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Contents

Notes from the Editor 2
Alexandria M. (Sandy) MacLennan Squire
Patton Boggs (US) LLP Tampa, Florida

2021-2022 NABL President's Speech....................4
Ann D. Fillingham
Dykema Gossett PLCC Lansing, Michigan

Federal Securities Law 7
Paul S. Maco
Bracewell LLP, Washington, D.C.

Federal Tax Law: The Tax Microphone....................14
Michael G. Bailey
Law Office of Michael G, Bailey, Chicago, Illinois

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Editor’s Notes

Alexandra M. (Sandy) MacLennan, Squire Patton Boggs LLP, Tampa, Florida

Welcome to the Fall 2021 Edition of *The Bond Lawyer*. Rick Weber has passed the baton to me and, so far, I haven’t dropped it. For six years and 24 editions of *The Bond Lawyer* Rick’s columns were something I looked forward to with anticipation of what interesting take he might have on some obscure (or not so obscure) term used in the world of public finance. He tackled Redemption, Defeasance, Arbitrage Rebate, Revenue, Pledge, Par, Special, Bond, Principal, Commandeer (with Dragoon, no less), Material, Maturity (with Term), Financial Difficulties, Coupon, Interest, Connection (with Circumstances), Indenture, Request (with Encourage, Urge, Should, and Benefit), Retail, Security, Risks (with Facts, Factors and Risk Factors), Forward (with Forwards), and last, but not least, Close (with Closings). Yes, there were some pretty corny jokes (some might say that is an understatement) and sometimes a bit of editorial license taken at the expense of federal regulators, but his columns were a welcome diversion from my day-to-day encounters with 100+ page indentures and endless healthcare regulatory and risk factor disclosure. Thank you, Rick, for your years of service as editor of *The Bond Lawyer* and your tireless efforts (and wit) on behalf of NABL. For those whose interest was piqued at the mention of “Dragoon” in the public finance context, I commend to you the entire library of past editions of *The Bond Lawyer* available on the NABL website.

In this Edition

In Rick’s last column he relayed the news that Mike Bailey would be “dropping the mic” and retiring from his column *The Tax Microphone*. As it turns out, Mike is back for an encore and one last column before turning over the tax space to Tony Martini for the Winter 2022 edition. (It’s official now, Tony. No turning back!). Mike, thank you (again) for your efforts and insights and best wishes to you in your retirement.

And thank you to Paul Maco for continuing on. Paul’s column in this edition is thought (and maybe fear?) provoking on the potentially louder saber-rattling at the SEC.

Also, in this edition are the remarks of NABL President Ann Fillingham given at the 2021 Workshop. Ann took the helm of NABL as its 43rd President and I wish her the best of luck in the coming year and all “in person” conferences.

Point of Personal Privilege

Speaking of retirements, you may have read that Mark Zehner has retired from the SEC. Some might have cheered at the prospect of the SEC Enforcement Division being Zehner-less. I, on the other hand, have mixed feelings about Mark’s retirement. I think I will miss going head to head with Mark on NABL securities law panels. We disagreed on many (but not all) points but had a bit of fun debating the issues. You were a worthy adversary, Mark, capable of intellectual sarcasm and a quick wit, and I wish you well in retirement. (But I still think MCDC was a huge mistake!)

Mark’s retirement provides a great opportunity for Rebecca Olsen who has taken over Mark’s position in the Public Finance and Abuse Office of the Division of Enforcement after heading up the Office of Municipal Securities since 2018. Rebecca brings to that position her OMS experience (since 2013) and her experience in the municipal market as a public finance attorney with Ballard Spahr. I echo

what others have said, that Rebecca's staying on with the SEC is a positive for the municipal market, and for NABL, in particular. Rebecca has always shown a willingness to engage in discussion on the issues and we look forward to continuing the discussion.

Going Forward

The Bond Lawyer accepts articles for consideration for publication. If you have written an article (or know someone who has), have an idea for an article, or would like to write an article and need an idea, contact us at publications@nabl.org. Op-Eds, as well as book and movie reviews, will also be considered. As a reminder, NABL will periodically award *The Carlson Prize*, named in honor of Rita J. and Charles P. Carlson, and conceived by Glenn E. Floyd, Norman, Oklahoma, to the author of the best scholarly article submitted for publication in *The Bond Lawyer*, or on the NABL website. The prize carries an honorarium of $500 and a registration grant for attendees at NABL U's The Workshop.

First Last Thoughts

One last thought as I finish this, my first column. When I was a younger NABL member and in my first few experiences as a panelist on the "Hot Topics in Securities Law" panel at the conference formerly known as the "Bond Attorney's Workshop," I used to hold my breath when I would see Rick Weber raise his hand in the audience to comment after something I had just said. I would think "Oh, no, here we go, I am about to be outed for the imposter I am, having the audacity to hold myself out as someone who knows anything about municipal securities law." And then it happened one year. Rick's first comment was "Sandy, you're right." And at that moment, I knew I had "arrived." I don't think normal people ever lose that imposter syndrome completely. But, I had the likes of Rick Weber and others (including Dean Pope, John McNally and Paul Maco) encouraging me earlier in my practice and that has made all the difference. This is one of the tacit, less heralded, benefits of participation in NABL. We, as bond lawyers and NABL members, in particular, have a penchant for extending a hand back (or over in many cases) to those who might be our competitors under different circumstances but whose continued growth and understanding in public finance matters benefits us all. If you haven't renewed your NABL membership, yet, please do so. The opportunities are endless and the rewards many.

And now for something completely different…

Rick's columns had a continuing thread, that of the meanings and sources of various words in the public finance vocabulary. I will leave you with one or more of my favorite lines from various sources. Today, it's from *Monty Python and the Holy Grail*. "Your mother was a hamster and your father smelt of elderberries." For those not familiar with this movie (or Monty Python generally), this somewhat curious insult (along with others) is hurled by a French soldier at King Arthur when the King and his entourage of knights come upon a castle in their search for the Holy Grail. Totally meaningless, yes, I agree, but truly memorable.

