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The Role of Underwriter's Counsel

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I. Introduction - Role of Underwriter's Counsel

A. Provide legal advice to the underwriter with respect to the structuring and closing of the financing.

B. Advise the underwriter regarding rules promulgated by the Municipal Securities Rulemaking Board (the "MSRB"), e.g., MSRB G-17 letters, Rule G-37.

C. Assist in issues relating to syndication agreements (i.e., AAUs or selling group agreements), as applicable.

D. Review financing, authorization and tax documents (generally prepared by bond counsel), including issue price certificates.

E. Advise the underwriter on legal disclosure and securities matters. The issuer or financing beneficiary may have (i) disclosure counsel regarding general disclosure and securities matters as they pertain to the issuer and/or (ii) special disclosure counsel regarding particular disclosure and securities matters (e.g. pensions).

F. Draft/assemble (or review, if prepared by separate disclosure counsel) offering documents (e.g., official statement or offering memorandum), sale/underwriting documents (e.g., bond purchase agreement) and, in some cases, continuing disclosure agreements and remarketing agreements.

G. Assist the underwriter in meeting "due diligence" obligations imposed under securities laws. Prepare due diligence questionnaire, checklist and memorandum.

H. Advise the underwriter on compliance issues with Rule 15c2-12 (continuing disclosure), promulgated by the Securities and Exchange Commission (the "SEC"), including information on historical compliance to be included in the offering document.

I. Advise the underwriter through a blue sky survey of actions required to sell bonds in certain states.

J. Review closing documents and opinions to ensure that all conditions of closing as specified in the bond purchase agreement are met.

K. Deliver required underwriter's counsel opinions at closing.

L. Provide any other advice requested by client. (Note the terms of the 2018 SIFMA Model Memorandum to Underwriter's Counsel, used in some form by most underwriting firms, and also see NABL's March 2019 analysis.)

II. Background - Role and Responsibilities of the Underwriter

A. Purchases bonds and redistributes to initial investors (i.e., underwrites the financing), and if initial investors walk prior to closing is nevertheless generally obligated to purchase the bonds (subject to certain "outs" in the bond purchase agreement).

B. How and when does the underwriter get involved in the financing? Who hires the underwriter? The issuer/borrower (*i.e.*, generally, the "Obligated Person" under SEC Rule 15c2-12). Process is often driven by requirements of local law or practice.

1. Negotiated sale - The issuer/borrower selects an underwriter or group of underwriters to underwrite the bonds and negotiates the terms and conditions of the relationship with one or more of such underwriters ("Managers") in a syndicate. A "request for proposal" or "RFP" process is sometimes used (and often with a municipal advisor overseeing the process).

2. Competitive sale - The issuer/borrower sets the general terms for the bonds (often with a municipal advisor assisting in establishing the timing of the sale and the overall debt structure) in a published notice of sale and asks potential underwriting firms to submit the best "interest cost" they can offer for the bonds. This is typically done pursuant to a notice of sale and bid form disseminated in writing or electronically through a bidding platform. The issuer/borrower selects the best offer submitted based on criteria set forth in the notice of sale.

C. What are the underwriter's responsibilities in a municipal bond financing?

1. In either a competitive or negotiated sale, the underwriter:

a. Commits by contract (or bid in a competitive sale) to buy the bonds when issued;

b. Offers the bonds pursuant to a public offering to potential investors;

c. Complies with SEC Rule 15c2-12, SEC Rule 10b-5 (each covered in General Securities Law Session), MSRB rules and state blue sky statutes (as defined below); and

d. Is responsible for conducting "due diligence" sufficient to have a reasonable basis for recommending the municipal securities and to provide a basis for a future defense of any securities law claims.

2. In a negotiated sale, the underwriter:

a. Often serves many of the same functions as a municipal advisor; *i.e.*, distributes a financing schedule, develops the structure of the bonds, provides market information to the issuer and the municipal advisor, prepares pre-pricing numbers runs based on then-current market data, assists with preparation of offering documents and investor and rating agency presentations, coordinates meetings with rating agencies, credit enhancers and liquidity providers, markets the bonds and oversees pricing; **but (i) SEC Municipal Advisor Rules makes clear that these activities may only occur within the scope of that particular negotiated sale, AND (ii) MSRB Rule G-23 makes it clear that a securities dealer who serves as a municipal advisor to an issuer for a transaction cannot serve as an underwriter of the bonds in the same transaction (see Section VII(C) below)**.

b. MSRB Rule G-23 prohibits a dealer serving as a municipal advisor to an issuer for an issuer of bonds from acting as remarketing agent for such bonds.

3. Underwriters and municipal advisors

a. The Dodd-Frank Act makes it unlawful for a person to provide *advice* to or on behalf of municipal entity or obligated person with respect to municipal financial products or issuance of municipal securities, or to undertake certain solicitations of either, unless the person registers, or qualifies for exemption, as a municipal advisor.

b. The Dodd-Frank Act amends the Securities Exchange Act of 1934 to impose on municipal advisors a fiduciary duty to municipal entities for which they act as a municipal advisor.

c. The SEC has adopted final rules to, among other things, define who is a municipal advisor and clarify exclusions and exemptions, including those for which Underwriters can qualify.

1) Exclusion for broker/dealers serving as an underwriter to the extent engaged in activities within the scope of an underwriting.

2) Exclusion when the issuer is represented by an independent registered municipal advisor ("IRMA") and the appropriate certifications and disclosures are made by all parties.

3) Exemption for responses to a request for proposal or qualification for services.

(Also note exemption for attorneys providing legal services of a traditional nature.)

