutes.

Each of these states has enacted its own version of the 1985 Act Exclusion.

The 1985 Act Exclusion focuses on “any security payable solely from revenues to be received from a nongovernmental industrial or commercial enterprise,” under the New Mexico, North Dakota, Rhode Island and Washington blue laws. See Section 201A. New Mexico Uniform Securities Act, Section 10-04-05.1., North Dakota Century Code, Section 7-11-401(1), Rhode Island General Laws and Section 21.20.310(1), Revised Code of Washington. The blue sky laws of Montana and Wisconsin require that such payments be “received in respect of property or money used under a lease, sale or loan arrangement by or for a nongovernmental industrial or commercial enterprise” [Emphasis added], which parallels the language of SEC Rule 131. See Section 30-10-104(1), Montana Code Annotated – 2007 and Section 551.201(1)(a), Wisconsin Statutes. The Wisconsin blue sky law deletes the word solely from the operative phrase.

The differences in these states’ formulation of the 1985 Exclusion become more pronounced when one tries to determine exactly what constitutes a nongovernmental industrial or commercial enterprise under these states’ blue sky laws. Often, the meaning to be gleaned is set forth in no action letters.

As to lack of meaning to the term NGICE, except for Washington, none of these states’ blue sky statutes, regulations, policy statements or published no action letters has provided a comprehensive definition of a NGICE. There is substantial disagreement among these states as to whether conduit 501(c)(3) bonds, student loan bonds and single family mortgage revenue bonds constitute bonds payable from revenues to be received from a NGICE. There is also substantial disagreement as to those entities whose insurance, guarantee or direct obligation can provide an exemption from registration for a security that would otherwise not be exempt

16 Some form of the 1985 Act Exclusion had also been in effect at one time or another in Iowa, Maine, Minnesota, Nevada and South Dakota, but ended when Iowa, Maine, Minnesota and South Dakota each enacted the 2002 Act and was expanded in Nevada when the operative term was changed to “enterprise.”

17 The citation is to the New Mexico Uniform Securities Act rather than to the New Mexico Statutes, because the New Mexico Uniform Securities Act became effective on January 1, 2010 and does not appear to have been codified as the date of this paper. The New Mexico Uniform Securities Act is based on the 2002 Act and is set forth in the CCH Blue Sky Law Reporter.

18 See Section I.E., supra, for a discussion of the extent to which no action letters can be used as part of legal analysis.
from registration because it is payable [solely] from revenues to be received from a nongovernmental industrial or commercial enterprise (hereinafter a “NGICE Bond”), and none of these states has adopted the 1985 Act list of such entities verbatim.

The following is a description of how each of these states deals with the concept of the municipal bonds payable from revenues to be received from a NGICE.

(b) Montana Section 30-10-104(1), Montana Code Annotated – 2007, excludes NGICE Bonds from the municipal bond exemption from registration unless the “enterprise or any security of which it is the issuer is within one of the exemptions enumerated in subsections (2) through (15)” of Section 30-10-104. As summarized in subparagraphs (1), (2) and (3) below, three of the subsections (2) through (15) of Section 30-10-104 provide possible exceptions to the Section 30-10-104 exclusion from the municipal bond exemption for NGICE Bonds, but only the exception described in subparagraph (2) below is useful as a practical matter.

(1) Conduit 501(c)(3) Bonds The unpublished position of the Securities Department of the Montana State Auditor’s Department is that conduit 501(c)(3) bonds are securities payable from revenues to be received by a nongovernmental industrial or commercial enterprise. Section 30-10-104(8), Montana Code Annotated – 2007 provides an exemption from registration for any security issued by a qualifying nonprofit entity, provided that the issuer pays a fee of $50 and files with the commissioner 20 days prior to the offering a written notice specifying the terms of the offer and the commissioner does not disallow the exemption in writing within the 20-day period. The administrative policy of its review, the Department sends a notice of exemption for a qualifying issue. Unpublished no action requests available through the online LexisNexis Total Research System indicate that this procedure has been used successfully for more than 20 years.

There are several problems with this procedure. First, while the general experience has been that the request for the waiver of the 20-day waiting period and the request for the exemption from registration are routinely granted, the granting of these requests is not automatic. Second, in many cases the period between the date of the preliminary official statement and the closing date may be less than twenty days. Third, it is often difficult to tell whether the underwriter has complied with the twenty day waiting period, especially when the period between the date of the preliminary official statement and the pricing (not the closing) date is less than twenty days. For these reasons, I rarely recommend using the procedure.

(2) New York Stock Exchange Companies Section 30-10-104(12) Montana Code Annotated – 2007 provides an exemption from registration for any security listed or approved for listing on the New York Stock Exchange and various other enumerated exchanges. This exemption is available only if the securities of the nongovernmental industrial or commercial enterprise that is obligated to make the payments under the related lease, sale or loan arrangement are so listed or approved for listing; i.e., this exemption is not available if the securities of a party related to the nongovernmental industrial or commercial enterprise are so listed or approved for listing (e.g., a corporate parent guarantor). Compare North Dakota, infra.
(3) Request for an Exemption  Section 30-10-104(11), Montana Code Annotated – 2007, provides an exemption for any security for which the commissioner determines by order that an exemption would better serve the purposes of Section 30-10-102, Montana Code Annotated – 2007, than registration. The purposes of that Section are to “(1) protect the investor, persons engaged in securities transactions and the public interest; (2) promote uniformity among the states; and (3) encourage, promote, and facilitate capital investment in Montana.” The fee for requesting such an exemption is $50. Section 30-10-209(4), Montana Code Annotated. On several occasions the Montana Securities Department has issued favorable orders in connection with the issuance of student loan bonds secured by a letter of credit or a standby bond purchase agreement. The problem with this procedure is that there is no guarantee that a favorable order will be granted on a timely basis.

(4) Notice Filing Requirement for Non-Exempt Covered Securities  In response to NSMIA, pursuant to Montana Rule 6.10.148, CCH para. 36,488, Montana has imposed a notice filing requirement on Section 18(b)(4)(C) covered securities that are not otherwise exempt from registration. The notice filing consists of a letter explaining that the bonds in question qualify for covered security status pursuant to Section 18(b)(4)(C), a consent to service of process signed by the issuer of the bonds and a filing fee of $200. Issuers routinely refuse to sign consents to service of process, so qualifying an issue for sale to the public in Montana by means of this type of notice filing is impossible as a practical matter and underwriters should be advised accordingly.

(c) New Mexico  New Mexico enacted the Uniform Securities Act of 2002, Section 58-13C-101 et seq., New Mexico Statutes, effective January 1, 2010. Following the model of the 2002 Act, Section 58-13C-201.A., New Mexico Statutes, provides a general exemption from registration and notice filings for all types of municipal bonds, including separate securities under SEC Rule 131, except that this exemption does not apply to a security issued by a New Mexico governmental entity, payable solely from the revenues of a nongovernmental commercial or industrial enterprise, unless such security is directly or indirectly insured or guaranteed by, or such revenues are derived from, a person whose securities are exempt from registration by Section 58-13C-201.A. (i.e., the federal, state and municipal entities that qualify under the municipal bond exemption from registration) or various other entities described in Sections 58-13C-201.B., C., D., E. or G, New Mexico Statutes. Sections 58-13C-201.D. and 201.G. can be useful for certain types of municipal bonds, as described in subparagraphs (1) and (2) below:

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(1) **Bond Insurance**  Section 58-13C-201.D., New Mexico Statutes, provides an exemption from registration for a security insured or guaranteed by an insurance company authorized to transact business in New Mexico. Most bond insurers are authorized to do business in all 50 states, the District of Columbia and the Commonwealth of Puerto Rico and the bond insurer offering document disclosure language mandated by most bond insurers usually contains a statement to that effect. Thus, in New Mexico a policy of bond insurance can provide an exemption from registration for an issue NGICE Bonds, provided that the insurance company is authorized to transact business in New Mexico.\(^{20}\)

(2) **Conduit 501(c)(3) Bonds**  Section 58-13C-201.G. provides an exemption from registration for “a security issued by a person organized and operated exclusively for religious, educational, benevolent, fraternal, charitable, social, athletic or reformatory purposes, and not for pecuniary profit, no part of the net earnings of which inures to the benefit of a private stockholder or other person,” subject, however to the right of the commissioner to adopt rules limiting the availability of this exemption. In other words, unless the New Mexico Securities Division adopts rules limiting the availability of the exemption, conduit 501(c)(3) bonds are exempt from registration and notice filings under the New Mexico blue sky law. As of the date of this paper, no such rules have been adopted.

(3) **Student Loan Bonds and Single Family Mortgage Revenue Bonds**  Section 58-13C-201.A., New Mexico Statutes, expressly provides that “for purposes of this subsection, a nongovernmental industrial or commercial enterprise does not include the financing of student loans or single-family residential mortgage loans.”

(d) **North Dakota**  The North Dakota Securities Act is based on the 1956 Act, but the municipal bond exemption set forth in Section 10-04-05.1., North Dakota Century Code, has been amended to incorporate the 2002 Act’s expansion of the municipal bond exemption to include any separate security as defined in SEC Rule 131 and to provide that municipal bond exemption provides an exemption from registration as well as notice filings. However, Section 10-04-05.1., North Dakota Century Code, excludes NGICE Bonds from the municipal bond exemption from registration unless the payments on the NGICE Bonds in question “are made or unconditionally guaranteed by a person whose securities are exempt from registration or the issuer first files a notice in a record specifying the terms of the proposed offer or sale and pays a nonrefundable fee of one hundred dollars.”  [Emphasis added.]  The underlined text was added in 2005 and follows a Policy statement for municipal securities dated September 16, 1998, CCH para. 44,525. The notice filing described in the underlined text applies to both North Dakota issuers and non-North Dakota issuers. Conduit borrowers and guarantors whose securities are exempt from registration (thereby providing an exception to the NGICE exclusion from municipal bond exemption from registration under Section 10-04-05.1., North Dakota Century Code) are described in subparagraphs (1) and (2) below:

(1) **Conduit 501(c)(3) Bonds**  One of the persons whose securities are exempt from registration under Section 10-04-05, North Dakota Century Code, is

\(^{20}\) See Section II.F.(c) (4), *infra*, for a discussion of the significance of this type of requirement in Texas.
“any person organized and operated not for profit but exclusively for religious, educational, benevolent, fraternal, charitable, social or reformatory purposes,” provided that prior to the offer of such security such person must, among other things, apply for and obtain the written approval of the commissioner, identify the basis of its qualification for this exemption and pay a $150 filing fee. See Section 10-04-05.5., North Dakota Century Code. The problem with this procedure is that obtaining the written approval of the commission is not automatic and it is not possible to predict whether the approval would be provided on a timely basis. The better route to compliance is set forth in subparagraph (3) below.

(2) New York Stock Exchange Companies Pursuant to Section 10-04-05.14., North Dakota Century Code, another person whose securities are exempt from registration is a person whose securities are listed or approved for listing on the New York Stock Exchange and various other listed exchanges. Since the exception to the NGICE Bonds exclusion from the municipal bond exemption under Section 10-04-05.1. includes the words “made or unconditionally guaranteed by” a person whose securities are exempt from registration, the exemption conferred by Section 10-04-05.14., North Dakota Century Code is also available to NGICE Bonds that are unconditionally guaranteed by such a person (e.g., a corporate parent guarantor whose securities are listed or approved for listing on the New York Stock Exchange).

(3) When In Doubt File Under Section 10-04-05.1. There is no published guidance as to the meaning the term nongovernmental industrial or commercial enterprise under the North Dakota blue sky law. The online LexisNexis Total Research System lists approximately 40 favorable no action letters from the North Dakota Securities Department covering conduit 501(c)(3) bonds, general airport revenue bonds, single family mortgage revenue bonds and student loan bonds. The notice filing provision underlined in subparagraph (d) above provides a simple and inexpensive means of resolving any interpretive issues without reliance on no action letters and of achieving blue sky compliance for the offer and sale of NGICE Bonds in North Dakota, regardless of the issuer’s location.

(e) Rhode Island Section 7-11-401(1), Rhode Island General Laws, excludes NGICE Bonds from the municipal bond exemption from registration unless payments on the NGICE Bonds in question are “insured or guaranteed by a person described as the issuer, insurer or guarantor of securities under” various enumerated subdivisions, which include insurance companies under subdivision (4) (see subparagraph (1) below) and companies whose stock is listed or approved for listing on a national securities exchange under subdivision (7) (see subparagraph (2) below), or “unless the revenues from which the payments are to be made are a direct obligation of a person” (presumably not just any person, but one of the persons described in the various enumerated sections). [Emphasis added.]

(1) Bond Insurance Subdivision (4) of Section 7-11-401, Rhode Island General Laws, provides an exemption from registration for “a security…insured…by an insurance company organized under the laws of any state and authorized to do business in this state.” Most bond insurers are authorized to do business in all

21 These no action letters can be found by searching “nongovernmental and North Dakota” under Securities\Blue Sky – State Securities Administrative Decisions, No-Action Letters, Releases.
50 states, the District of Columbia and the Commonwealth of Puerto Rico and the bond insurer offering document disclosure language mandated by most bond insurers usually contains a statement to that effect. Thus, in Rhode Island a policy of bond insurance can provide an exemption from registration for an issue of NGICE Bonds, provided that the insurer is authorized to do business in Rhode Island.22

(2) New York Stock Exchange Companies Subdivision (7) of Section 7-11-104, Rhode Island General Laws, provides an exemption from registration for “a security listed or approved for listing upon notice of issuance on a national securities exchange registered under Section 6 of the Securities Exchange Act of 1934,” e.g., a company whose stock is listed or approved for listing on the New York Stock Exchange. NGICE Bonds that are the direct obligation of such a company as well as NGICE Bonds that are insured or guaranteed by such a company enjoy the benefit of this exemption from registration.

(3) Other Types of NGICE Bonds During the 1990s, the Rhode Island Division of Securities issued favorable no action letters in connection with the issuance of conduit 501(c)(3) bonds,23 limited obligation and general obligation single family mortgage revenue bonds,24 student loan bonds25 and general airport system revenue bonds.26 Since Rhode Island has not enacted a notice filing requirement for bonds issued by out-of-state issuers, the problem of whether to treat these types of bonds as NGICE Bonds is limited to Rhode Island issuers. When dealing with these types of bonds issued by Rhode Island issuers, see the discussion concerning state no action letters and informal telephone advice set forth in Section I.E, supra.

(f) Washington Section 21.20.310(1), Revised Code of Washington, excludes NGICE Bonds from the municipal bond exemption from registration, unless the payments on the NGICE Bonds in question are made or unconditionally guaranteed by a person whose securities are exempt from registration under Section 21.20.310(7) (i.e., securities issued

22 See Section II.F.(c)(4), infra, for a discussion of the significance of this type of requirement in Texas.


25 See, for example, State Board of Regents of the State Student Loan Revenue Bonds, 1990 Series E, 1990 R.I. Sec. LEXIS 69, and RI Student Loan Authority Student Loan Program Revenue Bonds, 1996 R.I. Sec. LEXIS 13.

or guaranteed by a railroad, other common carrier, public utility or holding company that meets certain requirements) or Section 21.20.310(8) (i.e., any security which meets the criteria for investment grade securities that the Washington Director of Securities may adopt by rule, discussed below); provided that the Washington Director of Securities may, by rule or order, exempt any issue of NGICE Bonds if the Director finds that registration is not necessary in the public interest and for the protection of investors.

(1) Industrial or Commercial Enterprise – In General WAC 460-42A-020, CCH para. 61,738A, expansively provides:

The term “industrial or commercial enterprise” as employed in RCW 21.20.310(1) includes, but is not limited to, a private profit or nonprofit hospital, health care facility, college, university or educational institution, single or multifamily mortgage loan program, port authority concessionaire, or manufacturing or service business.

Under this provision, conduit 501(c)(3) bonds and single family mortgage revenue bonds are treated as NGICE Bonds (compare New Mexico, supra, and Wisconsin, infra). The key to qualifying for an exemption from registration for conduit 501(c)(3) bonds and single family mortgage revenue bonds is the satisfaction of the rating requirement pursuant to WAC 460-42A-30 (discussed in subparagraph (4) below). 27

(2) Student Loan Bonds In an unpublished no action letter the term “college, university or educational institution” under WAC 460-42A-020 was broadly interpreted to include a state educational loan authority that issued student loan bonds; the no action request was granted because counsel represented that the bonds would be rated AAA by Standard & Poor’s Ratings Services in accordance with the rating requirements of WAC 460-42A-030 (discussed in subparagraph (4) below). 28 In addition, in three unpublished orders of exemption the Washington Securities Administrator has granted orders of exemption for student loan bonds that satisfied the rating requirements of WAC 460-42A-030. 29


(3) What is not a NGICE  Several successful no-action requests provide a basis for concluding that a NGICE is not present in a particular financing.\textsuperscript{30} For example, in a no action request involving a public utility district that maintained and operated an electric utility, a water utility and a wastewater utility,\textsuperscript{31} counsel argued:

Further, it is our understanding that the Bonds are exempt governmental securities under Section 21.20.310(1) since no commercial or nongovernmental industrial purpose is involved and no non-exempt party receives the proceeds or repays the Bonds. To the extent the Bonds will be repaid from Revenues received from nongovernmental commercial or industrial users, these are only a portion of the Revenues, and the Bonds are not payable solely from Revenues to be received from a nongovernmental commercial or industrial enterprise. [Emphasis added.]

Similarly, in a successful no action request involving the Denver, Colorado airport,\textsuperscript{32} counsel argued:

\ldots In our view, the Series 1990A Bonds are exempt securities under Section 21.20.310(1) and are not subject to the exception for industrial or commercial enterprise financing. No single non-governmental enterprise stands behind the Bonds. Rather, the Series 1990A Bonds are backed by the City's pledge of its general revenues from the operation of the Airport System and its covenant to impose a variety of rates and charges upon all users of the Airport System sufficient to service the Series 1990A Bonds and provide a margin of additional debt service coverage. If the Series 1990A Bonds were issued for the purpose of providing a facility benefiting a single airline, we would come to a different conclusion, since the revenues payable by a non-governmental enterprise would be the sole source of payment of debt service on the Series 1990A Bonds and the bondholders would look only to that single enterprise for payment. However, in this instance, the enterprise being financed is the entire Airport System, the Series 1990A Bonds are payable from multiple sources, and the revenues pledged for payment of principal and interest on the Series 1990A Bonds represent proceeds of charges imposed by a governmental authority upon the users of a public facility. [Emphasis added.]

(4) Investment Grade Securities  WAC 460-42A-030, CCH para. 71,738B, provides an exemption from registration for bonds payable from a nongovernmental industrial or commercial enterprise if either:

\textsuperscript{30} The arguments made in these two Washington no action letter requests could be useful in no action requests in other jurisdictions, as well.


\textsuperscript{32} City and County of Denver, Colorado – Airport System Revenue Bonds, Series 1990A, 1990 Wa. Sec. LEXIS 55. See also $100,000,000 Massachusetts Port Authority Revenue Bonds,, Series 1988-A, 1988 Wa. Sec. LEXIS 499.
(1) the security receives a rating of “AA” or better from Standard and Poor’s Corporation [“S&P”] or an equivalent rating from Moody’s Investors Service, Inc. [“Moody’s”], or

(2)(a) the security is issued to fund a single-family mortgage program established and operated by a state housing finance agency, and (b) the security receives a rating of at least “A+” from S&P or an equivalent rating from Moody’s. [Emphasis added.]

Washington has not provided any guidance as to exactly which Moody’s ratings are equivalent to the various S&P ratings. One is tempted to argue that an AA rating from S&P is equivalent to an Aa2 rating from Moody’s, an AA+ rating from S&P is equivalent to an Aa1 rating from Moody’s, etc. However, when I asked a Washington Securities Division staff attorney for guidance, I was told that no guidance could be given, and it was recommended that I submit an interpretive request that included a comparison of the published standards of the two rating agencies for each of their respective rating categories. In short, we simply do not know what an equivalent Moody’s rating is. However, we do know that the right rating from S&P for the NGICE Bonds in question will provide exemption from registration (for Washington issuers) and notice filings (for non-Washington issuers).

See also unpublished Order of Exemption RCS 21.20.310(1) dated December 18, 1989, of the State of Washington Department of Licensing, Business License Services, Securities Division, which generally permits the Washington Health Care Facilities Authority (the “Washington Authority”) to issue its revenue bonds and notes in Washington and make the proceeds thereof available to the operators of private nonprofit or public health care facilities for the purpose of minimizing the cost of such facilities and minimizing the costs to the public of the use thereof without the need for registration, provided that (a) the bonds in question receive a rating of at least A “from a nationally recognized bond rating service” [emphasis added] and (b) prior to the issuance of such bonds the Washington Authority receives from the applicant a request for providing such bonds for the financing of health care facilities, investigates and determines the need and feasibility of providing such bonds, and determines it is necessary or advisable for the benefit of the public health to provide such financing. Bond counsel experienced in working with the Washington Authority routinely include in the bond documents a recitation of above described application, investigation and determinations. Before relying on this order, I recommend contacting the Washington Department of Licensing to verify that this Order of Exemption is still in effect and has not been amended.

(5) **Bond Insurance** Section 21.20.310(5), Revised Code of Washington, provides an exemption from registration for “any security issued by and representing an interest in or a debt of, or insured or guaranteed by, any insurance company authorized to do business in this state.” Does this Section provide an independent exemption from registration for NGICE Bonds that would otherwise be subject to registration? No, according to a staff attorney of the Washington Securities Division. The methods of saving NGICE Bonds from registration are set for in Section 21.20.310(1), namely, compliance under Sections 21.20.310(7) (payments are made or guaranteed by a railroad, other common carrier, public utility company or holding company, subject to certain conditions) or 21.20.310(8) (the statutory basis for the rating requirements under WAC 460-42A-20) or obtaining an interpretive opinion or no action letter.
(6) Interpretive Opinions and No Action Letters WAC 460-16A-202, CCH para. unavailable, sets forth the requirements for an interpretive opinion or no action letter, including the payment of the fee required by Section 21.20.340, Revised Code of Washington (i.e., $35, pursuant to Section 21.20.340(12)). Prior unpublished orders of exemption for student loan bonds\(^{33}\), single family mortgage revenue bonds\(^{34}\) and conduit 501(c)(3) bonds\(^{35}\) show substantial reliance on compliance with the rating requirement of WAC 460-42A-030, CCH para. 71,738B (discussed in subparagraph (4) above).

(7) Notice Filing Requirement Pursuant to WAC 460-18A-100, Washington has imposed a notice filing requirement on Section 18(b)(4)(C) covered securities that are not otherwise exempt from registration (e.g., NGICE Bonds that do not satisfy the rating requirements of WAC 460-42A-20). The notice filing consists of a “completed municipal covered securities notice filing form or other document identifying the transaction,” a consent to service of process signed by the issuer, and initial and renewal filing fees calculated pursuant to Section 21.20.340(1)(b), Revised Code of Washington. As in the case of Montana, issuers routinely refuse to sign consents to service of process, so qualifying an issue for sale to the public in Washington by means of a notice filing is impossible as a practical matter. In addition, even if the issuer is willing to provide a consent to service of process, the Washington filing fee is very expensive; namely, $100 for the first $100,000 of the offering price of bonds being offered in Washington plus 1/20 of one percent of the excess of the offering price of bonds being offered in Washington, with no upper limit.\(^{36}\) A notice filing fee for bonds having an offering price of $5,000,000 would be $100 plus $2,450 or $2,550.

(g) Wisconsin When Wisconsin enacted the 2002 Act effective January 1, 2009, new Section 551.201(a), Wisconsin Statutes, followed the 2002 Act model provisions of including within the municipal bond exemption any separate security under SEC Rule 131 and exempting municipal bonds from notice filing requirements. However, new Section 551.201(a) continued the prior Wisconsin blue sky law’s exclusion from the municipal bond exemption from registration for NGICE Bonds unless, pursuant to Section 551.201(b),

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Wisconsin Statutes, they are secured by a qualifying letter of credit or satisfy certain rules of the Wisconsin Division of Securities.

(1) **NGICE Bonds Secured by a Letter of Credit** Pursuant to Section 551.201(b), Wisconsin Statutes, NGICE Bonds are exempt from registration, provided that they are secured by an irrevocable letter of credit issued by a depository institution in favor of the bondholders providing for payment of all principal of and accrued interest on the bonds and the letter of credit is accompanied by an opinion of counsel stating, among other things, that payment of debt service pursuant to the letter of credit will not constitute a preference under the federal bankruptcy law if a petition in bankruptcy with respect to the enterprise is filed and that the enforceability of the letter of credit would not be materially affected by the filing of a petition in bankruptcy with respect to the enterprise or any person obligated to reimburse the depository institution for payments made under the letter of credit.