Now, Rick, how did I do?

December 2021

2021-2022 NABL President's Speech

Ann D. Fillingham
Dykema Gossett PLLC, Lansing, Michigan

I can't tell you all how happy I am to be here today. I am deeply honored to be named NABL's 43rd President. Welcome to everyone here in Chicago today, and welcome to everyone joining us virtually.

Teri and (i) the chairs of our three 2021 conferences, Karen Jordon, Deanna Gregory and Sani Williams, (ii) the Education and Member Services Committee, under the leadership of Allison Benge, and (iii) our great NABL staff, have all done an outstanding job of ensuring we could all stay connected, at least electronically, over the past two years. I personally believe, however, that there is no substitute for the learning and comradery that is forged when we have the opportunity to actually gather as some of us are doing today. I believe our opportunities to do so will continue to improve over the coming months.

Thirty years ago this spring I attended my first NABL conference, the Fundamentals of Municipal Bond Law, in New Orleans. The blue book from that conference, with all of its gloriously highlighted and dog-eared pages, still sits on the credenza in my office. I remember coming home from that conference so excited. The band at Tipatina's had been great, but more importantly, I had found my people. I had come to the conference knowing next to nothing, with 1,000 questions I asked rather indiscriminately. I left with a solid understanding of the legal framework of our market. More importantly, I left impressed with the openness and professionalism of NABL and its members, committed to making our profession and each other better.

Fast forward ten years. I was still attending conferences regularly, soaking up information like a sponge and picking the brains of my contemporaries and those more seasoned than me with abandon. I strongly encourage you to do the same. I learned a lot. I was also starting to feel some guilt about the entirely one-way nature of my participation, so I started volunteering to speak on panels and to be a team member on small projects. I was amazed to find how much I continued to learn. Again, I strongly encourage you to do the same.

Fast forward another ten years. I began participating in conference leadership, then board leadership, where I have had the privilege to serve under some true industry thought leaders: Tony Martini, Ken Artin, Cliff Gerber, Sandy MacLennan, Dee Wisor, Rich Moore, and Teri Guarnaccia. To all of you, thank you for your leadership and insight. It has been absolutely invaluable. Thanks too, to our currently retiring Board members, Sara Buss and Mike Bailey. It has been a true pleasure to work with you both over the years.

We sometimes take for granted, but never should, the organizational leadership of our Chief Operating Officer, Linda Wyman, and our Meetings and Sponsorship Director, Susan Zelner. Your contributions are always exemplary, but that has been particularly true as you both deftly navigated the NABL ship through the rough seas of the pandemic. We

were sorry to lose our Director of Government Affairs, Jessica Giroux, to the MSRB earlier this year, but we are delighted to welcome Brian Egan as our new DGA. Brian, please stand and raise your hand. If you haven't yet met Brian, please find time to do so this week.

Brian has already been hard at work on Capitol Hill on the infrastructure and reconciliation packages, and as we move into the new fiscal year, I have outlined our priorities to continue to include:

1. Protecting the Tower Amendment;
2. Preserving the tax-exemption of municipal bonds; and
3. Educating and informing the public about the unique legal constructs of our market.

When we speak with lawmakers and their staff, we remind them that NABL's position at the intersection of federal, state and local finance and policy concerns allows us to bring valuable insight to discussions related to public finance. Those education and advocacy efforts are ongoing as we deal with everything under discussion in Washington D.C., including the possibility of some updated and expanded public finance tools that help build strong, economically vibrant communities.

Our Governmental Affairs Committee, which is chaired by Keirston Woods, helps coordinate our D.C. outreach and congressional delegation meetings with NABL members. If you are interested in participating, I encourage you to reach out to either Keirston or Brian.

Our Securities Law Committee, under the leadership of Brian Garzione, has also been busy. The committee is finalizing a white paper on underwriter due diligence in competitive and negotiated sales. Stay tuned! The paper will be available on the NABL website and is a very worthwhile read. NABL and the committee have engaged in, and hope to continue to engage in, discussions with the Commission regarding climate change disclosure issues in the municipal marketplace. The committee has also begun projects on official statement Risk Factors
disclosure and development of a model Continuing Disclosure Undertaking, so look for those additional releases in the coming months.

Big things have also been underway this past year in the General Law and Practice Committee, which has been chaired by David Fernandez. Many of you may have a copy of NABL's Model Bond Opinion report in your desk. It is somewhat dated, February 14, 2003, to be exact, so this past year NABL assembled a subcommittee tasked with updating the report and recommended opinion practices, and we expect the updated report to be released shortly. Under the 2022 leadership of Kareem Spratling, I am looking forward to the continued development of a project unofficially titled To Lien or Not to Lien, which includes a helpful comparison of the distinctions between UCC commercial liens and statutory municipal bond liens, both in the ordinary state law context and in the unique chapter 9 bankruptcy context.

Not to be outdone, our Tax Law Committee, chaired by Christie Martin, recently released and submitted a compilation of proposed legislation and administrative relief useful in various disaster scenarios, as well as a letter to Congress advocating for public finance

initiatives related to tax advantaged financing. Copies of those submissions are available on the NABL website.
The Tax Law Committee will continue to work closely with our Director of Governmental Affairs and the Governmental Affairs Committee to seek opportunities to continue to educate and advocate for (i) the restoration of advance refundings, (ii) the reinstatement of direct pay bond instruments, this time better protected from sequestration, and (iii) an increase in the various bank qualified bond limitations.

I am delighted to report that our newly formed Issuer's and In-house Counsel Committee, led by Scott Ulrey and Dave Unkovic, is off to a great start. Not only are they creating a community where the perspectives of issuers can be shared with each other, they are putting together presentations, such as the one by Mark Kim of the MSRB, of interest to all NABL members. I am looking forward to the committee's continued work in establishment of an "issuer track" at the Essentials conference.

