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Editor's Notes

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

Welcome to the Winter 2022 Edition of *The Bond Lawyer*.

In this Edition

First and foremost, welcome and thanks to Tony Martini (aka Antonio D. Martini) who makes his debut as the federal tax columnist for *The Bond Lawyer*. Tony is a partner at Hinckley Allen in the Boston office. He is a familiar face (and voice) at NABL educational events. He has also served as Editor-in-Chief of NABL's Federal Taxation of Municipal Bonds and Chair of NABL's 2008 Tax and Securities Law Institute (now known as The Institute), as well as serving on the NABL Board of Directors from 2009 through 2016, including as President of NABL from 2014 to 2015. He is also a (very fine) Fellow of the American College of Bond Counsel. For his debut column, Tony provides the highlights of the final LIBOR transition regulations, as well as the extension of certain pandemic-related temporary relief and ….drum roll please…. the now permanent authorization for telephonic TEFRA public hearings.

Paul Maco's column in this edition is thoughtful and comprehensive, as usual. Paul delves into the recent SEC enforcement action against a Texas school district and certain individuals, as well as proposed SEC rules in the corporate market regarding cybersecurity and climate-related disclosure. As Paul points out, the proposed corporate rules are not applicable to municipal securities, however, we tend to look to corporate rules as a resource to analyze disclosure issues on the municipal side. The question to be pondered is how useful these newly proposed rules, including, in particular, the proposed rule regarding climate disclosure, will be in the context of municipal issuers and municipal securities.

In Honor of NABL's Women Leaders

March is Women's History Month which, according to information on https://womenshistorymonth.gov/ is to commemorate and encourage "the study, observance and celebration of the vital role of women in American history." Women have played a vital role in NABL's history, in particular. Ruth T. West, from King & Spalding in Atlanta, was Chair of the 1978 Bond Attorney's Workshop and played an important role in the establishment of NABL as an independent organization. When NABL was incorporated on February 5, 1979, Ruth West would serve as an inaugural Director and NABL's first Treasurer, but it would be 7 years before the late Sharon Stanton White was elected NABL's 8th (and first female) President in 1986. Any discussion of women's involvement in NABL's history is incomplete without mentioning the late Rita J. Carlson, NABL's first Executive Director, and the first NABL person I ever encountered. Below is the current list of female Presidents of NABL. Many more women have served on the NABL Board and in other leadership roles in NABL since 1979 and this March (and every month of every year, for that matter), we celebrate their contributions.

1986-87 Sharon Stanton White, San Francisco, CA
1992-93 M. Jane Dickey, Little Rock, AR
1996-97 Julianna Ebert, Milwaukee, WI
2002-03 Helen C. Atkeson, Denver, CO

2003-04 Linda B. Schakel, Washington, DC
2006-07 Carol L. Lew, Newport Beach, CA
2009-10 Kathleen C. McKinney, Greenville, SC
2011-12 Kristin H.R. Franceschi, Baltimore, MD
2017-18 Alexandra M. MacLennan, Tampa, FL
2020-21 Teri M. Guarnaccia, Baltimore, MD
2021-22 Ann Fillingham, Lansing, MI

What's all this talk about MSG?

Okay, you should read that headline in your best Emily Litella[1] voice. Yes, of course, I mean ESG, one of the issues "de jour" in the securities market, both corporate and municipal. ESG is an interesting discussion topic because it has two separate vantage points for discussion about materiality and disclosure. The concept of materiality, in its simplest form, is tied to what information would be important to a "reasonable investor" in making an investment decision. This appears pretty straightforward until you consider there are two distinct camps of investors relative to ESG—the credit-based investor who is interested in little beyond the value of and return on the investment, and the values-based investor who is motivated by sustainable investing in securities that are consistent with the investor's own value system. Assessing materiality with the credit investor as your target investor is no different than the disclosure of any other material credit risk under existing anti-fraud rules. With the values-based investor, however, the information important to that investment decision may go beyond "will my bonds be paid" to include more detailed information about the use of proceeds and related data, metrics, and intangibles concerning the impact of the investment.

Has the ESG conversation changed who the proverbial "reasonable investor" is? Is the "reasonable investor" different in the context of "labelled" bonds (e.g. "green bonds" and "social bonds") versus non-labelled bonds? If an issuer is not specifically marketing bonds to the values-based investor is there a need to address the relative environmental or social impacts of the anticipated financing? This question led to an interesting discussion at the 2022 NABL Institute, during which the counter question was raised as to whether an issuer has an obligation to disclose if the proposed financing will NOT have a positive social impact (could we label those as "anti-social" bonds?). Any discussion of materiality invariably leads to a "facts and circumstances" qualified answer. From a credit risk disclosure prospective (which in the municipal market currently seems to relate primarily to climate and other environmental risks), one would think the analysis is the same regardless of the label or lack thereof. However, if an issuer chooses to seek out the values-based investor by attaching a "look at me" label on its bond issue, then (to state the obvious) the additional information that might not be material to a credit investor is nevertheless part of the disclosure document and, as such, subject to the anti-fraud rules. I don't think we are at the point today where a disclaimer is necessary in non-labelled municipal bond transactions but there is concern that the boisterous ESG bandwagon may be headed in a direction that conflates the two vantage points.

[1] For our younger readers, Emily Letilla was a character created and performed by Gilda Radner on Saturday Night Live in the 1970's.

Adding to the ball of ESG confusion, are a growing number of third party firms providing risk assessment tools and "scores" to market participants, including brokers, institutional investors, analysts, lenders and, yes, corporate and municipal issuers. This was alluded to at the NABL Institute as something that may create "information asymmetry" in the municipal market where some investors may have access to more information provided by these third party firms than, perhaps, the retail investor. That may lead one to ask one of my older son's favorite retorts as a child, "So what and a half?". Should the fact third party companies are selling ESG "scores" or analytic software to brokers, analysts, and others somehow obligate or compel municipal issuers to "level the playing field" by providing (and in many instances, creating) data, metrics and additional analytics not necessarily related to credit risk? The quest to eradicate "information asymmetry" in the securities market was part of the justification for the relatively recent amendments to SEC Rule 15c2-12 regarding the disclosure of the incurrence of financial obligations (if material) and has become something of a recurring battle cry in terms of disclosure proposals. However, in the context of ESG disclosure, beyond credit-related risks, is it appropriate for the burden to be placed on municipal issuers?

The SEC appears poised to regulate some aspects of ESG disclosure in the corporate market which, according to the SEC Investment Advisory Committee recommendation on the topic, is something the SEC has been dancing around the fringe for close to 50 years.[2] The Committee's recommendation for regulation did not include specific disclosure points but rather suggested the SEC seek input from the market, which the SEC did in March 2021.[3] Likewise, in December 2020, the SEC Asset Management Advisory Committee released "potential" recommendations regarding ESG disclosure.[4] And, not to be left out, the Municipal Securities Rulemaking Board has now also requested comment on all things ESG.[5] Both the SEC and MSRB requests have generated significant comments, some more interesting than others. See Paul Maco's column in this edition for more on the SEC's newly issued proposal in the corporate market.

Second Last Thoughts

Speaking of the 2022 NABL Institute (May 3-4, 2022), a loud shout out to Mary Beth Orsini, Hillary Phelps, the entire NABL Institute Faculty, and the NABL staff for a successful conference. It was great to see "full size" people, as opposed to digital images in a box on an iPad. The presentations were informative, as well as thought-provoking and/or entertaining. I particularly liked the "Coffee Talk Sessions" Friday morning, which were reminiscent of (much) earlier NABL Workshop panels. I am told the CLE regulators in some states do not provide credit for sessions not set up "classroom style" so this type of session, while incredibly valuable, is limited.