4. Direct placements and placement agent role.

D. What Happens When There is More than one Underwriter?

1. "Syndicate" - A group of underwriters formed to purchase (underwrite) a new issue of municipal securities from the issuer and offer it for resale to the general public. The syndicate is organized for the purposes of sharing the risk of underwriting the issue, obtaining sufficient capital to purchase an issue, and for broader distribution of the issue to the investing public. One of the underwriting firms will be designated as the syndicate Manager or Lead Manager (otherwise called the "book runner") to administer the operations of the syndicate.

a. "Lead Manager" (or "Book-Runner") - The underwriting firm serving as head of the syndicate; generally handles negotiations in a negotiated underwriting of a new issue of municipal securities. Hires counsel and allocates securities among the members of the syndicate according to the terms of the syndicate agreement and orders received.

b. "Co-Managers" - Any underwriting firm which is the member of an underwriting syndicate other than the Lead Manager.

c. "Selling Group Member" - A securities broker or dealer that assists in the distribution of a new issue of securities. Selling group members are able to acquire new issue securities from the underwriting syndicate at syndicate terms (*i.e.*, less than the "total takedown") but do not participate in residual syndicate profits nor share any liability for any unsold balance. They do not have privity of contract with the issuer/borrower. Selling Group Members are not very common in recent years.

d. Syndicate often governed by master agreement among underwriters (AAU) – today often handled by the underwriter's back office rather than underwriter's counsel.

2. Increasingly, underwriters are entering into distribution or marketing agreements, which should be disclosed in the offering document.

3. Lead Managers may have differing preferences as to the level of involvement other syndicate members should have in the structuring of the deal and the disclosure and marketing processes.

E. Why do some deals have a single underwriter while others have an underwriting syndicate?

1. Size of the financing.

2. Type of product being offered and expertise of underwriting firms in certain investor markets.

3. Issuer's preference – "local" involvement of brokers or compliance with MBE/WBE or veteran business requirements. Issuers may specify particular firms as Co-Managers.

4. In a conduit financing, borrower's preference.

5. Desire to enhance distribution to retail investors.

6. Banking relationships between the sole underwriter and the issuer/borrower.

F. How does the Underwriter get paid?

1. Negotiated Sale - The fee is negotiated between the issuer/borrower and the underwriter prior to the engagement, generally based on a percentage of the principal amount of the bonds. Alternatively, the fee may include the components described below.

2. Competitive Sale - Fee set by bid or is in the "spread."

a. What is the "spread?" For new issue municipal securities, the difference between the price paid to the issuer by the underwriter for the new issue and the prices at which the underwriter initially offers the securities to the investing public, a/k/a the "gross spread" or "gross underwriting spread." There are four components to the spread:

1) Expenses. The costs of operating the underwriting syndicate for which the Lead Manager may be reimbursed.

2) Management Fee. The amount paid to the Lead Manager for handling the affairs of the underwriting syndicate.

3) Takedown. Normally the largest component of the spread, similar to a commission, which represents the income derived from the sale of the securities. If bonds are sold by a

member of the syndicate, the seller is entitled to the full takedown (a/k/a, the "total takedown"); if bonds are sold by a dealer which is not a member of the syndicate, such seller receives only that portion of the takedown known as the concession or the dealer's allowance, with the balance (a/k/a, the "additional takedown") retained by the syndicate. Typically includes the underwriter's counsel fees.

4) Risk or Residual. If "risk" is compensated, it is generally for riskier transactions; otherwise this is the amount of profit or spread left in a syndicate account after meeting all other expenses or deductions. A portion of the residual is paid to each member of the syndicate on a pro rata basis according to the number of bonds each dealer has committed to sell without regard to the actual sales by each member.

3. Under MSRB Rule G-17, underwriters' compensation cannot be so disproportionate to the nature of underwriting and related services performed as to constitute an unfair practice in violation of Rule G-17 (see Section VII(C) below). MSRB Rule G-20 also limits the ability of underwriters to reimburse issuer/borrower expenses, such as attending the pricing (and taking your spouse to dinner and a Broadway show). MSRB Rule G-37 (and some states) also limit the ability of underwriters to make political contributions.

4. The underwriter should also disclose to the issuer/borrower if compensation is contingent on closing (which it nearly always is) and if so, that this represents a potential conflict of interest.

III. Background – Structuring a Bond Issue

A. Who decides the terms and conditions of the bonds to be offered (fixed, variable, auction, drawdown, term or serial, security, credit enhancement, etc.)?

1. The underwriter (within the scope of its exemption under the municipal advisor rules):

a. Analyzes the capital needs or refunding requirements and debt capacity of the issuer/borrower;

b. Prepares projections of debt service structure on the bonds based on a variety of assumptions and bond types; and

c. Reviews projections with the issuer/borrower and its municipal advisor and discusses the economic and other advantages of the various options.

2. The issuer/borrower, with advice from its municipal advisor, then makes selection based on the proposal made by the underwriter.

3. Bond counsel should make sure the debt service structure complies with any state law statutory requirements (e.g., limitation on length of final maturity, level debt service in each year, etc.) and complies with any federal tax law limitations (e.g., weighted average maturity for qualified private activity bonds). Although underwriter's counsel does not have primary responsibility for these matters, they should be reviewed as a component of the due diligence process.

4. The type of obligation and security for the debt obligations is generally dictated by applicable state law. Various alternative legal structures may be considered by the financing team.

5. Under MSRB Rule G-23, the underwriter must make it clear at all phases of the transaction that it is acting solely as a principal and not as an advisor or agent to the issuer (see Section VII(C) below).

B. Other Pre-Sale Activities

1. Prepare for rating agency presentations and meetings with credit enhancers and/or institutional investors and assist issuer/borrower with responses to questions and comments from such entities.

2. Advise on the market cost or benefit of including certain provisions in the financing documents. Review the financing documents for key terms and provisions.

3. Assist with preparation and review of the preliminary official statement or other offering documents, including investor presentations.

4. Preparing a list of due diligence questions for due diligence call/meeting conducted prior to the time a preliminary official statement is circulated before pricing and sale of the securities.

5. Review the issuer's/obligated person's prior secondary market disclosure to determine compliance with SEC Rule 15c2-12.