NABL's Bylaws define our purposes to include "improv[ing] the law and solv[ing] common problems related to public finance by… educating its members and others in the law related to public finance." The Education and Member Services Committee, has been ensuring that we continue to do just that. Through (i) our conferences, both in person and virtual, (ii) the NABL U NOW webinars available on demand on our website, (iii) NABL Connect, our real- time online communities, and (iv) our regular e-mail communications like the Weekly Wrap, we endeavor to meet and anticipate your educational needs.

Active member participation has been a NABL hallmark for the 30 years I have been attending NABL events. I challenge each of you to so engage, or reengage, this week and in the coming year. I guaranty you will get more out of it than you give. I know I do, and I thank my firm, Dykema, and my colleagues and friends there, for trusting my assessment and supporting my involvement.

Hopefully we are on the back end of the pandemic, and our professional lives are starting to return to what we used to call normal. I want to close with a huge shout out to Teri Guarnaccia, who didn't have a single "normal" day in her Presidency. Teri, you are an amazing human, and NABL has been extraordinarily lucky to have you. I humbly hope to adequately follow your lead.

To each of you out there, thank you again for the opportunity to be NABL's 43rd President.

October 13, 2021

Federal Securities Law:

Paul S. Maco, Bracewell LLP, Washington, D.C.

Enforcement

Speeches

The tone set at the start of the Gensler Commission might be captured in Shakespearean terms – "Cry 'Havoc!' and let slip the dogs of war …"[1]

The Gensler era of enforcement at the Securities and Exchange Commission began publicly last spring with the awkward and time consuming process of installing a new Director of the Division of Enforcement.[2] Not public, but already underway as apparent to those defending an SEC investigation, was an aggressive toughening of the investigation process as well as an increase in the severity of sanctions, penalties, and other terms of settlement sought, accompanied by a professed lack of concern of litigation risk and an eagerness to litigate. Two speeches, a mid-October speech at SEC Speaks by Gurbir Grewal, the Director of Enforcement,[3] followed by an early November speech by Chair Gensler,[4] brought out into the daylight the Commission's increasingly aggressive approach to enforcing the federal securities laws. The speeches made clear the enforcement tone is set at the top. State and local governments (and their officials) that issue municipal securities, regulated by the SEC solely through enforcement of the antifraud provisions, should pay attention. So as well should all municipal participants.

The Director of Enforcement's Speech

Enforcement Director Grewal, spoke to members of the securities industry, the defense bar, and SEC staff at the annual SEC Speaks conference about "the decline in trust in our financial markets and what we can do to restore it."[5] The SEC's Division of Enforcement, he said, is responding on three fronts: (1) an increase in corporate responsibility, through "robust enforcement of laws and rules concerning required disclosures, misuse of nonpublic information, violation of record-keeping obligations, and obfuscation of evidence from the SEC or other government agencies; (2) continuing focus on gatekeeper accountability through enforcement; and (3) crafting appropriate remedies by "requiring admissions [of violations of law] in cases where heightened accountability and acceptance of responsibility are in the public interest," use of officer and director bars, particularly where "individual is likely to have an opportunity to become an officer or director of a public company in the future," even when the individual was not "an officer or director of a public company, or indeed a public employee at

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[1] Julius Caesar, Act 3, Scene 1, line 273

[2] *See*, The Bond Lawyer, Federal Securities Law, *Transition* Vol. 45, No. 2, Spring 2021.

[3] Director Gurbil Grewal, Remarks at SEC Speaks 2021, (Oct. 13, 2021) available at: https://www.sec.gov/news/speech/grewal-sec-speaks-101321

[4] Chair Gary Gensler, Prepared Remarks At the Securities Enforcement Forum (Nov. 4, 2021), available at: https://www.sec.gov/news/speech/gensler-securities-enforcement-forum-20211104

[5] N. 1, *supra*.

all," and conduct-based injunctions. Several of these measures, such as admissions of culpability, echo practices under former Chair Mary Jo White. Something new then followed.

In the portion of his speech under the heading Trusting and Empowering SEC Staff, Director Grewal said: "[w]hile I appreciate the importance of the Wells process, there are ways we can make that process more streamlined and efficient for everyone, starting with the Wells meeting itself. There are certainly cases that present novel legal or factual questions, or raise significant programmatic issues." But when cases don't present such issues, "it is more efficient and appropriate for the Associate Director or Unit Chief to take the Wells meeting and engage in a dialogue, alongside the staff who are best positioned to assess the record."[6]

Director Grewal left unsaid which cases will fit into the box of "novel legal or factual questions" or "raise significant programmatic issues." Many state and local government issuers of municipal bonds and their officials would likely think they do, particularly given the varieties of government structures under 50 state constitutions. Unlike registered entities, aside from the antifraud provisions, no SEC statutes or rules apply to them to generate routine compliance, filing, or reporting violations. The legal issues that do arise for them will involve application of the antifraud provisions -- "facts and circumstances" as SEC staff reply when questioned on application rationale. Yet such meetings may be essential for defense counsel to explain their case to someone higher up the food chain than the Associate Director or Unit Chief. The result may turn out to be a most productive use of the Director's time and avoid a waste of the Commissioner's time. Discussions with senior officials of larger picture issues and consequences of proposed enforcement initiatives could result in changes of approach that avoid unexpected consequences requiring post-hoc clarifications by the Commission[7] and turn out in the end to be in the best interest of the Commission.

The SEC Chair's Speech

Chair Gensler chose to begin his speech with a quote from the first speech of the first SEC Chair, Joseph Kennedy: "'The Commission will make war without quarter on any who sell securities by fraud or misrepresentation'" and followed with a comment, "Kennedy's words still ring true today." [8] More on this quote below. Gensler then picked up the theme of "trust"

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[6] Id.