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[2] See "Recommendation from the Investor-as-Owner Subcommittee of the SEC Investor Advisory Committee Relating to ESG Disclosure (As of May 14, 2020), available at www.sec.gov/spotlight/investor-advisory-committee-2012/recommendation-of-the-investor-as-owner-subcommittee-on-esg-disclosure.pdf.

[3] See, https://www.sec.gov/sec-response-climate-and-esg-risks-and-opportunities.

[4] U.S. Securities and Exchange Commission Asset Management Advisory Committee Potential Recommendations of ESG Subcommittee December 1, 2020, available at https://www.sec.gov/files/potential-recommendations-of-the-esg-subcommittee-12012020.pdf.

[5] See MSRB Notice 2021-17, issued December 8,2021. https://www.msrb.org/-/media/Files/Regulatory-Notices/RFCs/2021-17.ashx?

And now for something completely different…

In the Fall 2021 Edition, I closed with a favorite line from *Monty Python and the Holy Grail* which, of course, led to a few emails from Python fans with their own favorite lines. For this edition, I leave you with a snippet from a different corner of the literary universe. The late John Prine was a singer-songwriter who, for five decades, according to his April 2020 obituary in Rolling Stone magazine[6], "wrote rich, plain-spoken songs that chronicled the struggles and stories of everyday working people and changed the face of modern American roots music." As an interesting aside (at least for me), Prine's longtime bassist, David Jacques, is the brother of Hubert Jacques who was a longtime member of the Orange County, Florida, Comptroller's Office. Hubert arranged for my husband and me to meet John Prine (and Hubert's brother) after his concert at the Florida Theater in Jacksonville, Florida, many, many years ago. Sadly, that was prior to cell phones having reliable cameras.

One of my favorite John Prine songs is "Please Don't Bury Me"[7] which Prine described as the "best organ donor campfire song." [8] The line "Throw my brain in a hurricane" is a sentiment some of us may have shared in the midst of a challenging deal or two and I found myself repeating several times while watching the SEC's open meeting webcast March 21, 2022, during which the SEC considered the proposed rules on climate disclosure. Concerns about copyright laws prevent me from providing the lyrics (only lawyers think about stuff like that), so feel free to Google™ it, look it up on YouTube™, or just go to www.JohnPrine.com.

And, with that, please enjoy the rest of the Winter 2022 Edition.

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[6] https://www.rollingstone.com/music/music-country/john-prine-obit-253684/ Accessed 2-8-2022.

[7] Copyright Sour Grapes Music, Inc. (ASCAP), Walden Music Inc. (ASCAP). For more about John Prine, go to https://www.johnprine.com/ and www.ohboyrecords.com.

[8] See, https://genius.com/John-prine-please-dont-bury-me-lyrics. Accessed 3-8-2022.

Federal Securities Law:

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

There is much to report this quarter on activity at the Securities and Exchange Commission. New enforcement actions against a school district, its Chief Financial Officer, and the engagement partner of its outside auditor[1] underscore the SEC's focus on misleading financial reporting and use of aggressive enforcement tactics and settlement terms under Chair Gensler, as described in last quarter's column.[2] Two new rulemakings are underway, with the potential to indirectly influence municipal issuer disclosure on cybersecurity risk management[3] and climate change related disclosures, [4] respectively. In addition, SEC Commissioner [5] and OMS and Enforcement[6] Director and Staff changes have occurred or been announced.

Enforcement

On March 16, 2022, Crosby Independent School District ("Crosby" or the "District"), a public school district based in Crosby, Texas, in anticipation of SEC enforcement proceedings, consented to the entry of an order against it ("Crosby Order").[7] The Crosby Order finds that Crosby violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Section 17(a) of the Securities Act. The text of the Crosby Order findings describes both Crosby's disclosure based violations in January 2018 bond documents under Securities Act § 17(a)(2) and Rule 10b-5(b) and "transactions, practices, and a course of business that operated as a fraud or deceit" violations of Securities Act § 17(a)(3) and Rule 10b-5(c).

Simultaneously, the SEC filed a complaint against Carla Merka, the former Chief Financial Officer for the District , in U.S. District Court for the Southern District of Texas (the "Merka Complaint"),[8] charging her with violating the antifraud provisions of the federal securities laws. Subject to court approval, Merka has agreed to pay a $30,000 penalty, be permanently enjoined from violating Securities Act § 17(a), Exchange Act § 10(b) and Rule 10b-5 thereunder, and permanently barred from participating in any offering of municipal securities.

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[1] SEC Charges Texas School District and its Former CFO with Fraud in $20 Million Bond Sale, available at: https://www.sec.gov/news/press-release/2022-43.

[2] *See*, The Bond Lawyer, Federal Securities Law, *Enforcement* Vol. 45, No. 4, Fall 2021.

[3] Proposed Rule: Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure, Release Nos. 33-11038; 34-94382; IC-34529 (Mar. 9, 2022), as referred to herein, the " Cybersecurity Proposing Release".

[4] See Fact Sheet, Enhancement and Standardization of Climate-Related Disclosures regarding Release No. 33-11042, available at: https://www.sec.gov/files/33-11042-fact-sheet.pdf.

[5] SEC Commissioner Lee Plans To Step Down As Term Expires, available at: https://www.law360.com/securities/articles/1473959/sec-commissioner-lee-plans-to-step-down-as-term-expires

[6] Dave A. Sanchez to Lead Office of Municipal Securities, available at: https://www.sec.gov/news/press-release/2022-44 ; Ernesto A. Lanza Named Acting Director of OMS replacing Rebecca J. Olsen named Deputy Chief for the Division of Enforcement's Public Finance Abuse (PFA) Unit, replacing Mark R. Zehner, who retired, available at: https://www.sec.gov/news/press-release/2021-251.

[7] In the Matter of *Crosby Independent School District*, Sec. Act Rel. No. 11039, Exchange Act Rel. No. 94425, Order Instituting Cease-and-Desist Proceedings, Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order (Mar. 16, 2022).

[8] SEC v. Carla Merka, Civil Action No.: 4-22-cv-841, (TXSD, Houston, Mar. 16, 2022).

In addition, Shelby L. Lackey, formerly a partner in a national audit firm who served as the engagement partner on and had final audit responsibility over the District's 2017 audit engagement, consented to the entry of an order finding she engaged in improper professional conduct pursuant to Section 4C(a)(2) of the Exchange Act and Rule 102(e)(1)(ii) of the Commission's Rules of Practice and imposing remedial sanctions against her, including denial of the privilege of appearing or practicing before the Commission as an accountant, with the ability to petition for reinstatement three years after the date of the order (the "Auditor Order").[9] Ms. Lackey also entered an undertaking to "not serve as the engagement manager, engagement partner, or engagement quality control reviewer in connection with any audit expected to be posted in the MSRB's Electronic Municipal Market Access system ("EMMA") until reinstated to appear before the Commission as an independent accountant,"[10] which the Commission considered in determining whether to accept her offer of settlement.[11]

According to the SEC's narrative presented in the Crosby Order and the Merka Complaint:

