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Content

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Editor's Notes

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In this Edition

At (very) long last, we are pleased to republish the recent article titled *"Municipal Market Evolution Reflecting the Constitutional Underpinnings of the Law of Public Finance"* co-authored by Ann D. Fillingham, Joseph (Jodie) E. Smith, Perry E. Israel and this Editor. The article was first published in *The Urban Lawyer*, Volume 52, Number 1 on June 30, 2023. This article was a long time in the making and, while it might not include earth shattering revelations for many bond lawyers, it provides insight into why things are the way they are in the municipal space and lays the groundwork for future articles distinguishing our market from the corporate and other commercial markets. It is also a bittersweet moment to remember and be grateful for the valuable input and insight of Perry Israel on this project and all his other NABL endeavors.

Tony Martini's column in this edition includes the latest on the federal tax scene, including a marking of the end of the LIBOR era.

Drew Kintzinger reports on recent statements by SEC Commissioners, including statements made at the SEC's Office of Municipal Securities Disclosure Conference held last month in DC, as well as updates to ongoing litigation of enforcement matters of interest to the bond lawyer community.

Update of 1994 Interpretive Release (Yes, No, Maybe?)

For more than a decade, NABL has, on more than one occasion, suggested topics that might be addressed in an update of the 1994 Interpretative Release that would be beneficial for the municipal market. Drew Kintzinger's column in this edition suggests the SEC Commissioners' remarks could provide a rough outline of the next (updated) Interpretive Release, including voluntary disclosure, timeliness and uniformity of financial disclosures, and certain risk factors. Previous NABL suggestions included clarification of when a remarketing of bonds is a primary offering, scope of issuer governing body responsibility for disclosure in primary and secondary market disclosure, and the use of disclaimers, among others. In a new request to NABL members for input on this topic, NABL asks members to comment on whether recent SEC actions or market developments have negated the need for additional SEC guidance on these matters and/or revealed other areas in which authoritative guidance is needed (or at least welcomed). The topic of the sufficiency of recent statements on disclosure matters was raised in several of the panels at the May 2023 SEC Office of Municipal Securities Disclosure Conference. The distinction between formal Commission guidance (e.g. the 1996 Orange County Report and the 1994 Interpretive Release) and staff or individual Commissioner statements (e.g. the Staff Legal Bulletin of 2020 and the then SEC Chair and OMS Director joint "COVID" Statement in 2020) was specifically noted by NABL President Jodie Smith in a question to the first panel and later commented on by OMS Director Dave Sanchez and others. One panelist suggested the current library of statements (formal, staff, or individual), may provide sufficient level of comfort with respect to forward-looking statements and related disclaimers. There may or may not be consensus on that point, however, the current library of unofficial guidance or statements is temporary at best and may be made obsolete by subsequent conflicting statements and/or enforcement actions. From the panel discussions, it seems clear that clarification on matters relating to voluntary and selective disclosure topics, including the ability of a municipal issuer to draw a bright line to differentiate information intended for investors and all other information, could potentially advance the expansion of voluntary disclosure for the benefit of both investors and issuers. It will be interesting to see the results of the NABL survey in the future.

Affordable Housing

The National Low Income Housing Coalition released its 2023 report "Out of Reach"[1] which describes the realities of the long-term trend of an increasing population of lower-income renters, a decreasing relative supply of affordable rental units, and wages that have not kept up with the rising cost of housing. Bond lawyers practicing in the housing finance sector will confirm we are doing our part in financing affordable housing developments. This is illustrated by data on how much of the nation's private activity bond issuance is for single-family and multi-family housing purposes on an annual basis. In Florida, for example, in 2022 more than 90% of the private activity bonds issued, or $1.5 billion, in Florida were issued for housing purposes (single-family and multi-family but excluding mortgage credit certificates). This appears consistent with previous data collected by the Council of Development Finance Agencies (CDFA) which reported that in 2020 more than 87% of private activity bond issuance, or $24.3 billion, were issued for housing purposes. States have also passed significant legislation to address the affordable housing shortage, including Florida's "Live Local Act" that, by many accounts, represents the largest investment to date for affordable housing development in Florida history (although it does preempt local efforts regarding rent control). Other states have also recently passed legislation favorable to affordable housing developments. There are also several pieces of federal legislation passed, pending, or proposed that could assist in bridging the affordable housing gap by providing addition or