[7] An earlier exercise in aggressive enforcement in the municipal finance market, the Municipal Continuing Disclosure Cooperation ("MCDC") Initiative, required the *post hoc* articulation by the Commission of an analysis of materiality "distinct from the analysis required to determine whether a piece of information is material and must be disclosed to investors in offering materials." Amendments to Municipal Securities Disclosure 83 FR 44700, 44706 (Aug. 31, 2018). In N. 74, the Commission explained "The inquiry undertaken in connection with the MCDC Initiative required an assessment of whether the issuer or obligated person materially fulfilled its contractual obligations under its continuing disclosure agreement, which required a consideration of applicable state law and basic principles of contract law." By its nature MCDC did not provide for Wells meetings. Objections and clarifications that otherwise might occur in a Wells meeting were made by some submitting parties on their own initiative, not as part of the process.

[8] N. 2, supra, quote cite available at: https://www.sec.gov/news/speech/1934/072534kennedy.pdf

raised earlier by Director Grewal. “Without examination against and enforcement of our rules and laws, we can’t instill the trust necessary for our markets to thrive.” To accomplish the SEC’s mission, “our enforcement program [must] have tremendous breadth, be nimble, and penalize bad actors so we discourage misconduct before it happens” and “[bring] cases that matter.” What are cases that matter? “Deceptive conduct in the private funds space, offering frauds, accounting frauds, insider trading, market manipulation, Foreign Corrupt Practices Act cases, reporting violations, or fiduciary violations.”[9]

Chair Gensler announced four principles he had asked the Enforcement Division to consider when investigating misconduct and making recommendations to the Commission.

First is *economic realities*. Simply, “[w]hen I see a bird that walks like a duck and swims like a duck and quacks like a duck, I call that bird a duck.”

Second is *accountability*. He echoes themes sounded earlier by Director Grewal:

> We’ll use all of the tools in our toolkit to investigate wrongdoing and hold bad actors accountable — including administrative bars, penalties, injunctions, or undertakings, where appropriate. We’ll be prepared to litigate or seek a robust finding of facts if we settle. The public benefits, and justice benefits, from the robust finding of facts.”

Third is “*high-impact cases*,” different from “cases that matter” mentioned earlier. He states:

> We will continue to pursue misconduct wherever we find it. That will include the hard cases, the novel cases, and, yes, the high-impact cases — whether in special purpose acquisition companies; cyber; crypto; or private funds; whether accounting fraud, insider trading, or recordkeeping violations. I know, recordkeeping violations might come as a surprise. While these may not grab the headlines, the underlying obligations are essential to market integrity, particularly given technological developments.

Such cases “change behavior … send a message to the rest of the market, to participants of various sizes, that certain misconduct will not be permitted.” To remove any doubt as to the message he intends to send, he follows this point with “some market participants may call this ‘regulation by enforcement.’ I just call it ‘enforcement.’”

Fourth is *process*. Chair Gensler notes that he has emphasized three matters of process to both the Divisions of Enforcement and Examinations:

- Timeliness, or “bringing matters to resolution swiftly;”

[9] Id.

- Other Law Enforcement Agencies, or "benefit from working in parallel with our fellow federal agencies, law enforcement authorities at the state level, international regulators, and self-regulatory organizations;" and
- Sourcing of Cases, "from other law enforcement agencies and self-regulatory organizations … tips, complaints, and referrals of our robust whistleblower program … self-reporting …" cooperation such as "steps … that help us to identify additional misconduct."[10]

Timeliness is noteworthy. Typical of many enforcement investigations is a long silence between the completion of document production and subsequent contact from the SEC staff. But this is not what Chair Gensler seeks to curtail. Rather, quite the opposite.

> As the old legal saying goes, justice delayed is justice denied. The defense bar often makes a strategic decision to burn clock … Thus, I've asked staff to cut back on meetings with entities that want to discuss arguments in their Wells submissions. I believe it's important for the people closest to these cases to be making decisions and eliminating unnecessary process.

"I just call it 'enforcement'," economic realities, accountability, high impact cases, and process – the tone of both speeches is consistent with the arrival of the "new sheriff in town" a typical ingredient of changes in administration. Attention, change ahead! Seasoned defense counsel and securities industry veterans, who comprised much of both audiences come to expect such alerts, particularly from Democratic administrations.[11] "I just call it enforcement" is tough language as used in the Chair's speech. Such language may be understandable when the activities are clearly intentional fraud or blatant breaches of trust. Similarly, aggressive language should not be surprising while asserting jurisdiction as a security over, for example, cryptocurrency issuance and trading. The decision by the SEC of what is "unnecessary process" appears one-sided and likely differs substantially depending upon the point of view.

"War without quarter" is an interesting choice of phrase. Hyperbole was not unwarranted when employed by the first SEC Chair. The SEC and Joe Kennedy were brand new regulators, the first federal agency to regulate the securities markets. The SEC and its chair faced determined opposition. Financial markets were unregulated at the federal level, Congressional hearings continued following the 1929-32 crash, industry resistance to federal regulation was intense. Combat metaphor was not uncommon.[12] Whatever its inadequacies, the current state of financial market regulation is far better than in 1935. Almost ninety years

[10] Id.
[11] Disclosure point. Although not a political appointee, my SEC service was during Democratic administrations.
[12] See, e.g. Felix Frankfurter's June 10, 1935 assessment of the atmosphere in Washington "From now on it must be to a large extent trench warfare." Felix Frankfurter letter to Jerome Frank, June 10, 1935, Frankfurter Papers, Container No. 55, Library of Congress, quoted in Seligman, The Transformation of Wall Street, p. 122 (3d. Ed., 2003).

later, use of combat metaphor is common in modern sports commentary and, increasingly, politics. The horrific reality of some combat metaphor is dulled by overuse. There are, without a doubt, bad actors and bad entities in today's markets. But many passing through the SEC enforcement mill are, at the end, negligent or reckless, if not vindicated as innocent, and not evil. The SEC takes the words of its regulatory subjects quite seriously, and appellate courts have reminded the SEC "word choices have consequences."[13] Yet I doubt in this instance Chair Gensler means literally what he says. The literal meaning of "war without quarter" – as Wikipedia explains "a victor gives no quarter when the victor shows no clemency or mercy and refuses to spare the life in return for the surrender at discretion (unconditional surrender) of a vanquished opponent"[14] – is also a war crime.[15]

Not every securities issuer, advisor, or broker-dealer is engaged in novel or exotic activity, nor can many bankroll a pushback against regulatory overreach all the way through final outcome of litigation. This new tone may signal trouble for otherwise unregulated entities such as municipal bond issuers should Enforcement hear a go-ahead for example, to pursue charges previously brought against public companies based on violation of regulations not applicable to the unregulated municipal entity. Much will rest on the discretion and judgment of the now-empowered staff of the Division of Enforcement as well as the level of attention each Commissioner devotes in considering the enforcement recommendations they receive. Hopefully, the Division and the Commission also retains in their book of motivational proverbs another old saying "haste makes waste."