> In 2013, Crosby issued $86.5 million in municipal bonds (the "2013 Bond") to fund various capital projects, including the construction of a baseball and softball complex and renovations to its football stadium. The District hired a general contractor and a project and risk manager to undertake these projects, which were expected to be completed by May 2017. Crosby's then-Superintendent was actively involved in the construction projects, and personally directed contractors to perform project enhancements outside the original scope of work, which inflated the total cost of the projects. In part because of the project enhancements, the District exhausted the 2013 Bond proceeds prematurely, leaving the General Fund as the only available source of funding for approximately $12 million of future construction commitments.[12] By August 31, 2016, Crosby's then fiscal year-end, the District's General Fund lacked sufficient funds to cover the $12 million of future construction expenses required to complete its capital projects. For multiple reasons, including to increase General Fund reserves and pay for the 2013 Bond construction projects, Merka suggested, and Crosby's Board approved, changing the District's fiscal year-end date from August 31 to June 30. Merka incorrectly believed that shifting the fiscal year-end would create "a one-time savings" of approximately $10 million. While the change shortened Crosby's FY 17 to 10 months – from September 1, 2016 to June 30, 2017 – it did not generate the savings needed to cover the construction commitments, and the District concluded its FY 17 with a decrease in General Fund reserves of $5.2 million.[13] Crosby's teacher salaries represented a majority of the District's expenses. Teachers earn their salaries over a 10-month contract period corresponding with the start and end of the school year, though they were paid evenly over a 12-month period ending in mid-August. [14]

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[9] In the Matter of *Shelby L. Lackey, CPA*, Exchange Act Rel. No. 94426, Acct. and Auditing Enforcement Rel. No. 4289 Order Instituting Public Administrative Proceedings Pursuant to Section 4C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions (Mar. 16, 2022).
[10] Auditor Order ¶ 29.
[11] Id ¶ 30.
[12] Merka Complaint, ¶¶ 10 &11.
[13] Id.¶
[14] Crosby Order, ¶ 11.

When Crosby moved its fiscal year-end date, however, Crosby concluded fiscal year 2017 with unpaid payroll obligations related to the 2017 contract year (amounts paid in July 2017 and August 2017), Crosby failed to include these unpaid payroll liabilities in its fiscal year 2017 financial statements.[15] Crosby knew that the change in fiscal year-end date would result in a payroll liability for teacher salaries, but did not properly account for it. Crosby and Merka also knew that Crosby's auditor incorrectly believed that all contractual employees had been paid in full as of June 30, 2017. Merka never corrected this misunderstanding, nor did Merka calculate her own payroll liability. Instead, Crosby recorded only a $30,000 payroll liability related to hourly employees. Merka knew that the payroll liability was understated, but still signed a management representation letter falsely asserting that, among other things, the fiscal year 2017 financial statements were presented in accordance with GAAP and that the District's net position and fund balance had been properly reported.[16]

On January 18, 2018, Crosby issued $20 million of Unlimited Tax School Building Bonds to pay its outstanding construction liabilities and to fund new capital projects. Crosby's false and misleading fiscal year 2017 financial statements were appended to the official statement used to market the bonds to investors. Crosby's fiscal year 2017 audited financial statements understated payroll and construction liabilities by $3.8 million and $7.9 million, respectively. These errors resulted in an overstatement of Crosby's General Fund reserves by $11.7 million. Most importantly, Crosby's fiscal year 2017 financials reported a positive General Fund balance when it should have reported a negative one. Crosby's official statement also disclosed information concerning the District's fiscal year 2017 deficit.[17]

As CFO, Merka had ultimate responsibility over Crosby's fiscal year 2017 financial statements. She was responsible for reporting on financial issues to Crosby's Board and was Crosby's primary contact during the bond financing process. Merka and other officers from Crosby reviewed Crosby's official statement prior to its release to prospective investors. Crosby's then Board President signed Crosby's official statement used to market the bonds to investors. Crosby knew that its fiscal year 2017 financial statements were false and misleading, yet submitted them to the bond financing team for inclusion in the offering documents. In fact, Merka did not invite its external auditor to meetings with the bond financing team despite Crosby's municipal advisor making such a request. Nor did Merka reveal in communications with ratings agencies the District's true financial condition.[18]

Crosby's superintendent resigned in January 2018. Merka resigned at the end of May 2018 and accepted a CFO position at another independent school district in Texas. Crosby hired a new CFO and Superintendent, who assumed their positions in June and July 2018, respectively.[19] Shortly after arriving in June 2018, Crosby's new CFO discovered the payroll and construction liability errors and confronted the District's auditor about the

[15] Id.
[16] Id. ¶ 12.
[17] Id. ¶ 13.
[18] Id. ¶¶ 14 &15.
[19] Merka Complaint, ¶ 26.

> significant financial shortfalls.[20] In August 2018, Crosby's leadership disclosed the financial issues to its Board and the public, and began crafting a financial recovery plan with its financial advisor. On September 25, 2018, Moody's downgraded Crosby's bonds from A1 to A3 and placed the rating under review for further possible downgrade. In December 2018, Moody's changed its outlook on the 2018 Crosby bonds to "negative." In February 2019, the District's auditor issued its audit report for Crosby's FY 18 financial statements, which included material restatements of the FY 17 ending balances. On October 8, 2018, Crosby's Board declared a financial exigency with the Texas Education Agency (TEA), which allowed the District to implement a mid-year reduction in force. On December 6, 2018, S&P downgraded Crosby's bonds to A- from AA- due to "the district's rapid deterioration of reserves stemming from overspending, overestimating revenues, and a mistake in the audit that led to a negative prior period adjustment and the depletion of reserves." S&P also changed its outlook on Crosby bonds from "stable" to "negative."[21] Crosby's declaration of financial exigency required that a monitor from the Texas Education Agency oversee the District's finances and efforts to achieve financial solvency; the monitor is still in place.[22]

Crosby was not penalized, nor were undertakings imposed. The violations found, of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Section 17(a) of the Securities Act, are the full scope available to the Commission under the antifraud provisions of federal securities law, as is the order to cease and desist from committing or causing any violations and any future violations of those provisions. The Crosby Order states "In determining to accept the Offer, the Commission considered remedial acts undertaken by Respondent and cooperation afforded the Commission staff."[23]

The narrative presented by the SEC in the extracts of the Crosby Order and Merka Complaint provided above illustrates application of the Gensler Commission enforcement program articulated in speeches by the Chairman and Director of Enforcement as described in last quarter's column.[24] The matters involve accounting fraud, a topic included by Chair Gensler in "cases that matter" and "high-impact cases."[25] The consequences include Gensler's tools for accountability: administrative bars (Lackey), financial penalties (Merka), injunctions (Merka), and undertakings (Lackey). The narrative in both the Crosby Order and Merka Complaint as well as the Auditor Order is specific with respect to the respondents interaction with other parties, including the bond financing team, municipal advisor, and rating agencies, as the narrative in In the Matter of *Sweetwater Union High School District*[26] and the accompanying Complaint, *Securities and Exchange Commission v. Karen Marie Michel*[27] discusses in last quarter's column.[28]

Rulemaking

As noted in prior columns, since municipal securities offerings are almost always exempt from registration with the SEC, the amendments have no mandated impact on municipal securities disclosure. While line-

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[20] Id., ¶ 27.
[21] Id., ¶¶ 28 &29.
[22] Crosby Order ¶ 17.
[23] Crosby Order, ¶ 21.
[24] N. 2, *supra*.
[25] Id.
[26] Securities Act Rel. No 10981 (Sept 16, 2021)
[27] USDC SD Cal. Case No. 3-21-cv-01623-L-BGS
[28] N. 2, *supra*.

item disclosure requirements do not apply to municipal securities disclosure, aspects of line item disclosure, such as Regulation S-K, may be worthy of consideration when analyzing a new, rapidly developing, or infrequently addressed disclosure topic. In March, 2022, the Commission proposed such rulemakings regarding disclosure of Cybersecurity and Climate Change.