The opinion requirement of Section 551.201(1)(b), Wisconsin Statutes, parallels a prior, similar opinion requirement imposed by Moody’s on bond issues secured by letters of credit, based on an obscure bankruptcy case, *In the Matter of Twist Cap, Inc.*, 1 B.R. 284, 1979 Bankr. LEXIS 781. Moody’s eventually eliminated this requirement and, as one would expect, bank counsel stopped providing this opinion. Requests for such opinions are usually, but not always, denied, so for NGICE Bonds secured by a letter of credit, the availability of the exemption from registration depends on the willingness of bond counsel or bank counsel to provide this opinion, unless one files a notice filing described below.

(2) **NGICE Bonds and Rules of the Division of Securities**

(i) **Conduit 501(c)(3) Bonds** Wisconsin Department of Financial Institutions (“DFI”) Rule 1.02(11), CCH para. 64,502, provides that for purposes of determining the availability of the exemption from registration under Section 551.201(1)(a), Wisconsin Statutes, a NGICE is not present if: “(a) The source of the lease, sale or loan arrangement for the payment of principal of and interest on the revenue obligation, is a duly organized and existing not-for-profit corporation under applicable state law and is an organization described in section 501(c)(3) of the internal revenue code which qualifies for exemption from federal taxation under section 501(a) of the internal revenue code; and (b) The receipt of a limited amount of revenue by the corporation from commercial or retail sources does not result in a loss of the corporation’s status as a qualifying organization under sections 501(a) and (c)(3) of the internal revenue code.”

(ii) **Public Utilities** DFI Rule 2.01.(1)(a).1., CCH para. 64,511, provides that NGICE Bonds are exempt from registration if the enterprise in question is a public utility described in Section 551.201(5), Wisconsin Statutes, having securities registered under Section 12 of the Securities Act of 1934, or is a wholly-owned subsidiary of one or more of such utilities.

(iii) **New York Stock Exchange Companies** DFI Rule 2.01.(1)(a).2., CCH para. 64,511, provides that NGICE Bonds are exempt from registration if the securities of the enterprise, or any securities of an unconditional guarantor of all payments under
the lease, sale or loan arrangement, are covered securities under section 18(b)(1) or are exempt under Section 551.201(6), Wisconsin Statutes (i.e., securities listed or approved for listing on the New York Stock Exchange and certain other national exchanges).

(iv) **Notice Filing** DFI Rule 2.01.(1)(a).3., CCH para. 64,511, provides that NGICE Bonds are exempt from registration, if a notice filing is filed with the Securities Division of the Wisconsin Division of Securities, prior to the offering. The notice filing must include a trust indenture meeting the requirements of DFI Section 3.04 (i.e., the requirements of the Trust Indenture Act of 1939\(^{37} \)), unless the Wisconsin Division of Securities “otherwise permits or requires;” an offering document meeting the requirements of DFI Section 3.03 that contains the financial statements for the enterprise and additional information as the Wisconsin Division of Securities may require, and the Wisconsin Division of Securities does not by order deny the exemption within 10 days of the date the notice is filed. My impression is that the requirements of DFI Section 3.03 and 3.04 are generally waived. The filing fee is $200. See DFI Rule 7.01(2)(b).

(h) **Letters of Credit** As discussed under “Bank Guarantee Exemption,” supra, a properly structured letter of credit issued by the right type of bank will provide an independent exemption from registration for bonds that would otherwise be subject to registration under Section 3(a)(2).

Will a properly structured letter of credit issued by the right type of bank provide a similar exemption from registration for municipal bonds that would otherwise be subject to registration under the blue sky laws of Montana, New Mexico, North Dakota, Rhode Island, Washington and Wisconsin? No.

The blue sky laws of Montana, New Mexico, North Dakota, Rhode Island, Washington and Wisconsin each provide an express exemption from registration for any security issued or guaranteed by various types of financial institutions. See Section 30-10-104(3), Montana Code Annotated - 2007; Section 58-13B-26.C, New Mexico Uniform Securities Act; Section 202.G., Rhode Island General Laws; Section 10-04-05.2, North Dakota Century Code; Section 21.20.310.(3), Revised Code of Washington; and Section 551.201.(3)(b), Wisconsin Statutes.

The blue sky laws of Montana, New Mexico, Washington and Wisconsin each contain substantially identical, general definitions of the term “guarantee.” For example, Section 30-10-103(1), Montana Code Annotated - 2007 provides that guaranteed means “guaranteed as to payment of principal, interest or dividends.” The blue sky laws of North Dakota and Rhode Island do not define the term guaranteed.

\(^{37}\) Whatever they may be. Bond counsel and underwriter’s counsel routinely provide opinions to the effect that the bonds in question need not be qualified under the Trust Indenture Act of 1939, because Section 304(a)(4) of the Trust Indenture Act provides an exemption from its provisions for any security that is exempt under Section 3(a)(2). Since virtually all municipal bonds are exempt from registration under Section 3(a)(2), bond counsel and underwriter’s counsel rarely, if ever, need to familiarize themselves with the requirements of the Trust Indenture Act of 1939.
While it is tempting to argue by analogy to federal law that a letter of credit should be treated as a guarantee under state blue sky laws, except for the coordination of exemptions provisions of the Colorado and District of Columbia blue sky laws discussed in Section II.F.3.(a), infra, no published state blue sky statute, regulation or policy statement has adopted the federal approach discussed in Appendix A – Section D.2.(b)(iii), infra, that a properly structured letter of credit *(i.e., one that provides for payment in full of all principal and accrued interest and, if applicable, purchase price)* and that is issued by the right type of bank *(i.e., a state bank, a national bank or a qualifying domestic branch of a foreign bank)* can provide an independent exemption from registration as a security guaranteed by a bank.

2. **Other Attempts to Regulate Conduit Bonds and Revenue Bonds**

   (a) **Arizona**

      (1) **Traditional Blue Sky Analysis and Arizona Issuers**  Section 44-1843.A.1., Arizona Revised Statutes, as amended, provides a general exemption from registration for municipal bonds, but excludes from the exemption from registration bonds regulated pursuant to Section 44-1843.01, Arizona Revised Statutes. Bonds regulated under Section 44-1843.01, Arizona Statutes, include the following types of bonds when issued by **Arizona issuers** *(“Arizona Issuer Bonds”)*, unless the requirements of 44-1843.01.B., Arizona Revised Statutes, are satisfied:

         (i) “industrial development bonds” *(as defined in the 1954 Code)*, other than such bonds issued to provide residential real property for family units, airports, docks, wharves, mass commuting facilities, parking facilities, sewage or solid waste disposal facilities, air or water pollution control facilities, or facilities for the furnishing of water if available on reasonable demand to members of the general public;

         (ii) certain bond anticipation notes and improvement district bonds authorized pursuant to title 48, chapter 6, article 2, Arizona Revised Statutes, as amended; and

         (iii) securities of public subdivisions used to provide monies to finance the acquiring, constructing, improving, equipping or furnishing of medical office buildings, sanitariums, clinics, medical hotels, mortuaries, cemeteries, mausoleums, rest homes, nursing homes, skilled nursing facilities or other similar facilities for use by corporations or entities other than municipal which bonds or notes are not fully secured by an entity owning or operating, repurchasing or leasing a hospital from a political subdivision.

Section 44-1843.01.B., Arizona Revised Statutes, as amended, provides that Arizona Issuer Bonds issued for the purposes set forth in subparagraphs (i), (ii) and (iii) above are not subject to registration if a notice of the proposed offering, a trust indenture, a $200 filing fee and an offering document containing the extensive disclosures required by Section 44-1894, Arizona Statutes, are filed with the state securities commission and the exemption from registration is not denied within 20 days of receipt by the state securities commission.
(2) **NSMIA Analysis and Non-Arizona Issuers** Section 44-1843.01.C., Arizona Revised Statutes, provides that the types of bonds described in subparagraphs (i), (ii) and (iii) above plus bonds secured only by special assessments, when issued by a non-Arizona Issuer and provided that they qualify as covered securities under Section 18(b)(4)(C) of the Securities Act of 1933, are subject to a notice filing requirement consisting of a cover letter that describes the offering to be made in Arizona, any documents that are filed with the SEC and that are required by the commission 38, and a filing fee of $200.

(b) **Nevada**

(1) **Traditional Blue Sky Analysis** Section 90.520.2.(a), Nevada Revised Statutes, provides a general exemption from registration for municipal bonds except for bonds payable from payments to be made by an “enterprise,” unless:

(i) the payments are insured or guaranteed by the United States, certain instrumentalities of the United States, states, political subdivisions, agency or corporate or other instrumentality of one or more states or political subdivisions or a person whose securities are exempt pursuant to (b) to (e) and (g) 90.950.2(a)(i.e., various Canadian entities; certain depository institutions; an insurance company authorized to business in the State of Nevada; a qualifying railroad, other common carrier, public utility or holding company; a company whose securities are listed on or approved for listing the New York Stock Exchange or certain other exchanges) or the revenues are the direct obligation of such a person (Section 90.520.2.(a)(1)), or

(ii) the issuer is a Nevada issuer (Section 90.520.2.(a)(2)), or

(iii) the payments are insured or guaranteed by a person who, within the 12 months next preceding the date of issuance, has received a rating in one of the top four rating categories of Moody’s or S&P (90.950.2(a)(3)).

There is no published definition of the term “enterprise.”

The Nevada blue sky law exclusion from the municipal bond exemption for bonds payable from payments to be made by an “enterprise” is notable for two reasons.

First, the exclusion does not apply to Nevada issuers.

Second, at one time the exclusion from the exemption from registration was narrower; i.e., the prior version of the Nevada blue sky law excluded bonds payable from payments to be made from payments to be made by a nongovernmental industrial or commercial enterprise. In other words, governmental “enterprises,” such as municipally owned and operated airports, water

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38 Municipal bonds that qualify as covered securities under Section 18(b)(4) are, by definition, exempt from registration pursuant to Section 3(a)(2) and, therefore, no documents are filed with the SEC. The administrative practice is to require a copy of the cover page of the offering document.
and sewer systems and single family mortgage loan programs, are also excluded from the municipal bond exemption, unless the requirements of subparagraphs (i), (ii) or (iii) are satisfied. In two unpublished denials of no action requests, the Nevada Securities Division has expressed the view that only a general obligation that is backed by the taxing power is exempt from registration (now a notice filing) under this section, unless the bonds in question are secured by the types of credit enhancements described in (i) and (iii) above. See no action requests for $16,500,000 Natrona County, Wyoming Hospital Revenue Bonds Series 1990, March 28, 1990, 1990 Nev. Sec. LEXIS 11 and $600,000,000 City and County of Denver, Colorado Airport System Revenue Bonds, Series 1990A, May 18, 1990 Nev. Sec. LEXIS 15.

(2) **NSMIA Analysis** Nevada has imposed a notice filing requirement on bonds issued by out-of-state issuers that do not qualify for an exemption from registration. The notice filing consists of Nevada form N-9, a copy of the preliminary official statement (or final official statement if no preliminary official statement was prepared) and a filing fee $300 (or $400 if 24-hour turnaround is desired or $500 if same day turnaround is required). Section 90.519, Nevada Blue Sky Regulations, CCH para. 38,476.

(c) **New Hampshire**

(1) **Traditional Blue Sky Analysis** Section 421-B:17.1.(a), New Hampshire Revised Statutes Annotated (“RSA”) provides an exemption from registration for all types of municipal bonds except any “industrial bond.”

Section 421-B:2.VII, RSA, provides the following definition of “industrial bond”:

“Industrial bond” means any obligation issued by a governmental unit (including the United States, any state, any political subdivision of a state, or any agency, or corporate or other instrumentality, of one or more of them) other than a general obligation of a governmental unit having power to tax property or of an agency of the state of New Hampshire:

(a) Which is issued as part of an issue, all or a major portion of the proceeds of which are to be used directly or indirectly in any trade or business (the “New Hampshire Use Test”), and

(b) The payment of the principal or interest on which (under the terms of such obligation or any underlying arrangement) is, in whole or in major part:

(1) secured by any interest in property used or to be used in a trade or business or in payment in respect of such property, or

(2) to be derived from payments in respect of property or borrowed money, used or to be used in a trade or business. [Emphasis added]

The New Hampshire Use Test is fraught with ambiguity.
First, there is no official, published definition of the term “trade or business.” Thus, any activity that involves the provision of goods or services in exchange for money could be construed to be a trade or business, including, for example, the operation of a municipal water and sewer system, a publicly owned and operated airport and a single family mortgage revenue bond program.

Second, this ambiguity is reinforced by a comparison of the New Hampshire Use Test with the use test set forth in the definition of “industrial development bond” in Section 103(b)(2)(A) of the 1954 Code, on which the New Hampshire definition appears to be based.

The use test set forth Section 103(b)(2)(A) of the 1954 Code provides that the term “industrial development bond” means any obligation:

(A) which is issued as part of an issue all or a major portion of the proceeds of which are to be used directly or indirectly in any trade or business carried on by any person who is not an exempt person (within the meaning of paragraph (3)), and

Section 103(b)(3) of the 1954 Code provides that, for purposes of the Section 103(2)(A) industrial development bond use test, an exempt person means a governmental unit or an organization described in Section 501(c)(3) of the Internal Revenue Code.

By failing to adopt the 1954 Code industrial development bond limitation on who is conducting the trade or business (i.e., “carried on by any person who is not an exempt person (within the meaning of paragraph (3))”), the New Hampshire definition of industrial bond can be read to include, rather than exclude, any trade or business carried on by a governmental unit, which could include, once again, a water and sewer system, a publicly owned and operated airport and a single family mortgage revenue bond program.

In view of the foregoing, in most cases a bond issue will avoid characterization as an “industrial bond” only if it is a general obligation of a governmental unit having power to tax property or of an agency of the state of New Hampshire.

(2) NSMIA Analysis Section 421-B:11-a(d), RSA, imposes a notice filing requirement on Section 18(b)(4)(C) covered securities that are not exempt from registration. The notice filing fee is based on the principal amount of bonds being offered in New Hampshire and can be as much as $1,250. The notice filing must include a consent to service of process signed by the issuer of the bonds, unless the offering is being made on a “firmly underwritten” basis by a New Hampshire licensed broker-dealer. See Checklist, New Hampshire Bureau of Securities Regulation, February 28, 2008, Paragraph D. – Municipal Securities, CCH para. 39,610.

(d) New York The New York General Business Law, Chapter 20, Article 23-A, Section 352-e.1.(a), Real Estate Syndication Offerings, CCH para. 42,106, provides that it shall be illegal and prohibited for any person, partnership and various other entities to make a public offering in or from the state of New York of “securities constituted of participation interests or investments in real estate, mortgages, leases, including stocks, bonds,
debentures, evidences of indebtedness, limited partnership interests or other security or securities...when such securities consist primarily of participation interests or investments in one or more real estate ventures” unless and until there shall have been filed with the New York Department of Law, prior to such offering, an offering statement or prospectus containing the information required by Section 352-e.1.(b) or unless the offering is exempted under the exclusion set forth in Section 352-e.1.(a) or by rule or action of the attorney general.

The information required to be included in the offering statement or prospectus pursuant to Section 352-e.1.(b) (as well as the title of Section 352-e., namely, Real Estate Syndication Offerings) suggest that the type of transaction being regulated is the offer of interests in commercial enterprises, not municipal bonds. Nonetheless, Section 352-e. has been broadly construed by the New York State Department of Law, although its views on the scope of the Section do not appear to have been published. Based on telephone conversations with staff lawyers over the years, there appear to be three situations in which Section 352-e can become applicable to municipal bonds, namely: (1) the bond issue is secured by an interest in real estate (e.g., a mortgage in favor of a bond trustee or a mortgage that secures a master indenture note which has been pledged to a bond trustee), (2) more than 50% of the proceeds of the bond issue will be used to acquire land or an interest in real estate (e.g., a condominium), and (3) more than 50% of the revenues that are the source of payment are derived from rental income, even if the underlying lease or leases that are the source of the rental income are not pledged to the payment of the bonds. Thus, single family mortgage revenue bonds, multi-family mortgage revenue bonds, any other type of bond issue secured by a mortgage, bonds whose payment is derived from lease rentals and certificates of participation in installment sale agreements, lease-purchase agreements and conditional sale agreements for real property all fall within the scope of Section 352-e. Conduit 501(c)(3) bonds issued for the benefit of educational institutions may also fall within the scope of Section 352-e if more than 50% of the revenues that are the source of payment are derived from the room charge portion of dormitory room and board charges or from rentals of student apartments. Similarly structured transactions for equipment or other non-real estate assets, however, would not be subject to Section 352-e.

Prior to the enactment of NSMIA, the exemption “by rule or action of the attorney general referred to above” was accomplished by the filing of a Policy Statement 103 Application that is signed by the issuer of the bonds. The Policy Statement 103 Application is, among other things, a petition for an exemption from the offering document requirements of Section 352-e.1.(b). The Policy Statement 103 Application contains, among other things, the name, address and legal nature of the issuer; a listing of the officers, directors and “other principals” of the issuer; and the purpose of the offering. The Policy Statement 103 Application must be accompanied by a Notice of Appearance signed by the lawyer who prepared the Policy Statement 103 Application, a check for $300 to cover the filing fee and a copy of the preliminary offering document. Two copies of the final offering document are required to be filed within ten days of the closing. A staff member of the New York State Department of Law has indicated a general willingness to view 63-20 issuers and NYLDCs as instrumentalities of a state or political subdivision and permit the filing of a Policy Statement 103 Application, which does not require

39 The instructions for preparing a Policy Statement 103 Application are available online at www.ag.ny.gov/realestate/realestate.html.
the filing of a consent to service of process, rather than a Policy Statement 104 Application, which does require the filing of a consent to service of process. See Section II.H.4., infra.

A Policy Statement 103 Application may be made and signed by a principal of the underwriter in the event that there is no principal of the issuer able to make the required statements, provided that the issuer expressly authorizes that underwriter to file the Application.

Since the Policy Statement 103 Application is a petition for an exemption from offering document requirements and since most municipal bonds issued by non-New York issuers are Section 18(b)(4)(C) covered securities, NSMIA prohibits New York from imposing the offering document requirements of Section 352-e.1.(b) on Section 18(b)(4)(C) covered securities, as well as the Policy Statement 103 Application petition for exemption from such requirements.

In response to the enactment of NSMIA, New York introduced Form 99, which is a “Notification Filing Pursuant to the National Securities Improvement Act of 1996,” presumably in an effort to comply with NSMIA. Since the Form 99 is more detailed and thus more burdensome to prepare than the Policy Statement 103 Application and since filing a Policy Statement 103 Application is still permitted by New York law, I recommend filing the Policy Statement 103 Application.

(e) Ohio

(1) Traditional Blue Sky Analysis Section 1707.02(B)(1)(c), Ohio Revised Code, provides an exemption from registration and notice filings for all types of municipal bonds, except that, pursuant to Section 1707.(B), Ohio Revised Code, if an issue of municipal bonds described in Section 1707.02(B)(1)(a) through (c) is not payable out of the proceeds of a general tax, the bonds are exempt only if, at the time of first sale in the State of Ohio, there is no default in the payment of any interest or principal of the bonds, and there are no adjudications or pending suits adversely affecting its validity.

Ohio Rule 1301:6-3-02(C), CCH para. 45,113, provides:

A security is not deemed “payable out of the proceeds of a general tax” unless at the time of issuance machinery has been set up for the servicing of the security out of the proceeds of a general tax in the event that revenues collected by the issuer and allocated to the payment thereof prove to be insufficient. It is not sufficient for this purpose that the full faith and credit of a state is pledged to the payment of a security if it will be necessary, on the failure of specified revenues to meet security charges, to obtain legislative action which would make the security payable out of the proceeds of a general tax.

Most issues of revenue bonds should qualify for the Ohio exemption from registration because law suits challenging validity are rare and, except for a remarketing of existing bonds that are already in default, it is hard to imagine a new money issue being in default of payment or principal or interest on the date of issuance.
Documenting that the exemption from registration is available can be done either by having the issuer make appropriate representations about the lack of defaults and challenges to validity in the bond purchase agreement and closing certificate and/or stating these qualifications in a footnote to the blue sky memorandum. I prefer stating these qualifications in the blue sky memorandum, because it avoids having to negotiate with counsel to the issuer the exact compliance wording to be included in the bond purchase agreement and closing certificate and because the blue sky memorandum approach highlights these requirements for the underwriter or remarketing agent, particularly in the situation where the underwriter discovers prior to closing that such litigation is indeed pending but decides to close anyway on the strength of a legal opinion that the litigation has no legal merit.

Section 1707.02(K), Ohio Revised Statutes, provides a separate exemption from registration for “all bonds issued under authority of Chapter 165. [revenue bonds] or 761 [municipal corporations], or Section 4582.06 [issuance of bonds by port authority] or 4582.31 [port authority’s powers].” Bonds described in Section 1707.02(K) are not subject to the above requirement concerning lack of current defaults and lack of proceedings contesting validity.

(2) NSMIA Analysis Section 1707.92(C)(1), Ohio Revised Code, provides that Section 18(b)(4)(C) covered securities that are not exempt from registration because they are revenue bonds that cannot satisfy the requirements of a lack of a current default in the payments of interest or principal and a lack of law suits challenging validity are subject to a notice filing, which consists of a consent to service of process signed by the issuer and a filing fee of $100.

E. Offering Document Requirements

1. Offering Document Requirements Apply Only to In-State Issuers As discussed in Appendix A., paragraph D., infra, pursuant to NSMIA, states are not permitted to impose offering document requirements on Section 18(b)(4)(C) securities, i.e., municipal bonds that are (a) exempt from federal registration under Section 3(a)(2) and (b) issued by an out-of-state issuer. Thus, the offering document requirements described below apply only to issuers located within the boundaries of the respective states listed below.

2. Florida Revenue Bonds Section 517.051(1), Florida Statutes, provides a general exemption from registration for municipal bonds, provided that:

...no person shall directly or indirectly offer or sell securities, other than general obligation bonds, under this subsection if the issuer or guarantor is in default or has been in default any time after December 31, 1975, as to principal or interest:

(a) With respect to an obligation issued by the issuer or successor of the issuer; or

(b) With respect to an obligation guaranteed by the guarantor or successor of the guarantor, except by an offering circular containing full and fair disclosure as prescribed by rule of the commission. [Emphasis added.]
Florida Rule 69W-400-003.(1), Rules for governmental securities under Section 517.051(1), Florida Statutes, CCH para. 17,433, imposes detailed disclosure requirements on offering documents for revenue bonds issued by Florida issuers if any such defaults have occurred.

However, under certain circumstances Florida issuers are excused from complying with such disclosure requirements pursuant to subparagraph (2) of this rule, which provides:

(2) If the person required to make the above disclosures in good faith reasonably believes that any of the above disclosures is not an appropriate disclosure in that the information would not be considered material by a reasonable investor, the offering circular provided to each offeree as required herein shall set forth the fact that the Office of Financial Regulation has required such disclosure and the reason such disclosure is not deemed appropriate and material by the person required to make the disclosure(s). [Emphasis added.]

This Rule is a trap for the unwary, particularly in the context of conduit issues. For Florida issuers that infrequently offer bonds to the public or for Florida bond issues staffed by underwriters and underwriter’s counsel who have not previously participated in a Florida bond issue, it is not uncommon to find that the requirements of this Rule have been overlooked, with the result that the disclosure mandated by the Rule is simply omitted. I have also seen instances of Florida issuers that have worked out a form of disclosure that has become the issuer’s standard form of disclosure for conduit financings, but which fails to address all the elements of the Rule, particularly, a failure to state the reason why the disclosure mandated by the Rule is not required.

However, if in accordance with the provisions of Section 517.051(1), Florida Statutes, neither the issuer of the bonds nor any guarantor has been in default at any time after December 31, 1975, then no disclosure is necessary, although the general practice is to make a statement to that effect. There is no prescribed form of disclosure, either by statute, regulation or custom, so the actual disclosures vary from issuer to issuer.

The following is a sample of disclosure that can satisfy this Rule in the context of a Florida non-conduit revenue bond issue:

Disclosure Required by Florida Blue Sky Regulations

Rule 69W-400.003, Rules for government securities under Section 517.051(1), Florida Statutes (“Rule 69W-400.003”), promulgated by the Florida Office of Financial Regulation, requires the City to disclose each and every default as to payment of principal and interest with respect to obligations issued by the City after December 31, 1975. Rule 69W-400.003 further provides, however, that if the City in good faith believes that such disclosures would not be considered material by a reasonable investor, such disclosures may be omitted. The City has not defaulted on the payment of principal or interest with respect to obligations issued by the City after December 31, 1975.
As used in this Rule, the term guarantor is customarily interpreted to include, at a minimum, the conduit borrower(s). The following is a sample of disclosure that can satisfy this Rule in the context of a issue of hospital revenue bonds that is not secured by any form of credit enhancement. The final sentence of the third paragraph states the reason that is usually given.