Cases

Before the close of its 2021 fiscal year, the Commission announced several enforcement matters involving the municipal market. One matter worth reading closely in light of the views and instructions of the SEC Chair and Director of the Enforcement Division discussed above is In the Matter of *Sweetwater Union High School District*[16] and the accompanying Complaint, *Securities and Exchange Commission v. Karen Marie Michel*.[17] Both are described in a Press Release *SEC Charges School District and Former Executive with Misleading Investors in Bond Offering*.[18]

As the Press Release describes:[19]

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[13] SEC v. Tambone, 597 F.3d 436, 443 (1st Cir. 2010).
[14] https://en.wikipedia.org/wiki/No_quarter
[15] https://casebook.icrc.org/glossary/quarter-denial
[16] Securities Act Rel. No 10981 (Sept 16, 2021)
[17] USDC SD Cal. Case No. 3-21-cv-01623-L-BGS
[18] Press Release 2021-178 (Sept. 16, 2021) *available at*: https://www.sec.gov/news/press-release/2021-178 . Both the Order and the Complaint
[19] Id.

the SEC charged a San Diego County school district, Sweetwater Union High School District, and its former Chief Financial Officer, Karen Michel, with misleading investors who purchased $28 million in municipal bonds.

According to the SEC's complaint against Michel and its order against Sweetwater, in April 2018, Sweetwater and Michel provided investors with misleading budget projections that indicated the district could cover its costs and would end the fiscal year with a general fund balance of approximately $19.5 million, when in reality the district was engaged in significant deficit spending and on track to a negative $7.2 million ending fund balance. The order finds that Michel managed the bond offering for the district and was aware of reports showing that the projections were untenable and contradicted by known actual expenses. Nevertheless, as stated in the order, Sweetwater and Michel included the projections in the April 2018 bonds' offering documents and also provided them to a credit rating agency that rated the district, while omitting that the projections were contradicted by internal reports and did not account for actual expenses. Additionally, the complaint alleges that Michel signed multiple certifications falsely attesting to the accuracy and completeness of the information included in the offering documents.

The SEC's complaint against Michel, filed in U.S. District Court for the Southern District of California, charges her with violating Section 17(a)(3) of the Securities Act of 1933. Without admitting or denying the allegations in the complaint, Michel agreed to settle with the SEC and to be enjoined from future violations of the charged provision as well as from participating in any future municipal securities offerings. She also agreed to pay a $28,000 penalty.

Sweetwater also agreed to settle with the SEC and consented, without admitting or denying any findings, to the entry of an SEC order finding that it violated Sections 17(a)(2) and 17(a)(3) of the Securities Act, and requiring it to engage an independent consultant to evaluate its policies and procedures related to its municipal securities disclosures.

Several details of the settlement are worth noting. First, the Order[20] is regarding the School District, a separate complaint against the former school CFO in federal district court. The School District's future conduct, including an order "to cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act" is in the Order. The remedial measures against the CFO will be in an injunctive order issued by the federal judge assigned the case. That court order will also impose a $28,000 penalty and enjoin her from participating in any future municipal securities offerings as well as future violations of Section 17(a)(3) of the Securities Act. That is a "Conduct based injunction"

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[20] In full, the "Order Instituting Cease-And-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Making Findings, and Imposing a Cease-and-Desist Order."

as described by Director of Enforcement Grewal in his speech summarized above. The Order contains detailed findings regarding conduct of both the School District and the CFO, to which the School District consented without admitting or denying. The Complaint provides a detailed description of the conduct alleged against the CFO. These are "robust findings of fact" as the accountability called for by Chair Gensler, also described above. For example, paragraph 20 states:

> Michel or others acting at her direction also provided this same inaccurate information, while Michel simultaneously attested to its accuracy, to the professionals facilitating the offering, including the underwriter and its counsel, bond counsel, disclosure counsel, and Sweetwater's municipal advisor (collectively, the "Bond Deal Team Members"). These disclosures were misleading and deceptive in light of the facts that Sweetwater and Michel were aware of information indicating that the budget projections underestimated the actual expenses already incurred, and that Sweetwater and Michel knew that the District had no processes for incorporating actual expenses into its interim reports.

The Securities Act Section 17(a)(3)[21] violation is also worth noting. It has been used before, in the settled cease and desist proceeding In the Matter of *Montebello Unified School District and Anthony James Martinez*[22] finding a violation of and imposing an order that Superintendent of Schools Martinez cease and desist from committing or causing any violations and any future violations of Section 17(a)(3) of the Securities Act.

Happy Holidays

December 2021

[21] Under Securities Act Section 17(a)(3), "It shall be unlawful for any person in the offer or sale of any securities … (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

[22] Securities Act Rel. No. 10690, Exchange Act Rel. No. 87006 (Sept. 19, 2019)

Federal Tax Law: The Tax Microphone (A Postscript)

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The past three months have seen significant legislative activity relating to tax-advantaged bonds for infrastructure, including the enactment of the Infrastructure Investment and Jobs Act. On the administrative front, the Treasury Department and Internal Revenue Service have released a very modest amount of guidance concerning tax-exempt bonds.

The Infrastructure Investment and Jobs Act

On November 15, 2021, President Biden signed into law the Infrastructure Investment and Jobs Act.