Cybersecurity

On March 9, 2022, the SEC proposed rules to enhance and standardize disclosures regarding cybersecurity risk management, strategy, governance, and cybersecurity incident reporting by public companies that are subject to the reporting requirements of the Exchange Act. Comments are due 30 days after publication in the Federal Register or May 9 (which is 60 days after issuance), whichever is later.[29]

At the outset, the Cybersecurity Proposing Release explains that there are no disclosure requirements in Regulation S-K or S-X that explicitly refer to cybersecurity risks or incidents, over the past decade the Commission and staff have issued interpretive guidance concerning the application of existing disclosure and other requirements under the federal securities laws to cybersecurity risks and incidents. Specifically, in 2011, the Division of Corporation Finance issued interpretive guidance ("2011 Staff Guidance"), providing the Division's views concerning operating companies' disclosure obligations relating to cybersecurity risks and incidents.[30]

In 2018, recognizing the "the frequency, magnitude and cost of cybersecurity incidents," and the need for investors to be informed about material cybersecurity risks and incidents in a timely manner, the Commission issued interpretive guidance ("2018 Interpretive Release") to assist operating companies in determining when they may be required to disclose information regarding cybersecurity risks and incidents under existing disclosure rules.[31]

The proposed rules, as described in the Cybersecurity Proposing Release, would require current and periodic reporting of material cybersecurity incidents; periodic disclosures about a registrant's policies and procedures to identify and manage cybersecurity risk, including the impact of cybersecurity risks on the registrant's business strategy; management's role and expertise in implementing the registrant's cybersecurity policies, procedures, and strategies; and the board of directors' oversight role, and cybersecurity expertise, if any.[32] Specifically, the SEC proposes to:

[29] N. 3, *supra*. The Federal Register publication has not occurred as of the date of submission of this article.

[30] *See* CF Disclosure Guidance: Topic No. 2- Cybersecurity (Oct. 13, 2011), *available at* https://www.sec.gov/divisions/corpfin/guidance/cfguidance-topic2.htm.

[31] *See* Commission Statement and Guidance on Public Company Cybersecurity Disclosures, Release No. 33-10459 (Feb. 26, 2018) No. 33-10459 (Feb. 21, 2018) [83 FR 8166], *available at* https://www.sec.gov/rules/interp/2018/33-10459.pdf. In 2018, the Commission also issued a Report of Investigation pursuant to Section 21(a) of the Exchange Act regarding certain cyber-related frauds perpetrated against public companies and related internal accounting controls requirements. The report cautioned that public companies subject to the internal accounting controls requirements of Exchange Act Section 13(b)(2)(B) should consider cyber threats when implementing their internal accounting controls. The report is based on SEC Enforcement Division investigations that focused on business email compromises in which perpetrators posed as company executives or vendors and used emails to dupe company personnel into sending large sums to bank accounts controlled by the perpetrators. *See Report of Investigation Pursuant to 21(a) of the Securities Exchange Act of 1934 Regarding Certain Cyber-Related Frauds Perpetrated Against Public Companies and Related Internal Accounting Controls Requirements*, SEC Release No. 34-84429 (Oct. 16, 2018).

[32] Cybersecurity Proposing Release, p 20.

- Amend Form 8-K to add Item 1.05 to require registrants to disclose information about a cybersecurity incident within four business days after the registrant determines that it has experienced a material cybersecurity incident;[33]

- Amend Forms 10-Q and 10-K to require registrants to provide updated disclosure relating to previously disclosed cybersecurity incidents, as specified in proposed Item 106(d) of Regulation S-K. We also propose to amend these forms to require disclosure, to the extent known to management, when a series of previously undisclosed individually immaterial cybersecurity incidents has become material in the aggregate.[34]

- Amend Form 10-K to require disclosure specified in proposed Item 106 regarding:

    - A registrant's policies and procedures, if any, for identifying and managing cybersecurity risks;[35]

    - A registrant's cybersecurity governance, including the board of directors' oversight role regarding cybersecurity risks;[36] and

    - Management's role, and relevant expertise, in assessing and managing cybersecurity related risks and implementing related policies, procedures, and strategies.[37]

- Amend Item 407 of Regulation S-K to require disclosure about if any member of the registrant's board of directors has cybersecurity expertise.[38]

- Amend Form 20-F to require foreign private issuers ("FPIs")[39] to provide cybersecurity disclosures in their annual reports filed on that form that are consistent with the disclosure that we propose to require in the domestic forms;

- Amend Form 6-K to add "cybersecurity incidents" as a reporting topic; and

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[33] Proposed Item 1.05. Item 1.05 would require a registrant to disclose the following information about a material cybersecurity incident, to the extent the information is known at the time of the Form 8-K filing:

- When the incident was discovered and whether it is ongoing;
- A brief description of the nature and scope of the incident;
- Whether any data was stolen, altered, accessed, or used for any other unauthorized purpose;
- The effect of the incident on the registrant's operations; and
- Whether the registrant has remediated or is currently remediating the incident.

[34] Proposed Item 106(d) of Regulation S-K.

[35] Proposed Item 106(b) of Regulation S-K.

[36] Proposed Item 106(c)(1) of Regulation S-K.

[37] Proposed Item 106(c)(2) of Regulation S-K.

[38] Proposed Item 407(j).

[39] An FPI is any foreign issuer other than a foreign government, except for an issuer that (1) has more than 50% of its outstanding voting securities held of record by U.S. residents; and (2) any of the following: (i) a majority of its officers or directors are citizens or residents of the U.S.; (ii) more than 50% of its assets are located in the U.S.; or (iii) its business is principally administered in the U.S. *See* 17 CFR 230.405. *See also* 17 CFR 240.3b4(c).

- Require that the proposed disclosures be provided in Inline XBRL.[40]

The Cybersecurity Proposing Release provides examples of cybersecurity incidents that may require disclosure:

- An unauthorized incident that has compromised the confidentiality, integrity, or availability of an information asset (data, system, or network); or violated the registrant's security policies or procedures. Incidents may stem from the accidental exposure of data or from a deliberate attack to steal or alter data;

- An unauthorized incident that caused degradation, interruption, loss of control, damage to, or loss of operational technology systems;

- An incident in which an unauthorized party accessed, or a party exceeded authorized access, and altered, or has stolen sensitive business information, personally identifiable information, intellectual property, or information that has resulted, or may result, in a loss or liability for the registrant;

- An incident in which a malicious actor has offered to sell or has threatened to publicly disclose sensitive company data; or

- An incident in which a malicious actor has demanded payment to restore company data that was stolen or altered.

The SEC proposes to define cybersecurity incident as "an unauthorized occurrence on or conducted through a registrant's information systems that jeopardizes the confidentiality, integrity, or availability of a registrant's information systems or any information residing therein." The SEC believes this term is sufficiently understood and broad enough to encompass incidents that could adversely affect a registrant's information systems or information residing therein, such as gaining access without authorization or by exceeding authorized access to such systems and information that could lead, for example, to the modification or destruction of systems and information. The SEC also proposes to define information systems as "information resources, owned or used by the registrant, including physical or virtual infrastructure controlled by such information resources, or components thereof, organized for the collection, processing, maintenance, use, sharing, dissemination, or disposition of a registrant's information to maintain or support the registrant's operations."[41]

Notably, the proposed Item 1.05 of 8-K would not provide for a reporting delay when there is an ongoing internal or external investigation related to the cybersecurity incident. The Cybersecurity Proposing Release references the 2018 Interpretive Release, while an ongoing investigation might affect the specifics in the registrant's disclosure, "an ongoing internal or external investigation – which often can be lengthy – would not on its own provide a basis for avoiding disclosures of a material cybersecurity incident."[42] Additionally, any such delay provision could undermine the purpose of proposed Item 1.05 of providing timely and consistent disclosure of cybersecurity incidents given that investigations and resolutions of

[40] Proposed Rule 405 of Regulation S-T.

