

The Role of Underwriter's Counsel

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The Essentials

APRIL 19–21, 2023

Introduction

What is an Underwriter?

What are the duties of an Underwriter?

- Purchase of bonds and redistribution to ultimate investors
- Duty of fair dealing vs. fiduciary duty

Who regulates the Underwriter?

- SEC
- MSRB
- State regulators

Who hires the Underwriter?

- Issuer
- Other obligated person

How is an underwriter paid?

What are alternative means of sale and distribution of Bonds?

- Sole underwriter
- Underwriting syndicate or group (lead underwriter, co-managers, selling group and related agreements)
- Public/competitive sale
- Direct placement

Municipal Advisor Rule

- Underwriter's exception (and limits of underwriter's exception)

Duties of Underwriter's Counsel

- Provide legal advice to the underwriter as to the structure of the financing

- Review and comment on authorizing resolutions, bond/financing documents, credit enhancement documents and tax documents from the perspective of the underwriter

- Review and negotiate all documents and certificates to be signed by underwriter (such as underwriter's receipts, issue price certificates, etc.)

- Advise the underwriter on legal disclosure and securities matters

- Draft/assemble offering document (i.e., "preliminary official statement"/"preliminary offering memorandum")

- Assist the underwriter in meeting "due diligence" obligations imposed under securities laws, including continuing disclosure compliance

- "Posting" of preliminary official statement/preliminary offering memorandum
 - For offerings subject to SEC Rule 15c-2-12, confirm "deemed final"
 - Assist in preparation of any needed supplements/amendments to disclosure

- Draft bond purchase agreement ("BPA")

Duties of Underwriter's Counsel, cont'd

- Update and finalize/post official statement/offering memorandum, incorporating final terms
 - No more than seven (7) business days following execution of BPA under SEC Rule 15c2-12
 - For transactions subject to SEC Rule 15c2-12, note that changes should be subject to “permitted omissions”
- Draft or review continuing disclosure agreement (“CDA”) under SEC Rule 15c2-12
- Draft or review remarketing agreement (if applicable)
- Assist in regulatory compliance (e.g., MSRB Rule G-17, G-34, SEC Rule 15c2-12)
- Prepare blue sky survey of actions required to sell bonds in certain states
- Review all principal bond documents, closing documents/certificates, credit enhancement documents and opinions to confirm conditions of closing are satisfied
- Review closing/settlement statement/flow of funds memorandum
- Deliver required underwriter's counsel opinions/statements at closing

(Review underwriter's counsel memorandum or engagement letter, often based on 2018 SIFMA model, and related 2019 NABL analysis).

Structuring a Bond Issue

Who decides the terms and conditions of the bonds to be offered?

- The underwriter (operating under a municipal advisor exemption) analyzes the capital/refunding needs and debt capacity of the issuer/borrower, prepares projections of debt service structure, and reviews projections with issuer/borrower and its municipal advisor and discusses various options
- May propose ratings, credit enhancements, etc., considering cost/benefit
- The issuer/borrower working with its municipal advisor makes selection

Once terms are established:

- Bond counsel incorporates financial terms into bond documents and ensures structure complies with state and federal laws
- Underwriter's counsel confirms terms are as expected by underwriter and are properly disclosed

Other Pre-Sale Activities

- Rating agency presentations
- Meetings with credit enhancers
- Other investor activities (e.g. calls, "road shows")

Due Diligence

Investigation by an underwriter into the business, legal and financial affairs of the issuer/borrower in connection with securities offerings or other corporate transactions

- Underwriters cannot assign due diligence responsibilities to lawyers or anyone else
- Underwriters may nevertheless ask outside counsel to document activities undertaken on their behalf as part of underwriter's internal procedures

Purpose of due diligence

- Underwriter must have a reasonable basis to recommend securities
- SEC Rule 10b-5: *It is unlawful to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading*
- Underwriter's counsel helps to advise the appropriate level of due diligence and disclosure

Process of due diligence

- Due diligence questionnaire(s)
- Review of documentation
- Management interviews
- Due diligence call/meeting

(Consider efforts to coordinate UC due diligence with tax counsel and special disclosure counsel due diligence)

Due Diligence, cont'd.

Due diligence considerations

- Facts and circumstances
- Nature and operations of issuer/obligated person and structure/collateral of bond issue
- Materiality of information
- Issuer/obligor in-house counsel input
- Third-party input (i.e., accountants, consultants, etc.)
- Reliance on other legal opinions (e.g., bond counsel opinions, 501(c)(3) opinion, borrower/obligor opinion)

What would a reasonable investor want to know, taking into consideration the total mix of information?