As we all know by now, the Infrastructure Investment and Jobs Act is much more modest regarding additional authority for tax-advantaged bonds than had been hoped for by the public finance industry. It increases the volume cap for one type of existing qualified private activity bond and authorizes two new types of qualified private activity bonds, as described below, but does not include other new authorizations for tax-advantaged bonds.

The Infrastructure Investment and Jobs Act increases the national cumulative volume cap limitation amount for qualified private activity bonds for highway or surface freight transportation facilities under sections 142(a)(15) and 142(m) of the Internal Revenue Code from $15 billion to $30 billion.

The two new types of qualified private activity bonds are for (1) qualified broadband projects (proposed new sections 142(a)(16) and 142(n)) and (2) qualified carbon dioxide capture facilities (proposed new sections 142(a)(17) and 142(o)). Each new type has detailed requirements for the qualification of the targeted facility.

The proposed provisions for qualified broadband project bonds generally follow the Rural Broadband Financing Flexibility Act previously introduced by Senators Hassan (D-NH) and Capito (R-WV). The requirements for a qualified broadband project are basically intended to target eligibility to broadband projects for areas that are currently underserved. The legislation includes notification requirements to broadband providers to help to meet that objective.

The provisions for qualified carbon dioxide capture bonds generally follow the Carbon Capture Improvement Act previously introduced by Senators Bennet (D-Colo.) and Portman (R-Ohio). The requirements for qualified carbon dioxide capture facilities are much more detailed and technically complex.

In the Fall 2021 edition of *The Tax Microphone* I offered certain initial observations about how these new provisions may be applied. The proper interpretation of these complex new rules will likely continue to be a topic for many years to come.

Other Impacts of the Infrastructure Investment and Jobs Act

This is the most significant federal infrastructure legislation in decades and will certainly affect the public finance industry in numerous and fundamental ways. For example, the Infrastructure Investment and Jobs Act contains a number of modifications to the Transportation Infrastructure and Finance Act and other similar provisions that may expand the availability of low-cost federal loans for projects. Consideration of the many public finance implications and effects of the legislation other than the tax rules for tax-advantaged bonds is beyond the scope of this column.

Build Back Better Act Approved by the House of Representatives

On November 19, 2021, the United States House of Representatives passed a version of the of the massive legislation known as the Build Back Better Act (H.R. 5376). As of the date of this edition of *The Tax Microphone,* it is uncertain whether or how the legislation will proceed in the Senate. Because the fate of this legislation is currently uncertain and additional changes in the legislation are likely if it is enacted, this column provides a brief summary only of those tax provisions most directly relevant to public finance.

First, the legislation would favorably modify the so-called "50 percent test" in section 48(h)(4)(B) of the Code that allows a low-income housing tax credit on the entire eligible basis of a building without an allocation from a state or local housing credit agency so long as 50 percent or more of the aggregate basis is financed with tax-exempt bonds. For buildings that are financed with proceeds of tax-exempt bonds issued under section 142(d) of the Code in calendar year 2022 through 2026, the percent limitation would be lowered to 25 percent. Such a change would clearly increase the overall tax subsidy relating to the issuance of tax-exempt multifamily housing bonds issued under section 142(d) and likely tend to increase the demand for issuance of such bonds, although perhaps at a lower principal amount per transaction. The legislation would also make a number of other revisions to the rules for the low-income housing tax credit.

Second, the legislation would rationalize the federal tax rules for Indian Tribal Government bonds to make the rules more similar to the rules that apply to bonds issued by states and local governments. Among other things, the legislation would provide for a national volume cap for qualified private activity bonds issued by Indian Tribal Governments. The volume cap would be allocated by the Secretary of the Treasury "among all Indian Tribal Governments seeking such an allocation in a particular year under regulations prescribed by" the Treasury Department. No portion of the volume cap could be allocated to bonds financing certain gaming facilities. The legislation further would eliminate the requirement applicable to most Indian tribal government tax-exempt bonds to finance an "essential governmental function" and the special rules for Indian Tribal Government bonds issued to finance manufacturing facilities and for tribal economic development bonds.

The legislation of course contains a host of other provisions relevant to public finance, including a proposed corporate alternative minimum tax of 15 percent.

Much to the initial excitement of the public finance industry, earlier versions of the legislation contained a number of favorable provisions for tax-advantaged bonds that largely fulfilled the industry's wish list. These provisions included (1) authorization of a new type of direct-pay bonds for qualified infrastructure, (2) reauthorization of tax-exempt advance refunding bonds, (3) favorable modifications to the requirements for "bank qualified bonds" under section 265(b) of the Code, (4) favorable modifications to the requirements for qualified small issue bonds for manufacturing facilities, (5) exemption of certain water and sewage facility bonds from volume cap requirements, and (6) authorization of a new type of exempt facility bonds for zero-emission infrastructure. All were jettisoned as a part of the process to reduce the cost of the legislation.

Perhaps the most colorful, if harshly blunt, description of the Build Back Better abandonment of tax-advantaged bond provisions was set forth in an October 28, 2021, article in *Bloomberg News*:

> "Like a scene in a movie that wasn't crucial, muni provisions got left on the cutting room floor," said Eric Kazatsky of Bloomberg Intelligence. "This speaks to the growing divide between the importance of these provisions to MuniLand and perhaps the lack of importance to everyone else."

The task faced by NABL, and the rest of the public finance industry, may be to convince "everyone else" that they, too, actually do live in "MuniLand."

Some Observations on the Proliferation of Different Volume Cap Rules

One of the most important and interesting aspects of the provisions for the two new types of qualified private activity bonds authorized in the Infrastructure Investment and Jobs Act is the exemption of 75 percent of the principal amount of each type from the volume cap requirement. This treatment could reasonably be viewed as in increase in volume cap of somewhat indeterminate size. (Consider that, if the Code were modified to provide that such treatment applied to all types of bonds currently subject to the volume cap, the volume cap would in substance be about four times greater.) The alternative approaches Congress could have taken include (1) increasing the amount of volume cap allocated to states to provide for the increased issuance of the new types of bonds or (2) the authorization of a new special volume cap for each new type of bond. The intent of the chosen treatment (the 75 percent exclusion) likely was to "scale" the volume cap subsidy, such that the issuance of the new types of qualified private activity bonds would be favored over bonds subject to volume cap without any such exclusion. Whether these new types of bonds will in fact be favored by state and local governments allocating volume cap remains an open question.