[41] Cybersecurity Proposing Release, n. 51, p. 26.

42 *See supra* note 31, 2018 Interpretive Release.

cybersecurity incidents may occur over an extended period of time and may vary widely in timing and scope.[43]

Climate Change

On March 21, 2022, the Commission voted in open meeting to propose amendments that would enhance and standardize registrants' climate-related disclosures for investors. A Fact Sheet[44] prepared in advance of the meeting describes the proposed amendments that would require a domestic or foreign registrant to include certain climate-related information in its registration statements and periodic reports, such as on Form 10-K, including:

- Climate-related risks and their actual or likely material impacts on the registrant's business, strategy, and outlook;

- The registrant's governance of climate-related risks and relevant risk management processes;

- The registrant's greenhouse gas ("GHG") emissions, which, for accelerated and large accelerated filers and with respect to certain emissions, would be subject to assurance[45];

- Certain climate-related financial statement metrics and related disclosures in a note to its audited financial statements; and

- Information about climate-related targets and goals, and transition plan, if any.

According to the Fact Sheet, the proposed disclosures are similar to those many companies already provide based on broadly accepted disclosure frameworks, such as the Task Force on Climate-Related Financial Disclosures and the Greenhouse Gas Protocol. The proposing release has been published on SEC.gov[46] and will be published in the Federal Register. The comment period will remain open for 30 days after publication in the Federal Register, or 60 days after the date of issuance and publication on sec.gov, whichever period is longer.

Litigation Update

A final update on *Securities Industry and Financial Markets Association v. Securities and Exchange Commission.*[47] On February 18, 2022, the Court filed a Per Curiam Judgment (without memorandum) dismissing SIFMA's petition for review as moot.[48] The heart of the judgment follows:

> In August 2020, the Securities Industry and Financial Markets Association petitioned for review of that 2020 Order and asked us to vacate it. But between then and now, at the

[43] Cybersecurity Proposing Release, p. 27.
[44] N. 4, supra Available at: https://www.sec.gov/files/33-11042-fact-sheet.pdf
[45] "Assurance" refers to the attestation reports from an independent attestation service provider covering, at a minimum, Scopes 1 and 2 emission disclosure; see Fact Sheet pages 2 and 3 under the caption "Presentation and Attestation of the Proposed Disclosures.
[46] Available at: https://www.sec.gov/rules/proposed/2022/33-11042.pdf.
[47] C.A. D.C. Docket No. 20-1306, filed August 14, 2020.
[48] C.A. D.C. Docket No. 20-1306, Document #1935747

end of 2020, the Order expired as planned. That expiration provided the Association with the relief it sought.

The Association argues that two exceptions to the normal rules of mootness allow us to opine on the Order's legality.

First, the Association points to the voluntary-cessation doctrine. "That concept governs the case in which the defendant actor is not committing the controversial conduct at the moment of the litigation, but the defendant is free to return to its old ways — thereby subjecting the plaintiff to the same harm but, at the same time, avoiding judicial review." *True the Vote, Inc. v. IRS*, 831 F.3d 551, 561 (D.C. Cir. 2016) (cleaned up). But that doctrine does not apply here, where the SEC set the Order's expiration date before the Association petitioned for review. "[N]on-reenactment of a one-time condition that expired of its own terms cannot be viewed as cessation of conduct." *Clarke v. United States*, 915 F.2d 699, 705 (D.C. Cir. 1990).

Second, the Association relies on the capable-of-repetition-yet-evading-review doctrine. That exception to mootness applies to repeatable conduct that "is *by its very nature short in duration*, so that it could not, or probably would not, be able to be adjudicated while fully live." *Pharmachemie B.V. v. Barr Lab'ys, Inc.*, 276 F.3d 627, 633 (D.C. Cir. 2002) (cleaned up). But here, the Association has not offered any evidence that short durations are "typical of" exemptions from registration requirements for broker-dealers. *See Del Monte Fresh Produce Co. v. United States*, 570 F.3d 316, 322 (D.C. Cir. 2009). It has not pointed to a pattern of short time periods for similar orders. And it has not argued that the statute puts time limits on such orders.

In short, the voluntary-cessation exception to mootness does not apply because the SEC set the Order's expiration date before the Association petitioned for review. And the capable-of repetition-yet-evading-review exception does not apply because the Order was not "by its very nature short in duration." *Pharmachemie B.V.*, 276 F.3d at 633 (cleaned up).

We dismiss the petition for review as moot.

Commission Changes

Commissioners

On March 15, 2022 the SEC posted the following statement by Commissioner Allison Herren Lee, a Democrat, on her planned departure:

> My term as Commissioner expires in June of this year, and I have notified President Biden that I intend to step down from the Commission once my successor has been confirmed. Serving investors and the public as a Commissioner and as Acting Chair has been an extraordinary honor. My fellow Commissioners and the Commission staff are dedicated and tireless public servants, and working alongside them has been the privilege of a lifetime. Over the coming weeks and months, I will remain actively engaged in the

> Commission's critically important work, and I look forward to continued progress in advancing the Commission's regulatory agenda.[49]

Commissioner Lee has been an aggressive advocate of Climate and ESG related disclosure and enforcement. As Acting Chair of the Commission in February 2021, Acting Chair Lee directed the Division of Corporation Finance to enhance its focus on climate-related disclosure in public company filings.[50] In March 2021, she requested the Commission staff to evaluate our disclosure rules with an eye toward facilitating the disclosure of consistent, comparable, and reliable information on climate change.[51] Commissioner Lee's announcement above states that she will step down from the Commission once her successor has been confirmed. Commission action on the proposed rules regarding climate chance disclosures may likely occur before her departure. The issue, among others, will likely be a focus on hearings to replace her as well as Commissioner Roisman, whose last day as a Commissioner was January 21, 2022.[52]

Office of Municipal Securities and Enforcement

On December 3, 2021, the SEC issued a press release announcing that Ernesto A Lanza would serve as acting Director of the Office of Municipal Securities, replacing Rebecca J. Olsen, who was named Deputy Chief for the Division of Enforcement's Public Finance Abuse (PFA) Unit. Mark R. Zehner, who held the PFA role since July 2010, is retiring from the agency after 25 years of service. Chair Gensler said:

> "I look forward to working closely with Ernie on oversight of municipal securities. This critical $4 trillion market finances local governments and the essential infrastructure of our communities, such as roads, hospitals, and schools. I thank Rebecca for her leadership of OMS since 2018 and congratulate Mark on his retirement from the SEC."[53]

On December 6, 2021, Commissioners Peirce, Roisman, Lee, and Crenshaw issued a *Joint Statement of Appreciation for Rebecca Olsen's Service as Director of the Office of Municipal Securities*:[54]

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[49] Available at: https://www.sec.gov/news/statement/lee-20220315

[50] Statement on the Review of Climate-Related Disclosure, available at: https://www.sec.gov/news/public-statement/lee-statement-review-climate-related-disclosure.

[51] Public Input Welcomed on Climate Change Disclosures, available at: https://www.sec.gov/news/public-statement/lee-climate-change-disclosures.

[52] Commissioner Roisman's departing statement was posted on his departure date: On my final day at the Commission, I cannot help but reflect on what an incredible privilege it has been to work here, both as a staffer and a Commissioner. For the past several years, I have served as a temporary steward of this important agency, with a job to uphold and further the SEC mission: to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. To me, this mission has meant much more than its handful of words—it encapsulates critical elements for a successful economy and country. I will always be grateful for the time I have been able to work alongside my fellow Commissioners and the thousands of dedicated SEC staff, who not only believe in this mission, but unceasingly demonstrate their commitment to it through action. Available at: https://www.sec.gov/news/statement/roisman-departure-statement-012122

[53] N. 6, *supra*.