C. Pricing – How are bonds priced?

1. Competitive Sale -

a. The municipal advisor and the issuer/borrower select a sale date.

b. Underwriters or underwriting syndicate members submit offers on the sale date through the bidding process prescribed in the published notice of sale.

c. Award of bond made to the underwriter or underwriting syndicate offering the lowest interest cost and complying with the other conditions of the notice of sale.

2. Negotiated Sale -

a. The underwriter in conjunction with the issuer/borrower and its municipal advisor select a pricing date.

b. Underwriter and municipal advisor monitor the market prior to the pricing date to determine if it is still in the issuer/borrower's best interest to enter the market at the agreed upon date.

c. Bonds are priced based on the type of bond and the rates/yields for similar bonds being offered and sold in the municipal bond market that day.

d. Underwriting desk gets indications from potential investors, and then prices the bonds based on those indications. BPA "locks" interest rates; firm trade tickets are established between underwriter and investors once BPA is signed.

3. MSRB Rule G-17 includes an implied representation that the price that the underwriter pays is fair and reasonable (see Section VII(C) below).

4. Governmental or other approvals may be necessary as a pre-condition to the bond sale or establishing a sale date.

D. How does the Underwriter offer the bonds?

1. Markets the bonds with a preliminary official statement (usually).

2. May arrange and oversee investor calls and investor presentations or "road shows," which are often posted online (and should contain the same material content as the preliminary official statement).

3. Circulates pricing information on day of pricing via a "pricing wire".

4. Different underwriters may have particularly strong relationships or reputations with certain markets and institutions.

E. When does the Underwriter buy and sell the bonds?

1. Purchase the bonds and resell them for delivery on closing date (generally 1 to 2 weeks after sale for fixed rate bonds and shorter period for variable rate bonds).

2. The underwriter commits to buy the bonds through execution of a bond purchase agreement (negotiated sale) executed on the pricing date.

3. Longer periods between pricing and closing can present challenges. "Forward delivery" purchases may also require additional disclosures, tax analysis, certifications and opinions at the time of the forward delivery.

F. Who buys the bonds?

1. Bond funds.

2. Other institutional investors (e.g., insurance companies, pension funds).

3. Individuals (i.e., "retail" investors or "mom and pop" investors). Rule G-17 requires the Underwriter to follow the issuer's preferences as to retail pricing.

4. Sometimes there are separate "pricing" days for institutional and retail investors.

IV. Responsibilities of Underwriter's Counsel

A. Preparation of the Official Statement (assuming no separate disclosure counsel engaged by issuer or obligated person).

1. The preliminary official statement ("POS") and final official statement ("OS") are the primary disclosure and marketing documents.

2. Both documents are generally prepared by Underwriter's Counsel (one of the main functions), except in those situations where an issuer has retained disclosure counsel (e.g., City of New York, District of Columbia, Miami-Dade County, Denver Public Schools, Colorado metropolitan/special districts, etc.) or where the issuer has those instruments prepared by its bond counsel.

a. The POS should be the "deemed final" official statement for purposes of Rule 15c2-12, except for pricing information that is determined on the sale date. Thus, it should be substantially identical to the final OS except for such pricing information.

b. A POS may need to be supplemented (or "stickered") to incorporate information or events occurring after the posting of the original POS but prior to the pricing. Similarly, an OS may need to be supplemented after pricing up through the period specified in Rule 15c2-12.

c. The POS and OS set forth all information material to making an investment decision, including but not limited to: the bond terms,

security for the bonds, plan of finance, sources and uses of funds, debt service schedule, bondholders' risks, material financial and operating data on the issuer/borrower, information on any credit enhancers and summaries of the bond documents.

3. Certain sections of the POS and OS (i.e., financing document summaries; feasibility reports, financial statements, bond counsel opinion) are prepared by other parties such as bond counsel, feasibility consultants, accountants, credit enhancers, etc. Underwriter's counsel is responsible for reviewing and commenting on these sections, but typically excludes those sections/reports from its negative assurance letter.

4. What level of disclosure is appropriate?

   a. Underwriter's counsel will advise on what level of disclosure is appropriate for the financing. See SEC Release No. 34-26100 (1988), accompanying the SEC's explanation of Rule 15c2-12, setting forth the SEC's view that underwriters must form a reasonable belief in the accuracy and completeness of key representations set forth in the disclosure documents.

   b. In financings where the issuer/borrower retains disclosure counsel, the question of the accuracy and completeness of the disclosure will be worked through by both underwriter's counsel and the issuer/borrower's disclosure counsel (and should also receive the input of the issuer/borrower's in-house counsel).

   c. This duty applies for both negotiated and competitive offerings and depends on the factors and circumstances surrounding the issue. These factors include, but are not limited to:

      1) The extent to which the underwriter relied on municipal officials, employees, experts, and other persons whose duties have given them knowledge of particular facts.

      2) The role of the individual underwriter (as Manager, syndicate member or dealer).

      3) The type of security for the bonds (general obligation, revenue or private activity).

      4) The length of maturity of the securities.

      5) The presence or absence of credit enhancement.

      6) The age/staleness of financial information.

5. Primary concerns in drafting and producing the POS and OS:

a. Clarity and accuracy (*i.e.*, "Plain English").

b. Appropriate disclosure of material information.

c. Appropriate disclosure of risks related to purchase of the bonds.

6. Recent emphasis on crafting disclosure policies and procedures for municipal issuers.

a. Identification of the types of disclosures covered by the policy.

b. Explanation of the processes that the issuer uses to prepare its disclosures and to demonstrate compliance with its policy.

c. Examination of the role of the issuer's officers, employees and governing body in the disclosure process and the creation of a system where such officers or employees are adequately supervised, and duties are appropriately apportioned among such officers or employees.

d. Explanation of the process for educating applicable officers or employees regarding their duties under the securities laws and the issuer's disclosure policy, including provisions for specific training of individual officers or employees.