The enacted legislation also makes qualified broadband project bonds completely exempt from volume cap if the facility is owned by a governmental unit. It is not clear whether qualified broadband projects will be the types of projects that will readily lend themselves to governmental ownership.

On the whole, the partial exemption approach taken by the Infrastructure Investment and Jobs Act at least avoids some of the practical problems incident to the authorization of special volume caps for different types of bonds, particularly if the additional volume cap allocations are relatively modest. Special volume caps for particular types of tax-advantaged bonds have been enacted in the past (for example, for qualified tax credit bonds). In practice, those volume cap allocations often were fragmented into small amounts that were cumbersome to use effectively.

The approach taken in the Infrastructure Investment and Jobs Act for qualified highway or surface freight transportation facility bonds, by contrast, is to authorize a special volume cap (an increase of volume cap from $15 billion to $30 billion). The increased special volume cap, however, continues to be a national volume cap allocated by the Department of Transportation. The approach of a national volume cap administered by the federal government at least tends to avoid the practical problem of "fragmenting" the available volume cap in a manner that makes it cumbersome and inefficient to use. One downside of that approach, at least as a policy matter, is that the provision could be viewed as less in the spirit of federalism than volume cap allocated to the states, because the federal government decides which projects will receive the federal tax benefits rather than allocating states and local governments. So far, however, I haven't heard much complaining that the national volume cap approach pays less deference the spirit of federalism and to the roles of the states; most have simply welcomed the increased volume cap allocation.

Another issue lurking in the recent enacted and proposed legislation relating to national volume caps is what federal agency or agencies should most properly allocate the different types of volume cap. The volume cap for qualified highway and surface freight transportation bonds is allocated by the Department of Transportation. The proposed national volume cap for Indian Tribal Government Bonds would be allocated by the Treasury Department. By contrast, the special national volume cap for tribal economic development bonds is currently allocated by the Treasury Department "in consultation with the Secretary of Interior." To my way of thinking, the allocation of volume cap by an agency other than the Treasury Department tends to give bond authorizations more of a flavor of federal grant programs than allocations of volume caps by the federal government that are not based on a policy review of the merits of different proposed projects.

Private Letter Ruling on the Private Security or Payment Test

In PLR 2021144007 (November 5, 2021) the IRS considered the application of the private security or payment test under section 141(b)(2) of the Code to a proposed issue of tax-exempt governmental bonds of a water utility system. A portion of the proceeds of the bond issue was to be used to finance the replacement of privately-owned lead service lines ("LSL") with new copper service lines. The issuer expected the bond issue would meet the private business use test (presumably because more than 10 percent of the proceeds would be used to finance the new copper service lines).

The question presented by the private letter ruling was whether the bond issue would also meet the private security or payment test (and thereby fail to qualify as a tax-exempt

governmental bond). The issuer argued to the IRS that none of the payments should be taken into account, on the theory that all customer payments should be regarded as in respect of water service, and not as payments in respect of the LSLs. Because the costs of the bond-financed LSLs were clearly to be repaid by customer payments, however, the IRS rejected that approach, and determined at least certain customer payments would need to be considered as private payments (and security).

The bonds were secured by and payable from utility payments made by all customers of the utility, including customers who owned the bond-financed LSLs and other customers that did not own the bond-financed property. The private letter ruling analyzed the payments by separating them into three categories: payments from (1) customers that do not receive LSL replacements, (2) customers who receive LSL replacements and are not private business users (that is, residential users not using their residences in a trade or business), and (3) customers who receive LSL replacements and are private business users. The private letter ruling determined only the last category (payments from customers owning bond-financed property) would need to be taken into account as private payments or security. The IRS further concluded that only payments by those customers "attributable to the costs of replacing LSLs" would need to be taken into account as private payments or security (and not the customer payments "attributable" to the delivery of water service). Under that approach, the IRS accepted the determination of the issuer that the percentage of private payments would not exceed 10 percent of the debt service on the bonds, and accordingly determined that the bonds would not be treated as private activity bonds.

Although the result seems reasonable enough, the private letter ruling does not fully explain the analysis under the private activity bond regulations. One question raised is that the private activity bond regulations clearly provide that, at least in some circumstances, payments from persons who are not private business users of bond-financed property do need to be taken into account as private payments if those payments are "in respect of" property used for a private business use. As is cited in the private letter ruling, Treasury Regulation 1.141-4(c)(2)(i)(A) expressly provides that "payments for a use of proceeds include payments (whether or not to the issuer) in respect of property financed (directly or indirectly) with those proceeds, even if not made by a private business user." Example 5 under Treasury Regulation section 1.141-4(g) is captioned "Payments from users of proceeds that are not private business users taken into account." In that example, a city finances a hospital with an issue of governmental bonds. The hospital is managed by a private person under a management contract that causes the hospital to be treated as a used for a private business use. The example concludes that all payments made by users of the hospital (which presumably mostly consist of the general public) need to be treated as private payments because "revenues from the hospital are in respect of property used for a private business use." The private letter ruling contains no discussion distinguishing this example. At a minimum, the private letter ruling appears to conclude in substance that the scope of the rule stated in Example 5 is limited. One possible analysis could be that payments from those customers who are not actual owners of the LSL replacement lines should not be taken into account as private payments because such users might be properly regarded as not using the replacement LSL lines in any respect. The private letter ruling expressly states,

however, that the issuer determined the lead from LSL lines could "leach into the water supply, causing a health risk" presumably for all customers (although that fact is not clearly stated). In that sense all customers, regardless of whether they are owners of the LSL replacement lines, would possibly benefit from the bond-financed property (and are all also paying for it). The private letter ruling does state, in summary fashion, that payments from customers who are not owners of the LSL replacements are "not using the LSL Replacements and therefore, not using proceeds of the Bonds that financed the LSL Replacements."