[54] "We want to thank Rebecca Olsen for her exceptional leadership in the Office of Municipal Securities. Rebecca has been a mainstay of the office for many years, ultimately rising to the role of Director in 2018. Her passion for the markets and protecting investors has shone through her work, and we are grateful that she will continue serving the Commission as Deputy Chief for the Division of Enforcement's Public Finance Abuse Unit," available at: https://www.sec.gov/news/statement/joint-statement-rebecca-olsen-20211206.

On March 16, 2022, the SEC issued a press release announcing that Dave A. Sanchez will return to the SEC to serve as Director of the Office of Municipal Securities (OMS) effective April 11.[55] Sanchez currently advises municipal issuers, broker-dealers and municipal advisors as a Senior Counsel at Norton Rose Fulbright US LLP.

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[55] Dave A. Sanchez to Lead Office of Municipal Securities, available at: https://www.sec.gov/news/press-release/2022-44.

Federal Tax Law: The Tax Microphone, "Redux"

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Let me begin this column, my first in *The Bond Lawyer*, by saluting my friend and predecessor in this space, Mike Bailey. For all his affability, modesty and apparent taciturnity, Mike has always struck me as a bond tax lawyer with a real fire in the belly for all things 103. For years, NABL members have been the beneficiaries of his incisive analysis of developments in the federal tax law affecting tax-exempt (and other tax-benefited) obligations of state and local governments, not only in *The Tax Microphone* column, but at countless NABL seminars, on NABL Tax Committee projects and initiatives and, more broadly, during his years of service on the NABL Board of Directors. I had the good fortune to work across the table from Mike over the years on a handful of financings, and I can attest to Mike's thorough and thoughtful approach to the work, and to finding solutions for the good of all the participants on those transactions. I'm sure NABL's membership will want to join me in wishing Mike the very best in his new, "post-Microphone" chapter of life!

Speaking of "*The Tax Microphone*", I should note that after several weeks of musing on the question, I've decided to stick with the moniker. Frankly, I couldn't come up with a better handle for the column—The 103 Megaphone? The Tax Law Telegram? The Private Activity Register? The Arbitrage Intelligencer? The Imputed Proceeds Avalanche? The Federal Tax Law Tombstone? For this first go-round, I've tacked on the modifier "redux" (from the Latin *reducere*, meaning "to lead back"), which, to the extent it appears at all in modern usage, signifies a thing brought back or revived. Of interest to some, the *Merriam-Webster Dictionary* advises that "redux" is a word that "belongs to a small class of English adjectives that are always used 'postpositively'—that is, they always follow the word they modify." Be that as it may, for succeeding columns, and with another tip of the cap to Mike Bailey, I expect to revert to the simpler, unadorned appellation of "*The Tax Microphone*".

With that, I will move on to developments in the over the last several months.

Final Treasury Regulations for LIBOR Transitions

The most notable recent development, by far, is the release in Treasury Decision 9961 (December 30, 2021) of final regulations addressing the ongoing transition from and elimination of certain "interbank offered rate" (IBOR) quotations, including the London Interbank Offered Rate (LIBOR) reference rates used in so many financial instruments in world markets, including, (but not by any means limited to) tax-exempt bonds issued by state and local governmental issuers in our domestic markets, and the many interest rate derivative contracts relating to such bonds. The final rulemaking, which is largely captured in new Treasury Regulations Section 1.1001-6, provides standards for determining whether the modification of the terms of a financial instrument, such as a tax-exempt bond or an interest rate swap contract, to replace references to an IBOR with a new reference rate, either at the time of modification or thereafter, will trigger a "realization event" that could necessitate the recognition of income, or of a deduction or gain or loss item, for federal income tax law purposes.

As applied in the field of tax-exempt finance, these regulations are intended to govern whether bonds with LIBOR-indexed interest rates must be treated as reissued when the parties to the bonds modify their terms to provide for a successor index rate, such as the Secured Overnight Financing Rate (SOFR), or whether the interest rate swap contracts related to those bonds have been materially modified when something comparable is done with respect to the LIBOR benchmarks they reference. On the whole, these rules appear to live up to the advertising of our old friend, John Cross, the former Treasury Department official in charge of directing federal tax policy for tax-exempt bonds, who assured us a number of years back that the tax regulators were developing helpful guidance that would provide an assurance, in most (if not all) cases, that modifications of bonds to implement a LIBOR transition would not result in a pesky, and possibly overlooked, reissuance of the bonds in question, or that a similar modification of a bond-related interest rate swap would necessitate a fresh analysis under Treasury Regulations Section 1.148-4(h) and a possibly a re-identification in order to maintain its "qualified hedge" status.

The new regulations follow the promulgation of proposed regulations in October 2019 on the same subject matter, reflecting an adoption of the proposed rules, with certain changes, and offering additional guidance on the inclusion of "fallback" language in a financial instrument that is designed to take effect with respect to an IBOR succession occurring after the date of modification of the instrument. The release of this guidance, which applies to modifications of financial instruments on and after March 7, 2022, is particularly timely as banking regulators have prescribed the cessation of publication of U.S. dollar-denominated overnight, one-month, three-month, six-month and twelve-month rates no later than June 30, 2023.

Overall, the final regulations appear to follow the design of the 2019 proposed regulations, although there are notable changes. For example, the final regulations do away with the contrast in the proposed regulations between debt contracts and non-debt contracts (keep in mind that these rules are intended to address modifications to all sorts of LIBOR-referencing instruments that may affect tax reporting for a U.S. taxpayer, not just tax-exempt debt obligations); the final regulations instead employ a broad "contract" terminology that is meant to cover insurance contracts, corporate stock, leases and other financial arrangements that reference IBORs, in addition to bonds, notes and interest rate derivative contracts.

For our purposes, though, the most significant evolution in the final regulations, compared to the 2019 proposed regulations, is the helpful jettisoning of the requirement for testing fair market value equivalency (comparing the modified financial instrument to the unmodified one) in connection with modifications to effectuate a LIBOR transition. This development may come as a relief to some financial advisors, as they will no longer be asked to "step up to the plate" with fair market valuation certifications with respect to LIBOR-transitional modifications to bond documents. In general this should enhance the administrability of these rules from the viewpoint of bond counsel, though for business reasons some issuers and borrowers may still seek independent advice regarding the comparability of the new reference rate formula in their bond and swap instruments to the prior LIBOR-based formula. The final regulations manage to dispense with fair market value concepts by employing the notion of "covered modifications" to identify LIBOR-related modifications that will not trigger a realization event for federal tax law purposes, and by excluding from the definition of "covered modifications" certain specified changes to financial instruments that are treated as "excluded modifications" that may trigger a realization event under the generally-applicable rules of Treasury Regulations Section 1.1001-3. In doing so, Treasury appears to have taken a rough justice approach to approximate the outcomes that would have obtained under the explicit fair market valuation standards of the 2019 proposed regulations.

Covered Modifications and Associated Modifications

Under the final regulations, a "covered modification" is generally defined as any modification of a financial instrument: (1) to replace a discontinued IBOR with a "qualified rate"; (2) to provide a "qualified rate" as a fallback to a discontinued IBOR; or (3) to replace a discontinued IBOR that serves as a fallback in the instrument with a "qualified rate". In connection with each of the foregoing, the final regulations contemplate that the parties may make "associated modifications" that are reasonably necessary to adopt or implement a covered modification, including for the making of an "incidental" cash payment by one counterparty to the other to cover "small" differences in the valuation of the modified instrument compared to the instrument's value prior to modification, without triggering a realization event. These definitional provisions also contemplate that a "covered modification" can be accomplished by the parties to a financial instrument by way of replacement of the entire instrument with a substitute, as long as the effect of the replacement is to make covered modifications (and associated modifications) to the existing arrangement.