[1] The 2023 report is available at Out of Reach | National Low Income Housing Coalition (nlihc.org).

enhanced incentives for affordable housing development and rental assistance. The question remains as to the reaction time for these legislative measures to produce meaningful alleviation in the housing market.

Forward Refunding Deals

Congratulations to all the finance directors (and their municipal advisors and bond lawyers) who are looking particularly brilliant at closings this year on forward deals entered into prior to the uptick in interest rates. A recent governmental transaction we closed was originally structured in 2020, with a forward delivery in March 2023 and a tax-exempt rate of 1.72% for a 7-year term. For reference purposes, according to The Bond Buyer, the yield on the 10-year Treasury Note at the beginning of March 2023 was around 4% and the Bond Buyer Index for 20 year GO bonds was 3.75%. It doesn't take a math magician to know that turned out to be good deal for the issuer.

Closing Thoughts

A question for the bond lawyers with children: How do you explain to a child what it is you do for a living? It's easy to just say, "Mom (or Dad) is a lawyer," but with the plethora of personal injury lawyer advertisements on TV and social media, this explanation may not be sufficient to differentiate us from "them." I have never seen an advertisement on TV that opens with "Does your city need a new wastewater treatment facility? At our firm, 'Bonds R Us,' we provide high quality legal advice for your infrastructure financing needs. No project too large (maybe some too small, but never too large). Call us today for your free consultation and complimentary copy of the 'ABC's of Arbitrage.'" When my kids were younger, we lived in Jacksonville and the drive into town over the Matthews Bridge took us by the Jacksonville Jaguars stadium. So, I told them "That's what mommy does. I helped build the Jaguars Stadium." They were very impressed with that but not so much with the water and wastewater treatment plants, roads, schools, hospitals, and affordable housing developments.

And now, enjoy the rest of this edition of *The Bond Lawyer*.

Federal Securities Law

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The Spring quarter just wrapping up brought us remarks and views on the municipal securities market from the SEC Chair and from three of the SEC's Commissioners. A review of these speeches from Spring conference season allows us to "take stock" of where the Commission may be headed in rulemaking, interpretative guidance and enforcement efforts affecting municipal securities. The Spring quarter also brought us some case law updates relevant to our practices.

Commissioner Views on the Municipal Market
In late March, **Commissioner Caroline Crenshaw** (D) offered remarks regarding the municipal market at the *Fixed Income Forum Spring Roundtable*. Observing that equity market structure gets a lot of attention, she set the stage that, by some measures, investor protection and outcomes in the fixed income markets, including the municipal bond markets, "lag behind." Making the case for structural reforms in these markets, she noted the important role of the "*$4 trillion municipal bond markets*" in the U.S. economy:

> *The . . .municipal securities markets are relied upon by both retail and institutional investors, including Americans who are approaching retirement or are already there . . . . In the municipal securities market, transactions of less than $25,000 account for more than half of the trades, and those less than $100,000 account for 87% of trades, reflecting that individual investors hold the majority of outstanding municipal bonds.*

In describing the municipal markets, she did note that EMMA lacks information on customer types, so determining the precise proportions of retail and institutional traders is not possible, further noting that "$100,000 is an often-used proxy for retail size trades."