The private letter ruling might have distinguished Example 5 by suggesting the payments from the general public for use of the hospital in Example 5 need to be taken into account as private payments because those payments should be deemed to be first received by the manager, but no such distinguishing analysis is set forth in the private letter ruling.

The possible basis in the regulations for the argument that the payments attributable to LSLs should be completely disregarded is also not fully explored in the private letter ruling. In particular, Example 4 under Treasury Regulation section 1.141-4(g) (captioned "Payments not in respect of financed property") might be viewed as providing a basis for such an analysis. In that example, a city issues assessment bonds to move electric utility lines underground. Although the electric utility lines are owned by a nongovernmental utility company, the company is under no obligation to move the lines. The debt service on the bonds is paid by assessments levied by the city on customers of the utility. The example concludes that, although the utility lines are privately owned and the utility customers make payments to the utility company for use of those lines, the assessments payments are treated as payments "in respect of the cost of relocating the utility line" and not as payments "made in respect of property used for a private business use." Arguably, the payments by utility customers in the private letter ruling could be similarly regarded. In substance, the private letter ruling might be viewed as a narrow reading of the favorable example set forth in Example 4.

Another key aspect of the analysis in the private letter ruling that is not explained is the basis for determining which portion of the customer payments made by owners of the bond-financed property are "attributable" to the LSL replacements and which portion are attributable to water service. For example, an allocation based on relative capital costs of assets used to provide the water service might be reasonable, but no method is described. Instead, the private letter ruling somewhat summarily states that the issuer determined the "attributed" payments would be less than 10 percent, without explaining how the attribution was made.

Private letter rulings are not required to include a complete and robust discussion of the tax analysis, but have often included a much more fulsome analysis. In any event, the private letter ruling is favorable, and will likely be the subject of some lively discussions in future NABL panels.

New Form 8038-CP

On October 25, 2021, the IRS released a new draft Form 8038-CP, Return for Credit Payment of Issuers of Qualified Bonds, including a new Schedule A, Specific Tax Credit Bonds

Interest Limit Computation, and related draft instructions. The IRS has indicated that issuers should use the January 2022 version of Form 8038-CP for submissions received by the IRS starting in January 2022 and that using a prior form may cause a delay in processing a request for credit payment.

Although the new Form 8038-CP does not yet implement electronic filing, it was prepared in light of anticipated electronic filing requirements.

As was discussed in the last edition of *The Tax Microphone* on July 23, 2021, the Treasury Department and IRS published proposed regulations that would require electronic filing for a number of different types of federal tax returns. Qualified tax credit bonds and other tax-advantaged bonds are covered by the proposed regulations. Prop. Reg. 301.6011-11. The proposed regulations more specifically provide that the Form 8038-CP for Build America Bonds and direct-pay tax credit bonds would generally be required to be filed electronically if the issuer is required to file at least 10 federal tax returns of any type during the calendar year. The proposed regulations further provide that the IRS may prescribe, for additional forms for tax-advantaged bonds (including tax-exempt bonds), the same type of requirement to file electronically.

The proposed regulations would apply to tax-advantaged bond returns required to be filed after the later of December 31, 2021, or the date of publication of final regulations.

Bob Griffo of the IRS helpfully described the anticipated release of this new form at "The Commissioner's Side" panel at this year's Workshop. The IRS also provided educational Zoom meetings in November to explain the new form.

The new draft form and further information can be found at https://www.irs.gov/tax-exempt-bonds/tax-exempt-bonds-community-updates

P.S.

Finally, I have been musing about what to call this second last edition of *The Tax Microphone*. After all, I previously reported that the last edition of *The Tax Microphone* would be my last edition, but here I am again -- back once more, but now as a temporary bridge to my esteemed successor in this endeavor.

I originally thought that "coda" (Italian for "tail") would be appropriate (as in *Tax Microphone Coda*). Then I discovered that prominent examples of "codas" include such things as the finale of Mozart's Jupiter symphony, and quickly concluded that description would be a bit too grand. "Codetta" had some appeal (a "little coda" or a "dominant-tonic cadence at the end of an exposition"), but still too grand for this humble column.

Then I thought that it might be best to choose a description in a vernacular most readily digestible by bond lawyers: something along the lines of "*First Supplement to Tax Microphone*"

or "*Addendum to Tax Microphone*." I am in the process of moving on from all that, however, so that approach did seem so apt either.

Next, it occurred to me that some country or popular song might be a good reference point (as in *Goodbye Tax Microphone, Again).* It turns out that there are indeed a number of songs titled "Goodbye Again" or "Fairwell Again", as you might expect. I have never been a big fan of Bob Denver, however, so I passed over that one.

It also occurred to me that movies possibly could offer inspiration (as in *Tax Microphone II* or *The Return of Tax Microphone*, or even *Tax Microphone Resurrection*). To dramatic, I decided.

Finally, I settled on that old friend "postscript." At first, I thought that "postscript" would be too dated, a vestige of a prior era, but then I realized that is largely its charm. After all, who needs a postscript anymore in the age of universal word processing software? The postscript was originally used when, after meticulously writing out a letter in longhand, a correspondent had a further thought (it was harder to revise the main text in those days). I have had the small delight to discover, however, that the postscript is having something of a Renaissance. Many marketers now recommend adding a "p.s." to letters, even though entirely unnecessary. It turns out that many people are far more likely to read the postscript than the text of a letter itself – perhaps because the reader may think that a p.s. is actually a personal note directed specifically to the reader or perhaps because the harkening back to a bygone era has some intrinsic appeal. (Try this on your clients sometime.) Besides, the Fall edition of *The Tax Microphone* is as good as set in stone, much like a letter written in longhand. A "postscript" has something of the same pre-digital retro allure as analog LPs. Perhaps you can imagine why that might appeal to me. "Postscript" it is.

p.s. Thanks again.

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