The basic definitional parameters as to what will constitute a covered modification seem intuitive enough, and they should be if these regulations are to have any utility to market participants, but there may be doubts at the margins as to what constitutes, or does not constitute, an "associated modification", which is defined by the final regulations to mean a change to the technical, administrative or operational terms of the financial instrument that are reasonably necessary to adopt or implement an IBOR transition. Many bond counsel will take a "but for" approach to resolve these interpretive questions and perhaps take comfort from the administratively deferential formulation in the regulations, which countenances associated changes that are "reasonably necessary" to effectuate a LIBOR transition in a debt instrument. Some bond counsel may even seek input from financial advisors as to what modifications are reasonably necessary to implement a particular LIBOR succession effectively.

I expect there may be more doubt, however, and more rumination among bond counsel, about what constitutes an "incidental" cash payment. Here I quote from Section 1.1001-6(h)(5):

> An associated modification also includes an *incidental* cash payment intended to compensate a counterparty for *small* valuation differences resulting from a modification of the administrative terms of a contract, such as the valuation differences resulting from a change in the observation period.

To begin, it seems quite clear that this provision is *not* intended to permit *any* true-up payment associated with LIBOR succession to be treated as part of a "covered modification" sequence: unless the payment stems from the modification of purely administrative terms in the contract, the payment probably will not constitute an "associated modification" that can be viewed as going hand-in-hand with a "covered modification". And, even if the payment stems from such a modification, it will only be treated as part of the "covered modification" plan if it is "small". This is clearly not the stuff bright lines are made of, and I suspect bond counsel will sometimes be hard pressed to wrestle this standard to the ground; in some cases, the alternative may be to analyze the payment provision separately from the "covered modification" provisions in a LIBOR succession exercise, under the general reissuance principles of Treasury Regulations Section 1.1001-3.

Discontinued IBORs

For reasons that aren't entirely clear to me, the final regulations add a concept of "discontinued IBORs" into the analytic mix. Generally, an IBOR will be treated as a "discontinued IBOR" when a competent banking regulator announces that publication of that particular IBOR will be discontinued permanently or indefinitely, and (here's the catch) an IBOR will no longer be a "discontinued IBOR" one year after the regulator no longer publishes that particular IBOR. I understand that these LIBOR transitional rules have been implemented as a matter of administrative grace, more or less, and that Treasury wishes to signal that taxpayers should make reasonable haste to implement modifications of their financial instruments in reliance on these rules; as the preamble to Treasury Decision 9961 notes, the purpose of the new term is to "better match the problem that the Final Regulations are intended to address". Fair enough, but it seems fair as well to say that this newly-introduced concept, with a one-year cut-off after cessation of publication, appears to be a solution in search of a problem. Let's hope this rather straitened and somewhat counterintuitive definition of "discontinued IBORs" doesn't upend tax compliance for some unsuspecting bond issuer or borrower out there.

Qualified Rates

Let's take a look now at the "qualified rate" concept in the final regulations. "Qualified rates" generally will include any "qualified floating rate" within the meaning of Treasury Regulations Section 1.1275-5(b), but without regard to the limitations on multiples set forth in those regulations. Examples of such qualified floating rates are given, including SOFR, the Sterling Overnight Index Average (SONIA), the Tokyo Overnight Average Rate (TONA) and the Swiss Average Rate Overnight (SARON), as well as the euro short-term rate administered by the European Central Bank. The definition of "qualified rate" also includes a rate selected, endorsed or recommended by the Alternative Reference Rates Committee (also known as the ARRC) as a replacement for U.S. dollar-denominated LIBOR, but only if the Federal Reserve Bank of New York is an ex officio member of the ARRC at the time of the selection/endorsement/recommendation (query whether the Treasury had any doubt about this when the final regulations were drafted). Rates that are determined by adding fixed spreads to the foregoing categories of "qualified rates" also are treated as "qualified rates". Finally, for our purposes, additional "qualified rates" can be specified by the tax regulators by publication in the Internal Revenue Bulletin.

All of this seems straightforward enough, particularly if the current trend toward SOFR as a durable, long-term replacement for LIBOR reference rates in the tax-exempt bond market continues. I will note that certain reference rates, not explicitly referenced in the final regulations, have been discussed in some circumstances as possible successors to LIBOR rates for outstanding bonds or for bond-related swaps. For example, there apparently has been some discussion in the banking world of employing forward-looking, unsecured rate benchmarks such as the Bloomberg Short-Term Bank Yield Index (BSBY) and the American Interbank Offered Rate (AMERIBOR) as replacements for LIBOR in financial instruments to which they are parties. To the extent BSBY or AMERIBOR, or another similar rate, is proposed as a substitute for a LIBOR-referencing rate in bond or swap documents, bond counsel would presumably have to evaluate whether the proposed rate is a "qualified floating rate" under the substantive standards of Treasury Regulations Section 1.1275-5(b) or whether, perhaps, the ARRC has selected, endorsed or recommended the proposed substitute.

If there's an unforeseen shift in the market to another type of objective reference rate, to one that is not clearly captured in the substantive standards described above, let's hope that Treasury can be nimble enough to respond quickly with an endorsement of that rate in the IRB.

Fallback Rates

Fallback rates are intended to be implemented as substitutes for IBORs after the modification of a financial instrument, on the happening of specified events, such as the actual cessation of publication of a LIBOR reference rate that is still being published at the time of modification. As noted above, a covered modification will include the specification of a fallback rate that is a qualified rate. The final regulations also recognize that parties to a financial instrument may specify multiple fallback rates (fallback waterfalls?) at the time of modification, and they provide that as long as each of the specified fallback rates constitutes a qualified rate, a modification of a financial instrument to include those fallbacks will be a covered modification.

Note that under the final rules, fallbacks must be tested twice—at the time of initial modification of the financial instrument and again at the time the fallback is activated as an operative reference rate. Bond counsel may wish to advise their clients to add an approving opinion of counsel requirement in connection with the post-modification activation of a fallback rate to assure full compliance with the requirements of the final regulations.

If, however, a fallback rate is indeterminate at the time of modification, the modification will not be treated as a covered modification, and presumably, the modification will be thrown into the general reissuance rules of Treasury Regulations Section 1.1001-3 for analysis, unless the fallback rate constitutes a remote contingency. I doubt that these rules regarding indeterminacy and remoteness will make much of a difference in practice for bond counsel, as the parties to bond transactions will naturally want clarity and resolution in their LIBOR succession planning, and bond counsel will be naturally inclined to give firm advice whenever possible.

Excluded Modifications

As noted above, the final regulations carve out certain "excluded modifications" from "covered modification" treatment, in order to provide a regulatory framework that, as a whole, is consistent with the now-abandoned fair market value equivalency standard. Under the final rules, excluded modifications are any modifications that alter the amount or timing of cash flows provided in a financial instrument and are intended to (1) induce a counterparty to perform an act necessary to consent to a covered modification; (2) compensate a counterparty for a modification that is not a covered modification; (3) grant a concession to a counterparty because that counterparty is in financial difficulty; (4) secure a concession by a counterparty to account for the credit deterioration of another party to the financial instrument; or (5) compensate a counterparty for a change in rights or obligations that are not derived from the modification of the financial instrument. It is noteworthy that the regulations frame the excluded modification analysis in part on the intention of the parties, which is not always a simple thing for bond counsel to discern and which may induce bond counsel when there is doubt to take a more conservative approach to applying the law to the facts.