7. Collateral matters in preparing the POS and OS.

a. Seeking appropriate consents from experts (e.g. accountants, feasibility consultants or consulting engineers, verification agents) for use of information prepared by them and included or incorporated by reference in the POS and OS.

b. Coordination of agreed upon procedures letter/consent with the accountants and appropriate sign off prior to printing. Advising the underwriter as to whether such letters should be required and disclosure regarding their absence.

c. Coordination of cover and overall document production with the printer and/or electronic dissemination agent.

d. Use of information obtained from third party sources and/or sites and their inclusion (or explicit disclaimer of inclusion) as part of the POS

8. Reference sources:

a. Government Finance Officers Association, Disclosure Guidelines for State and Local Securities (1991 Edition).

b. National Federation of Municipal Analysts, various "Recommended Best Practices" and "White Papers."

c. ABA Section of Urban, State and Local Government Law, Disclosure Roles of Counsel In State and Local Government Securities Offerings (Third Edition, 2009).

d. National Association of Bond Lawyers, Crafting Disclosure Policies (August 20, 2015).

B. Bond Purchase Agreement (BPA).

1. Competitive Sale - bond purchase agreements are not used in competitive sales. The notice of sale constitutes the terms and conditions of the sale, bids represent offers to purchase on the terms set forth in the notice of sale, and the award is the acceptance of the offer of the underwriter or the underwriting syndicate with the lowest compliant bid. The winning bidder often has to make a "good faith" deposit with the issuer.

2. Negotiated Sale - bond purchase agreements are used in negotiated underwritings to commit to writing between the issuer and the underwriter (and the borrower in a conduit financing):

a. Pricing terms upon which the underwriter or underwriting syndicate agrees to purchase the bonds upon their issuance.

b. Representations and warranties of the underwriter or underwriting syndicate and the issuer and/or borrower relating to the offering and sale of the bonds.

c. Closing conditions (e.g., delivery of certain documents, certificates, opinions, etc.), including forms of issue price certificates to be executed by the underwriter.

d. "Outs" or events which, if occurring, would allow the underwriter or underwriting syndicate to refuse delivery of the bonds.

e. Indemnity provisions, choice of law, severability, etc.

f. NOTE: The Securities Industry and Financial Markets Association ("SIFMA") has created both a form of bond purchase agreement and model guidelines for underwriter's counsel, which are located at *www.sifma.org* for reference.

3. Generally the bond purchase agreement is drafted by the underwriter's counsel. In some cases, underwriters have standard forms (or at least standard provisions) that they require or request to be used based on a desire to provide uniform rights, duties and obligations for all transactions. Many

of those standard forms are based on the SIFMA model bond purchase agreement. Recently, in-house counsel of the underwriter has begun to review the bond purchase agreement in circumstances where the form used is not supplied by the underwriter.

4. Following the MSRB Rule G-23 amendments (and interpretive guidance to MSRB Rule G-17), many underwriters are requiring the following disclaimer language in bond purchase agreements (which such disclaimers should also be presented to the issuer in a separate letter prior to the execution of the bond purchase agreement):

   a. The purchase and sale of the bonds is an arm's-length commercial transaction between the issuer/borrower and the underwriter;

   b. The underwriter is acting solely as a principal and not as an advisor, agent or a fiduciary of the issuer/borrower;

   c. The underwriter has not assumed a fiduciary responsibility in favor of the issuer/borrower with respect to the offering of the bonds or the process leading thereto or any other obligation to the issuer/borrower except the obligations expressly set forth in the bond purchase agreement; and

   d. The issuer/borrower has consulted with its own legal and municipal advisors to the extent it deemed appropriate in connection with the offering of the bonds.

5. Under the new tax regulations relating to the determination of issue price, bond purchase agreements now contain the Issuer's election of a pricing rule (i.e., Actual Facts Rule, Hold the Price Rule, or Competitive Sale Rule), and terms related to the pricing rule determined by the issuer.

6. Note timing of execution and return of signed bond purchase agreement to satisfy underwriter's regulatory and reporting obligations.

C. Continuing Disclosure Agreement.

1. A Continuing Disclosure Agreement ("CDA") is an undertaking required by SEC Rule 15c2-12 for certain municipal bonds that are publicly offered. This undertaking may be in a separate CDA or contained within other financing documents (e.g., a loan agreement).

2. CDAs generally require the issuer or "obligated person" (as defined by SEC Rule 15c2-12) to provide certain annual financial information (e.g., audited financial statements and other financial operating data included in the OS), as well as timely notice of certain enumerated events described below.

a. As of July 1, 2009, all disclosure filings must be submitted in electronic format to the MSRB's Electronic Municipal Market Access web-based system ("EMMA").

b. Prior to July 1, 2009, the information was provided to the Nationally Recognized Municipal Securities Information Repositories ("NRMSIRs"), commonly through the "Central Post Office" operated by the Texas Municipal Advisory Council. While EMMA simplifies filings, EMMA does not contain the filings previously made to the NRMSIRs, and any search for filings made prior to July 1, 2009 cannot be made through EMMA.

3. Pursuant to SEC Rule 15c2-12, the issuer or obligated person must also provide notice within 10 business days of the occurrence of the following events with respect to the particular issue subject to the continuing disclosure undertaking:

a. Principal and interest payment delinquencies;

b. Non-payment related defaults, if material;

c. Unscheduled draws on debt service reserve fund reflecting financial difficulties;

d. Unscheduled draws on credit enhancements reflecting financial difficulties;

e. Substitution of credit or liquidity providers, or their failure to perform;

f. Adverse tax opinions, the issuance by the IRS of proposed or final determinations of taxability, Notice of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations with respect to the tax status of the security, or other material events affecting the tax status of the security

g. Modification to rights of security holders, if material

h. Bond calls, if material, and tender offers;

i. Defeasances;

j. Release, substitution, or sale of property that secures the repayment of the securities, if material;

k. Rating changes;

l. Bankruptcy, insolvency, receivership or similar event of the obligated person;

m. The consummation of a merger, consolidation or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person (other than in the ordinary course of business), the entry into a definitive agreement to undertake such action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material;

n. Appointment of a successor or additional trustee, or the change in name of the trustee, if material;

o. Incurrence of a financial obligation of the obligated person, if material, or agreement to covenants, events of default, remedies, priority rights or other similar terms of a financial obligation of the obligated person, any of which affect security holders, if material; and

p. Default, event of acceleration, termination event, modification of terms, or other similar events under the terms of a financing obligation of the obligated person, any of which reflect financial difficulties.