Disclosure Required by Section 517.051(1), Florida Statutes

Section 517.051(1), Florida Statutes, as amended, provides for the exemption from registration of certain governmental securities, provided that if an issuer or guarantor of governmental securities has been in default at any time after December 31, 1975 as to principal and interest on any obligation, its securities may not be offered or sold in Florida pursuant to the exemption except by means of an offering circular containing full and fair disclosure, as prescribed by rules of the Florida Department of Banking and Finance (the “Department”).

Under the rules of the Department, the prescribed disclosure is not required if the information is not an appropriate disclosure because the information would not be considered material by a reasonable investor. The Authority has not been in default at any time after December 31, 1975, as to principal or interest with respect to any obligation issued or guaranteed by the Authority for the benefit of any Member of the Obligated Group. No Member of the Obligated Group has been in default at any time after December 31, 1975 as to principal or interest with respect to any obligation issued or guaranteed by the any Member of the Obligated Group.

The Authority has the power to issue, and has issued, bonds for the purpose of financing projects for other facilities. Bonds issued by the Authority for parties other than the Members of the Obligated Group may have been, or may be, in default as to principal and interest. However, disclosure with respect to any default on such bonds is not deemed appropriate or material with respect to the Bonds, because the source of payment for any such defaulted bonds, if any, is separate and distinct from the source of payment for the Bonds.

What else constitutes a “guarantor” under this Rule?

The Florida definitions of the terms guarantor and guaranty under Section 517.021(11) and (12), Florida Statutes, are broad enough to encompass a letter of credit and a policy of bond insurance, as well as any document expressly labeled a guaranty. Sections 517.021(11) and (12), Florida Statutes, provide:
(11) “Guarantor” means a person who agrees in writing, or who holds itself out to the public as agreeing, to pay the indebtedness of another when due, including, without limitation, payments of principal and interest on a bond, debenture, note or other evidence of indebtedness, without resort by the holder to any other obligor, whether or not such writing expressly states that the person signing is signing as a guarantor. The obligation of a guarantor hereunder shall be a continuing, absolute and unconditional guaranty of payment, without regard to the validity, regularity or enforceability of the underlying indebtedness.

(12) “Guaranty” means a writing in which one party either agrees, or holds itself out to the public as agreeing, to pay the indebtedness of another when due, including, without limitation, payments of principal and interest on a bond, debenture, note or other evidence of indebtedness, without resort by the holder to any other obligor, whether or not such writing expressly states that the person signing is signing as a guarantor. An agreement that is not specifically denominated as a guaranty shall nevertheless constitute a guaranty if the holder of the underlying indebtedness or her or his representative or trustee has the right to sue to enforce the guarantor's obligations under the guaranty. Words of guaranty or equivalent words which otherwise do not specify guaranty of payment create a presumption that payment, rather than collection, is guaranteed by the guarantor. Any guaranty in writing is enforceable notwithstanding any statute of frauds. [Emphasis added.]

Under Traditional Blue Sky Analysis, financial institutions that provide letters of credit and insurance companies that provide policies of bond insurance would also be subject to the provisions of this Rule and appropriate disclosure would be required. However, under NSMIA Analysis, the most common forms of credit enhancement (i.e., a properly structured letter of credit issued by a state bank, a national bank or the domestic branch of a foreign bank, a policy of bond insurance or a bond guaranty by a company whose stock is listed on the New York Stock Exchange) are usually also covered securities and therefore exempt from the requirements of this Rule because pursuant to Section 18(a) a state may not impose offering document requirements on a covered security. Nonetheless, a form of credit enhancement that does not qualify as a covered security under NSMIA could be subject to the requirements of this Rule.

3. New Hampshire: Unlawfulness of Certain Representations New Hampshire issuers are required to include in their offering documents statements about the unlawfulness of making certain representations concerning registration of the bonds or the availability of an exemption from registration. Section 421-B:20, New Hampshire Revised Statutes Annotated.

4. New Jersey: Current Defaults Occasionally, I will see a blue sky memorandum that provides in a footnote that the bonds in question are exempt from registration, “provided that the issuer or guarantor is not in default as to principal or interest with respect to an obligation issued by the issuer or a successor of the issuer or, an obligation guaranteed by the guarantor or a successor to a guarantor.” This limitation on the New Jersey municipal bond exemption from registration was repealed in 1997.
5. **Pennsylvania Legend Requirement and Financial Forecasts** Pennsylvania has two offering document requirements applicable to issuers located within its boundaries:

(a) **Legend Requirement** Pennsylvania Rule Section 606.031(d)(2), CCH para. 48,576, requires that in connection with the offer or sale of municipal bonds that are exempt from registration under Section 202(a) of the Pennsylvania Code and which are less than a general obligation of the issuer, “a legend adequately describing the limited nature of the obligation shall appear prominently in bold face type of at least 12 points in size on the face page of any preliminary offering statement, official statement or advertisement published in this Commonwealth.” This Rule seems absurd since the type face of most official statement cover pages is less than 12 points in size, but I have been advised by a staff lawyer of the Pennsylvania Securities Commission that this Rule is still in effect.

(b) **Financial Forecasts** Pennsylvania Rule Section 609.010, CCH para. 48,585, imposes several restrictions on the use of prospective financial statements (i.e., “an entity’s expected financial position, results of operations and changes in financial position”) in connection with the offer of securities that are required to be registered or exempt from registration, including municipal bonds issued by Pennsylvania issuers, unless the prospective financial statements accompanied by a standard report on an examination prepared in accordance the *Statement of Standards for Accountants’ Services on Prospective Financial Information* promulgated by the American Institute of Certified Public Accountants. See Pennsylvania Rule Section 609.010(e). Financial projections can take many forms, but most financial projections (e.g., a traffic study for a tollway) are exempt from the provisions of this Rule because they do not contain prospective financial statements described in the Rule.

F. **Separate Securities Under Traditional Blue Sky Analysis, NSMIA Analysis and the 2002 Act**

1. **General** In essence, separate security analysis is a technique used by securities commissions to require registration of some component of a bond issue under circumstances where the bonds themselves are exempt from registration. The general idea is that the separate security must either be registered or qualify for its own, separate exemption from registration. See, generally, the SEC’s use of this technique in attempting to require the registration of a lease, sale or loan arrangement, by or for an industrial or commercial enterprise, as discussed in Appendix A., paragraph G, *infra*.

No state has promulgated a rule or regulation comparable to SEC Rule 131 except Pennsylvania, which incorporates it by reference (see Section II.F.4., infra). Some states have attempted to achieve the same result by requiring the registration of NGICE Bonds (see Section II.D.1, *supra*). Several states have issued policy statements and interpretive opinions in attempts to state when a component of a bond issue constitutes or fails to constitute a separate security. The focus of such efforts has mostly been on credit enhancements, particularly, letters of credit.

This Section discusses how various jurisdictions have dealt with the concept of the separate security under Traditional Blue Sky Analysis, NSMIA Analysis and the 2002 Act.
The following factors have substantially limited the application of separate security analysis under state blue sky laws:

(1) Several jurisdictions expressly integrate credit enhancements with municipal bonds that are exempt from registration, as discussed in Section II.F.2., infra.

(2) In most (but not all) jurisdictions, bond insurance is excluded from the definition of security, as discussed in Section II.F.3, infra.

(3) Pursuant to NSMIA, the most common forms of credit enhancements qualify as covered securities, which, in turn, limits the effect of separate security analysis to a notice filing requirement, as discussed in Section II.F.4., infra.

As discussed below, the jurisdictions that are of concern with respect to separate security analysis are:

(1) Those jurisdictions that have both announced applicability of separate security analysis and imposed a notice filing requirement on Section 18(b)(4)(C) covered securities, namely, Illinois, Montana, Tennessee, Texas and Washington;

(2) Colorado and the District of Columbia, whose blue sky laws coordinate registration requirements and exemptions from registration with federal registration requirements and exemptions from registration; and

(3) Pennsylvania, which has imposed separate security status on any security that constitutes a separate security under Rule 131 and merit conditions on certain guaranties.  

As discussed below, the Illinois, Tennessee and Texas applications of the separate security concept have several exceptions. The treatment of letters of credit issued by domestic

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40 Spellings are not consistent in this area. When referring to a promise to answer for the payment of a debt, the Uniform Acts and the Securities Act of 1933 use the terms “guarantee” and “guaranteed.” Consistent with this approach, under the Pennsylvania blue sky law the term “security” includes a “guarantee” (see 70 Pennsylvania Statutes, Section 102(t)) and exempt securities include securities issued or “guaranteed” by various entities (see 70 Pennsylvania Statutes, Section 202). However, Pennsylvania Rule 202.092, entitled “Guaranties of certain debt securities exempt” [emphasis added], uses the terms “guaranty” for the noun and “guarantees” for the verb. The Florida blue sky law definition of the term “security” contains no reference to either a guaranty or a guarantee (see Section 517.021(21), Florida Statutes); however, the Florida blue sky law does contain an expansive definition of the term “guaranty” and included within this definition is the term “guaranteed” (see Section 517.021(12), Florida Statutes, discussed under Section II.E.2., supra). With respect to exempt securities, the Florida blue sky law uses the term issued or “guaranteed” (see Section 517.051, Florida Statutes). In the remainder of this paper, I will use the terms “guarantee” and “guaranteed” unless the cited material uses a different spelling.
branches of foreign banks varies greatly among Illinois, Montana, Tennessee, Texas and Washington.

The coordination of registration requirements for and exemptions from registration under the Colorado and District of Columbia blue sky laws with registration requirements for and exemptions from registration under federal law means that separate securities under federal law are also separate securities under the Colorado and District of Columbia blue sky laws, unless some other exemption from registration is available. The applicability of the Pennsylvania rules is limited in scope because of the many exceptions to covered security status under Rule 131 and because most guarantees are also covered securities, which, pursuant to NSMIA, are exempt from Pennsylvania’s merit condition and offering document requirements for guaranties.

2. Traditional Blue Sky Analysis and Integration in Jurisdictions Which Have Not Enacted the 2002 Act

In several of the jurisdictions which have not enacted the 2002 Act, pursuant to blue sky statutes, regulations, policy statements and releases, letters of credit and other forms of credit enhancement have been held not to constitute separate securities. Often, the rationale is that the credit enhancement is an integral part of the underlying exempt security (i.e., the bonds in question), is not separable from the underlying exempt security and has no value apart from the underlying exempt security.

See, for example:

(a) Arizona Policy Statement of the Arizona Corporation Commission, Securities Division, dated January 21, 1991, CCH para. 9,618: “The Securities Division holds the position that when a guarantee/letter of credit is an integral part of an underlying security and is not separable from the underlying security and has no value apart from the underlying security, the guarantee/letter of credit and the underlying security will be considered as a single unit. When the underlying security is exempt from registration, separate registration of the guarantee/letter of credit is not required. When registration is required, a single registration of both the underlying security and the guarantee/letter of credit is sufficient.” See also Arizona no action letter dated October 8, 1992, CCH para. 9,654, in which a guarantee of airport bonds was considered to be an integral part of the bonds.

(b) The Louisiana municipal bond exemption from registration includes “any underlying or separate security which secures” any municipal bond. Section 51:708(1), Louisiana Statutes.

(c) Maryland Securities Division Release No. 26, issued September 23, 1985, CCH para. 30,568:

The Division of Securities has received a substantial number of no-action requests relating to offerings involving revenue obligations issued or guaranteed by the United States, a state or a political subdivision of a state, or an agency, corporation or other instrumentality of one or more of them, where the transaction involves a guaranty or quasi-guaranty in the form of a letter of credit of a financial institution.
In cases where these letters of credit are not separable as independent securities but serve simply as a part of the financing mechanism of the offering, or where they function as a back-up source of funds to purchase bonds for remarketing pursuant to a standby bond purchase agreement, the Commissioner has determined that the Division will take no action to require registration of these letters of credit.

For purposes of this position, it is immaterial whether the letter of credit is issued by a state or federally chartered savings and loan association, savings bank, bank or state branch of a foreign bank. It is also immaterial whether the letter of credit serves as a full guaranty or provides for draws up to a stated amount; whether it runs the full term of the bonds, or a fixed limited period or lapses upon a defined event.

Where these letters of credit cannot be separated from the underlying offering and cannot be sold separately and represent no value to the investor apart from the offering but simply serve as a supplementary source of revenues for payment on the bonds under certain circumstances, issuers will not be required to register the letters of credit as separate securities.\(^4\)

\(^{4}\)See, also, the following unpublished no action letters, which are based on Maryland Securities Division Release 26: $9,000,000 The City of Los Angeles Variable Rate Demand Certificates of Participation, dated June 17, 1987, 1987 Md. Sec. No-Act. LEXIS 100; $51,500,000 California Pollution Control Financing Authority Variable Rate Demand Resource Recovery Revenue Bonds, dated February 2, 1987, 1987 Md. Sec. No-Act LEXIS 147; City of Lenexa, Kansas $13,000,000 Multi-family Housing Revenue Refunding Bonds and $8,000,000 Multi-family Housing Revenue Refunding Bonds, dated July 7, 1988, 1988 Md. Sec. No-Act LEXIS 20; and $50,000,000 Development Authority of Burke County (Georgia) Pollution Control Revenue Bonds (Georgia Power Company Plan Vogtle) First Series 1989, due May 2019, dated May 9, 1989, 1989 Md. Sec. No-Act LEXIS 50. See, the following unpublished no action letters, in which bond insurance policies are included within the scope of Maryland Securities Division Release 26: USHCSO-Portsmouth Project and USHCSO-Richmond Place Project, dated June 15, 1988, 1888 Md. Sec. No-Act LEXIS 43 and $111,531,003.06 (subject to change) Commonwealth of Kentucky State Property and Buildings Commission Bonds, dated September 29, 1988, 1988 Md. Sec. No-Act. LEXIS 41.
of credit backs the full payment of principal and interest and/or dividends of the underlying security.”

(e) Ohio Rule 1301:6-3-03(E)(7), CCH para. unavailable, provides an exemption for: “Any guarantee, letter of credit, standby purchase agreement, or other credit enhancement that is offered and sold in conjunction with a security that is exempt under division (B) of section 1707.02 of the Revised Code [the Ohio municipal bond exemption from registration] and which is not traded separately is exempt under division (V) of 1707.03 of the Revised Code [the Ohio exempt transaction exemption for the sale of any security for which the Division finds that registration is not necessary or appropriate in the public interest or for the protection of investors].”

(f) The Oregon municipal bond exemption from registration includes “any other security offered in connection with or as part of the security set forth in paragraph (a) of this subsection [i.e., the municipal bond exemption] if the security cannot be severed and sold separately from the security in paragraph (a) of this subsection.” Section 59.025.(1)(b), Oregon Revised Statutes.

(g) Wyoming Rule Section 1., CCH Blue Sky Law Reporter 66,432: “(a) Credit enhancements such as ‘put options’ and ‘letters of credit’ attached to an otherwise exempt issue of securities under W.S. 17-4-114(a)(i) and (ii) [the Wyoming municipal bond exemption from registration] having no investment value separate and apart from the exempt issue are considered an integral part of the otherwise exempt security and require no separate registration or exemption.”

42 See, for example, Illinois Student Assistance Commission $50 Million Taxable Variable Rate Demand Student Loan Revenue Bonds Series B, dated June 29, 1990, 1990 Mass. Sec. No-Act, and Colorado Student Obligation Bond Authority Weekly Adjustable/Fixed Rate Student Loan Program Senior Banks, Series 1990A, dated January 17, 1990, 1990 Mass. Sec. No-Act LEXIS 5, in which the requirements of this Bulletin were applied to bond issues secured letters of credit issued by the domestic branch of a foreign bank.


Finally, see Request for No Action Letter For Offering To Be Made Pursuant To The Exemption Provided by G.L.M. Section 402(a)(1) $50,000,000 Development Authority of Burke County (Georgia) Pollution Control Revenue Bonds (Georgia Power Plant Vogtle) First Series 1989, Due May 1, 2019, dated May 4, 1989, 1989 Mass. Sec. No-Act. LEXIS 64, in which a letter of credit issued by a national bank was treated as integrated with the related bond issue.
3. **Bond Insurance In General** Bond insurance policies usually escape treatment as separate securities under Traditional Blue Sky Analysis. In most Blue Sky Jurisdictions insurance policies either enjoy a separate exemption from registration (see, for example, Section 517.051(10), Florida Statutes) or are expressly excluded from the definition of the term security *i.e.*, there can be no separate security if there is no security to begin with (see, for example, Section 45.55.990(32), Alaska Statutes).

However, blue sky exemptions from registration for an insurance policy or an exclusion of an insurance policy from the definition of security, are sometimes conditioned upon the insurer being licensed or authorized to do business in the state in question. For example, Section 44-1843.4., Arizona Statutes, provides an exemption from registration for insurance policies issued by a person subject to the supervision of and licensed by the state’s insurance commissioner or certain other public agencies. Section 10-04-05.3., North Dakota Century Code, provides an exemption from registration for policy contracts of an insurance company subject to supervision by an agency of the State of North Dakota. The Pennsylvania blue sky law excludes insurance policies from the definition of security, provided that the insurer is “admitted” in Pennsylvania. See 70 Pennsylvania Statutes, Section 102(t). The Texas blue sky law similarly excludes insurance policies from the definition of security, provided that the policy is “issued by an insurance company subject to the supervision or control of the Texas Department of Insurance when the form of such policy...has been duly filed with the Department of Insurance as now or hereafter required by law.” See Article 581-4.A., Texas Statutes.

Standard disclosure for most bond insurers provides that the insurer in question is licensed to do business in all 50 states, the District of Columbia and the Commonwealth of Puerto Rico, so the requirement that the insurer be regulated by the state in question is usually not an issue. However, the Texas requirement of local regulation of the insurance company, coupled with Texas’ use of the separate security concept, can raise the possibility of a notice filing with respect to the insurance policy when the insurance company’s standard disclosure fails to state that the insurer is authorized to do business in all 50 states, Puerto Rico and the District of Columbia. See Section II.F.5.(b) (4), *infra*.

4. **General Effect of NSMIA on Separate Security Analysis** Because of the enactment of NSMIA, the most common forms of credit enhancement (*i.e.*, letters of credit issued by state or national banks or by qualifying domestic branches of foreign banks, bond insurance and guarantees by companies whose stock is listed on the New York and certain other stock exchanges) are usually covered securities under NSMIA.

Letters of credit that qualify under the Bank Guaranty Exemption (see Appendix A, Section D.2.(iii), *infra*) are covered securities under Section 18(b)(4)(C) because they are exempt from registration under Section 3(a)(2). Bond insurance policies that qualify under Section 3(a)(8) are also covered securities under Section 18(b)(4)(C). Since such letters of credit and bond insurance policies are not municipal securities, they are not subject to the exception to covered security status for municipal securities issued by in-state issuers; in other words, they are covered securities in all jurisdictions, including the jurisdiction in which the issuer of the credit enhancement is located. Thus, even if these forms of credit enhancement are treated as separate...
Guarantees and other securities issued by companies whose stock is listed, or authorized for listing, on the New York Stock Exchange or certain other stock exchanges are covered securities under Section 18(b)(1). As covered securities, they are exempt from state registration, offering document and merit condition requirements pursuant to Section 18(a). In addition, pursuant to Section 18(c)(2)(D), securities that qualify for covered security status under Section 18(b)(1) are also exempt from state notice filing requirements.

5. Jurisdictions Other Than Pennsylvania

(a) NSMIA Analysis In Jurisdictions Which Have Not Enacted the 2002 Act and Also Have Not Imposed a Notice Filing Requirement on Section 18(b)(4)(C) Covered Securities  As discussed in Section II.F.2. supra, the most common forms of credit enhancement (i.e., letters of credit issued by state banks, national banks and qualifying domestic branches of foreign banks, bond insurance policies and guarantees issued by companies whose stock is listed or approved for listing on the New York Stock Exchange or certain other stock exchanges) are usually covered securities under NSMIA. Since these forms of credit enhancement are not municipal securities, they are not subject to the exception from covered security status for in-state issuers of municipal securities and, therefore, they are covered securities in all jurisdictions and, at most, are subject to a notice filing requirement, if any. For these types of credit enhancements, the following jurisdictions’ application of separate security analysis has been rendered moot by the enactment of NSMIA, because the Arkansas notice filing requirement applies only to covered securities under Section 18(b)(2) (securities issued by investment companies) and offerings under Rule 506 of Regulation D and because California and Connecticut have not imposed a notice filing requirement on any type of covered security:

(1) Arkansas Policy Statement dated April 10, 1986, CCH para. 10,664:

The Department routinely receives requests for a no-action position to be taken concerning a letter of credit issued by a bank or savings and loan association which guarantees a security being issued by a government agency or municipality. The security being issued is exempt pursuant to Section 14(a)(1) [§23-42-503]. The guarantee of the security would be exempt pursuant to Section 14(a)(3), 14(a)(4) or possibly 14(a)(5) [§23-42-503]; however, it would normally require a filing. This Department has taken a no-action position on numerous occasions that the letter of credit is an integral part of the security being issued and exempted under 14(a)(1) [§23-42-503]. This procedure has not required a separate filing for the letter of credit. Each offering must be reviewed on an individual basis.

The Department also receives requests for a no-action position to be taken concerning put options which are issued by a bank or a savings and loan association in connection with a security exempted by 14(a)(1) [§23-42-503]. If the option is not separately tradeable, the Department usually takes a no-action position because the option

43 See Appendix A, Section D.2.(c)., infra.
is an integral part of the security exempted by 14(a)(1) [§23-42-503].

(2) California Rule 260.105.38, CCH para. 11,820F: A guarantee, letter of credit, standby purchase agreement or similar security is exempt from registration provided that the related exempt municipal security is an “investment grade security” or the issuer of the guarantee, letter of credit, standby bond purchase agreement or similar security meets certain standards.

(3) Connecticut Policy Statement dated June 25, 1968, CCH para. 14,539: Letters of credit issued by domestic financial institutions and domestic branches of foreign banks that are issued in connection with governmental bond offerings must qualify for an exemption from registration available for banking institutions.

(b) NSMIA Analysis In Jurisdictions Which Have Not Enacted the 2002 Act But Which Have Imposed a Notice Filing Requirement on Section 18(b)(4)(C) Covered Securities Illinois, Montana, Tennessee, Texas and Washington have adopted the separate security concept in varying degrees and have imposed notice filing requirements on Section 18(b)(4)(C) covered securities that are not otherwise exempt from registration under Traditional Blue Sky Analysis. Except for letters of credit issued by domestic branches of foreign banks (see Illinois and Montana below), credit enhancements that qualify as Section 18(b)(4)(C) covered securities usually qualify for an exemption from registration in these states under Traditional Blue Sky Analysis without resorting to no action requests.

(1) Illinois Guidelines (the “Illinois Guidelines”) on industrial development bonds, CCH para. 23,211, provides:

Many IDBs are marketed with credit enhancement features to increase their attractiveness as investments. These features are reviewed separately, and unless they are deemed exempt from registration the IDBs they support lose their exempt status. Then, the IDBs’ offeror must decide whether to drop the non-exempt credit enhancement features or register the offering.

In general, letters of credit, insurance company guarantees and puts are exempt from registration under Sections 3.C., 3.D. and 3.M. [Sections 5/3.C., 5/3. and 5/3.M.] of law [Illinois Revised Statutes]. Insurance policies are also exempt, as they are not considered “securities”…

Personal and corporate guarantees of IDBs are also viewed separately and may similarly affect the exempt status of the IDBs they support. [Emphasis added]

Illinois no action letters confirm the separate security position set forth in the above Guidelines.\(^{44}\) With respect to letters of credit and standby bond purchase agreements issued by

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\(^{44}\) See, for example, Oklahoma Industries Authority – Hospital Revenue Refunding Bonds Series 1994A, Sections 3.A. and 3.C., January 12, 1995, 1995 Il. Sec. NEXIS 2, with respect to a standby bond purchase agreement; Pollution Control Refunding Revenue Bonds, Section 3.A.,
banks and savings and loan associations, the Guidelines appear to be more liberal than the statutory sections to which they refer. The Guidelines provide that, in general, Section 3.C. of the Illinois Securities Law of 1953 provides an exemption from registration for letters of credit issued by certain banks; Section 3.D. of the Illinois Securities Law of 1953 provides an exemption from registration for letters of credit issued by certain savings and loan associations; and Section 3.M. provides an exemption from registration for insurance company guarantees. However, each of these Sections requires that the security in question be “issued by and representing an interest in or a debt of” the bank, savings and loan association or insurance company. [Emphasis added.] A letter of credit or insurance company guarantee probably is a security issued by a bank, savings and loan association or insurance company, but, on its face, would not appear to be either an interest in (e.g., shares of stock) or a debt of (e.g., an evidence of indebtedness) a bank, savings and loan association or insurance company.