Examples of excluded modifications given in the final regulations include an "inducement spread" scenario, in which the issuer of widely-held LIBOR-indexed bonds offers what appears to be a 10 basis point "sweetener" to the spread on a bond to be modified to provide for a SOFR index, to ensure that bondholders will give required consents to the modification. Although the premise is unstated in the example, it appears that this sweetener is over and above the index spread on the modified SOFR-referencing bonds that would be required to achieve substantial equivalency between the fair market value of the bonds before and after modification. Another example, with what appears to be comparable economics, describes the payment of a "consent fee" to the bondholder to secure the required consents, with the same outcome.

Yet another example describes a situation in which, for reasons unrelated to LIBOR succession, the parties agree to modify customary financial covenants in the debt instrument in a manner that benefits the obligor; in exchange, the obligor agrees to add another 30 basis points to the spread on the modified SOFR-indexed obligation. This too constitutes an excluded modification, for reasons that are pretty self-evident. There are a couple of other examples of excluded modifications in the regulations, but you get the idea. I suppose the takeaway is that bond counsel will have to think critically about each and every modification exercise in which she or he is told that the intention is simply occasioned by the need to do LIBOR housekeeping. There will always be a potential for other, more extraneous factors to weave their way into the modifications, and to the extent that they appear not to be strictly mandated by the goal of replacing a LIBOR-referenced rate in a bond or swap instrument, bond counsel will do well to ask herself or himself whether those other modifications shouldn't be analyzed separately under the general reissuance principles of Treasury Regulations Section 1.1001-3.

I will end my sketch-out of new Treasury Regulations Section 1.1001-6 here. As of this writing, these rules have only been in effect for a week. Bond counsel are and will be percolating these rules and their import in practice, and there will be much more to be said in coming weeks and months about their application in real-world cases. I welcome thoughts, questions and commentary from readers of *The Bond Lawyer* on any aspect of the rules; and, perhaps, there will be additional discussion of the regulations on this microphone.

Revenue Procedure 2022-20: Toll-Free Teleconference TEFRA Hearings

On March 18, 2022, just as this column was about to go to press, the IRS released Revenue Procedure 2022-20, making permanent the ability to conduct TEFRA hearings "virtually" for purposes of Code Section 147(f)(2)(B)(i), by means of toll-free telephonic access to the hearing for members of the public interested in commenting on a proposed bond issuance or on the assets and facilities to be financed or refinanced by the bonds. This guidance follows a succession of Revenue Procedures released in 2020 and 2021 in response to the COVID-19 public health emergency that permitted TEFRA hearings to be conducted on the same kind of "virtual" basis, but only temporarily, and the most recent predecessor release, Revenue Procedure 2021-39, had set an expiration date of March 31, 2022. So the release of Revenue Procedure 2022-20 is very timely.

This is a welcome and eminently sensible regulatory development, and NABL's Board of Directors and its Tax Committee should be commended for advocating with the IRS for the change. I suspect that going forward many of the governmental authorities that regularly conduct TEFRA hearings will want continue to offer toll-free telephonic access to the public, even if they also permit or invite in-person attendance. And, provided that they are offering access to TEFRA hearings in one or both of these ways, there is nothing to stop these agencies from using other, more new-fangled technology to facilitate public participation at TEFRA hearings, like Zoom or Microsoft Teams.

IRS Notice 2022-05

On January 31, 2022, Treasury and the Internal Revenue Service published Notice 2022-05 in the IRB. This notice extends pandemic-related temporary relief from certain compliance requirements related to achieving low- and moderate-income set-aside thresholds under Section 142(d) of the Internal Revenue Code and to the time for completing substantial rehabilitations for bonds financing the acquisition of existing property to be operated as a qualified residential rental project. The Notice also provides temporary relief with respect to certain requirements under Section 42 of the Code relating to qualified low-income housing projects.

The first bond-related provision of Notice 2022-05 provides that if the last day of a 12-month "transition period" (see Section 5.02 of Revenue Procedure 2004-39) for a multifamily project acquired with exempt facility bonds would have fallen between April 1, 2020 and December 30, 2022, the last day of the transition period is extended to December 31, 2022. The last day of such a transition period is significant for borrowers and operators of acquired multifamily projects because it coincides with the first day on which initial compliance with the low- and moderate-income set-aside thresholds of Code Section 142(d)(1) must be demonstrated. And the relief in Notice 2022-05 is helpful because it affords extra time during the pandemic for borrowers and operators of tax-exempt bond financed multifamily projects to find tenants with lower incomes to whom to lease units in their bond-financed facilities. We have all read reports in the general press about dislocations in the residential rental markets during the COVID-19 emergency, so the need for this temporary relief likely would have been pressing for some operators and borrowers.

The second bond-related provision in the Notice extends the end date of the 2-year rehabilitation period under Code Section 147(d) if it otherwise would have ended during the period from April 1, 2020, to the earlier of eighteen months of the original end date or December 31, 2023. Here too, a case for the temporary relief appears to have been made as a result of the dislocations in the construction and labor markets that have been precipitated by the pandemic.

As pointed out above, Notice 2022-05 extends the Section 142(d) relief provision in its predecessor, Notice 2021-12 (which in turn extended temporary relief provisions originally published in Notice 2020-53), from December 31, 2021 to December 31, 2022. I would like to pause here to remark that because Notice 2022-05 was released in late January 2022, there was a gap in the relief under Section 142(d), for something like a month from December 31, 2020. I would note in addition that if the pandemic-related reasons for offering this relief are compelling (and I have no doubt that they are), it is only fair to point out that some conscientious borrowers may have experienced legitimate concerns during the one-month hiatus in the guidance about appearing to have backed into a non-compliance posture that Treasury and the IRS clearly didn't intend. I can appreciate that the Treasury and IRS staff who are tasked with overseeing the tax-exempt bond market have very full plates and a lot of demands on their time and attention, especially these days. But I think this guidance gap illustrates, in a small way, the value to market participants of having timely, seamless and well thought-through guidance from the regulators, especially to assist them in confronting big-picture challenges not of their making.

Form 8038 Updates

Finally, before dropping the mic for this issue of *The Bond Lawyer*, I have a couple of updates to share on the 8038 series of IRS Forms. First, on March 8, 2022, IRS TEB advised that it has released a new version of Form 8038 (the February 2022 revision), together with updated instructions, to include references to exempt facility bonds for qualified broadband projects (line 11k) and qualified carbon dioxide capture facilities (line 11o), which were authorized to be financed with private activity bonds by the Infrastructure Investment and Jobs Act, Pub. L. 117-58, 135 Stat. 429 (2021).

Second, in early February 2022, the IRS confirmed that it is extending its policy to temporarily allow the use of electronic or digital signatures on Form 8038, Form 8038-G and Form 8038-GC, as long as these forms are e-signed and postmarked by October 31, 2023. Additional information about these Form 8038-related developments can be found on the Tax Exempt Bonds Community Updates page of the IRS website at https://www.irs.gov/tax-exempt-bonds/tax-exempt-bonds-community-updates.

I'd submit that there's no practical reason why the ability to use e-signatures on the 8038 series of IRS forms shouldn't be made permanent. As the release of Revenue Procedure 2022-20 demonstrates, the IRS is flexible enough to make sensible updates to its guidance when experience shows that a newer and easier compliance approach will carry out the purposes of the federal tax laws. Perhaps we will see a similar flexibility forthcoming with respect to e-signatures sometime soon.