Note that items o. and p. were added in recent (2019) amendments to Rule 15c2-12 and are often the subject of discussion (i.e., what constitutes a "financial obligation").

4. Primary drafting concerns:

a. Accurately describing the continuing disclosure undertaking in the POS/OS (sometimes included as an exhibit).

b. Determination of the annual financial information to be included in continuing disclosure undertaking, taking into consideration consistency with the issuer/borrower's existing disclosure obligations and the ability of the issuer/borrower to replicate that type of information in the future.

c. Disclosure regarding material non-compliance with prior continuing disclosure undertakings under SEC Rule 15c2-12 for the past five years. This was the main premise for the SEC's Municipalities Continuing Disclosure Cooperation Initiative ("MCDC").

1) MCDC was announced on March 10, 2014, pursuant to which the SEC Enforcement Division would recommend to the SEC "favorable settlement terms" for issuers and underwriters if they self-reported possible violations

involving materially inaccurate statements relating to prior compliance by issuer/obligated person with their CDAs.

2) Three waves of underwriter settlements announced (June 18, 2015 (36 firms); September 30, 2015 (22 firms); February 2, 2016 (14 firms)).

3) One wave of issuer settlements announced (August 24, 2016 (71 issuers)). The SEC subsequently announced no other settlements or actions would then be taken with any person or entity that self-reported under MCDC, and the SEC would now be reviewing issuers and underwriters who did not self-report under MCDC.

4) Underwriters now conduct extensive due diligence related to CDA compliance. Underwriter's counsel involvement on these matters varies depending upon the arrangement made with the underwriter/underwriting syndicate. Often Digital Assurance Corporation ("DAC") or other vendors are contracted for review (and may very well be the issuer/borrower's disclosure agent already).

D. Remarketing Agreement (Variable Rate Issues).

1. Pursuant to the remarketing agreement, the underwriter or another designated member of the underwriting syndicate agrees to use its best efforts to remarket any bonds that are tendered and determines the interest rate at the beginning of each new interest rate period.

2. Primary concerns in drafting the remarketing agreement:

a. Appropriate limitations on the obligations of the remarketing agent (best efforts, agent);

b. Coordination with the provisions in the bond documents on the obligations of the remarketing agent and their timing;

c. No obligation to purchase if bonds cannot be remarketed; and

d. Procedures for resignation or removal of remarketing agent (consistent with provisions in the bond documents).

E. Agreement Among Underwriters and Selling Group Agreement.

1. Agreement Among Underwriters - Agreement among the Senior Manager and the other Co-Managers setting forth the original participation of each, the financial agreement among the parties and the responsibilities of each of the parties. Based on a standard industry form (see, The Bond Market Association 1997 form and SIFMA form Master Agreement). Once a formal

document that underwriter's counsel was responsible for preparing, the common form is now a wire sent by the Senior Manager to the Co-Managers.

2. Selling Group Agreement - Letter of instruction to members of the selling group regarding availability of disclosure and details regarding bonds. These were often prepared by the underwriters but rarely utilized today.

3. Under the new tax regulations relating to the determination of issue price, these agreements contain terms requiring members to comply with the "hold the offer price" rule, if that method is selected by the issuer to determine the issue price of any maturity of the related bonds. Issue price certificate(s) should be reviewed for requirements imposed on lead underwriter.

F. Due Diligence

1. What exactly is "due diligence"?

a. The term due diligence refers to the investigation by an underwriter into the business, legal and financial affairs of the issuer or other obligated person concerned in connection with securities offerings or other corporate transactions. A reasonable investigation can provide a future defense for the underwriter in response to securities law or common law claims stemming from a transaction or offering that has gone bad.

b. The underwriter cannot assign its due diligence responsibilities to lawyers or anyone else. Lawyers do not "do due diligence." They assist the underwriter in fulfilling those portions of its due diligence undertakings where lawyers can be useful.

c. In general, the purpose of due diligence is to provide the underwriter with defenses to claims under the securities laws (see below); however, there is an expanding body of SEC interpretive and enforcement law which is changing the underlying basis of "due diligence" from that of establishing due diligence defenses to the affirmative undertaking of certain due diligence responsibilities (primarily related to disclosure).

2. What should conducting due diligence accomplish?

a. Provide backup for the decisions made as to the content of the disclosure document. Due diligence involves document review and interviews with personnel of the issuer/obligated person knowledgeable about such matters during the course of preparing the disclosure document.

1) Frequently, the preparation of disclosure materials occurs in conjunction with the conduct of "due diligence" activities.

2) Confirms the accuracy of the POS/OS and the underwriter's counsel's 10b-5 "negative assurance" letter. The antifraud provisions of the 1933 and 1934 Acts and SEC Rule 10b-5 apply to municipal securities. In order to give its letter (and potentially meet its obligations under these provisions), Underwriter's Counsel needs to conduct a due diligence investigation.

3) End result for an underwriter: Receipt of a 10b-5 negative assurance letter (*i.e.*, "Underwriter's Counsel" opinion letter).

b. Review the basis for the tax-exempt status of the bonds. Although underwriter's counsel usually assumes no responsibility for the validity or tax-exempt status of the securities in question, they generally review the underlying support for bond counsel's opinion respecting those matters. For guidance in the tax area, refer to BAW 2005, *"Tax Due Diligence and Documentation."* In doing so, underwriter's counsel seeks to confirm that the bond counsel opinion:

1) has a reasonable basis;

2) addresses the issues necessary to be addressed in the transaction;

3) is given by counsel who are competent; and

4) is one upon which the underwriter may reasonably rely.

c. Address federal and state law securities questions.