The requirement that a security represent an interest in or debt of the issuing entity is also found in the exemption from registration for bank securities under Section 402(a)(3) of the 1956 Act, the exemption from registration for securities issued by savings and loan associations under Sections 402(a)(4) of the 1956 Act and the exemption from registration for securities issued by insurance companies under Section 402(a)(5) of the 1956 Act. The NCCUSL Comment to these sections provides that these exemptions apply:

…only if the security represents an interest in or debt of the particular issuer, or is guaranteed by the particular issuer. The purpose is to make it clear that these exemptions do not apply when, for example, a bank acting as depository for a protective committee in a reorganizations issues certificates of deposit, which in no sense represent an interest in or claim against the bank. The exemption for bank securities in Illinois was so construed before it was specifically limited as it now is. [Emphasis added]

In support of the above, the NCCUSL comment cites (1) Jaffe v. Goldner, 251 Ill. App. 188, 190 (1929): “It would seem obvious, then, that when the act refers to a security issued by a bank, it means a security which is a lien or charge upon the bank or its property or assets.” [Emphasis added.]; (2) Commissioner of Banks v. Chase Securities Corp., 298 Mass. 285, 301-305, to the effect that the exemption from registration for a security issued by a trust company applied to a security that represented an interest in or “direct contract right against” a trust company. [Emphasis added.]; and (3) Young v. Three For One Oil Royalties, 31 P.2d. 789 (Cal. 1934), rehearing denied with opinion, 1 Cal. 2d. 639, 36 P.2d 1065 (1934), in which a statutory amendment limiting the exemption for securities issued by a national bank to any security “issued by and representing an interest in or direct obligation of a national bank” [Emphasis added.] had been needed to override a contrary interpretation that any security issued by a

October 17, 1994, 1994 Il. Sec. LEXIS 269, with respect to a guaranty provided by a subsidiary of a company whose stock was listed on the New York Stock Exchange; City of Urban[a], Illinois Adjustable Rate Multifamily Housing Revenue Bonds and Letter of Credit Sections 3.A. and 3.C., June 22, 1994, 1994 Il. Sec. NEXIS 129, with respect to a letter of credit issued by a federal savings bank; and San Joaquin County Transportation Authority Sales Tax Revenue Bonds (Limited Tax Bonds, Series 1993. Sections 3.A. & C, June 21, 1993, 1993 Il. Sec. LEXIS 115, with respect to a letter of credit issued by the domestic branch of a foreign bank.
national bank would be exempt from registration. See, also, the current version of Section 25100(c), California Code, which provides an exemption from registration for “any security issued or guaranteed by and representing an interest in or direct obligation of a national bank…”

However, in view of the NCCUSL Comment and cases cited by the NCCUSL Comment, I think that the no action letters are a fair interpretation of the Illinois exemption from registration for securities issued by a bank or savings and loan association, i.e., the words “representing a debt of” should be construed in the broader sense of a representing a claim against or direct obligation of the bank or savings and loan association in question, which would include a letter of credit. In the bank securities exemption under Section 401(3) of the 1985 Act and in the bank securities exemption under Section 201(3) of the 2002 Act, the words “debt of” have been replaced with the words “direct obligation of.”

Most of the Illinois no action letters concern letters of credit, and there are over 50 examples of no action letters involving qualifying letters of credit available through the LexisNexis Total Research System, including letters of credit that were issued by domestic branches of foreign banks that qualified under the Bank Exemption (i.e., SEC Release No. 33-6661).45

The Illinois blue sky law is not kind to separate securities that do not qualify under the Guidelines. For such separate securities, no action requests in Illinois are virtually impossible to obtain because Illinois Securities Law of 1953 Regulation 130.1520(a)(1)(E), CCH para. unavailable, provides that no action requests contain “a representation that the transaction in question has not been commenced and will not commence for at least 30 days.”

The other alternative to registration available to separate securities that do not qualify under the Illinois Guidelines is a notice filing. The Illinois notice filing requirement includes page one of Form U-1 (Uniform Application to Register Securities) and a filing fee of 1/20 of 1% of the maximum aggregate offering price, but not less than $500 nor more than $2,500. Illinois Rule Section 130.293.a(6), CCH para. 22,635A.

(2) Montana no action letters concerning bond issues secured by letters of credit treat a letter of credit as a guaranty and therefore a separate security, which must qualify for its own exemption from registration, typically as a security issued by a bank. The Montana Commissioner of Securities had previously indicated a willingness to issue no action letters with respect to transactions involving letters of credit issued by domestic branches

of foreign banks. Montana Interpretive Statement 86-1, which was cited in the no action request for Dade County Florida Adjustable Tender Solid Waste System Revenue Bonds Series 1988 (Montenay – Dade Ltd Project), February 18, 1988, 1988 Mont. Sec. LEXIS 1944, appeared to confirm this position, provided that “In each case, the Commissioner will require an opinion from the issuer’s counsel indicating the type and extent of regulation to which the domestic branch of the foreign bank is subject and further that this exemption is available to the particular issuer.” However, I have been advised by a staff attorney of the Montana Securities Commission that Interpretive Statement 86-1 is not an accurate, current statement of Montana law, because the domestic branch of a foreign bank is not one of the types of banks whose securities are exempt from registration under the Montana blue sky law.

The Montana exemption from registration for bank securities, Section 30-10-104(3), Montana Code Annotated – 2007, contains the same requirement that the Illinois exemption from registration contains, namely that the security be issued by and represent an interest in or debt of the bank. The Montana exemption from registration for bank securities should be construed in the same manner as the Illinois exemption (i.e., a security issued by and representing a claim against or direct obligation of the bank in question) and for the same reasons (see Illinois, supra).

(3) The Tennessee blue sky law excludes from the definition of security any “bank letter of credit” and “an insurance or endowment policy under which an insurance company promised to pay money either in a lump sum or periodically for life or for some other specified period.” Sections 48-2-102(16)(B) and (E), Tennessee Code. The term “bank” is not defined in the Tennessee blue sky law. Pursuant to Policy Statement dated October 10, 1985, CCH para. 54,513, the term bank has the meaning set forth in Section 3(a)(6) of the Securities Exchange Act of 1934; namely:

banking institution, whether incorporated or not, doing business under the laws of any State of the United States, a substantial portion of the business of which consists of receiving deposits or exercising a fiduciary power similar to those permitted to national banks under section 11(k) of the Federal Reserve Act, as amended, and which is supervised and examined by State or Federal authority having supervision over banks and which is not operated for the purpose of evading the provisions of this title.

The Policy Statement further provides:

It is the Division’s position that letters of credit issued by banks which meet this Exchange Act definition of Bank [the definition set forth above] are excluded from the definition of security under the [Tennessee Securities] Act and therefore are not subject to the securities registration requirements of the Act. Since domestic branches of foreign banks typically are supervised by the banking authority of the state in which they are located their letters of credit generally need not be registered under the Act.

The Policy Statement cautions that it does not address whether securities issued by the domestic branch of a foreign bank are exempt from registration pursuant to the bank exemption from registration set forth in Section 42-2-103(a)(3), Tennessee Code. That section provides an exemption for securities issued by any bank organized and existing under the laws of any state. Since the domestic branch of a foreign bank is typically not organized under state law, the bank exemption from registration under Section 42-1-103(a)(3), Tennessee Code, is not available for such securities.

The Tennessee view of separate securities is set forth in a Policy Statement dated October 10, 1985, CCH para. 54,514:

The Division has received several requests for no action letters regarding whether certain instruments or commitments (“Instruments”) are exempt from the securities registration requirements of the Tennessee Securities Act of 1980 (the “Act”) if they are issued in connection with or as an integral part of bond issues or other securities offerings (“Bonds”) that are exempt pursuant to Section 48-2-103(a)(1) of the Act. These requests most commonly involve an indenture executed by and between the issuer of the Bonds and the Bond trustee. Requests also have involved other Instruments such as letters of credit, guaranty agreements and bond default insurance policies. Other types of credit or liquidity enhancement devices may raise identical concerns.

Except in rare cases these Instruments will be exempt. The Division’s position is that if such Instruments are within the definition of security in Section 48-2-102(12) of the Act they do not avoid the securities registration requirements of the Act simply because they are issued in connection with or as an integral part of an exempt securities offering. Every security must find its own exemption. [Emphasis added.]

Section 48-2-125(a), Tennessee Code, which was enacted in 1997 (subsequent to the date of the above policy statement), provides that all virtually covered securities are subject to a notice filing requirement that includes a consent to service of process and a filing fee of $500. Section 18(b)(1) covered securities (i.e., securities issued by companies whose stock is listed or approved for listing on the New York Stock Exchange and certain other stock exchanges) were expressly excluded from the notice filing requirements of Section 48-2-125(a). Section 48-2-125(a) was effectively repealed by the enactment in 1999 of Section 48-2-126(2) which provides an exemption from registration for covered securities that are exempt from registration under Section 3(a)(2).

47 i.e., the section of the Tennessee blue sky law that provides for the municipal bond exemption from registration.
Thus, separate security analysis has a very limited scope in Tennessee. Bank letters of credit and bond insurance policies are excluded from the definition of security and are therefore beyond the reach of the Tennessee blue sky law. Covered securities that are exempt from registration under Section 3(a)(2) (including a qualifying letter of credit issued by the domestic branch of a foreign bank) are exempt from the Tennessee notice filing requirement, pursuant to Section 48-2-126(1), Tennessee Code. Securities issued by companies described in Section 18(b)(1) are exempt from both registration and notice filings pursuant to NSMIA and from notice filings pursuant to Section 48-2-125(a)(1), Tennessee Code.

(4) Texas Rule 139.15, CCH para. 55,720D: Any “qualified credit enhancement” need not be registered as a separate security when no additional consideration is required to receive the enhancement and the enhancement is offered and sold in conjunction with, and is not tradable separately from, securities that are included within a transaction exempt under Section 5 of the Texas Securities Act (e.g., the exemption from registration for municipal bonds set forth in Section 5.M. of the Texas Securities Act).

Qualified credit enhancements include a letter of credit issued by a qualifying domestic branch or agency of a foreign bank if the nature and extent of the regulation and supervision of the particular branch or agency is substantially equivalent to that applicable to federal or state chartered domestic banks doing business in the same domestic jurisdiction (i.e., the test of SEC Release No. 33-6661, discussed in Appendix A, Section D.2.(b)(iii), infra) and a municipal bond insurance policy or guarantee issued by an insurance company licensed or supervised by the Texas Department of Insurance. Failure of the insurance company to be licensed or supervised by the Texas Department of Insurance or failure of the insurance company’s standard offering document disclosure to state that the insurance company is authorized to do business in all 50 states, the District of Columbia and Puerto Rico can render the insurance policy subject to the Texas notice filing requirement described below. See also Section II. F.2, supra.

See also favorable no action letters issued with respect to: a liquidity facility issued by the domestic branch of a foreign bank, CCH para. 55,827H; master indenture obligation issued by nine non-profit corporations, CCH para. 55,827X; and letter of credit issued by a national bank, CCH para. 55,828. In a no action letter dated June 9, 1995, CCH para. 55,815B, put options for the purchase of certain state and local government bonds and the letter of credit issued by a national bank providing security for the payment of the purchase price of the put were treated as securities issued by a bank and guaranteed by a bank, respectively, under Section 581-5.L., Texas Statutes, as opposed to being integrated with the bonds; however, it may be that the puts and letter of credit were provided after the issuance of the bonds, which would provide an argument against integration.

See also the exemption from registration under Section 5.L., Texas Securities Act, for “The sale by the issuer itself, or by a registered dealer of any security issued or guaranteed by any bank organized and subject to regulation under the laws of the United States or under the laws of any State or territory of the United States, or any insular possession thereof, or by any savings and loan association organized and subject to regulation under the laws of this State, or the sale by the issuer itself of any security issued by any federal savings and loan association.”
If the foregoing are not sufficient to provide an exemption from registration for the credit enhancement in question, the Texas notice filing requirement consists of page 1 of a Form U-1, Uniform Application to Register Securities, with items 1-6 completed or a document providing substantially the same information, a consent to service of process (unless the “filing is made by a registered dealer and acting as a principal in a firm commitment underwriting”), and filing fee equal to the sum of $100 plus 1/10 of 1% of the aggregate amount of the Bonds to be offered to the public in Texas. See Texas Rules 114.1 through 114.4, CCH paras. 55,590P through 55,590S. The Texas notice filing fee is expensive because it has no upper limit. Thus, a notice filing for $5,000,000 of bonds offered for sale to the public in Texas requires a filing fee of $100 plus $5,000 or $5,100.

(5) Washington Interpretive Statement IS-03, January 1, 1991, CCH para. 61,805: Without stating whether a letter of credit constitutes a security under the Washington blue sky law, securities issued by the domestic branch of a foreign bank that is subject to regulation that is substantially equivalent to that applicable to federally or state-chartered domestic banks doing business within the same jurisdiction are included in the exemption from registration available to banking institutions. The Washington exemption from registration for bank securities, RCW 21.20.310(3), contains the same requirement that the Illinois exemption from registration contains, namely that the security be issued by and represent an interest in or debt of the bank. Washington Interpretive State IS-03 does not mention this requirement; neither do prior Washington Securities Division orders of exemption that I have examined.\footnote{See In the Matter of Anaheim Housing Authority Multifamily Housing Revenue Bonds (Villas at Anaheim Hills Apartments) 1989 Series B, September 18, 1989, 1989 Wa. Sec. LEXIS 460 and In the Matter of Yakima County Public Corporation Variable Rate Demand Revenue Bonds, 1989 (Can-Am Millwork, Ltd. Project), December 4, 2989, 199 Wa. Sec. LEXIS 459.} The Washington exemption from registration for bank securities should be construed in the same manner as the Illinois and Montana exemptions (i.e., a security issued by and representing a claim against or direct obligation of the bank in question) and for the same reasons (see Illinois and Montana, \textit{supra}).

(c) Separate Security Analysis in Jurisdictions Which Have Enacted the 2002 Act As of the date of this paper: the 2002 Act is in effect Georgia, Hawaii, Idaho, Indiana, Iowa, Kansas, Maine, Michigan, Minnesota, Mississippi, Missouri, New Mexico, Oklahoma, South Carolina, South Dakota, Vermont, the U.S. Virgin Islands and Wisconsin. The 2002 Act provides an exemption for “a security, including a revenue obligation as defined in Rule 131 (17 C.F.R. 231.131) adopted under the Securities Act of 1933...” Thus, the 2002 Act includes within the municipal bond exemption from registration (i.e., integrates with the exempt municipal bond) any separate security under SEC Rule 131. What constitutes a separate security under Rule 131? See Section II.F.4., \textit{infra}, and Appendix A. paragraph G., \textit{infra}.\footnote{See In the Matter of Anaheim Housing Authority Multifamily Housing Revenue Bonds (Villas at Anaheim Hills Apartments) 1989 Series B, September 18, 1989, 1989 Wa. Sec. LEXIS 460 and In the Matter of Yakima County Public Corporation Variable Rate Demand Revenue Bonds, 1989 (Can-Am Millwork, Ltd. Project), December 4, 2989, 199 Wa. Sec. LEXIS 459.}
However, the 2002 Act may not have gone far enough, by not taking into account separate securities that may exist independently of Rule 131. According to Steven Bradford Lyons:  

…However, the evolution of more complex financing structures has produced a “separate” separate security. This can be described as an independent third party obligation to make payments on the bonds by someone who is neither a user of the project nor directly related to the user of the project, i.e., not a defined rule 131 separate security or so directly associated therewith that it merges into a defined rule 131 separate security. This ordinarily involves insurance policies, letters of credit or guaranty agreements from unrelated parties whose sole relationship to the IDB issuers and project users is a business relationship involving provisions of security for the project financing…It is claimed, therefore, it must then have its own registration exemption.

Under Traditional Blue Sky Analysis, what does the 2002 Act provide with respect to the most common forms of credit enhancement in the current municipal market (i.e., letters issued by state banks, national banks and by qualifying branches of domestic branches of foreign banks, policies of bond insurance and guarantees by companies whose stock is listed on the New York Stock Exchange and certain other stock exchanges)?

Under Section 102(28)(B) of the 2002 Act, the definition of “security” specifically excludes “an insurance policy…under which an insurance company promises to pay a fixed…sum of money either in a lump sum or periodically for life or other specified period,” i.e., policies of bond insurance. All of the states that have enacted the 2002 Act have enacted this provision.

As to letters of credit, the definition of security includes a guarantee of an evidence of indebtedness. Paragraph 12 of the Official Comments to the 2002 Act (but, alas, not the 2002 Act itself) provides the following with respect to the definition of the term guaranteed: “Any method of guarantee that results in a guarantee of payment of all principal and interest will suffice including, for example, an irrevocable letter of credit.” Thus, letters of credit are probably guarantees and, if they are, they are securities. Even if they are separate securities independent of Rule 131, most of the banks that issue them should qualify under the broad bank guarantee exemption from registration under Section 201(3) of the 2002 Act, including the domestic branch of a foreign bank (see Section 201(3)(C) of the 2002 Act).

In addition, under NSMIA Analysis, letters of credit issued by state banks, national banks and qualifying branches of domestic branches of foreign banks under the Bank Exemption are Section 18(b)(4)(C) covered securities. Most of these jurisdictions’ versions of the 2002 Act do not authorize the imposition of notice filing requirements on Section 18(b)(4)(C) covered securities. Maine, Michigan and Vermont authorize their respective securities commissioners to impose a notice filing requirement on Section 18(b)(4)(C) covered securities that are not

otherwise exempt from registration under Traditional Blue Sky Analysis, but none of these jurisdictions have done so. Thus, even if bank letters of credit constitute separate securities independent of Rule 131, they are not subject to notice filings in jurisdictions which have enacted the 2002 Act.

As to guarantees issued by unrelated parties, Section 102(5) of the 2002 Act continues the exemption under Section 402(a)(7) of the 1956 Act for any security issued or guaranteed by any railroad, other common carrier, public utility or holding company, subject to certain enumerated conditions. A guarantee that constitutes a covered security under Section 18(b)(1) (i.e., a guarantee issued by a company whose stock is listed or approved for listing on the New York Stock Exchange and certain other stock exchanges) would also be exempt from registration under Section 201(6) of the 2002 Act.

Thus, in general, the 2002 Act provides separate exemptions from registration for such separate securities, but it is an issue to be mindful of when confronted with a novel, nonstandard form of credit enhancement or a guaranty by an unrelated party.

(d) Express Coordination With Federal Law: Colorado and the District of Columbia

The blue sky statutes of Colorado and the District of Columbia each provide express coordination of federal and state exemptions from registration, coupled with a lack of a notice filing requirement in Colorado and an exception from the notice filing requirement in the District of Columbia for securities that are exempt from federal registration.

Specifically, Section 11-51-101(2), Colorado Statutes, entitled “Short title and purpose,” provides that the purposes of the Colorado blue sky law “are to protect investors and maintain public confidence in securities markets while avoiding unreasonable burdens on participants in the securities markets.” Section 11-51-101(3), Colorado Statutes, provides that “The provisions of this article and rules made under this article shall be coordinated with the federal acts and statutes to which references are made in this article and rules and regulations promulgated those federal acts and statutes, to the extent coordination is consistent with the purposes and the provisions of this article.” [Emphasis added.] In furtherance of the statutory policy of Section 11-51-101(3), Colorado Statutes, Section 11-51-311, Colorado Revised Statutes, provides that the exemptions from registration under the Colorado blue sky law shall be coordinated with exemptions for securities and transactions under the Securities Act of 1933, so that an offering registered under the Securities Act of 1933 shall be subject to registration by filing under the Colorado blue sky law in the absence of an exemption under the Colorado blue sky law and so that an offering exempt from registration under the Securities Act of 1933, other than pursuant to the exemption for intrastate offerings, shall also be exempt from registration under the Colorado blue sky law.

However, the coordination provisions of Section 11-51-311, Colorado Statutes, are limited by Section 11-51-202(1), Colorado Statutes, which provides that each reference in the Colorado blue sky law to a federal act or statute means, unless the context provides otherwise, that act or statute as in effect on January 1, 1990, together with related rules and regulations. Moreover, pursuant to Section 11-51-202(2)(a), Colorado Statutes, whenever amendment to any federal act or statute to which reference is made in the Colorado blue sky law is enacted with an
effective date on after January 1, 1990 or whenever an amendment to any rule or regulation under any such federal act or statute is promulgated with an effective date on or after such date, the securities commissioner shall determine whether giving effect to such an amendment is inconsistent with the purposes of the Colorado blue sky law set forth in Section 11-51-101(2), Colorado Statutes (described above) or any other provision of the Colorado blue sky law (e.g., Section 11-51-101(3) (described above). If the securities commissioner determines that an inconsistency exists, the securities commissioner shall commence rule-making proceedings for the purpose of making, amending, or rescinding such rules as may be appropriate to carry out the policy stated in Section 11-51-101(3). Pursuant to Colorado Rule 51-2.2, if any SEC rule or regulation incorporated into the Colorado Rules is amended by the SEC subsequent to the date the Colorado Rule was adopted, such subsequent SEC rule amendment may apply to the Colorado Rule provided that the securities commissioner does not commence rule making proceedings within 90 days after the effective date of any such amendment.

A securities examiner for the Colorado Securities Commission confirmed to me by telephone on February 23, 2010 that no such rule-making had ever been undertaken with respect to municipal bonds. In addition, a no action request dated subsequent to January 1, 1990, ([Exemption request – Domestic branch of a foreign bank may issue unregistered letters of credit] Colorado, opinion letter dated February 17, 1995, CCH para. unavailable) mentions the above statutory coordination provisions only in passing in a footnote. A no action request dated July 9, 1992 with respect to the treatment of certificates of participation where the underlying obligors were the Board of Education of the City of Chicago the Community College District No. 508, Cook County, Illinois did not mention these statutory coordination provisions at all (see General Obligation Lease Certificates, 1992 Series B (Board of Education of the City of Chicago) and General Obligation Lease Certificates, 1992 Series C (Community College District No. 508, July 16, 1992, 1992 Colo. Sec. No-Act. LEXIS 10).

Similar to Colorado, Section 31-5601.02(a) of the District of Columbia Code [Section 102(a) of the District of Columbia Securities Act], entitled “Purpose and coordination with federal law,” provides, “The purpose of this act is to protect investors and maintain public confidence in securities markets while avoiding unreasonable burdens on participants in capital markets.” Section 31-5601.02(b) of the District of Columbia Code [Section 102(b) of the District of Columbia Securities Act] provides that the District of Columbia blue sky law and the rules and regulations thereunder “shall be coordinated with the federal acts and statutes to which references are made in this act [the District of Columbia blue sky law] and the rules and regulations promulgated under those federal acts and statutes to the extent that coordination is consistent with both the purposes and provisions of this act [the District of Columbia blue sky law]. [Emphasis added.] Section 31-5604.06(a) of the District of Columbia Code [Section 406(a) of the District of Columbia Securities Act] provides that in furtherance of the policy stated in Section 31-5601.02(b) of the District of Columbia Code [Section 102(b) of the District of Columbia Securities Act], the exemptions from registration found in the District of Columbia blue sky law “shall be coordinated with exemptions for securities and transactions under the Securities Act of 1933 so that an offering registered under the Securities Act of 1933 shall be subject to registration by filing under this act [the District of Columbia blue sky law] in the absence of an exemption under this act, and an offering exempt from registration under the Securities Act of 1933, other than under the exemption for intrastate offerings, shall be exempt
from registration under this act.” [Emphasis added.] The District of Columbia blue sky law does not contain the limitation on changes made in federal law after January 1, 1990 found in the Colorado blue sky law.

Section 31-5603.08 of the District of Columbia Code [Section 308 of the District of Columbia Securities Act] authorizes the Commissioner to impose a notice filing requirement on Section 18(b)(4)(C) covered securities that are not otherwise exempt from registration pursuant to Section 401 or 402. District of Columbia Rule 1941, CCH para. 16,540 imposes such a notice filing on Section 18(b)(4)(C) covered securities, but the coordination of the federal and District of Columbia exemptions from registration makes this Rule inapplicable to Section 18(b)(4)(C) covered securities (because they are exempt from registration pursuant to Section 3(a)(2)).