Commissioner Crenshaw explained that municipal bond investors are incurring trading costs that far outstrip transaction costs in the equity markets, noting that municipal bond trading costs are as high as 90 basis points for retail-size trades. She offered her view that, surprisingly, smaller bond transactions more likely to originate with retail investors are more expensive to complete than larger transactions, the opposite of what occurs in equity markets. Her recommendations include improving pre-trade price transparency and improved visibility into market intermediaries and trading platforms:

> *When I discuss pre-trade transparency, I sometimes use the example of airline travel. When I am searching for a flight, I do not go to an airline website and book the flight for whatever price is offered. I start with one of the aggregation websites, which gathers all the available prices online and allows me to select the best offer. Like most people, I want to be able to see the best price available before making my purchase.*

She observes that, despite several initiatives on both fronts, "municipal bonds have been largely left out of these initiatives." She suggests expanding markup and markdown disclosures as perhaps the simplest way to improve investor outcomes:

> *I urge my colleagues at the SEC to consider providing investors in . . . municipal bond markets—who, again, are often individuals seeking safety and reliability—with some of the same protections that we provide to investors in other asset classes.*

Commissioner Crenshaw strikes theme of not just investor protection, but proactively engaging market structure reform to improve investor outcomes. Note that this Commissioner's comments follow the SEC Enforcement Division's January 2023 settled administrative proceeding against Bloomberg Financial L.P. regarding Bloomberg's BVAL pricing methodology for municipal bond trades and disclosures about such methodology, reported on in the Winter 2023 edition of this Column.

The May 2023 Municipal Securities Disclosure Conference, produced by the Commission's Office of Municipal Securities and held at Commission headquarters in Washington DC (combined live and online attendance of approximately 1,000) offered speaking remarks from **Chair Gary Gensler** (D), **Commissioner Jaime Lizarraga** (D) and **Commissioner Hester M. Peirce** (R). **Chair Gensler** commenced the Conference with a general history overview of Rule 15c2-12 and the Commission's enforcement role in disclosure cases. He acknowledged the uniqueness of the municipal market:

> *While the SEC oversees more than 7,000 public company issuers, there are around 50,000 municipal securities issuers. Strikingly, there are approximately one million different outstanding municipal securities—more than 30 times the number of outstanding corporate bonds.*

With his nod to the diversity of the issuer community and the complexity of municipal securities types, Chair Gensler highlighted that he looked forward to conference day panels on voluntary disclosures and on the Fair Data Transparency Act (FDTA). Key factors in progress on voluntary disclosure and in grappling with the FDTA are the very diversity of issuers and the complexity of exempt securities that comprise the municipal securities market.

Commissioner Lizarraga focused his remarks on the FDTA and the municipal market:

> *The FDTA requires the SEC to consult market participants in establishing data standards for the municipal market . . . . Congress gave the SEC, and the other federal financial regulators, two years to develop and publish data standards through a joint rulemaking. After those standards are finalized, the SEC will have up to two more years to issue rules for municipal securities. This means that municipal issuers and other market participants may have up to four years to prepare before any data standards adopted under FDTA are issued . . . . The FDTA allows for scaling of disclosure for smaller issuers—state, local, tribal, and territorial governments and other relevant authorities. This flexibility may address some of the concerns about costs for smaller municipal issuers.*

Commissioner Lizarraga also touched on the importance of ESG risk disclosures for the municipal securities markets and cybersecurity disclosures for municipal issuers.

From Chair Gensler and Commissioners Crenshaw and Lizarraga, one can see the rough outline perhaps of a next interpretive release – an update of the 1994 Interpretive Release – on current topics of voluntary disclosure, more timeliness and uniformity of financial disclosures, ESG risk disclosures and cybersecurity disclosures. These speakers' remarks see these topics in an inherently retail municipal marketplace, with investor protection of retail investors a key motivation for future Commission rulemaking and interpretation activities.