1) Federal securities registration and exemption.

2) MSRB provisions.

3) State blue sky and legal investment laws.

d. Confirm compliance with existing continuing disclosure obligations of the issuer.

1) SEC Rule 15c2-12 requires that the offering document state whether the issuer has failed to comply "in all material respects" with its previous continuing disclosure undertakings under SEC Rule 15c2-12 for the previous five years.

- This should always be a due diligence question posed by underwriter's counsel.

- Should discuss with the underwriter the level of due diligence review by underwriter's counsel the underwriter expects as part of the underwriter's counsel engagement.

- Many underwriters are employing other service providers to conduct due diligence review of EMMA filings.

2) A due diligence investigation of filings on MSRB/EMMA provides the underwriter a reasonable basis for reliance on the issuer's continuing disclosure representations in the offering document.

3) Separate inquiries may be appropriate as they relate to listed events, particularly depending on the type of issuer/bonds.

3. The form of due diligence request varies based on the type of transaction, prior history with the issuer/borrower and the underwriter and the underwriter's counsel preference or practice. Many underwriters will have "form" diligence questionnaires for certain types of transactions.

a. Underwriter's counsel frequently circulates to the issuer/borrower a list of documents that it will need to review and a questionnaire for the issuer/borrower to respond to in writing or on a due diligence call.

1) Documents on the due diligence list should include financial information (audits), board minutes, tax returns, material contracts, articles and bylaws, budgets, insurance coverage information, environmental information, feasibility studies, litigation, and regulatory information. In the case of qualified 501(c)(3) bonds, certain issues related to tax-exempt status need to be reviewed (such as proper accreditation, proper tax filings to maintain 501(c)(3) status (Form 990 and 990-T), proof of current 501(c)(3) status by the IRS – IRS Determination Letter).

2) Areas of concern include potential material financial liabilities, any threat to status as a qualified issuer/borrower of tax-exempt bonds and accuracy of disclosure regarding the issuer/borrower in the POS/OS.

4. The "Document Review" session.

a. Who normally goes out to do the diligence? Associates for underwriter's counsel, bond counsel and borrower's counsel.

b. What About Interviews? It depends on the entity, but could involve the CEO, CFO, strategic/planning person, risk manager, general counsel (re: litigation and/or regulatory issues), board members, project manager, among others. It should include all issuer/obligated person officials responsible for providing the content of the POS and OS.

5. Does underwriter's counsel produce a due diligence report or other document? This depends on a particular firm's practice and the internal requirements of the underwriter. Some firms produce a short memo (which documents the responses from the Q & A session) for internal files. Some underwriters request a due diligence memo from time to time from underwriter's counsel. Underwriter's Counsel's due diligence file should include notes, documents collected from due diligence, the completed due diligence questionnaire and any support necessary for 10b-5 negative assurance letter.

6. Recent practice has been to hold a formal due diligence call with working group members to document responses to certain due diligence questions. All members of the underwriting syndicate should also participate.

7. The "Due Diligence" defense.

a. Section 11 of the 1933 Act permits the purchaser of a security to bring an action based on an untrue statement of a material fact in, or omission of a material fact from, a registration statement.

b. Section 11 does not apply to municipal securities; nevertheless, the SEC has taken the position that parties to exempt transactions are under obligations of investigation similar to those that form the basis of the due diligence defense set forth in Section 11(b) of the 1933 Act. This section exempts from liability any person other than the issuer who can prove that he or she made a reasonable investigation of the underlying facts and had reasonable grounds to believe, and did believe, that the statements made were true.

c. There is an expanding body of SEC interpretive and enforcement law that is changing the underlying basis of due diligence from that of establishing a defense to an affirmative undertaking of certain due diligence responsibilities. An underwriting constitutes an implied recommendation about the securities (SEC Proposing Release for Rule 15c2-12). Also derived from "fair dealing" theory (MSRB Rule G-17 discussed below).

G. Blue Sky Survey.

1. What are blue sky laws?

   a. State securities laws. Each state has its own laws for sale of securities. These laws are designed to prevent fraudulent practices and will, in some cases, require registration of entities selling or offering securities and/or register the securities or provide notice of sale.

   b. As a general rule, municipal general obligation securities are exempt from state securities registration. Nonetheless, recent defaults by the issuer on non-general obligation securities for the bonds may result in registration requirements. In addition, the type of sales (institutional vs. retail) will impact the application of the blue sky laws.

   c. The National Securities Markets Improvement Act of 1996 amends the 1933 Act to preempt important areas of the blue sky laws affecting national markets. The effect of the new legislation is that municipal securities are classified as "covered securities," which prohibits states from regulating them, with certain exceptions such as information filings. One exception is that a municipal security is not deemed to be a covered security in the state in which the issuer is located.

2. Prepare preliminary blue sky survey.

   a. Summary document.

   b. Lists assumptions about the structure of the bonds.

   c. Confirms which states will require action for sale of the bonds, which will not require action and in which states the underwriter has instructed counsel to proceed with the required action.

   d. Generally delivered around time of printing the POS directly to the underwriter.

3. Assist the underwriter with any required filings.

4. Prepare the final blue sky survey or bring-down letter - summary at sale and closing of which states have been cleared for sale of the bonds.

5. Occasionally with the blue sky survey, the underwriter requests a "Legal Investment Survey." This generally is intended to provide information on which institutional investors are allowed to own the bonds under the laws of the investor's state.

6. Some underwriter's counsel outsource blue sky survey work to other specialty firms.

H. Underwriter's Counsel Letter

1. Who is it addressed to?

a. The underwriter.

b. In some cases, the issuer, or a reliance letter to the issuer (the 10b-5 portion of the opinion should never be given to the issuer).