Municipal bonds are also exempt from the notice filing requirement of this Rule, because the municipal bond exemption from registration under District of Columbia blue sky law is based on the 1956 Act, which contains no exceptions to the municipal bond exemption from registration. See, also, District of Columbia, Questions and answers on District of Columbia securities laws and regulations, Securities Release No. 02-1, Department of Insurance and Securities Regulation 5-2002, CCH para.16,759:

Question 10. Do the notice filing requirements for federal covered securities of Sections 1941 [Notice filing of securities covered under Section 18(b)(3) and 18(b)(4)(A)-(C) of the Securities Act of 1933] and 1942 [Regulation D. offerings] of the rules apply to bonds, notes, and other obligations issued by states, counties and municipalities (“municipal securities”)?

Answer: The requirements of sections 1941 and 1942 of the rules apply only to federal covered securities that are not otherwise exempt from registration under Sections D.C. Official Code §31.5604.01 [exempt securities] and §31-5604.02 [exempt transactions] of the Securities Act of 2000. Bonds, notes, and other obligations issued by states, counties and municipalities are exempt from registration and require no filing or fee. D.C. Official Code §31-5604.01(1).

The unspoken converse of the Colorado and District of Columbia blue sky laws is that a separate security under SEC Rule 131 that does not qualify for an exemption from registration under the Securities Act of 1933 will also not qualify for an exemption from registration under the Colorado blue sky law or from registration or notice filing under the District of Columbia blue sky law, unless some other exemption is available.

What is a separate security under SEC Rule 131? See Appendix A, Section G., infra, for a general description of SEC Rule 131, and Section II.F.6. Pennsylvania, infra, for a description of state law treatment of separate securities under federal law where the state expressly attempts to regulate such federal separate securities.

6. Pennsylvania
Securities Issued By A Governmental Unit

Pennsylvania Rules

Section 202.010, Securities issued by a governmental unit, CCH para. 48,419, provides that the municipal bond exemption under Section 202(a) of the Pennsylvania blue sky law (70 Pennsylvania Statutes Section 1-202(a)) is available for any exempt security under Section 3(a)(2) except for any part of an obligation evidenced by a bond, note, debenture or other evidence of indebtedness issued by a governmental unit specified in Section 3(a)(2) of the Securities Act of 1933 “that is deemed to be a separate security under United States Securities and Exchange Commission Rule 131 (17 CFR 230.131 (relating to the definition of security issued under governmental obligations)).”

This Rule is of limited scope because of the many exceptions to Rule 131. What is a separate security under Rule 131?

As discussed in Appendix A, Section G., *infra*, the SEC in SEC Release No. 33-5103 acknowledged that tax-exempt IDBs that qualified under the IDB Exemption *(i.e., tax-exempt IDBs issued to provide manufacturing facilities or “exempt activities” pursuant to Sections 103(c)(4) or 103(c)(6) of the 1954 Code, other than “projects for residential rental property”)* would not be subject to registration, and, thus, the related lease, sale or loan arrangement would be included within the IDB exemption.

However, SEC Release 33-5103 also made clear that Rule 131 still applied to IDBs that did not qualify under the IDB exemption; thus, a lease, sale or loan arrangement entered into in connection with the taxable bonds issued to provide manufacturing facilities or “exempt activities” pursuant to Sections 103(c)(4) or 103(c)(6) of the 1954 Code constitutes a separate security which must either be registered or qualify for an exemption from registration under the Securities Act of 1933 *(e.g., the Bank Exemption)* or fit within one of the exemptions contained in Rule 131.

The exemptions under Rule 131 can be very useful. As discussed in *Fundamentals of Municipal Bonds* 2005, note 7, *supra*, Section 3, beginning at page 57, the exception contained in Rule 131(b)(2) *(relating to a public project owned and operated by or on behalf of and under the control of a governmental unit)* is the basis for concluding that the loan, lease or sale arrangement between an issuer and a for-profit developer entered into in connection with an issue of multi-family housing bonds is not a separate security under Rule 131, to wit:

…The most common governmental controls articulated, as meeting the Rule 131 and Rule 3b-5 exemption *(under the Securities Exchange Act of 1934)*, include 1) the right of access to the project; 2) the right to inspect the private enterprise’s books and records relating to the project; 3) the right to receive periodic reports relating to the operation of the project; 4) the right to obtain possession of the project in the event of any material default under the mortgage on the project; 5) approval of the timing of construction; and
6) approval of all plans and specifications revolving around the structures, construction and design…

To minimize the possibility that an obligation is deemed a separate security, issuers often include the following additional controls: 1) the private enterprise is required to maintain insurance on the project; 2) the private enterprise is prohibited from discrimination regarding the construction and rental of the project’s units; 3) the private enterprise must notify the issuer of any changes in organization or bankruptcy and any dishonest or illegal acts by employees; 4) the private enterprise complies with and provides evidence of compliance with low and moderate income occupancy requirements; 5) the issuer holds public hearings to obtain public comment regarding the project prior to the sale of the bonds; and 6) the private enterprise gives the issuer notice of condemnation. Based on SEC no-action letters it is the practice of most issuers of multi-family housing bonds to include as many examples of governmental control over the project financed by the bonds as possible in order to ensure an exemption from registration. For example, in City of Burnsville, MN (available January 14, 1981) the letter to the SEC set forth a partial list of not less than eighteen separate control mechanism imposed by the City.

Control by a governmental unit under Rule 131(b)(2) may also be present if: (a) the issuer and the developer have entered into a Housing Assistance Payments Contract with respect to the bond finance facility (see Troy Housing Development Corp., October 29, 1987), (b) the underlying loan to the developer is insured by the Federal Housing Administration (see Troy Housing Development Corp., supra, and City of Des Plaines, Illinois, January 30, 1987), (c) the bonds are guaranteed by the Small Business Administration (see Minnesota Small Business Administration, August 5, 1983) or (d) the extensive and substantial requirements of Section 142(d) of the 1986 Code (relating to limits on tenant income, the “qualified project period,” monitoring of tenant income, annual certification by the project operator to the U.S. Department of Treasury, etc.) are satisfied.

A lease, sale or loan arrangement entered into in connection with an issue of conduit 501(c)(3) bonds is also not a separate security under Rule 131. SEC Release No. 33-5103 deals


51 The SEC no action letters cited for these requirements are the same no action letters cited in the immediately preceding footnote.
with separate security status of lease, sale or loan arrangements entered into in connection with “industrial development bonds,” as defined in Section 103(c)(2) of the 1954 Code. The definition of industrial development bond expressly excludes issues the proceeds of which are used in the trade or business of any person who is not an exempt person; Section 103(b)(3) of the 1954 Code provides that the term exempt person means (1) a governmental unit or (2) an organization described in Section 501(c)(3) of the 1954 Code and exempt from tax under Section 501(a) of the 1954 Code (but only with respect to a trade or business carried on by such organization which is not an unrelated trade or business).

The non-applicability of Rule 131 to a lease, sale or loan arrangement entered into in connection with an issue of conduit 501(c)(3) bonds has been confirmed on several occasions in SEC no action letters; see, for example, City of Birmingham South Highlands of Alabama – Medical Center, November 1, 1973; New Jersey Health Care Facilities Financing Authority, September 12, 1974 and October 21, 1974; Health Education Authority of La. Rev., October 3, 1975; and Health Education Authority of Louisiana, December 1, 1975 with respect to bonds issued to finance health care facilities; and Student Loan Fund of Idaho Marketing Association, Inc., January 6, 1993, and no action letters cited therein with respect to nonprofit corporation issuers of student loan bonds.

Student loan bonds issued by a governmental entity have also been found not to be encumbered with a separate security under Rule 131, either because Rule 131(a) should not apply in the first place (i.e., the loan repayments of the student loans do not involve an “industrial or commercial enterprise”) or, if Rule 131(a) does apply, the underlying loan agreements qualify for the exception under Rule 131(b)(2) (i.e., the financing of student loans is a public project or facility which is owned, operated and controlled by a governmental instrumentality). See Pennsylvania Higher Education Assistance Agency, December 12, 1988.

Similarly, traditional single family mortgage revenue bonds have also been found not to be encumbered with a separate security under the same type of analysis used in the immediately preceding paragraph. See Alaska Housing Finance Corporation, November 17, 1972; Kentucky Housing Corporation, December 3, 1973; Alaska Housing Finance Corporation, April 27, 1981; and Finney County, Kansas, October 26, 1983.

Finally, as to investment agreements, the LYONS ARTICLE, note 44, supra, page 253, explains:

…Also, investment of bond proceeds in investment agreements or guarantied investment contracts (in which the issuer of the investment agreement is the sole source of credit) is not considered to be a separate security even when the issuer of the investment agreement does not possess its own exemption from registration.\footnote{52} The SEC staff apparently has taken the position that such investments are not loans because they are controlled and owned by a Section 3(a)(2) municipal issuer or because the investment agreement has

\footnote{52} The citation given at this point is to Steven L. Clark, Taxable Municipal Bonds: A Working Guide to Federal Securities Law Considerations, MUNICIPAL FINANCE JOURNAL, Summer, 1986, page 184.
been privately placed with the issuer of the municipal bonds or the bond trustee, thus
gaining an exemption under section 4(2) of the Securities Act of 1933. For example, the
SEC staff would not issue a no-action letter for a pass-through certificate secured by an
insurance company’s guarantied investment contract.\textsuperscript{53} Even though insurance company
securities are exempt from registration under section 3(a)(8) of the Securities Act of
1933, the SEC staff focused on the non-municipal, non-exempt issuer of the certificates.

(b) Guaranties Pennsylvania Rules Section 202.092, Guaranties of
certain debt securities exempt, CCH para. 48,431A, provides a separate exemption from
registration for (i) a guaranty of a bond, debenture or other evidence of indebtedness that is an
exempt security under Section 3(a)(2) when the issuer is located in Pennsylvania and (ii) a
guaranty of a bond, debenture or other evidence of indebtedness that is an exempt security under
Section 3(a)(2), when the guaranty is deemed to be a separate security under SEC Rule 131 (for
non-Pennsylvania issuers), provided that certain offering document, use of bond proceeds, trust
indenture and other requirements are satisfied.

The term guaranty is broadly defined to mean:

A duly executed written agreement wherein a person, not the issuer, in connection with
offer and sale of bonds in this Commonwealth, guarantees the prompt payment of the
principal of, and interest on, the bonds whether at the stated maturity, at redemption prior
to maturity or otherwise, and premium, if any, when and as the principal and interest shall
become due and the guaranty cannot be bought, sold or traded as a security or otherwise
realized upon by a bondholder separately from the bondholder’s interest in the bonds.

As defined, the term guaranty appears broad enough to include letters of credit and bond
insurance policies (except that letters of credit and bond insurance policies usually do not
provide for the payment of premium upon redemption).

As discussed below, under Traditional Blue Sky Analysis credit enhancement in the form
of a letter of credit or bond insurance will usually be exempt from registration under other
provisions of the Pennsylvania blue sky law, regardless of where the issuer is located (\textit{i.e.}, clause
(b)(i) above) and regardless of whether the letter of credit or bond insurance policy is a separate
security under Rule 131 (\textit{i.e.}, clause (b)(ii) above).

Section 202(b), Pennsylvania Statutes, provides an exemption from registration for “any
security issued by a bank or savings association…” Section 102(d), Pennsylvania Statutes,
defines “bank” to mean a bank, savings bank, savings institution and similar organizations,
provided that its deposits are insured by the Federal Deposit Insurance Corporation (“FDIC”) or
a successor authorized by federal law. The deposits of all national banks are insured by the
FDIC. The deposits of most state banks are insured by the FDIC as well. The FDIC web site
(\texttt{www.fdic.gov}) provides a listing of those institutions whose deposits are insured by the FDIC.

\textsuperscript{53} The citation given at this point is to Morgan Stanley & Co., December 4, 1985.
As to bond insurance, the definition of “security” under Section 102(t)(iii), Pennsylvania Statutes, specifically excludes, “Any insurance or endowment policy or annuity contract under which an insurance company admitted in this State promises to pay a sum of money (whether or not based upon the investment performance of a segregated fund) either in a lump sum or periodically for life or some other specified period.” [Emphasis added.] The standard disclosure required by bond insurers will usually state that the insurer in question is licensed to do business in all 50 states, the Commonwealth of Puerto Rico and the District of Columbia.

In addition, under NSMIA Analysis a letter of credit that qualifies under the Bank Exemption as a “security issued...by any bank” is a covered security under NSMIA. Bond insurance policies should also qualify as covered securities under NSMIA, because they are exempt from registration pursuant to Section 3(a)(8). Thus, the offering document, use of bond proceeds, trust indenture and other requirements of Pennsylvania Rules Section 202.092 do not apply to a letter of credit or a bond insurance policy that qualifies as a covered security, because Sections 18(a)(1) prohibits the imposition of offering document requirements and merit conditions on covered securities.

A guaranty by a company whose stock is listed or approved for listing on the New York Stock Exchange or various other stock exchanges would be exempt from the provisions of Pennsylvania Rules Section 202.092 under Traditional Blue Sky Analysis pursuant to Section 202(f), Pennsylvania Code, as well as under NSMIA Analysis as a covered security pursuant to Section 18(b)(1). A guaranty by an investment company that is registered, or that has filed a registration statement, under the Investment Company Act of 1940 would also be exempt under NSMIA Analysis as a covered security under pursuant to 18(b)(2).

Finally, for non-Pennsylvania issuers (i.e., clause (b)(ii) above), the general approach of the SEC has been that a guaranty in an industrial revenue bond financing does not constitute a separate security under Rule 131 if the guarantor is the primary user or related to the primary user of the bond-financed facility; for example, a guaranty by a parent corporation of the obligation of its wholly owned subsidiary that is the principal user of the bond-financed facility. FUNDAMENTALS OF MUNICIPAL BOND LAW 2005, note 7, supra, Section 3, beginning at page 59, provides several examples of this principle.
G. **Certificates of Participation**

1. **General** Unlike a bond or note which contains a promise by the issuer to pay principal and interest, a certificate of participation evidences a proportionate interest in payments to be made by a state or political subdivision under various types of obligations. Such obligations may include installment sale agreements, lease-purchase agreements and conditional sale agreements for real or personal property. In many states, a captive corporation is created by the state or political subdivision for the purpose of being the lessor or seller of the property being leased or sold to the state or political subdivision. As part of the transaction, the captive corporation assigns its rights to receive payments under the installment sale, lease-purchase or conditional sale agreement to the bond trustee, who applies the payments received under the agreement to the payment of principal of and interest on the certificates of participation. The holders of the certificates of participation have no recourse against the bond trustee for the payment of principal of and interest on the certificates of participation.

   The certificate of participation structure is often resorted to when the issuance of long-term debt in the form of bonds would not be permitted under state law debt limits. Installment sale agreements, lease-purchase agreements and conditional sale agreements are often exempt from such debt limits because they are viewed as short-term obligations (*i.e.*, payable in full in a year or less), since continuing payments thereunder are subject to annual appropriation by the state or political subdivision. The risk of nonpayment resulting from non-appropriation is usually described in great detail in the offering document. The issuance of certificates of participation is widespread but not universal. Based on my informal (*i.e.*, not necessarily complete) survey of official statement postings on [www.munios.com](http://www.munios.com), this technique has been used by states and political subdivisions located in Arizona, California, Colorado, Florida, Georgia, Illinois, Maryland, Michigan, Missouri, New Jersey, New York, North Carolina, Ohio, Oklahoma, Oregon, Rhode Island, South Carolina, Texas, West Virginia and Wisconsin.

   In most cases certificates of participation are issued to finance genuinely public facilities (*e.g.*, city halls, public school buildings and public transportation facilities and equipment) and payable solely from the resources of the state or political subdivision (*i.e.*, the source of funds lacks anything resembling a NGICE). In most cases, if the financing had been structured as an issuance of bonds by the state or political subdivision, the bonds in question would have been exempt from blue sky registration and notice filings.

2. **Tax Treatment of Certificates of Participation** The Internal Revenue Service treats the interest portion of a payment made under a certificate of participation in a tax-exempt municipal obligation as excludable from gross income.

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54 Occasionally, certificates of participation have been used in connection with a financing for a nongovernmental industrial or commercial enterprise, such as a nonprofit hospital. See, for example, Hospital Revenue Certificates of Participation Inter Community Health Services Inc. Project 1987 Series A, February 11, 1987, 1987 Mont. Sec. LEXIS 195.
In Revenue Ruling 73-27, a bank regularly made short-term loans to municipalities by purchasing their short-term tax-exempt notes. The bank sold participation certificates in the notes to investors. Under the terms of the participation certificates, the owner thereof was the owner of an undivided share, to the extent of the sum stated, in one particular note of a municipality. Upon payment of the principal of and interest on the note, the bank remitted to the participant his proportionate share of the principal and interest less a stated percentage thereof for its services in holding and servicing the notes. The participation certificates recited that the owner thereof had no recourse against the bank, either for the principal or interest on the underlying note, and that the bank’s only liability was to remit to the owner his share of the principal and interest when, as and if collected by the bank.

Based on the above facts, the Internal Revenue Service held:

Since the holder of the participation interest has no recourse against the bank, either for the principal or interest on the underlying note, and the bank’s only liability is to remit to the participant his share of the principal and interest when, as, and if collected, the holder of the participation certificate is owner of an undivided share of the municipal security, and his proportionate share of the interest payable thereon is excludable from gross income under section 103(a)(1) of the [Internal Revenue] Code.

See also Internal Revenue Service Private Letter Rulings 8843058, 8742030, 8328084 and 8324063.

3. SEC Treatment of Certificates of Participation
   The SEC has issued favorable no action letters in connection with certificates of participation in the following types of underlying obligations:

   1. installment sale, lease-purchase and conditional sale agreements for real or personal property (see First Municipal Leasing Corporation, July 6, 1976; Smith, Barney, Harris, Upham & Co., Inc., January 7, 1977; Garfield County School District No. 16, October 14, 1981; State of New Jersey, May 21, 1984; Kelling & Co., Inc., October 22, 1984; Peoples National Bank of Washington, February 26, 1988);

   2. pooled debt obligations issued by several municipalities and pooled general obligation tax anticipation notes issued by several school districts (see Central Utah Rural Impact Capital Corp., August 29, 1980, and Piper, Jaffray & Hopwood, Inc., March 5, 1987); and

   3. insurance premium payments to be made by municipalities participating in a joint self-insurance program (Kelling, Northcross & Nobriga, Inc., February 25, 1987).

Certificates of participation are considered to be issued by the state, municipality or school district in question by analogy to the treatment of equipment trust certificates under the Section 2(4) of the Securities Act of 1933. The definition of the term “issuer” contained in Section 2(4) provides, “...with respect to equipment-trust certificates or like securities, the term
issuer means the person by whom the equipment or property is or is to be used...” (see Smith, Barney, Harris, Upham & Co., Inc., and Kelling & Co., Inc., supra).

In the SEC no-action letters involving certificates of participation, the issuers of the underlying obligations are often described generically: for example, “states of the United States and the political subdivisions of such states” (First Municipal Leasing Corporation, supra), and “cooperating Utah municipalities” (Central Utah Rural Impact Corp., supra), without any analysis of the state law characterization of the issuer, since the main thrust of the no-action letter is whether the certificates of participation have been correctly structured in order to qualify for an exemption under Section 3(a)(2).

In general, the minimum, structural requirements that must be met for an issue of certificates of participation to qualify as an obligation of a governmental issuer under Section 3(a)(2) are:

1. each certificate must evidence a direct and undivided proportionate interest in the payments to be derived from the underlying obligation;

2. the state or municipal issuer must be directly obligated for the payment of the payments thereunder and, upon default by the issuer, each holder will have the right to sue the issuer in the same manner as under a conventional municipal bond (including the customary, limited right to sue only after an event of default has occurred, the bond trustee has received notice of the default and a request by certificate holders to exercise available remedies, the bond trustee has been provided indemnity against costs, and the trustee has failed or refused to comply with such request); and

3. the trustee’s function is purely ministerial for the receipt and disbursement of interest and principal payments. See, for example, Piper, Jaffray & Hopwood, Inc., and Peoples National Bank of Washington, supra.

Additional structural requirements can include:

1. the recognition by each municipality participating in a pool of municipal obligations the certificate holders as the holders of the municipality’s securities (Central Utah Rural Impact Corp., supra); and

2. the obligation of the public body must not be subject to set-off or counterclaim as a result of a dispute between the public body and a third party, the obligation of the public body cannot be dischargeable as a result of damage to or destruction of the subject property, the public body must be required to maintain the property at its own expense and to make all payments of insurance premiums, the public body may not be permitted to sell or encumber the property absent the consent of the certificate holders, and the rights of the certificate holders will not be adversely affected by any insolvency proceeding to which the bond trustee might become subject (State of New Jersey, supra).
A corporate guaranty of certificates of participation did not raise a separate security problem under Rule 131 on the theory that upon a default by the school district the corporate guarantor would obtain title to the school building being financed and thereby qualify under the user of the facilities exception to Rule 131 developed under no action letters concerning guarantees of IDBs (see Garfield County School District No. 16, supra). Letters of credit and bond insurance securing certificates of participation have been determined to qualify for their own exemptions from registration (Kelling & Co., Inc. and Piper, Jaffray & Hopwood, Inc., supra).

Properly structured certificates of participation are not considered separate securities (i.e., they are not treated as being separate from the underlying municipal security). According to Robert A. Fippinger, THE SECURITIES LAW OF PUBLIC FINANCE, Second Edition, Section 2:4.2, page 2-48, “Participations will not be separated from an underlying municipal obligation if the participations retain the fundamental characteristics of the underlying municipal obligations, often referred to as the mirror image of the municipal obligation.”

Mr. Fippinger explains on page 2-52:

The mirror image theory requires the following to establish the absence of a separate security:

(1) the holder of the certificate must be a beneficial owner of the underlying instrument with remedial rights directly against the underlying issuer;

(2) the trustee issuing the certificates must have the relatively passive role generally associated with trustees under trust indentures in public and corporate finance; and

(3) any pooling function at the trust level must not have risk-spreading aspects or devices to improve security beyond what is contained in the underlying instrument.

4. **Certificates of Participation Are Securities Under State Blue Sky Laws**

Certificates of participation are securities under state blue sky laws. The almost universal formulation in the definition of the term security is a “certificate of participation in… an evidence of indebtedness.” The blue sky laws of Florida, Ohio and Texas use slightly different formulations, but the result is the same. The New York blue sky law (known generally as the Martin Act) does not contain a definition of security and focuses mainly on the registration of broker-dealers. However, Chapter 20, Article 23, Section 352-3, New York Consolidated Laws, CCH para. 42,106, requires the preparation and filing of an offering document or prospectus containing detailed information as part of the offering or sale in or from New York of “securities constituted of participation interests or investments in real estate, mortgages or leases, including stocks, bonds, debentures, evidences of interest or indebtedness….when such securities…consist primarily of participation interests or investments in one or more real estate ventures...” unless the offering is exempted by rule or action of the attorney general.

5. **Failure to Recognize the User as the Issuer Jurisdictions**

As discussed in Section II.G.3., infra, a properly structured issue of certificates of participation is treated under
Section 3(a)(2) as the obligation of the underlying state or municipal obligor, by analogy to equipment trust certificates, because the definition of the term “issuer” contained in Section 2(4) provides “…with respect to equipment trust certificates or like securities, the term issuer means the person by whom the equipment or property is or is to be used…”

Like Section 2(4), the definition of issuer contained in most state blue sky laws provides for user-as-issuer treatment for equipment trust certificates and like securities. Thus, under most state blue sky laws, certificates of participation are treated as obligations of the underlying state or municipal obligor.55

However, the definition of the term issuer contained in the blue sky laws of the following jurisdictions fails to provide for the treatment of the user as the issuer in the case of equipment trust certificates or like securities: Alabama, Alaska, Delaware, Florida, Guam, Kentucky, Maryland, Massachusetts, Montana, Nebraska, New Hampshire, New Jersey, North Carolina, Ohio, Oregon, Puerto Rico, Texas, Washington, West Virginia and Wyoming (each of which is a “Failure to Recognize the User as the Issuer Jurisdiction” and, collectively, the “Failure to Recognize the User as the Issuer Jurisdictions”).56

The failure to recognize the user as the issuer in Failure to Recognize the User as the Issuer Jurisdictions has the technical potential for requiring (1) registration when the underlying state or municipal obligor is an in-state issuer and (2) a notice filing when the underlying state or municipal obligor is an out-of-state issuer, which could be troublesome if bonds or notes that qualify under the state municipal bond exemption from registration had been issued by the underlying state or municipal obligor rather than certificates of participation (for example, school bonds issued by a political subdivision, backed by the taxing power, and no nongovernmental industrial or commercial enterprise is part of the financing).