Avoid “asymmetric disclosure”

Note applicable disclosure policies

Consider NABL/GFOA disclosure guidance

How long does Underwriter’s due diligence responsibility continue?

Drafting/Reviewing Disclosure

- **Primary concerns:**

- clarity, accuracy and completeness
- appropriate disclosure of information material to making investment decisions
- assessment and disclosure of due diligence results
- “staleness” of financial information
- verifications, agreed-upon procedures
- disclosure of structure and bond terms
- appropriate disclosure of risks related to purchase of the bonds
- disclosure of litigation/regulatory matters
- disclosure related to SEC rule 15c2-12 compliance (MCDC)

- **Recent emphasis on disclosure policies and procedures for municipal issuers**

- **“Special disclosure counsel” may be retained to prepare POS/OS (or for particular sections/subject matter areas, e.g. pension matters, pending litigation, etc.)**

- Does not change responsibilities of underwriter’s counsel

- **Consents for inclusion of third-party reports (i.e., audited financial statements, projections, etc.) may be required**

- **Special Designations (e.g., Social Bonds, Sustainability Bonds, Green Bonds, etc.)**

- **Who approves the disclosure document prior to posting?**

Disclosure Counsel

- **Often, specialized disclosure counsel is engaged to draft some/all of disclosure document**
- **Role of Disclosure Counsel**
 - Prepares disclosure document, to provide disclosure advice to the issuer and to provide limited comfort to the issuer on such disclosure
 - May assist in preparation for underwriter “due diligence calls” and investor calls
- **Effect of Disclosure Counsel on role of Underwriter’s Counsel**
 - Underwriter’s counsel will often cease to be the primary drafter of the official statement
 - Should not otherwise affect duties/obligations of underwriter’s counsel
- **Underwriter’s counsel will often include in the BPA a closing requirement that disclosure counsel deliver a “10b-5” or “negative assurance” letter to the underwriter**

Offering and Sale of Bonds in Negotiated Sale

Posting of preliminary official statement/preliminary offering memorandum

- Timing of posting may take into consideration market conditions, other similar issues in the market, etc.
- For transactions subject to SEC Rule 15c2-12, confirm “deemed final”
- Coordination with “printer”

Marketing of bonds

- Underwriting “desk” communicates with investors (institutional, retail)
- Marketing period varies, often 1-3 weeks

Order period(s) at end of marketing

- Institutional and retail

Offering and Sale of Bonds in Negotiated Sale, cont'd

➤ Pricing

- Established and provided by underwriter to issuer/obligated person/municipal advisor for approval (Note: MSRB Rule G-17 – implied representation that prices are fair/reasonable)
- Pricing information circulated via pricing wire
- Note “Issue Price Rule”, general rule maturities and unsold/undersold “hold the price” maturities
- Final pricing incorporated into bond purchase agreement
- Bond purchase agreement executed, establishing underwriter’s commitment to purchase bonds
 - Note importance of timely execution and delivery of BPA to permit underwriter to make required reporting
 - Bonds priced on date of BPA for purchase and delivery on future closing date
 - Often 1-4 weeks from BPA to closing
 - Forward delivery structure may extend delivery period

Offering and Sale of Bonds in Negotiated Sale, cont'd.

Posting of final official statement/offering memorandum

- For transactions subject to SEC Rule 15c2-12
 - Within seven (7) business days after BPA
 - Changes should be limited to “permitted omissions”
- Coordination with “printer”

Pre-closing

- Execution of bond documents
- Delivery of bonds to purchaser(s), trustee/paying agent or DTC

Closing

- Underwriter pays for bonds
- Bonds delivered to underwriter (often via DTC)
- Underwriter distributes bonds to accounts of ultimate purchasers
- Note obligations that may extend beyond closing under BPA (i.e., “end of the underwriting period”)

Bond Purchase Agreement (“BPA”)

In negotiated sales, BPAs are used to commit to writing between the issuer and the underwriter (and borrower, in a conduit transaction)

- Pricing terms
- Underwriting compensation, fees/expenses
- Representations and warranties
- Closing conditions
- “Outs”
- Indemnity and contribution provisions
- General contractual provisions (choice of law, severability, etc.)
- Forms of documents to be delivered (e.g., opinions, agreed-upon procedures letter, issue price certificate)

Parties may have preferred form of BPA

SIFMA model form BPA is located at www.sifma.org

Amendments to MSRB Rule G-23 and guidance on MSRB Rule G-17 have resulted in many underwriters requiring disclaimer language in BPAs