2. What does it generally cover?

a. Neither the sale of the bonds to the underwriter nor the resale of the bonds by the underwriter to the public requires that the bonds be registered under the Securities Act of 1933. (Sometimes broader – not necessary to register any security.)

b. The bond indenture or similar instrument need not be qualified under the Trust Indenture Act of 1939, as amended.

c. The 10b-5 or "negative assurance" statement – "On the basis of our [the underwriter counsel's] participation in the transaction, but without independent verification of factual matters, nothing has come to our attention that would lead us to believe that the OS, as of its date and as of the date of the opinion letter, contains any untrue statement of material fact or omits to state any material fact necessary to make the statements therein, in light of the circumstances under which they were made, not misleading." Generally excludes financial and statistical data and lists certain excluded sections of the OS. **Note: This is not a legal opinion, only a factual statement. Also Note: It is now common to be asked to give the same statement for the POS, and the current NABL Model Letter of Underwriters' Counsel contemplates such addition.**

d. Compliance of the CDA with SEC Rule 15c2-12 with respect to form.

e. Should rely on bond counsel opinion for tax exemption in order to reach the conclusions in a. and b. above. May also need to rely on the opinion of counsel to the credit enhancer.

V. Disclosure Counsel.

A. Role of Disclosure counsel.

1. In recent years, issuers have increasingly retained "disclosure counsel" to prepare the OS or other disclosure documents, to provide disclosure advice to the issuer and to provide limited comfort to the issuer on such disclosure.

2. Disclosure counsel also frequently assists the issuer in preparation for the underwriter's due diligence calls and investor calls.

B. Effect on Role of Underwriter's Counsel.

1. While underwriters sometimes decline to retain counsel when disclosure counsel is involved, most underwriters recognize that disclosure counsel does not provide the underwriter with assistance in the "due diligence" investigation and does not provide advice generally to the underwriter on disclosure matters and other matters affecting the legal duties of the underwriter. (Disclosure counsel's reliance letter to the underwriter will often make this clear.)

2. The presence of disclosure counsel often means that underwriter's counsel is not the primary drafter of the POS/OS, but underwriter's counsel customarily reviews the POS/OS and provides advice to the underwriter on its organization and adequacy. Commonly disclosure counsel and underwriter's counsel work together to address challenging disclosure issues.

3. Underwriter's counsel often includes in the bond purchase agreement a closing requirement that disclosure counsel deliver a "10b-5" or "negative assurance" letter to the underwriter. The letter often specifically points out that the disclosure counsel has not advised the underwriter on its responsibilities under the federal securities laws or otherwise served as counsel to the underwriter.

VI. Practice Tips

A. Who is the Client?

1. Questions exist as to who is the client - The underwriting syndicate as a separate "entity"? The Senior Manager? The Co-Managers? The underwriting syndicate and all selling group members?

2. Some active, large issuers actually recommend the firm who serves as underwriter's counsel (or select a pool of law firms from which an underwriter must select its counsel). Both SIFMA and the MSRB (see Notice 2017-14) have expressed concerns with this practice. Even in these instances, the issuer is <u>not</u> the client; the underwriter is. A practitioner who is confronted by this arrangement should always be mindful of this.

3. Think through the conflicts implications and specify the arrangement in the engagement letter.

4. Consider what is proper disclosure of any conflicts or relationship among parties in the POS/OS.

B. Offering Period - Make sure you know if a "substantial amount" (i.e., 10%) of each maturity of the bonds are sold immediately. Otherwise the underwriting period is still "open" and this has consequences under the bond purchase agreement (particularly obligations under an underwriter's "hold the offering price" commitments in a BPA and issue price certificate).

C. "Firm" underwriting v. "best efforts" - The modern structure of the bond purchase agreement is a hybrid. A "firm underwriting" represents a real financial commitment by the underwriter that affects its balance sheet and requires a much stricter internal approval process. While underwriters in a "best efforts" situation will still purchase all of the issuer's unsold bonds, this is done as a courtesy to the client and not as a result of a legally binding arrangement. Be very clear about the exceptions that allow the underwriter not to close the transaction (which may vary depending on type of issue – e.g., certain high yield offerings may permit an underwriter to walk if a significant investor backs out).

VII. MSRB – What is it and Why Do You Need to Know About it?

A. What is the MSRB?

1. Background: The Securities Act Amendments of 1975 created the 15 member Municipal Securities Rulemaking Board ("MSRB") as a self-regulating rulemaking organization, subject to substantial control by the SEC.

2. Authority: The MSRB's rulemaking authority extends to municipal brokers and dealers, but <u>not</u> to issuers.

3. Responsibilities:

a. Development of a system for registration and regulation of dealers engaged in underwriting and trading municipal securities.

b. Promulgation of rules governing professional qualifications of dealers in municipal securities, record keeping, quotations and advertising.

c. Proposing and adopting rules to effect the purposes of the Securities Exchange Act of 1934 with respect to municipal securities transactions.

d. After July 1, 2009, operate its web-based system known as EMMA, located at http://emma.msrb.org (as described further under Section V., below).

e. With passage of the Dodd-Frank Act, directed by Congress to protect municipalities.

4. Possible structural and jurisdictional changes in pending legislation, including regulation of municipal advisors.

B. MSRB Rules.

1. Purpose: MSRB rules are designed to prevent fraudulent and manipulative acts and practices, to promote equitable trade practices, to foster cooperation and coordination among persons engaged in facilitating transactions, to remove impediments to a free and open market in municipal securities, and generally to protect investors and the public interest.

2. Approval: MSRB rules are generally subject to approval by the SEC. MSRB rules have the force of law.

3. Powers: The MSRB has the power to interpret its rules, but has no inspection or enforcement powers. Inspection and enforcement powers belong to a variety of regulatory bodies, including the SEC, the Financial Industry Regulatory Authority ("FINRA") and federal banking agencies.

C. Summary of MSRB Rules Most Likely to be Encountered.

1. Rule G-11 sets forth the rules for sales of new issue municipal securities during the underwriting period.

2. Rules G-17 through G-39 are known as the "fair practice" rules which prohibit brokers and dealers from engaging in fraudulent or manipulative acts and practices.