A search for guidance in state no action letters concerning the treatment of certificates of participation under the municipal bond exemptions from registration of the blue sky laws of the Failure to Recognize the User as the Issuer Jurisdictions, as published in the CCH Blue Sky Law Reporter or online at www.LexisNexis.com/State Securities Administrative Decisions, No

55 California and Louisiana are two of the states whose blue sky law definition of the term issuer follows the approach of Section 2(4). In addition, Section 5951of the California Government Code provides that it is unlawful for any person to offer or sell in an issuer transaction any security constituting a fractional interest in a lease, installment sale or other obligation of a local agency without obtaining the prior written consent of that local agency to that offer or sale, unless the security is created concurrently with, and is an integral part of, the financing to which the local agency is a party (Section 5951(f). Local agency is defined broadly under Section 5950(f), California Government Code, as “any city, county, city and county, school district, special district, public corporation, or other public entity” of the State of California. The Louisiana blue sky law also expressly includes certificates of participation in its municipal bond exemption from registration. See Section 71-708(1), Louisiana Statutes.

56 The blue sky laws of most of the Failure to Recognize the User as the Issuer Jurisdictions are based in substantial part on the 1956 Act, which also did not provide for treatment of the user as issuer in its definition of the term issuer.
Action Letters, yields mixed results. Alaska, Guam, Nebraska, New Hampshire and Puerto Rico provide no guidance, because there do not appear to be any no action letters for these Jurisdictions that treat this issue. There appears to be a single no action letter for Ohio, which concluded that the certificates of participation in question should be treated as the obligation of the underlying obligor (Ohio State University). No action letters from the securities commissions of Alabama, Delaware, Florida, Kentucky, Maryland, Massachusetts, Montana, North Carolina, Oregon, Texas, Washington and West Virginia generally show a pattern of treating certificates of participation as obligations of the underlying state or municipal obligor, the exceptions being some early no action letters issued by the staffs of the Alabama and Wyoming securities commissions to the contrary. No action letters from the staff of the New Jersey securities commission sometimes treat certificates of participation as the obligation of the underlying state or municipal obligor and sometimes not.

Provided that the structural requirements for certificates of participation enunciated by SEC no action letters in interpreting Section 3(a)(2) are satisfied, I think that the practice of analyzing certificates of participation under state blue sky laws based on an examination of the transaction at the level of the underlying state or municipal obligor is appropriate. The use of this form of financing has been commonplace for decades, the SEC’s views on this form of financing have been known for decades (presumably, to state securities commissions), and I have not found any state blue sky law, regulation or interpretation intended to be relied upon as precedent by third parties to the contrary.

H. Obligations of Nonprofit Corporations

1. Introduction Nonprofit corporations are occasionally called upon to issue bonds for the purpose of financing facilities or activities that one would normally expect to be financed by bonds issued by states, state agencies or political subdivisions.

This Section examines the effects of NSMIA Analysis and Traditional Blue Sky Analysis on:

(a) Obligations of nonprofit corporations generally,

(b) three special types of obligations issued by nonprofit corporations, namely, 63-20 Bonds issued pursuant to Internal Revenue Service Revenue Ruling 63-20, bonds issued by New York Local Development Corporations and Texas Qualified Scholarship Funding Bonds issued pursuant to Section 150(d)(2) of the Internal Revenue Code of 1986, as amended.

2. Nonprofit Corporations Under Traditional Blue Sky Analysis Under Traditional Blue Sky Analysis, it can be very difficult to conclude that bonds of nonprofit corporations qualify for the nonprofit corporation exemptions from registration under state blue sky laws.

To begin with, approximately 30 of the 54 Blue Sky Jurisdictions impose substantial limitations on the offer and sale of nonprofit corporation bonds to the general public. The following are some examples of such limitations:

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(a) In Alabama, Arkansas, Kentucky and Tennessee, certain filings claiming the availability of the exemption must be made with the state securities commission, followed by a waiting period during which the state securities commission may disallow the exemption.

(b) In Virginia, facilities that may be financed with proceeds of nonprofit corporation bonds are severely limited (i.e., only church bonds qualify).

(c) In Louisiana and Ohio, the nonprofit exemption from registration explicitly excludes evidences of indebtedness.

(d) In Maryland, qualifying for the nonprofit exemption from registration includes a filing with the securities division 10 days prior to first sale and an offering document that satisfies detailed disclosure requirements that were originally promulgated in connection with the Maryland limited offering exemption.\(^{57}\)

Beyond such limitations, there is the more general problem of eliciting the facts needed to support the conclusion that the exemption from registration is available. The nonprofit corporation exemption under the Connecticut blue sky law is illustrative of this problem. Section 36b-21(a)(9), General Statues of Connecticut, which is based on the Uniform Securities Act of 1956, provides an exemption from registration for:

Any security issued by a person organized and operated not for private profit but exclusively for religious, educational, benevolent, charitable, fraternal, social, athletic, or reformatory purposes or as a chamber of commerce, trade, or professional association. [Emphasis added.]

The offering document may contain enough information about the nonprofit corporation issuer to conclude that the issuer is organized for one of the specified purposes. If not, analysis of the issuer’s articles of incorporation and by-laws will often provide a basis for concluding that the issuer is organized for one of the specified purposes.

But what about being operated for one of the specified purposes and not for private profit? My experience is that offering documents do not contain the detailed, factual information needed to come to such conclusions about the issuer’s operations. That sort of information (for example, the information contained in IRS Form 990, Return of Organization Exempt From Income Tax) is typically assembled and analyzed as part of an opinion of counsel to the effect that the issuer is an organization described in Section 501(c)(3) of the Internal Revenue Code. However, such information is not usually found in the primary document on which blue sky practitioners rely (i.e., the official statement) and not all 63-20 issuers are 501(c)(3) organizations to begin with.

\(^{57}\) See Maryland Blue Sky Regulations, Title 02 – State Law Department, Subtitle 02 – Division of Securities, Chapter 04 Exemption from Registration Regulations, Rule .01 Requirements for compliance with not-for-profit exemption, CCH para. unavailable.
In short, in using Traditional Blue Sky Analysis, it can be very difficult to conclude that bonds issued by a nonprofit corporation, including 63-20 Bonds, NYLDC Bonds and Texas Qualified Scholarship Funding Bonds, qualify for exemptions from blue sky registration requirements, because: (a) the majority of the states impose substantial limitations on the availability of the nonprofit corporation exemption from registration, (b) offering documents usually do not contain the kind of information needed concerning the issuer’s operations and (c) not all nonprofit issuers are organizations described in Section 501(c)(3) of the Internal Revenue Code.

3 Exemptions from Registration Under Section 3(a)(2) for 63-20 Bonds, NYLDC Bonds and Texas Qualified Scholarship Fund Bonds This section describes (1) the basic federal tax law requirements for 63-20 Bonds, NYLDC Bonds and Texas Qualified Scholarship Funding Bonds and (2) how 63-20 Bonds, NYLDC Bonds and Texas Qualified Scholarship Funding Bonds qualify for an exemption from registration under Section 3(a)(2).

(a) 63-20 Bonds Internal Revenue Service Revenue Ruling 63-20 provides that nonprofit corporations formed under the general nonprofit law of a state may issue obligations “on behalf of” a political subdivision, provided that the following structural tests are met: (1) the corporation must engage in activities which are essentially public in nature; (2) the corporation must be one which is not organized for profit (except to the extent of retiring indebtedness); (3) the corporate income must not inure to any private person; (4) the state or a political subdivision thereof must have a beneficial interest in the corporation while the indebtedness remains outstanding and it must obtain full legal title to the property of the corporation with respect to which the indebtedness was incurred upon retirement of such indebtedness; and (5) the corporation must have been approved by the state or a political subdivision thereof, either of which must have approved the specific obligations issued by the corporation (obligations of nonprofit corporations which satisfy the foregoing requirements are referred to herein as “63-20 Bonds”).

This financing technique was used extensively in the 1970s to overcome state law limitations on the issuance of municipal bonds that precluded the “on behalf of” entity (for example, a county, city or school district) from issuing the bonds itself. Typical financing structures included (1) the leasing of the bond financed facility by the nonprofit corporation to the on behalf of entity and (2) the leasing of the real estate by the on behalf of entity to the nonprofit corporation coupled with a lease back of the real estate and the bond financed facility from the nonprofit corporation to the on behalf of entity. Lease payments made by the on behalf of entity provided the revenues needed to pay debt service on the bonds.

Rev. Proc. 82-26 sets for the circumstances in which the five tests outlined in Internal Revenue Service Revenue Ruling 63-20 will be deemed to have been met and, consequently, the Internal Revenue Service will issue a favorable advance ruling.

Pursuant to the no action letters listed paragraphs 9. and 10. of Appendix D, 63-20 Bonds are exempt from registration pursuant to Section 3(a)(2).
Occasionally, counsel in a no action request has argued explicitly that the 63-20 Bonds in question are being issued by a “public instrumentality” under Section 3(a)(2), followed by a favorable, generic response from the SEC staff that the bonds are exempt from registration pursuant to Section 3(a)(2). However, in most of the no action letters listed in paragraphs 9. and 10. of Appendix D, neither the no action request nor the favorable no action response from the SEC states explicitly why the 63-20 Bonds in question qualify under Section 3(a)(2). The usual pattern is for counsel to recite either the factual elements needed to qualify the bonds in question as 63-20 Bonds or recite such elements coupled with a statement that the bonds will be issued on behalf of a political subdivision pursuant to Revenue Ruling 63-20, followed by a claim of an exemption under Section 3(a)(2), without stating exactly why compliance with Revenue Ruling 63-20 would result in an exemption from registration for a political subdivision or public instrumentality under Section 3(a)(2). This reticence to state the exact characterization of the issuer in the parlance of Section 3(a)(2) (i.e., political subdivision or public instrumentality) may be due to the fact while that Section 3(a)(2) provides an exemption from registration for public instrumentalities of states and territories, it does not explicitly provide an exemption from registration for obligations of instrumentalities of political subdivisions (e.g., counties, cities, school districts), which are the usual “on behalf of” entities listed in no action requests.

Notwithstanding the lack of an explicit characterization of the nature of the issuer in the literal words of Section 3(a)(2), the SEC no action letters listed in paragraphs 9. and 10. of Appendix A provide that 63-20 Bonds are exempt from registration pursuant to Section 3(a)(2). The clear implication from the facts of these no action letters is that the obligations of instrumentalities of political subdivisions qualify for an exemption from registration under Section 3(a)(2). The willingness of the SEC staff to interpret Section 3(a)(2) to include instrumentalities of political subdivisions is not limited to 63-20 Bonds. See the discussion of Texas Qualified Scholarship Funding Bonds in the immediately following subsection. See also Illinois School District Liquid Asset Fund Plus, May 16, 1974, discussed in Robert A. Fippinger, THE SECURITIES LAW OF PUBLIC FINANCE, Second Edition, Section 2:9.3.A, page 2-112, in which counsel successfully argued that a common law trust fund that was created to provide township treasurers and public school district treasurers a method of combining investments of temporary cash reserves was an instrumentality of the school districts (which are political subdivisions under Section 3(a)(2)), township treasurers and school treasurers which become participants in and place public school district moneys in the fund.

(b) New York Local Development Corporations and Revenue Ruling 57-187

New York local development corporations (hereinafter referred to as “NYLDCs”) are not-for-profit corporations that may be incorporated or reincorporated by one or more counties, cities, towns or villages of the State of New York, or any combination thereof, or the New York Job Development Authority, for various charitable or public purposes (i.e., relieving and reducing unemployment, promoting and providing for additional and maximum employment, bettering and maintaining job opportunities, etc.). The statute providing for such incorporation or reincorporation expressly provides that in carrying out such purposes and in exercising the

powers conferred by it such corporations will be performing an essential public function. See Section 1411, New York Not-For-Profit Corporation Law.

NYLDCs routinely issue tax-exempt bonds, either in reliance upon Revenue Ruling 63-20 for public projects that ultimately become the property of the “on behalf of” entity (see Section II.H.3.(a), supra) or Revenue Ruling 57-187 for conduit issues (described below).

Revenue Ruling 57-187 holds that bonds issued by Alabama Industrial Development Boards are considered issued on behalf of a political subdivision of a state where the following factors are present: (1) the Board is formed only after the governing body of the political subdivision concerned has given its formal approval to the creation of the Board and to the form of certificate of incorporation; (2) the board of directors of the Board is elected by the governing body of the political subdivision concerned and serves without compensation; (3) the Board’s corporate powers include the power to acquire, improve, maintain, equip and furnish projects, to lease such projects and collect rent; to sell and convey any and all of its property whenever the board of directors shall find such action to be in furtherance of the purposes for which it was organized; and to issue bonds for the purposes of carrying out any of its powers; (4) all bonds are payable solely out of revenues and receipts derived from the leasing or sale by the Board of its projects; (5) the political subdivision is not liable for the payment of principal or interest on any of the bonds of the Board; (6) the Board is exempt from all state taxation, and interest on bonds issued by the Board is exempt from state taxes; (7) the Board is a nonprofit corporation and no party of its net earnings may inure to the benefit of any private person; and (8) upon dissolution of the Board, the title to all property owned by it shall vest in and become the property of the political subdivision in which the Board is located.

In two private letter rulings the Internal Revenue Service has concluded that the NYLDCs described therein satisfied the requirements of Revenue Ruling 57-187 and that the bonds in question were treated as issued on behalf of a state or political subdivision. See Internal Revenue Service Private Letter Rulings 200307004 and 200936012.

The only SEC no action request that I have found that considers whether obligations of a NYLDC are exempt under Section 3(a)(2) is Troy Housing Development Corporation, October 29, 1987, which involved the issuance of taxable refunding bonds by Troy Housing Development Corporation (“Troy Housing”). Troy Housing was incorporated under the New York Not-For-Profit Corporation Law. The purposes for which Troy Housing was formed were to act as a “public housing agency” and “instrumentality” of the Troy Housing Authority within the meaning of Sections 3(a) and 11(b) of the United States Housing Act of 1937 (the “Housing Act”). The bonds to be refunded had been issued in 1982 and the interest thereon was excludable from gross income pursuant to Section 11(b) of the Housing Act, rather than pursuant to Section 103 of the Internal Revenue Code. The requirements for tax-exempt status under Section 11(b) included a determination by the United States Department of Housing and Urban Development (“HUD”) that the issuer in question qualified as a “public housing agency” and that the interest on the obligations in question were exempt from taxation pursuant to Section 11(b) of the Housing Act; such a determination had been made by HUD with respect to Troy Housing and the interest on the bonds to be refunded. However, subsequent to the issuance of the bonds to be refunded, HUD’s ability to designate bonds as tax-exempt pursuant to Section 11(b) had
been effectively repealed by Section 149(c)(1) of the Internal Revenue Code of 1986 and, thus, no such determination would be made with respect to the refunding bonds.

Counsel requesting no action letter asked for confirmation that the refunding bonds would be treated as obligations of a public instrumentality under Section 3(a) notwithstanding the lack of such a determination by HUD, based on the following: (1) the issuer’s public purposes as set forth in its certificate of incorporation, (2) prior approval of the Authority, a municipal housing authority, was required for each project undertaken by the issuer, (3) the issuer could not issue bonds, notes or other obligations without the approval of the Authority, (4) the activities, books and records of the issuer were subject to review and audit by the Authority, (5) upon dissolution, all assets of the issuer would be transferred to the Authority, to another public housing agency or to another not-for-profit entity as determined by the Authority and approved by HUD and (6) HUD had previously determined that issuer was a public housing agency under the Housing Act.

The no action request also argued that the fact that the interest on the refunding bonds was subject to federal income taxation was irrelevant to the status of the refunding bonds as exempt securities under Section 3(a)(2) and that the obligation of the for-profit owner to make payments under the mortgage note insured by the Federal Housing Administration ("FHA") pursuant to Section 221(d)(4) of the Housing Act did not give rise to a separate security under Rule 131, because such obligation qualified under the Rule 131(b)(2) exception to Rule 131 for any public project owned and operated by or on behalf of and under the control of a governmental unit specified in Section 3(a)(2) (such control being evidenced by the regulatory agreement between the FHA and the owner and the Housing Assistance Payments Contract between the Authority and HUD with respect to the Project). The no action request was granted.

While SEC no action letter requests for 63-20 Bonds under Section 3(a)(2) often expressly cite and demonstrate satisfaction of the requirements of Revenue Ruling 63-20, I have found no SEC no action letter requests that cite Revenue Ruling 57-187 as the basis for the request or that even mention it in passing. However, SEC no action letters have treated Alabama Industrial Development Boards as entities that qualify under Section 3(a)(2), without any analysis of the issuers’ status (see The Industrial Development Board of the City of Mobile, Alabama, May 1, 1974; The Industrial Development Board of the City of Mobile, June 17, 1974; The Industrial Development Board of Huntsville, Alabama, September 27, 1974; Industrial Development Board of the City of Montgomery, Alabama, June 16, 1975 (“Montgomery); and Industrial Development Board of the City of Dothan, Alabama, September 22, 1975), except that in Montgomery, supra, counsel pointed out that the board was a public corporation and instrumentality under the laws of the State of Alabama).

Like bonds issued by Alabama Industrial Development Boards, bonds issued by NYLDCs that satisfy the requirements of Revenue Ruling 57-187 (determined on a case-by-case basis) (“NYLCD Bonds”) should be treated as securities issued by public instrumentalities under Section 3(a)(2).

(c) Texas Qualified Scholarship Funding Bonds  Qualified scholarship funding bonds issued by Texas nonprofit corporations described in Section 150(d)(2) of the 1986
Code ("Texas Qualified Scholarship Funding Bonds") are issued to provide funds to purchase (i.e., provide a secondary market for) student loans originated by banks and other lenders. Pursuant to Section 150(d)(2) of the 1986 Code, a qualified scholarship funding bond is a bond which is issued by a corporation which (i) is a corporation not for profit established and operated exclusively for the purpose of acquiring student loan notes insured under the Higher Education Act of 1965, and (ii) is organized at the request of a state or one or more political subdivisions thereof or is requested to exercise such power by one or more political subdivisions and required by its charter and bylaws, or required by state law, to devote any income (after payment of expenses, debt service, and the creation of reserves) to purchase additional student loan notes or pay over any income to the United States.

Section 150(d)(2) of the 1986 Code is a carryover of Sections 103(a)(2) and 103(e) of the Internal Revenue Code of 1954, as amended (the “1954 Code”), which sections were added to permit states (namely, Texas), whose political subdivisions did not have authority to issue bonds to finance student loans, to issue tax-exempt bonds through nonprofit corporations which would not otherwise qualify as “on behalf of” issuers (i.e., they would not qualify as “constituted authorities” for federal tax purposes because they were not specifically authorized by a state statute to issue bonds on behalf of a state or local governmental unit, as required by Treasury Regulation 1.103-1(b), and because student loans are not tangible property, as required by Revenue Ruling 63-20). Qualified scholarship funding bonds must satisfy the requirements applicable to qualified student loan bonds under Section 144(b) of the 1986 Code if the interest thereon is to be excludable from gross income.\(^\text{59}\)

However, the fact that an issuer is capable of issuing qualified scholarship funding bonds the interest on which is excludable from gross income is not, by itself, sufficient to provide for an exemption from registration pursuant to Section 3(a)(2) and, by extension, covered security status under Section 18(b)(4)(C). In a series of no action letters from the 1970s involving the issuance of qualified scholarship funding bonds by Texas nonprofit corporations,\(^\text{60}\) the incoming letters requested a no action position based on Section 3(a)(2), and the Texas legislation under which the nonprofit corporations were organized was reviewed to demonstrate the control of the nonprofit corporations by the governing bodies of the political subdivisions.\(^\text{61}\) A primary characteristic of such control appears to be the power of the political subdivision to appoint and remove the directors of the nonprofit corporation. The South Texas Higher Education Authority

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\(^{59}\) This paragraph and the two paragraphs immediately preceding it are based on a similar discussion contained in FUNDAMENTALS OF MUNICIPAL BOND LAW 2005, note 6, supra, Section 2, pages 257-258.


\(^{61}\) The bonds that were the subject of these no action requests were issued by nonprofit issuers described in Section 53.47 of the Texas Education Code. That section was deleted, effective September 1, 2005, but simultaneously replaced with comparable provisions under the Section 53.47B of the Texas Education Code.
no action request described the drafting of the Texas legislation, which was in consultation with the Treasury Department to assure that the legislation paralleled the control requirements of Revenue Ruling 63-20. In each no action letter, counsel argued that the issuer was an instrumentality of the sponsoring city (i.e., a political subdivision). The responses to these no action requests concluded that an exemption from registration under Section 3(a)(2) was available.

Subsequent no action letter requests involving Section 150(d) nonprofit corporations whose directors were appointed by the existing directors argued for exemptions from registration in the alternative, i.e., either under Section 3(a)(2) or 3(a)(4). The bases for the favorable responses were either unclear (Nebraska Higher Education Loan Program) or Section 3(a)(4) (California Student Loan Finance Corp. and Student Loan Fund of Idaho Marketing Association, Inc.). In any event, these three no action letters do not provide a basis for covered security status under Section 18(b)(4)(C).

4. Out-of-State Issuers 63-20 Bonds, NYLDC Bonds and Texas Qualified Scholarship Funding Bonds that qualify for an exemption from registration under Section 3(a)(2) and that are issued by out-of-state issuers constitute covered securities under Section 18(b)(4)(C). Pursuant to Section 18(a), states may not impose registration, offering document or merit condition requirements on such covered securities but may, pursuant to Section 18(c)(2)(A), impose a notice filing requirement. Compliance with a notice filing requirement provides an alternative route to blue sky compliance in those situations where, under Traditional Blue Sky Analysis, an exemption from registration under the nonprofit corporation exemption from registration is not available. See Section II.H.2., supra, for a discussion of the difficulties in qualifying under state blue sky law exemptions from registration for securities issued by nonprofit corporations.

If the jurisdiction in question has not imposed a notice filing requirement on covered securities described in Section 18(b)(4)(C), then covered security status of the 63-20 Bonds, NYLCD Bonds and Texas Qualified Scholarship Bonds in question is sufficient for compliance.

However, as of the date of this paper, there are eleven jurisdictions in which covered securities described in Section 18(b)(4)(C) may be subject to a notice filing requirement. The jurisdictions are: Illinois, Maryland, Montana, New Hampshire, New York, North Dakota, Ohio, Oregon, the Commonwealth of Puerto Rico, Texas and Washington.

A consent to service of process signed by an officer of the issuer must be provided as part of the notice filing for eight of these jurisdictions, namely: Maryland, Montana, New

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63 A filing is required in New York for financings that include “participation interests or investments in one or more real estate ventures.” See Section II.D.2.(d), supra.
Hampshire, New York, Ohio, the Commonwealth of Puerto Rico, Texas and Washington. When the issuer is a state or political subdivision, as a practical matter compliance with a notice filing requirement that includes a consent to service of process signed by an officer of the state or political subdivision is not possible, because such issuers routinely refuse to sign consents to service of process as a matter of public policy and their bond purchase agreements routinely provide that they are not obligated to sign such consents. “On behalf of” entities and sponsoring political subdivisions can be expected to object to related issuers of 63-20 Bonds, NYLDC Bonds and Texas Qualified Scholarship Funding Bonds signing such consents.

5. In-State Issuers In-state issuers of 63-20 Bonds, NYLDC Bonds and Texas Qualified Scholarship Funding Bonds that qualify for an exemption from registration under Section 3(a)(2) are not covered securities in the state in which the issuer is located and, thus, usually face the difficulties of compliance with state blue sky law exemptions from registration for nonprofit corporations, as described in Section II.H.2., supra.

63-20 Bonds, NYLDC Bonds and Texas Qualified Scholarship Funding Bonds may, however, be treated as obligations that qualify under the state municipal bond exemption from registration if they have been validly designated under state law as an instrumentality of a state or political subdivision. See the discussion in Section II.A.3. concerning the effect of instrumentality status under state blue sky laws. For example, sponsoring political subdivisions of NYLDCs occasionally designate the related NYLDC as an instrumentality of the sponsoring political subdivision.