Commissioner Hester Peirce struck a different tone with her "*Forest and Trees Remarks before the 2023 Municipal Securities Disclosure Conference.*" Her theme was that, with respect to FDTA and ESG, "*an insistence on standardization can obscure real differences across municipal issuers.*" Expressing doubts about imposing uniform data standards, she noted:

> *Congress made it clear, however, that it expects the Commission and other financial regulators to require the use of structured data in financial reporting, including, with respect to municipal securities, "for information submitted to the [Municipal Securities Rulemaking Board ("MSRB")].*

On its face, that language in the statute should give the issuer community some comfort that FDTA will not alter the substantive financial disclosure that may be required under Rule 15c2-12, but rather only affect the form of such financial submissions with a goal of uniformity in mind. However, Commissioner Peirce went on to express concerns about the nuances of the limitation to information submitted to the MSRB:

> *The unique characteristics of the municipal bond market will require us to consider carefully how the structured mandate should apply. After all, if the costs of a public municipal bond offering get too high, municipal issuers can raise funds in ways other than selling bonds, such as through the private markets or bank financing. Moreover, because the FDTA empowers the Commission to call for structured data only with respect to "information submitted to the [MSRB]," our implementation of structured data requirements inadvertently could deprive investors of information if issuers reduce their voluntary disclosures through the EMMA system.*

The tie-in between achieving structural data uniformity and reducing voluntary disclosures is an interesting market structure challenge for the municipal issuer community. Commissioner Peirce goes on in her remarks to ask a number of policy questions that bear reprinting and consideration by the municipal issuer and municipal bond lawyer communities:

> *Although broad, the statutory mandate expressly reserves the Commission's ability to tailor requirements, and we should use that authority to get the balance right. To do so, we need more than enthusiastic hand-waving about the general benefits of increased transparency. We need a frank discussion, grounded in the municipal market's unique qualities, about what concrete benefits we expect structured data to produce. We need to understand what structured data*

will make possible that is not possible now, and how those new possibilities will advance the quality of these disclosures in ways that benefit our markets and investors. For example, if a key benefit of structured data is in empowering analysts to aggregate data across issuers, how does that aggregation benefit participants in this specific market? Do municipal issuers face unique costs in structuring their data? Are there tools upon which small and infrequent municipal securities issuers could rely to minimize these costs? How can the SEC best assist municipal issuers seeking to standardize their data? Will standardization of data obscure important distinctions across municipal securities or their issuers?

Only after we have had this discussion will we be ready to determine how the Commission should tailor the structured data mandate to the municipal market. For example, given the great diversity in sizes and types of municipal issuers, the Commission may determine that the benefits of requiring certain issuers to use structured data are minimal or that the costs are too high. Similarly, given the nature of the disclosures required under MSRB Rule G-32 and Exchange Act Rule 15c2-12, the Commission may determine that a blanket imposition of the structured data requirement to all "information provided to the [MSRB]" will not provide significant benefits to the market. Moreover, the Act applies not only to information supplied by municipal issuers but also presumably to information provided to the MSRB by Commission-regulated market participants, such as broker-dealers and municipal advisors, and the Commission will need to give careful thought to whether structuring this information also makes sense. Of paramount importance, as we think about the scope of tailoring FDTA requirements, our focus must be on what investors need and not on eliciting data for other purposes.

Commissioner Peirce went on in her remarks to ask a similar series of market structure and disclosure policy questions about the current topic of encouraging or mandating ESG risk disclosures, citing GFOA commentary that each issuer should determine what, if any, disclosures are appropriate as discussed with bond counsel.

It is unique that we heard from the Chair and three Commissioners about the municipal market in such a short period of time, afforded to us mainly by the SEC's Municipal Securities Disclosure Conference, ably presented by the Office of Municipal Securities. As a lawyer community that has worked with Commission staff on the development and evolution of Rule 15c2-12, we know that staff across the Office of Municipal Securities, the Trading and Markets Division and the Enforcement Division necessarily work with each Commissioner and Commissioner staffs in developing rules and enforcement positions regarding municipal securities market practices and municipal bond disclosure principles. In addition, parties that find themselves involved or targeted in SEC enforcement investigations in the municipal securities space are keen to know the positions and "tenor" of Commissioners when evaluating how best to respond and defend in SEC proceedings.