Determination of issue price governed by BPA

Note importance of timing - real-time pricing information posted on EMMA

BPA Not used in competitive sales

Continuing Disclosure Undertaking (“CDA”)

- **Required by SEC Rule 15c2-12 in connection with**
 - the purchase or sale of municipal securities
 - in connection with a primary offering of municipal securities
 - with an aggregate principal amount of \$1,000,000 or more
- **Undertakings may be in a separate CDA or contained within other financing documents**
- **CDAs generally require the issuer or “obligated person” to provide**
 - certain annual information (i.e., financial information and operating data)
 - timely notice (10 days pursuant to Rule 15c2-12) of certain enumerated events
 - note recent amendments calling for disclosure of “financial obligations”
- **Exemptions – requirement does not apply to a primary offering of municipal securities in authorized denominations of \$100,000 or more, if such securities:**
 - (i) Are sold to no more than thirty-five persons each of whom the Participating Underwriter reasonably believes: (A) Has such knowledge and experience in financial and business matters that it is capable of evaluating the merits and risks of the prospective investment; and (B) Is not purchasing for more than one account or with a view to distributing the securities; or
 - (ii) Have a maturity of nine months or less.
 - *(NOTE: recent enforcement actions relating to this exemption)*

Continuing Disclosure Undertaking (“CDA”), cont’d.

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| ➤ Underwriter must make a determination that it reasonably believes the issuer or obligated person, as applicable, will comply with Rule 15c2-12 |
| ➤ Underwriter must establish reasonable basis for future compliance if there have been past failures to comply |
| ➤ Primary drafting concerns <ul style="list-style-type: none">➤ Confirm requirements of Rule 15c2-12 are included in CDA➤ Discuss proper contents of annual financial information with issuer/obligor and underwriter➤ Identify annual financial information in a manner that is “workable”➤ Seek consistency of forms/reporting for frequent issuers, but don’t just blindly use the last form➤ Discuss whether third-party “dissemination agent” will be involved➤ Consider provisions permitting amendments |
| ➤ Accurately describe continuing disclosure undertaking from CDA in POS |
| ➤ Disclose material noncompliance with prior CDAs under Rule 15c2-12 for the past five years <ul style="list-style-type: none">➤ Third-party consultants will review EMMA and prepare reports➤ Discuss disclosure review for complex issuers, e.g., HFAs with single-family programs |
| ➤ MCDC |

Remarketing Agreement

- Typically, applies to variable rate bonds (VRDOs) and other “multi-modal” structures and obligates the “remarketing agent” (often the underwriter, but sometimes another entity) to:
 - determine periodic interest rate resets
 - use best efforts to remarket (i.e., re-sell to new investors) bonds that are tendered for purchase under the applicable indenture provisions
- **Primary drafting concerns**
 - Appropriate limitations on obligations of the remarketing agent
 - Rating “floor”
 - No obligation to purchase if bonds cannot be remarketed
 - Nature of duty – “best efforts”
 - Remarketing disclosure
 - Coordination with provisions of bond documents, particularly intra-day timing provisions
 - Resignation/removal of remarketing agent
 - Succession clause

Blue Sky

Blue Sky Laws – STATE laws governing the sale of securities

Preliminary Blue Sky Survey

- Advises the underwriter of state law requirements associated with the sale of bonds
- Generally delivered around the time of the printing of the POS

Final Blue Sky Survey or Bring-Down Letter

- Summary at sale and closing of which states have been cleared for sale of the bonds

What if underwriter requests a blue sky survey and UC firm does not feel comfortable preparing one?

Underwriter's Counsel Letter

Addressed to underwriter

Generally covers:

- Neither sale of the bonds to underwriter nor resale of the bonds by underwriter to the public requires bonds be registered under the Securities Act of 1933
- Bond indenture or similar instrument need not be qualified under the Trust Indenture Act of 1939
- 10b-5 or “negative assurance” statement – note, this is not a legal opinion, only a factual statement
 - Note customary exclusions
- Compliance of continuing disclosure undertaking with Rule 15c2-12

See NABL model form and related commentary

Should rely on bond counsel opinion for tax exemption in order to reach first two conclusions above (although reliance must be reasonable)

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Other Considerations

Who is the client?

- Is it the Syndicate as a separate entity? The Lead Manager? The Co-Managers? The Syndicate and all Selling Group Members? How does this impact conflict searches?
- Sometimes issuers will recommend underwriter's counsel; even in these cases, the issuer is not the client
- Seek clarity in engagement letters

Consider proper disclosure of conflicts/relationships among parties in the POS/OS

Never forget professional responsibility obligations

Questions

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