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64 In New York, if the 63-20 Bonds or NYLDC Bonds in question constitute a participation interest in or investment in real estate (see Section II.D.2.(d), supra), the methods of compliance are the filing of either a Policy Statement 104 Application or a Form 99, both of which require a consent to service of process signed by the issuer. However, a staff member of the New York State Department of Law has indicated a general willingness to view 63-20 issuers and NYLDCs as instrumentalities of a state or political subdivision, in which case the filing of a Policy Statement 103 Application would be appropriate. A Policy Statement 103 Application does not require a consent to service of process. However, one may wish to check first with Mr. William Peters of the New York State Department of Law, telephone (212) 416-8145, before filing a Policy Statement 103 Application in connection with an issue of 63-20 Bonds or NYLDCs.
Appendix A

Fundamental Bases of Blue Sky Requirements Applicable to Municipal Bonds

A. Introduction The fundamental bases of blue sky requirements applicable to municipal bonds are a combination of state and federal law, namely:

   (1) the uniform securities acts and amendments promulgated from time to time by the National Conference of Commissioners on Uniform State Laws (“NCCUSL”),

   (2) the amendments made to Section 18 of the Securities Act of 1933 (attached hereto as Appendix B) pursuant to the National Securities Markets Improvement Act of 1996 (“NSMIA”), and


The purpose of this Appendix is to summarize basic requirements of the foregoing.

B. The First Blue Sky Law and the Uniform Securities Act of 1956

The first blue sky law was enacted in 1911 in Kansas, where the term “blue sky” apparently came into general use to describe legislation designed to protect investors from promoters who, if let to their own devices, “would sell building lots in the blue sky in fee simple.”65 Since 1911, blue sky laws have been enacted in various forms in every state, the District of Columbia, the Commonwealth of Puerto Rico, Guam and the U.S. Virgin Islands. In 1917, the United States Supreme Court held in various cases that a number of these statutes did not violate the Fourteenth Amendment or unduly burden commerce.66

The Uniform Securities Act of 1956 (the “1956 Act”) was promulgated by the National Conference of Commissioners on Uniform State Laws (“NCCUSL”). Section 402(a)(1) of the 1956 Act provides an exemption from registration for “any security (including a revenue obligation) issued or guaranteed by the United States, any state, any political subdivision of a state, or any agency or corporate or other instrumentality of one or more the foregoing; or any certificate of deposit for any of the foregoing.” [Emphasis added.] Section 401(e) of the 1956 Act defined “guaranteed” to mean “guaranteed as to payment of principal, interest or dividends.”

The commentary of the 1956 Act’s draftsman, Professor Louis Loss, noted that this general, across-the-board exemption from registration for municipal bonds was “substantially standard” among the states and that the differences among states were “essentially


phraseological." The 1956 Act has been adopted at one time or another, in whole or in part, by 37 jurisdictions. 68

Neither the 1956 Act nor the accompanying commentary defined the terms “political subdivision” or “instrumentality.” As will be seen, the lack of definitions for these terms has continued through various statutory enactments during the ensuing half century.


The Uniform Securities Act (1985) with 1988 Amendments, also promulgated by NCCUSL (the “1985 Act”), expanded the municipal bond exemption contained in Section 401(a)(1) by changing the phrase “issued or guaranteed” to “issued, insured or guaranteed.” [Emphasis added.]

Section 401(a)(1) of the 1985 Act slightly revised the definition of the term “guaranteed” to mean: “guaranteed as to payment of all or substantially all of principal and interest or dividends.” [Emphasis added.] Section of the 1985 Act 401(b)(1) defined the term “insured” to mean: “insured as to payment of all or substantially all of principal and interest and dividends.”

While Section 401(b)(1) of the 1985 Act retained the exemption from registration for municipal bonds, it also provided in bracketed text an optional exclusion from this exemption for any security:

any security payable solely from revenues to be received from a nongovernmental industrial or commercial enterprise unless the payments are insured or guaranteed by a person whose securities are exempt from registration under paragraph (2), (3), (4), (5), (7), (9) or (13) or the revenues from which the payments are to be made are a direct obligation of such a person. [Emphasis added.]

The persons described in paragraphs (2), (3), (4), (5), (7), (9) and (13) of the Section 401(b) of the 1985 Act referred to above (i.e., those persons whose insurance, guarantee or direct obligation can save the exemption from registration) include:

(2) Canada and Canadian provinces, territories and political subdivisions;

(3) a depository institution whose accounts are insured by the Federal Deposit Insurance Corporation and similar entities;

(4) an insurance company organized under the laws of any state and authorized to do business in the issuer’s state;


(5) a railroad, other common carrier, public utility or holding company that is (i) subject to the jurisdiction of the Interstate Commerce Commission, (ii) a registered holding company under the Public Utility Company Holding Act of 1935 or a subsidiary of a registered holding company within the meaning of that Act, (iii) regulated in respect to its rates and charges by a governmental authority of the United States or a state; or (iv) regulated in respect to the issuance or guarantee of the security by a governmental authority of the United States, a state, Canada, or a Canadian province or territory;

(7) an entity whose securities are listed or approved for listing on certain stock exchanges, including the New York Stock Exchange;

(9) certain clearing agencies registered under the Securities Exchange Act of 1934; and

(13) certain nonprofit membership cooperatives, provided that they are not traded to the public.

The idea of excluding from the municipal bond exemption from registration bonds payable from revenues to be received from a nongovernmental industrial or commercial enterprise was not original to the 1985 Act. The NCCUSL Comment to municipal bond exemption from registration contained in Section 401(b)(1) of the 1985 Act noted that “A small number of jurisdictions presently require the registration of IDBs or other revenue bond securities.”

Neither the 1985 Act nor the accompanying commentary defined the terms “political subdivision,” “instrumentality” or “nongovernmental industrial or commercial enterprise.”

D. National Securities Markets Improvement Act of 1996 ("NSMIA")

1. Section 18(a) Pre-Emptions After NSMIA NSMIA became law on October 11, 1996. NSMIA significantly amended the Securities Act of 1933, as amended (the “Securities Act of 1933”), the Securities Exchange Act of 1934, the Investment Company Act of 1940 and the Investment Advisers Act of 1940.

Prior to NSMIA, Section 18 provided that the Securities Act of 1933 did not pre-empt the jurisdiction of any state securities commission with respect to municipal bonds offered or sold in that state. Prior to NSMIA, several states required registration of certain types of municipal bonds and/or imposed requirements on the content of offering documents as a condition to the offer and sale of such municipal bonds to the general public.

Section 18 of the Securities Act of 1933, as re-written by NSMIA, is set forth in the Appendix B attached hereto. An understanding of NSMIA’s amendments to Section 18 is of critical importance to a blue sky law practitioner because NSMIA’s amendments to Section 18

resulted in the federal pre-emption of many, but not all, state registration and offering document requirements applicable to municipal bonds.

Section 18 limits state authority to regulate the offer and sale of municipal bonds that constitute “covered securities”.

Section 18(a) provides that, except as otherwise provided in Section 18, no law, rule, regulation, or order, or other administrative action of any state or any political subdivision thereof:

(a) requiring registration or qualification of securities or securities transactions shall apply to a covered security,

(b) shall prohibit, limit, or impose any conditions upon the use of any offering document (i.e., an official statement) for a covered security, or

(c) shall prohibit, limit, or impose conditions, based on the merits of such offering or issuer, upon the offer or sale of any covered security.

2. Covered Securities

(a) General The key to understanding NSMIA is an understanding of the two types of municipal bonds that constitute covered securities. Municipal bonds are covered securities under Sections 18(b)(4)(C) or 18(b)(4)(D) of the Securities Act of 1933, respectively, if they are:

(i) \textbf{Section 18(b)(4)(C) Covered Securities} Section 18(b)(4)(C) provides covered security status (“Section 18(b)(4)(C) covered securities”) for securities that are exempt from registration under Section 3(a)(2), except that a municipal security that is exempt from registration pursuant to Section 3(a)(2) is not a covered security if it is offered or sold in the state in which the issuer is located. In addition, the definition of Section 18(b)(4)(C) covered security excludes securities of certain nonprofit organizations under Section 3(a)(4), securities issued in connection with a bankruptcy or reorganization under Section 3(a)(10) and securities sold only to residents in a single state under Section 3(a)(11).

(ii) \textbf{Section 18(b)(4)(D) Covered Securities} Section 18(b)(4)(D) provides covered security status (“Section 18(b)(4)(D) covered securities”) for securities that are exempt from registration under SEC rules and regulations promulgated pursuant to Section 4(2) of the Securities Act of 1933. These rules and regulations consist of Rule 506 of SEC Regulation D, which provides a “safe harbor” exemption from registration for “transactions by an issuer not involving any public offering.”

\footnote{Section 18(d)(3) provides that the term “State” has the same meaning as in Section 3 of the Securities Exchange Act of 1934. Under Section 3 of the Securities Act of 1934, State means “any State of the United States, the District of Columbia, Puerto Rico, the Virgin Islands, or any other possession of the United States.”}
These exemptions are discussed in sub-section (b) below.

(b) **Section 3(a)(2) Exemptions from Registration** There are three exemptions from registration for municipal bonds under Section 3(a)(2), which this paper will refer to as: (a) the General Exemption, (b) the IDB Exemption and (c) the Bank Guaranty Exemption (collectively, the “Section 3(a)(2) Exemptions”). The IDB Exemption requires that the interest on the municipal bond in question be excludable from gross income. As noted above, Section 18(b)(4)(C) confers covered security status **only** on municipal bonds issued by out-of-state issuers; municipal bonds that qualify for an exemption from registration under the General Exemption or the IDB Exemption are **not** covered securities in the state in which the issuer is located.

In addition to the Section 3(a)(2) exemption for the bonds in question, counsel must also consider whether the bonds in question include a “separate security,” that is subject to registration or qualifies for its own exemption from registration, as more fully discussed below under “Separate Securities,” infra.

(i) **General Exemption** Section 3(a)(2) provides an exemption from registration for “Any security issued or guaranteed by… the District of Columbia, or by any State of the United States, or by any political subdivision of a State or Territory, or by any public instrumentality of one or more States or Territories…” (the “General Exemption”). The General Exemption provides the exemption from registration for traditional or “governmental purpose” municipal bonds such as general obligation bonds and water and sewer revenue bonds, as well as private activity bonds constituting single family mortgage revenue bonds, student loan bonds, redevelopment bonds, conduit 501(c)(3) bonds and bonds issued to finance qualified residential rental projects (i.e., multi-family revenue bonds). This exemption is available regardless of whether the interest on the municipal bonds is tax-exempt.

(ii) **IDB Exemption** Section 3(a)(2) provides an exemption from registration (the “IDB Exemption”) for any security that is an industrial development bond (“IDB”), as defined in Section 103(c)(2) of the Internal Revenue Code of 1954 (the “1954 Code”) and issued to provide manufacturing facilities or certain “exempt activities,” provided that the interest thereon is excludable from gross income pursuant to Sections 103(c)(4) or 103(c)(6) of the 1954 Code, respectively. The IDB Exemption does not apply to IDBs issued

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71 See “Separate Securities,” *infra*, for a discussion of why the underlying lease, sale or loan arrangement for an issue of 501(c)(3) bonds does not constitute a “separate security” under SEC Rule 131.

72 The need to issue taxable IDBs typically arises because issuance expenses for the financing exceed 2% of the proceeds of a related tax-exempt issue, in violation of the limitation imposed by Section 147(g) of the 1986 Code.
to provide “projects for residential rental property” under Section 103(c)(4)(A) of the 1954 Code or industrial parks under Section 103(c)(5).\textsuperscript{73}

The term “industrial development bond” was used in the 1954 Code but was eliminated from the Internal Revenue Code of 1986 (“1986 Code”) and replaced with the concept of the private activity bond (“Private Activity Bond” or “Private Activity Bonds”). The IDB Exemption under Section (3)(a)(2) has not been amended to make a corresponding change, but following the adoption of the 1986 Code, at least one SEC no action request indicates that the words “private activity bond” should be substituted for the words “industrial development bond” under Section 3(a)(2).\textsuperscript{74}

In addition, references in Section 3(a)(2) to 1954 Code Sections 103(c)(4) and 103(c)(6) should be read to mean the corresponding successor provisions under the 1986 Code, as amended from time to time. For example, tax-exempt bonds issued to provide “exempt activities” under Section 103(c)(4) of the 1954 Code have been construed to include “exempt facility bonds” issued to provide “qualified hazardous waste facilities” under Section 142(a) of the 1986 Code.\textsuperscript{75}

Thus, under the IDB Exemption, Private Activity Bonds under the 1986 Code that are issued to provide either: (1) manufacturing facilities, as defined in Section 144 of the 1986 Code, or (2) “exempt facilities” under Section 142(a) of the 1986 Code (other than “qualified residential rental projects”) are exempt from registration under Section 3(a)(2) pursuant to the IDB Exemption, provided that the interest on such Private Activity Bonds is excludable from gross income for federal income tax purposes.\textsuperscript{76, 77}

\textsuperscript{73} After the IDB Exemption was enacted, the subsections of Section 103 of the 1954 Code were re-lettered, so that Section 103(c)(2) became Section 103(b)(2), Section 103(c)(4) became Section 103(b)(4), etc. The cross references to the 1954 Code in the IDB Exemption were never up-dated to reflect the re-numbering of the 1954 Code. However, the cross references in Section 3(a)(2) are interpreted by practitioners to mean the re-lettered sections in Section 103 of the 1954 Code.

\textsuperscript{74} See, for example, Tooele County, SEC No Action Letter (August 30, 1989).

\textsuperscript{75} See Tooele County, SEC No Action Letter (August 30, 1989).

\textsuperscript{76} In addition to qualified residential rental projects, under current law exempt facility bonds may be issued under Section 142 of the 1986 Code to provide airports, docks and wharves, mass commuting facilities, facilities for the furnishing of water, sewage facilities, solid waste disposal facilities, facilities for the local furnishing of electric energy or gas, local district heating or cooling facilities, qualified hazardous waste facilities, high-speed intercity rail facilities, environmental enhancements of hydroelectric generating facilities and qualified public educational facilities.
However, taxable Private Activity Bonds issued to provide manufacturing facilities, as defined in Section 144 of the 1986 Code, or “exempt facilities” under Section 142(a) of the 1986 Code (other than “qualified residential rental projects”) (collectively, “Taxable IDBs”) are not exempt from registration under Section 3(a)(2) and do not constitute covered securities.

(iii) Bank Guaranty Exemption Finally, municipal bonds may be exempt from registration under Section 3(a)(2) as securities “guaranteed by any bank” (the “Bank Guaranty Exemption”), by virtue of the issuance of a letter of credit that secures the payment of principal of and accrued interest on the bonds in question. As described below, the letter of credit itself is exempt from registration under Section 3(a)(2) as a “security issued...by any bank.”

Section 3(a)(2) provides an exemption from registration for any “security issued or guaranteed by any bank” and defines “bank” to include “any national bank, or any banking institution organized under the laws of any state...the business of which is substantially confined to banking and is supervised by the state...banking commission...”

The domestic branch of a foreign bank may also qualify as a “bank” under Section 3(a)(2). On September 23, 1986, the SEC issued its Securities and Exchange Release No. 33-6661 (the “1986 Release”), in which it reaffirmed the position expressed in numerous no-action letters to the effect that for purposes of the Section 3(a)(2) exemption, a branch or agency of a foreign bank located in the United States is deemed to be a “national bank” or a “banking institution organized under the laws of any state” if the nature and extent of federal and/or state regulation and supervision of the particular branch or agency is substantially equivalent to that applicable to federal or state chartered domestic banks doing business in the same jurisdiction. In the 1986 Release, the SEC pointed out that the determination with respect to the requirement of “substantially equivalent regulation,” as well as the determination as to whether the business of the branch or agency in question “is substantially confined to banking and supervised by the state...banking commission...” is the responsibility of the issuers and their counsel. I will note in passing that arriving at such legal conclusions is an arduous task that is best left to banking law specialists in one’s law firm, if one is fortunate enough to have such colleagues.

Even though IDBs (now, Private Activity Bonds) issued to provide residential rental property described in Section 103(c)(4)(A) of 1954 Code are not covered by the IDB Exemption, practitioners routinely take the position that both tax-exempt and taxable Private Activity Bonds issued to provide qualified residential rental projects under Section 142(d) of the 1986 Code are exempt from registration pursuant to the General Exemption, in reliance upon a series of SEC no-action letters in which, by reason of the public purpose of the financing and the control of the project by the issuer, the project is determined to be a public project owned and operated by or on behalf of and under the control of a governmental unit within the meaning of SEC Rule 131(b)(2). See, for example, Kidder Peabody & Co., Incorporated, SEC No-Action Letter (January 3, 1984) and FUNDAMENTALS OF MUNICIPAL BONDS 2005, note 6, supra, Section 3, pages 57 to 58.
Typically in letter of credit transactions, the payment of the principal of and interest on the municipal bonds is secured by an irrevocable direct-pay letter of credit issued by a state or national bank or a by a qualifying domestic branch of a foreign bank, in an “available amount” equal to the full principal amount of the obligations plus accrued interest. The payment of the purchase price, if applicable, upon mandatory or optional tender, may also be covered by the letter of credit. This exemption is available regardless of whether the interest on the municipal bonds is tax-exempt.

In Illinois Export Development Authority, SEC No Action Letter (July 2, 1986), a letter of credit issued by the domestic of a foreign bank (i.e., the New York Agency of The Bank of Tokyo) secured the payment of an issue of taxable industrial development bonds. Absent the letter of credit, the bonds would have been subject to registration.

Citing United California Bank, SEC No Action Letter (March 16, 1971), counsel argued that the SEC staff had previously taken the position that although a letter of credit is not technically a “guarantee” under banking laws, the term “guarantee in” Section 3(a)(2) “should be interpreted to cover the practical realities of the situation.” [Emphasis added.] Citing Underwood Neuhaus & Co., Allied Bank of Texas, SEC No Action Letter (February 21, 1985) and Chemical Bank, Lomas & Nettleton Mortgage Investors, SEC No Action Letter (December 1, 1971), counsel pointed out that the SEC staff had previously concluded the term “guarantee” in Section 3(a)(2) “refers to arrangements whereby one person agrees to see to the payment of a security issued by another, whether or not a technical guaranty relationship exists between that person and the issuer.” [Emphasis added.] Counsel argued that the letter of credit provided an independent basis for an exemption from registration by reason of Section 3(a)(2) of the Securities Act. The SEC granted the no action request.

SEC Release 33-6688 dated February 6, 1987, officially confirmed the position taken by the Illinois Export Development Authority no action letter and its predecessors:

Financial guarantees issued by domestic banks in the form of standby letters of credit are exempt from registration pursuant to Section 3(a)(2) of the Securities Act, which exempts "any security issued...[by] any national bank, or any banking institution organized under the laws of any State, Territory, or the District of Columbia, the business of which is substantially confined to banking and is supervised by the State or territorial banking commission or similar official...." In addition, Section 3(a)(2) exempts from registration "any security...guaranteed by" such a bank. Although a standby letter of credit may be deemed not to be a guarantee for some purposes, but rather an "engagement...[of] the issuer [to]...honor drafts or other demands for payment upon compliance with the conditions specified," the Commission’s Division of Corporation Finance has treated standby letters of credit as being "tantamount to guarantees by [a] bank." Thus, the security backed by the letter of credit and the letter of credit itself have not been registered under the Securities Act. [Emphasis added]

On November 26, 2008, the SEC released updated Compliance and Disclosure Interpretations (“CD&Is”), which comprise the SEC’s Division of Corporation Finance interpretations of the Securities Act of 1933.
Section 218.03 of the CD&Is reiterated the position taken by SEC Release 33-6688. Section 218.08 provides:

A bank guarantee of an industrial development bond is exempt under Section 3(a)(2) as a security issued by a bank. The underlying industrial bond, if tax-exempt, likewise would be exempt under Section 3(a)(2), either because it satisfies the requirements applicable to tax-exempt industrial development bonds or because it is a security guaranteed by a bank. [Emphasis added.]

(c) Exemption from Registration Under Rule 506 of Regulation D
Municipal bonds that are exempt from registration under Rule 506 of Regulation D are also covered securities. Covered security status pursuant to Rule 506 does not depend upon the issuer’s location and, thus, can provide an exemption from registration for municipal bonds in the state in which they are issued. The exemption from registration pursuant to Rule 506 also does not depend upon whether the interest on the securities in question is tax-exempt. Rule 506 theoretically provides an additional means of achieving covered security status and a Securities Act exemption from registration for Taxable IDBs. However, Rule 506 offerings of municipal bonds are so rare as to be virtually non-existent, probably because municipal bond underwriters overwhelmingly prefer to avoid the Rule’s private placement requirements and because most states’ notice filing requirements for Rule 506 offerings include a consent to service of process signed by the issuer and issuers routinely refuse to sign consents to service of process. Thus, the rest of this paper will only discuss notice filing requirements for municipal securities that are exempt from registration under Section 3(a)(2) (i.e., Section 18(b)(4)(C) covered securities).

3. State Requirements Not Pre-empted by NSMIA

NSMIA’s amendments to Section 18 did not pre-empt the following blue sky requirements applicable to the sale of municipal bonds:

(a) For municipal bonds that are exempt from registration under Section 3(a)(2), a state may impose registration, offering document restrictions and conditions

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78 Rule 506 provides an exemption from registration for limited offers and sales without regard to the dollar amount of the offering. Rule 506(b)(1) provides that offers and sales that qualify under Rule 506 must satisfy all the terms and conditions of Rules 501 (Definitions and Terms Used in Regulation D) and 502 (General Conditions to Be Met).

Regulation D also includes Rules 504 and 505, which were promulgated pursuant to Section 3(b) of the Securities Act. Section 3(b) of the Securities Act provides that the Securities and Exchange Commission may, from time to time by its rules and regulations and subject to such terms and conditions as may be prescribed therein, add any class of securities to the securities exempted from registration under Section 3, if it finds that the enforcement of the Securities Act is not necessary in the public interest and for the protection of investors by reason of the small amount involved or the limited character of the offering, provided that the aggregate amount of the issue does not exceed $5,000,000.
upon sale, based upon the merits of the offering or issuer, upon the sale of municipal bonds by issuers located within its boundaries.\(^79\)

(b) A state securities commission may impose a notice filing requirement upon the sale of covered securities. Such a filing may include the filing of any document filed with the SEC, together with annual or periodic reports of the value of the securities offered or sold to persons located in the state, solely for notice purposes, together with a consent to service of process and any required fee.\(^80\)

(c) A state may impose on the sale of covered securities that are exempt from registration under SEC rules and regulations promulgated pursuant to Section 4(2) (\textit{i.e.}, Rule 506 of Regulation D), notice filing requirements that are substantially similar to those required by Regulation D as of September 1, 1996.\(^81\)

(d) Unless otherwise provided by state law (for example, by a blue sky law amendment that grants an exemption from registration for covered securities), filing or registration fees with respect to securities or securities transactions in amounts determined pursuant to state law as in effect on October 10, 1996 (the day before the effective date of NSMIA) shall continue to be collected.\(^82\)

(e) A state securities commission may suspend the offer or sale of securities within its boundaries because of the failure to submit any filing or fee required under state law and permitted by Section 18 (\textit{i.e.}, the filings and fees described in subparagraphs (b), (c) and (d) above).\(^83\)

(f) A state securities commission (or any agency or officer performing like functions) shall retain jurisdiction to investigate and bring enforcement actions with respect to fraud and deceit, or unlawful conduct by a broker or dealer, in connection with securities and securities transactions.\(^84\)

E. 1997 Amendments to the 1956 Act and the 1985 Act

In 1997, in response to the enactment of NSMIA, NCCUSL promulgated amendments to the 1956 Act and the 1985 Act (the “1997 Amendments”), which codified many of NSMIA’s

\(^{79}\)Section 18(b)(4)(C).

\(^{80}\)Section 18(c)(2)(A).

\(^{81}\)Section 18(b)(4)(D).

\(^{82}\)Section 18(c)(2)(B)(i).

\(^{83}\)Section 18(c)(3).

\(^{84}\)Section 18(c)(1).
provisions. Most states that had enacted the 1956 Act or the 1985 Act enacted the 1997 Amendments. The 1997 Amendments had two profound effects on blue sky analysis: the imposition of notice filings and dual track blue sky analysis.

1. Notice Filings

The 1997 Amendments authorized the state’s securities commission to impose notice filing requirements on various types of covered securities, including Section 18(b)(4)(C) covered securities.

In response to NSMIA, many states proceeded to impose notice filing requirements on Section 18(b)(4)(C) covered securities, either as a result of their enactment of the 1997 Amendments or pursuant to other rule-making authority contained in their blue sky laws.