Case Law Update

The Summer 2022 edition of this publication (Volume 46, Issue No. 3) discussed the ***SEC v. Cochran*** case pending before the US Supreme Court regarding whether a defendant in an SEC administrative proceeding can go directly to federal district court to challenge the SEC's adjudication as unconstitutional, or whether the defendant must proceed through a full administrative hearing with the Administrative Law Judge ("ALJ"), appeal through the Commission, and only then ultimately appeal to the US Court of Appeals. In ***Cochran***, Michelle Cochran, a certified public accountant, was the subject of an SEC enforcement action. She sued the SEC in federal district court while her enforcement action was pending in an administrative proceeding. Specifically, Cochran claimed that the SEC's basic administrative proceeding and ALJ structure and operation was unconstitutional and, consequently, the pending SEC enforcement action was unconstitutional. In 2016, the SEC had commenced an enforcement action against Cochran, alleging she had not complied with federal auditing standards. The SEC chose to try the case before an ALJ, who found that Cochran had violated federal law, fined her $22,500 and banned her from practicing before the SEC for 5 years. The full Commission upheld the ALJ finding, and Cochran filed a lawsuit in federal district court challenging the constitutionality of the ALJ structure.

On April 14, 2023, the US Supreme Court unanimously held in Cochran's favor that federal district courts have jurisdiction to hear extraordinary claims challenging the constitutionality of the structure and use of ALJs by the SEC. ***SEC v. Cochran, No. 21-1239***. The ***Cochran*** decision means that persons and entities subjected to SEC enforcement administrative actions can more promptly and easily raise certain structural and constitutional challenges in federal district court without having to first complete lengthy and costly administrative hearings and proceedings. Meaningful and earlier judicial consideration of "here and now injury" is more at hand to enforcement targets. After ***Cochran***, it can be expected that the SEC will file contested claims in federal district court rather than proceeding through the administrative proceeding/ALJ process. This is a trend that has been noted in this column in recent issues.

On a related case note, on June 30, the US Supreme Court granted the government's petition for writ of certiorari in ***Jarkesy v. SEC***. In this case, the 5^{th} Circuit Court of Appeals held, among other issues, that the SEC's "in-house adjudication" of alleged securities law violations by an SEC ALJ violated a defendant's right to a jury trial. In October 2022, the 5^{th} Circuit declined to grant a rehearing *en banc* in this case. The Court will hear the case next Term.

The second quarter of this year was quiet in the way of newly published administrative settlements with the SEC on municipal matters, and quiet with respect to newly filed litigation actions file by the Commission on municipal securities matters. We know from conference discussions that work continues on previously filed litigation actions, and we will monitor developments over the summer months.

The Tax Microphone

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As I write this column, we are fast approaching the midpoint of 2023. June 30 is particularly notable this year, as it marks the end of the LIBOR era, at least in terms of the publication of USD-LIBOR rates established by the modified estimate quotation methodology that has been in place for some 10 years or so. I suspect that many bond practitioners will feel some relief beginning on July 1, given the sheer numbers of currently-outstanding tax exempt bond issues whose interest rates are or may be set by reference to LIBOR tenors, to say nothing of the interest rate hedging instruments for those issues that do the same. For some of us, the cascade of LIBOR transition exercises that required attention have been fairly overwhelming; perhaps that's been a blessing for some of us in a soft market for new tax-exempt issuances. More than once over the last six months or so, the flurry of LIBOR-related housekeeping activity has reminded me of another deadline years back that we all thought was looming: Y2K. Unlike Y2K, LIBOR cessation is an objectively demonstrable fact—June 30 will roll around, and USD LIBOR rates will no longer be discoverable.