3. Rule G-17 broadly prohibits any "deceptive, dishonest or unfair practice."

a. Rule G-17 contains an anti-fraud prohibition; however, it goes beyond prohibiting deceptive conduct on the part of the dealer and establishes a general duty to deal fairly even in absence of fraud.

b. Rule G-17 requires the underwriter, in a negotiated underwriting, to make certain disclosures to the issuer to clarify its role and its actual or potential material conflicts of interest.

c. Rule G-17 prescribes the timing and manner of such disclosures and requires the underwriter to attempt to receive written acknowledgement by an official of the issuer of receipt of the disclosure.

d. Rule G-17 also prescribes issuer disclosures by the underwriter in negotiated underwritings on aspects of routine or complex financings.

4. Rule G-21 regulates the advertising of the sale of municipal securities. The Rule prohibits any dealer from publishing materially false or misleading advertisements.

5. Rule G-23 – Key amendments adopted in November 2011 redefined the underwriter's role and relationship to the issuer. In general, Rule G-23 prohibits a dealer that serves as municipal advisor to the issuer for a particular issue sold on either a negotiated or competitive bid basis from switching roles and underwriting the same issue.

   a. Rule G-23 is solely a conflicts-of-interest rule and does not establish normative standards for dealer conduct (*i.e.,* it does not determine whether advice permitted by Rule G-23 would cause a dealer to be considered a "municipal advisor" that is subject to a fiduciary duty under Section 15B(c)(1) of the Act).

   b. Under Rule G-23, an underwriter may provide advice concerning the structure, timing, terms and other similar matters concerning an issue of municipal securities that it is underwriting if:

      1) it clearly identifies itself in writing as an underwriter and not as a municipal advisor from the earliest stages of its relationship with the issuer with respect to that issue (*e.g.*, in a response to RFP or in promotional materials provided to an issuer);

      2) the writing makes clear that the primary role of an underwriter is to purchase securities in an arm's-length commercial transaction between the issuer and the underwriter and that the underwriter has financial and other interests that differ from those of the issuer; and

      3) the dealer does not engage in a course of conduct that is inconsistent with the arm's-length relationship with the issuer in connection with such issue of municipal securities.

6. Rule G-32 sets forth the disclosure requirements for brokers, dealers and municipal securities dealers in connection with new issues and sets forth certain admission requirements with respect thereto to the MSRB's EMMA system.

   a. Requires that brokers or dealers who sell municipal securities deliver to the customer (i) an official statement (or, if no official statement is being prepared, a written notice to that effect), and (ii)

in negotiated sales of new securities, information about the underwriting spread, dealer fees and the initial offering price for each maturity offered by the underwriters ("Confirms").

b. Also sets out the responsibilities of managing underwriters, sole underwriters and municipal advisors.

c. Covers underwriter submissions to EMMA (including notices if no POS or OS is being prepared).

d. If a POS or OS is amended or "stickered" during the primary offering disclosure period, the broker, dealer or municipal securities underwriter must send the amended POS or OS to EMMA within one business day of receipt from the issuer.

e. Underwriters are required to submit the OS, together with Form G-32, electronically.

7. Rule G-34 sets forth requirements for obtaining CUSIP numbers for new securities, making new securities depository eligible (DTC) and filing certain documents with the MSRB relating to variable rate municipal securities (i.e., variable rate demand obligations or VRDOs).

8. Rule G-37 requires municipal securities dealers to file reports with information on political contributions made. The rule also prohibits dealers from engaging in municipal securities business with an issuer within two years of making a non-exempt contribution to an official of such issuer. Rule G-37 requires dealers to file reports, which the MSRB makes public, that detail the contribution amount, the contributor, and the official to whom the contribution was made. In Blount v. SEC, 61 F.3d 938 (D.C. Cir. 1995), Rule G-37 withstood both a First Amendment freedom of speech challenge and a Tenth Amendment state sovereignty challenge.

9. Rule G-38 prohibits payments by a broker, dealer or municipal securities dealer to any affiliated person obtain municipal securities business from an issuer. There are transitional payment rules in effect for agreements with consultants made prior to August 29, 2005, which must be in writing, must be disclosed in writing when related to any issuer with which the broker, dealer or municipal securities dealer is engaging or seeking to engage in municipal securities business information and must be disclosed quarterly to the MSRB.

10. Rule G-42 sets forth core standards of conduct for municipal advisors that engage in municipal advisory activities, other than municipal advisory solicitation activities. The adoption of Rule G-42 (and related amendments to Rule G-8) represent a significant milestone in the MSRB's development of a comprehensive regulatory framework for municipal advisors in the

exercise of the rulemaking authority granted to the MSRB by the Dodd-Frank Wall Street Reform and Consumer Protection Act. Rule G-42 became effective on June 23, 2016.

D. Underwriter's Counsel Responsibilities with Respect to Compliance with MSRB Rules.

1. Generally, in-house counsel is responsible for compliance with MSRB rules. Occasionally, underwriter's counsel is asked to weigh in on MSRB rules compliance issues.

2. Certain MSRB rule requirements are reflected in the terms of the bond purchase agreement (e.g., delivery of the OS).

3. Working knowledge of MSRB rules is very beneficial.

4. Underwriter's counsel should notify the underwriter's in-house counsel of transaction issues with potential MSRB compliance implications.

Sources for further review:

Websites:

1. MSRB: *www.msrb.org* ("Rules, Forms and Glossary" icon)
2. Securities Industry and Financial Markets Association: *www.sifma.org*
3. NABL: *www.nabl.org*

Publications:

1. NABL, "Rule 15c2-12 Handbook" (May 1, 1996)
2. NABL, "Model Letter of Underwriter's Counsel"
3. ABA "Disclosure Roles of Counsel in State and Local Government Securities Offerings," 3d Edition