As of the date of this paper, the following jurisdictions have imposed notice filing requirements on various types of Section 18(b)(4)(C) covered securities (unless they are otherwise exempt from registration under that jurisdiction’s blue sky law): Arkansas, Arizona, the District of Columbia, Illinois, Maryland, Montana, Nebraska, Nevada, New Hampshire, New York, North Dakota, Ohio, Oregon, Tennessee, Texas and Washington.

Municipal bonds that are issued by out-of-state issuers and offered for sale to the public in the District of Columbia, Illinois, Maryland, Oregon, Tennessee and Texas usually escape compliance with the notice filing requirements in these jurisdictions, because the municipal bond exemption from registration in these jurisdictions covers all types of municipal bonds. As discussed in Section II, supra, the blue sky laws of Arizona, Montana, Nevada, New Hampshire, New York, North Dakota, Ohio and Washington limit the availability of the municipal bond exemption to certain types of municipal bonds (e.g., all municipal bonds are exempt from registration in Montana, except for certain municipal bonds payable from revenues to be received from a nongovernmental industrial or commercial enterprise), so in these jurisdictions notice filings may be required for municipal bonds issued by out-of-state issuers.

In addition, in response to NSMIA, Nebraska has limited its municipal bond exemption from registration to bonds issued by Nebraska issuers (see Section 8-110(1), Nebraska Revised Statutes). However, NSMIA prohibits Nebraska from imposing registration, offering document and merit condition requirements on municipal bonds issued by out-of-state issuers that qualify as covered securities. Since the Nebraska notice filing requirement currently only applies to offerings by investment companies, offerings pursuant to Rule 506 of Regulation D and offerings by certain agricultural cooperatives (see Chapter 20, Nebraska Blue Sky Rules, CCH para. 37,420), virtually all municipal bonds issued by out-of-state issuers are exempt from the Nebraska notice filing requirement.

Similarly, in response to NSMIA, Arkansas also limited its municipal bond exemption from registration to bonds issued by Arkansas issuers (see Section 23-42-503, Arkansas Statutes). The Arkansas notice filing requirement (Arkansas Rule 509.01, CCH para. 10,509) applies only to covered securities under Section 18(b)(2) (securities issued by investment companies) and offerings pursuant to Rule 506 of Regulation D, so virtually all municipal bonds issued by out-of-state issuers are exempt from the Arkansas notice filing requirement.
2. **Dual Track Blue Sky Analysis**  Prior to the enactment of NSMIA, the general approach of state blue sky laws was that it was unlawful to offer and sell an issue of securities in the state in question unless the issue (1) was registered or (2) qualified for an exemption from registration because it qualified as an exempt security or because it was offered and sold as part of an exempt transaction.\(^{85}\) Since the enactment of NSMIA and its partial pre-emption of state blue laws, there is now a second, alternative means of blue sky law compliance that does not involve registration, namely, the security in question constitutes a covered security, as defined by NSMIA, provided that the applicable notice filing requirement, if any, is satisfied.\(^{86}\)

The gist of dual track blue sky analysis is to ask the following two questions for the municipal bonds in question:

1. What is the result under each state’s blue sky law without taking NSMIA into account (hereinafter referred to as “Traditional Blue Sky Analysis”)?

2. To the extent that some form of action is required pursuant to question (1), what is the result after applying NSMIA’s provisions (hereinafter referred to “NSMIA Analysis”)?

If Traditional Blue Sky Analysis for a particular state’s blue sky law reveals that no action needs to be taken in that state for the issue in question, then it is unnecessary to consider the effect of NSMIA on that issue, including any notice filing requirement that the state may have imposed on covered securities.

If, however, Traditional Blue Sky Analysis indicates that some form of action needs to be taken, then one must also determine what the result is after applying NSMIA Analysis. The final step in the analysis is to compare the two outcomes and choose the less burdensome outcome as the means of compliance.

In general, when Traditional Blue Sky Analysis indicates that action needs to be taken, the action required is usually registration. In general, the result of NSMIA Analysis is either a notice filing or no action at all (since some states have not imposed notice filing requirements). And, therefore, generally speaking, compliance with NSMIA’s provisions is usually the less burdensome course.

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\(^{85}\) See, for example, Section 301 of the Uniform Securities Act of 1956.

\(^{86}\) In any particular jurisdiction, this alternative non-registration means of compliance arises either: (1) because the jurisdiction has enacted the 1997 Amendments to its blue sky law, (2) because the jurisdiction has enacted the Uniform Securities Act of 2002, which provides for both non-registration means of compliance or (3) simply because of the pre-emptive nature of NSMIA.
But not always. For example, filing the New York Policy Statement 103 Application (which is a condition for an exemption from registration) is actually less burdensome than filing the New York Form 99 (which is notice filing promulgated in response to NSMIA).\(^\text{87}\)

In addition, while a notice filing under NSMIA is usually less burdensome than a registration, even a notice filing under NSMIA may be more burdensome than an underwriter cares to tolerate. For example, the notice filing fee in New Hampshire reaches its maximum amount of $1,250 when the offering price of the bonds being offered in New Hampshire equals or exceeds the relatively small offering price of $525,000.\(^\text{88}\) The Washington notice filing fee is the sum $100 for the first $100,000 of the offering price of bonds being offered in Washington plus 1/20 of one percent of the excess of the offering price of bonds being offered in Washington, with no upper limit.\(^\text{89}\) A notice filing fee for bonds having an offering price of $5,000,000 would be $100 plus $2,450 or $2,550. Faced with the prospect of paying such fees as part of a notice filing in these states, an underwriter may decide to forego the ability to make offers to the public in these states.

In those states where separate security analysis is applied, Dual Track Blue Sky Analysis must be applied both to the bonds in question and any separate security. See generally Section II.F., \textit{supra}.

F. Uniform Securities Act of 2002

The Uniform Securities Act of 2002 (the “2002 Act”) was also promulgated by NCCUSL.

Section 201(1) of the 2002 Act provides:

The following securities are exempt from the requirements of Sections 301 through 306 [registration and notice filings contemplated by NSMIA] and Section 504 [filing of sales and advertising literature]:

(1) a security, including a revenue obligation or a separate security as defined in Rule 131 (17 C.F.R. 230.131) adopted under the Securities Act of 1933, issued, insured or guaranteed by...a State; by a political subdivision of a State; by a public authority, agency, or instrumentality of one of more States; by a political subdivision of one or more States...”

Thus Section 201(1) of the 2002 Act expands the municipal bond exemption from registration to include any related separate security under SEC Rule 131 (see “Securities and

\(^{87}\) See Section II.D.2.(d), \textit{supra}.

\(^{88}\) See Section II.D.2.(c)(2), \textit{supra}.

\(^{89}\) See Section II.D.1(g)(7), \textit{supra}.
Exchange Rule 131,” *infra*) and abolishes all registration and NSMIA-inspired notice filing requirements applicable to all types of municipal bonds.  

The 2002 Act also expands the categories of institutional investors to whom sales may be made without registration or the taking of other action pursuant to an “exempt transaction” exemption.  

True to form, neither the 2002 Act nor the accompanying commentary defined the terms “political subdivision” or “instrumentality.”

As of the date of this paper, the 2002 Act has been enacted and is in effect in Georgia, Hawaii, Idaho, Indiana, Iowa, Kansas, Maine, Mississippi, Michigan, Minnesota, Missouri, New Mexico, Oklahoma, South Carolina, South Dakota, Vermont, the U.S. Virgin Islands and Wisconsin.

G. **Securities and Exchange Commission Rule 131**

Securities and Exchange Commission (the “SEC”) Rule 131 was originally promulgated in 1968, but its relevance to blue sky analysis did not become fully apparent until enactments of NSMIA in 1996 and the 2002 Act by the states listed in Section F. above. An understanding of Rule 131 is important to blue sky analysis because:

1. It can answer the question of whether a lease, sale or loan arrangement, guaranty or letter of credit is (a) a “separate security” which requires its own exemption from registration under the Securities Act of 1933, separate and apart from the related bond issue or (b) deemed “integrated with” or part of the related bond issue that is exempt from registration under Section 3(a)(2) and, by extension, “integrated with” or part of the related bond issue that qualifies as a Section 18(b)(4)(C) covered security;

2. In two separate regulations, Pennsylvania has attempted to impose either registration or offering document requirements on obligations that constitute separate securities under Rule 131 (see Section II.F.4., *supra*); and

3. Rule 131 separate security analysis has, on occasion, been an important part of the analysis contained in state no action requests (see, for example, Wisconsin no action letters, CCH paras. 64,976 [student loan bonds], 64,977 [single family mortgage revenue bonds] and 64,988 [multi-family bonds]).

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90 However, as discussed under “Separate Securities Under Traditional Blue Sky Analysis, NSMIA Analysis and the 2002 Act – General,” *infra*, the versions of the 2002 Act enacted in Maine, Michigan and Vermont *permit* the promulgation of rules or regulations that would impose a notice filing requirement on Section 18(b)(4)(C) covered securities. As of the date of this paper, none of these jurisdictions has imposed a notice filing requirement on Section 18(b)(4)(C) covered securities.

Prior to 1970, Section 3(a)(2) provided an exemption for registration for “any security issued or guaranteed by...any State of the United States, or by any political subdivision of a State.”

In 1968, after reviewing the potential abuses related to industrial development bond financing, the SEC adopted Rule 131 under the Securities Act of 1933 and corresponding Rule 3b-5 under the Securities and Exchange Act of 1934. These rules were designed to provide information about the private enterprise being financed, as well as the terms and conditions of the financing arrangement. This was accomplished under both rules by providing that any part of a municipal obligation which is payable from funds generated by a private enterprise would be a separate “security,” within the meaning of Section 2(1) and the Securities and Exchange Act of 1934. To the extent industrial development bonds constituted such securities, the SEC’s position was that they were subject to the registration provisions of the Securities Act of 1933 and the Securities Act of 1934.92

SEC Rule 131, 17 CFR § 230.131, provides:

§230.131. Definition of security issued under governmental obligations.

(a) Any part of an obligation evidenced by any bond, note, debenture, or other evidence of indebtedness issued by a governmental unit specified in section 3(a)(2) of the Act [Securities Act of 1933] which is payable from payments to be made in respect of property or money which is or will be used, under a lease, sale or loan arrangement, by or for an industrial or commercial enterprise, shall be deemed to be a separate security under Section 2(1) of the Act, issued by the lessee or obligor under the lease, sale or loan arrangement.

(b) An obligation will not be deemed a separate security as defined in paragraph (a) of this section if, (1) the obligation is payable from the general revenues of a governmental unit, specified in section 3(a)(2) of the Act, having other resources which may be used for payment of the obligation, or (2) the obligation relates to a public project or facility owned and operated by or on behalf of and under the control of a governmental unit specified in such section, or (3) the obligation relates to a facility which is leased to and under the control of an industrial or commercial enterprise but is part of a public project, which, as a whole, is owned by and under the general control of a governmental unit specified in such section or an instrumentality thereof.

(c) This rule shall apply to transactions of the character described in paragraph (a) of this section only with respect to bonds, notes, debentures or other evidences of indebtedness sold after December 31, 1968.

92 This paragraph and the one immediately preceding it are an almost verbatim excerpt from FUNDAMENTALS OF MUNICIPAL BOND LAW 2005, note 6, supra, Section 3, “Industrial Development Bonds,” page 56.
In response to Rule 131, Congress enacted Section 401 of the Employment Securities Amendments of 1970, as a means of exempting from registration certain industrial development bonds that would have required registration under Rule 131 and Rule 3b-5. Section 401 amended Section 3(a)(2) and Section 3(a)(12) of the Securities Act of 1934 by including within the definition of exempt security any security which is an industrial development bond (as defined in Section 103(c)(2) of the 1954 Code) the interest on which is excludable from gross income under Section 103(a)(1) of such Code, provided that such bonds were issued for certain specified purposes under Section 103(c)(4) (i.e., “certain exempt activities” in the parlance of the 1954 Code or “exempt facilities” under Section 142 of the 1986 Code) or within certain limited dollar amounts under Section 103(c)(6) (i.e., “exempt small issues” in the parlance of the 1954 Code or “qualified small issues” under Section 144 of the 1986 Code) (i.e., the IDB Exemption).93 Regardless of whether the interest on the bonds in question was taxable or tax-exempt, this amendment excluded from the Section 3(a)(2) exemption bonds issued to provide multi-family housing bonds (i.e., “projects for residential rental property”) under Section 103(c)(4)(A) of the 1954 Code and industrial parks under Section 103(c)(5) of the 1954 Code. Subsequent to the enactment of Section 401, the SEC in SEC Release No. 33-5103 acknowledged that tax-exempt IDBs that qualified under the IDB Exemption (i.e., tax-exempt IDBs issued to provide manufacturing facilities or “exempt activities” pursuant to Sections 103(c)(4) or 103(c)(6) of the 1954 Code, other than “projects for residential rental property”) would not be subject to registration.

Thus, the related lease, sale or loan arrangement under which the conduit industrial or commercial enterprise agrees to make payments sufficient to pay the debt service on tax-exempt private activity bonds that are exempt from registration pursuant to the IDB Exemption is included within the IDB Exemption and is not a separate security that requires its own exemption from registration.

However, SEC Release 33-5103 also made clear that Rule 131 still applied to IDBs that did not qualify for the IDB exemption (either because the interest thereon was taxable or because the IDBs in question were not issued for the one of the purposes specified in Section 3(a)(2)).

93 Fundamentals Article of Municipal Bonds 2006, note 6, supra, at page 57.
APPENDIX B

Section 18 of the Securities Act of 1933, as amended

18. EXEMPTION FROM STATE REGULATION OF SECURITIES OFFERINGS.

(a) SCOPE OF EXEMPTION--Except as otherwise provided in this section, no law, rule, regulation, or order, or other administrative action of any State or any political subdivision thereof --

(1) requiring, or with respect to, registration or qualification of securities, or registration or qualification of securities transactions, shall directly or indirectly apply to a security that--

(A) is a covered security; or

(B) will be a covered security upon completion of the transaction;

(2) shall directly or indirectly prohibit, limit, or impose any conditions upon the use of--

(A) with respect to a covered security described in subsection (b), any offering document that is prepared by or on behalf of the issuer; or

(B) any proxy statement, report to shareholders, or other disclosure document relating to a covered security or the issuer thereof that is required to be and is filed with the Commission or any national securities organization registered under section 15A of the Securities Exchange Act of 1934, except that this subparagraph does not apply to the laws, rules, regulations, or orders, or other administrative actions of the State of incorporation of the issuer; or

(3) shall directly or indirectly prohibit, limit, or impose conditions, based on the merits of such offering or issuer, upon the offer or sale of any security described in paragraph (1).

(b) COVERED SECURITIES--For purposes of this section, the following are covered securities:

(1) EXCLUSIVE FEDERAL REGISTRATION OF NATIONALLY TRADED SECURITIES--A security is a covered security if such security is--

(A) listed, or authorized for listing, on the New York Stock Exchange or the American Stock Exchange, or listed, or authorized for listing, on the National Market System of the Nasdaq Stock Market (or any successor to such entities);
(B) listed, or authorized for listing, on a national securities exchange (or
tier or segment thereof) that has listing standards that the Commission determines
by rule (on its own initiative or on the basis of a petition) are substantially similar
to the listing standards applicable to securities described in subparagraph (A); or

(C) is a security of the same issuer that is equal in seniority or that is a
senior security to a security described in subparagraph (A) or (B).

(2) EXCLUSIVE FEDERAL REGISTRATION OF INVESTMENT
COMPANIES--A security is a covered security if such security is a security issued by an
investment company that is registered, or that has filed a registration statement, under the
Investment Company Act of 1940.

(3) SALES TO QUALIFIED PURCHASERS--A security is a covered security
with respect to the offer or sale of the security to qualified purchasers, as defined by the
Commission by rule. In prescribing such rule, the Commission may define the term
"qualified purchaser" differently with respect to different categories of securities,
consistent with the public interest and the protection of investors.

(4) EXEMPTION IN CONNECTION WITH CERTAIN EXEMPT OFFERINGS-
-A security is a covered security with respect to a transaction that is exempt from
registration under this title pursuant to--

(A) paragraph (1) or (3) of section 4, and the issuer of such security files
reports with the Commission pursuant to section 13 or 15(d) of the Securities
Exchange Act of 1934;

(B) section 4(4);

(C) section 3(a), other than the offer or sale of a security that is exempt
from such registration pursuant to paragraph (4), (10), or (11) of such section,
except that a municipal security that is exempt from such registration pursuant to
paragraph (2) of such section is not a covered security with respect to the offer or
sale of such security in the State in which the issuer of such security is located; or

(D) Commission rules or regulations issued under section 4(2), except that
this subparagraph does not prohibit a State from imposing notice filing
requirements that are substantially similar to those required by rule or regulation
under section 4(2) that are in effect on September 1, 1996.

(c) PRESERVATION OF AUTHORITY--

(1) FRAUD AUTHORITY--Consistent with this section, the securities
commission (or any agency or office performing like functions) of any State shall retain
jurisdiction under the laws of such State to investigate and bring enforcement actions with
respect to fraud or deceit, or unlawful conduct by a broker or dealer, in connection with securities or securities transactions.

(2) PRESERVATION OF FILING REQUIREMENTS–

(A) NOTICE FILINGS PERMITTED--Nothing in this section prohibits the securities commission (or any agency or office performing like functions) of any State from requiring the filing of any document filed with the Commission pursuant to this title, together with annual or periodic reports of the value of securities sold or offered to be sold to persons located in the State (if such sales data is not included in documents filed with the Commission), solely for notice purposes and the assessment of any fee, together with a consent to service of process and any required fee.

(B) PRESERVATION OF FEES--

(i) IN GENERAL--Until otherwise provided by law, rule, regulation, or order, or other administrative action of any State, or any political subdivision thereof, adopted after the date of enactment of the National Security Markets Improvement Act of 1996, filing or registration fees with respect to securities or securities transactions shall continue to be collected in amounts determined pursuant to State law as in effect on the day before such date.

(ii) SCHEDULE--The fees required by this subparagraph shall be paid, and all necessary supporting data on sales or offers for sales required under subparagraph (A), shall be reported on the same schedule as would have been applicable had the issuer not relied on the exemption provided in subsection (a).

(C) AVAILABILITY OF PREEMPTION CONTINGENT ON PAYMENT OF FEES–

(i) IN GENERAL--During the period beginning on the date of enactment of the National Securities Markets Improvement Act of 1996 and ending 3 years after that date of enactment, the securities commission (or any agency or office performing like functions) of any State may require the registration of securities issued by any issuer who refuses to pay the fees required by subparagraph (B).

(ii) DELAYS--For purposes of this subparagraph, delays in payment of fees or underpayments of fees that are promptly remedied shall not constitute a refusal to pay fees.

(D) FEES NOT PERMITTED ON LISTED SECURITIES--Notwithstanding subparagraphs (A), (B), and (C), no filing or fee may be required
with respect to any security that is a covered security pursuant to subsection (b)(1), or will be such a covered security upon completion of the transaction, or is a security of the same issuer that is equal in seniority or that is a senior security to a security that is a covered security pursuant to subsection (b)(1).

(3) ENFORCEMENT OF REQUIREMENTS--Nothing in this section shall prohibit the securities commission (or any agency or office performing like functions) of any State from suspending the offer or sale of securities within such State as a result of the failure to submit any filing or fee required under law and permitted under this section.

(d) DEFINITIONS--For purposes of this section, the following definitions shall apply:

(1) OFFERING DOCUMENT--The term "offering document"--

(A) has the meaning given the term "prospectus" in section 2(a)(10), but without regard to the provisions of subparagraphs (a) and (b) of that section; and

(B) includes a communication that is not deemed to offer a security pursuant to a rule of the Commission.

(2) PREPARED BY OR ON BEHALF OF THE ISSUER--Not later than 6 months after the date of enactment of the National Securities Markets Improvement Act of 1996, the Commission shall, by rule, define the term "prepared by or on behalf of the issuer" for purposes of this section.

(3) STATE--The term "State" has the same meaning as in section 3 of the Securities Exchange Act of 1934.

(4) SENIOR SECURITY--The term "senior security" means any bond, debenture, note, or similar obligation or instrument constituting a security and evidencing indebtedness, and any stock of a class having priority over any other class as to distribution of assets or payment of dividends."
Appendix C

Examples of SEC No Action Letters

The following SEC no-action letters are available online through www.lexisnexis.com. The date listed for each no-action letter is the date it was made publicly available. No-action letters listed in italics involve the issuance of taxable bonds or notes.

1. Counties: Finney County, Kansas, October 26, 1983; County of Jefferson, Kentucky, March 15, 1984; Cache County, Davis County, Salt Lake County, Utah County & Weber County, January 16, 1987.


7. Local authorities and special purpose districts: East Sevier County Utility District, February 15, 1974; The Coosa River Water, Sewer and Fire Protection Authority, December 6, 1974; Smith, Barney, Harris, Upham & Co., Incorporated (Public Utility District No. 1 of Chelan County, Washington), July 15, 1985 and August 7, 1985; Bar Lake Village Metropolitan District, November 18, 1985; Arvada Urban Renewal Authority, July 1, 1986; Port Authority of the City of St. Paul, November 24, 1986; City of Lansing Building Authority, January 30, 1987; Port of Corpus Christi Authority of Nueces County, Texas, February 2, 1987; The Redevelopment Authority of the City of Harrisburg, November 25, 1987; Capital Area...

8. Local boards or agencies issuing conduit bonds (i.e., multi-family and conduit 501(c)(3) bonds): City of Birmingham South Highlands Alabama - Medical Clinic Board, November 1, 1973; Redevelopment Agency of the City of Colton, June 4, 1979; Bucks County Industrial Development Authority (Pennsylvania), June 7, 1979; Urban Residential Finance Authority of the City of Atlanta (Georgia), October 5, 1981; Industrial Development Authority of the County of Clay, Missouri, December 16, 1981; Harris County Housing Finance Corporation, April 25, 1983.


11. Texas nonprofit corporations issuing qualified scholarship funding bonds: Abilene Higher Education Authority, Inc., November 29, 1976; South Texas Higher Education

12. Various issuers issuing tax-exempt industrial development bonds in reliance upon the IDB Exemption: Calhoun County Medical Facilities, Inc., December 3, 1973; Great Salt Lake Convalescent Hospital, February 17, 1975; Charlotte County, Florida, February 11, 1977; Industrial Development Authority of the City of Chesapeake, Va (Lone Star Cement, Inc.), August 7, 1978; Walton County Convalescent Center, Inc., March 27, 1979; McDonald's Corp., January 17, 1980 (for bonds issued by 13 Pennsylvania Industrial Development Authorities); Industrial Development Authority of the City of St. Louis, Missouri, February 27, 1981; The County Commission of Kanawha County, September 14, 1981; W.W. Grainger, Inc., November 5, 1981 (for separate series of bonds to be issued by the Suffolk County (New York) Industrial Development Agency, the Dade County (Florida) Industrial Development Authority, The Industrial Development Authority of the City of Roanoke, Virginia, The Industrial Development Authority of the County of Maricopa (Arizona), The Industrial Development Authority of the City of Kansas City, Missouri, the Village of Arlington Heights, Illinois, the Village of Alsip, Illinois, and Natrona County, Wyoming), November 5, 1981; Industrial Development Authority of St. Charles County, Missouri, March 15, 1982; Industrial Development Authority of Franklin County, Missouri, May 28, 1982.

13. Various entities not issuing bonds or notes: State entities offering qualified state tuition programs pursuant to Section 529 of the Internal Revenue Code of 1986, as amended, as public instrumentalities of a state (Virginia Higher Education Tuition Trust Fund, November 5, 1996; College SAVE, August 2, 2001; State of Hawaii College Savings Trust, October 22, 2001; Maryland College Investment Plan, December 7, 2001; Tuition Account Investment Program Fund, June 26, 2002); Tuition Investment Program Fund, June 26, 2002; trusts formed by school districts and townships to provide a method of combining cash reserves for temporary investment, as instrumentalities of a state (Illinois School District Liquid Asset Fund Plus, June 15, 1984 and Michigan School District Liquid Asset Fund Plus, May 26, 1987); trusts formed by municipalities and governmental units to provide a method of combining cash reserves for temporary investment, as instrumentalities of such municipalities or governmental units (Minnesota Municipal Money Market Fund, May 27, 1987, and Wisconsin Investment Trust, February 17, 1987); fund created by state legislation to enable plans of local governments that meet the definition of eligible deferred compensation plan under Section 457 of the Internal Revenue Code of 1986, as amended, to participate in a state deferred compensation plan, as a public instrumentality of a state (Public Employees’ Retirement Board of the State of Oregon, March 3, 1998).

Source: POLITICAL SUBDIVISIONS ARTICLE, note 8, supra.