Actually, and perhaps somewhat surprisingly, that's not exactly the full story. In early April 2023, the United Kingdom's Financial Conduct Authority (the "FCA"), the body with regulatory responsibility to oversee the establishment and publication of LIBOR rates, announced its decision to require LIBOR's administrator, the ICE Benchmark Administration, to continue publication of 1-, 3- and 6-month USD LIBOR quotations for "a short period" following June 30, 2023 (i.e., through September 30, 2024, though the FCA has reserved its authority to adjust the duration of this period) using a synthetic rate-setting methodology, to facilitate the settlement of certain legacy financial contracts and to serve as a temporary bridge to a post-LIBOR epoch in which so-called "risk-free reference rates" prevail (presumably, SOFR is viewed by the financial regulators as one such rate). During this run-on period, according to the FCA, synthetic LIBOR rates will be calculated "using the relevant CME Term SOFR Reference Rate plus the respective ISDA fixed spread adjustment." Synthetic USD-LIBOR rates may not be used in new financial instruments or products. You can read the FCA's synthetic LIBOR announcement and find other related resources at https://www.fca.org.uk/news/news-stories/fca-announces-decision-synthetic-us-dollar-libor.

Let's move on now to a couple of news clippings regarding tax law developments in what has been an otherwise fairly dormant second quarter of 2023.

Treasury and the IRS Release Proposed Section 6417 Regulations.

On June 14, 2023, the Department of Treasury and the Internal Revenue Service released a notice of proposed rulemaking (REG-101607-23) offering guidance on the making of elections under the provisions of the Inflation Reduction Act of 2022 (the "IRA") that permit certain tax-exempt entities, including state and local governmental entities and 501(c)(3) organizations, to claim refundable tax credits (also referred to colloquially as "direct-pay" credits or subsidies) for their capital investments in clean or renewable energy projects. A full print of the proposed regulations can be found at https://public-inspection.federalregister.gov/2023-12798.pdf.

These proposed regulations, which can be applied prior to finalization by tax-exempt entities to claim direct-pay payments, have been much anticipated by the client base of NABL's membership and are most welcome. Their release in the first half of 2023 is a good example of timely engagement by the tax regulators with the real-world needs of the market.

Taking a step back, you will recall that, prior to the enactment of the IRA, for many years, federal tax law offered tax credits to taxpayers making investments in clean energy, allowing those taxpayers to use those credits to offset their federal income tax liabilities. These credits, however, were "nonrefundable," meaning that any excess credits beyond a taxpayer's federal tax liability would simply disappear if they could not be used in a timely way. This meant that most state and local governments and 501(c)(3) organizations, being exempt for the most part from federal income tax, generally would have no federal tax liabilities that could be offset and therefore could not make use of the tax credits. State and local governments and other tax-exempt entities instead would (and presumably still will) sometimes enter into joint ventures with for-profit entities for any such clean energy investments so that the for-profit entity could realize the value of the tax credits.

The IRA, for the first time, shifts this paradigm, making energy tax credits available under new Section 6417 of the Internal Revenue Code to state and local governments and to 501(c)(3) organizations as cash payments. Under Section 6417, by election, certain energy tax credits can be directly refunded as a one-time cash payments to eligible state and local governments and 501(c)(3) organizations. State and local governments and 501(c)(3) organizations that have no federal income tax liability are entitled under Section 6417 to make an election to receive the full amount of the credit as a payment from the IRS; 501(c)(3) organizations that do have a current federal income tax liability are entitled to make an election to claim the credit in their Form 990-T returns for the tax year.

I am not offering a full summary of the statutory provisions (nor of the proposed regulations) here, but it will not surprise you to read that many practitioners have noted that the text of Section 6417 leaves a number interpretational gaps and lacunae in this direct-pay tax credit scheme, some of which would make it difficult to claim a direct pay subsidy payment for what would otherwise be an eligible renewable energy investment. Let's take a look at a couple of the highlights of the proposed regulations to see what they do to clarify the application of the law in this area.

First of all, the proposed rules helpfully answer a question raised by the text of Section 6417, confirming that agencies and instrumentalities of state and local governments, including such diverse entities as public school districts, fire protection districts, state college systems and public park authorities, are eligible to claim the direct pay subsidies offered under this program. This is a good and intuitive result, and it aligns neatly with the statutory text and Congressional intent.

The proposed regulations also establish a mandatory registration process, which is intended to reduce opportunities for fraud. An eligible tax-exempt entity is required to register through an online platform to indicate its intention to make an election to receive a refundable credit payment for renewable energy capital investments under Section 6417. The registration will also disclose to the regulators a listing of the credits intended to be claimed as wells as details regarding the renewable energy projects that will give rise to the credits, including as to the nature of the assets, their location, documentation evidencing construction or acquisition, dates of commencement of construction and placement in service, and so on. Apparently, the tax-exempt entity that completes its Section 6417 registration will receive one or more registration numbers that will put it in a position to claim a refundable credit payment, or to use the credit to offset an otherwise-existing federal income tax liability on its tax return. At the time of publication of this column this registration platform is not accessible by the public; the IRS has indicated that it will be available in approximately the third quarter of 2023. Time will tell whether this online registration process is as smooth and efficient as it ought to be, or whether it is unduly burdensome. I personally would not bet on smoothness and efficiency in the roll-out phase (see my personal comments about the IRS Secure Messaging platform below). NABL and its leadership probably will want to be prepared to collect some "test-drive" feedback regarding the registration platform as soon as it is available and to provide constructive end-user input to the regulators to make the platform as user-friendly and bug-free as possible.

Once registered, an eligible tax-exempt entity must make an election to receive a direct-pay subsidy payment on its annual tax return filing for the tax year in which the right to make the election arises; generally, the filer will use IRS Form 3800, General Tax Credit, to furnish details about the clean energy project that provides the basis for capturing the Section 6417 credit. Notably, the proposed regulations stress that the Section 6417 election must be made on the original return; it will not do to make the election on an amended version of the return. If, by contrast, the tax-exempt entity is not required to file a federal tax return for that year, its Section 6417 election must be made on the due date that would have applied if it had been obligated under Code Section 6033(a) to file a federal tax return (which, under Code Section 6072(e), would appear to be the 15th day of the fifth month after the end of the entity's taxable year).

The proposed regulations also address the treatment of partnerships and S corporations under Section 6417, the text of which clearly recognizes that tax-exempt entities may wish to partner with for-profit enterprises to develop new clean energy facilities. Obviously, this is a familiar theme, and it should not come as a surprise to anyone that P3 synergies will sometimes make ambitious clean energy projects look more feasible to state and local government and 501(c)(3) organization sponsors. Unfortunately, the proposed regulations appear generally to prohibit partnerships and S corporations from making elections with respect to Section 6417 credits, even with respect to the share of capital investment that is clearly traceable to a state or local governmental entity or a 501(c)(3) organization and even, perhaps, if all of the partners in the venture are themselves eligible state or local governmental or 501(c)(3) entities. Although it seems possible that tax-exempt entities and their counsel will find workarounds to this regulatory bar (think of the concept of tenancies in common in the world of public power), this part of the proposed regulations seems to me on first impression to be somewhat of an overreach, and out of line with other, helpful pronouncements on P3s from the tax regulators in our field. This may well be an aspect of the proposed guidance that will benefit from the public's input during the comment process.

Another part of the proposed regulations addresses the interplay between Section 6417 and an adjacent statutory provision, Section 6418 (also enacted by the IRA), which permits taxpayers (i.e., those who are not tax-exempt entities for purposes of Section 6417) to transfer renewable energy tax credits. Because the credits that are covered by Sections 6417 and 6418 are the same, the question has arisen whether a state or local government entity could purchase a renewable energy tax credit from a third-party taxpayer (typically at a discount) and then turn around and "arbitrage" that investment by asking Uncle Sam for the full value of the credit by way of a direct-pay subsidy payment. Unsurprisingly, the proposed regulations put the kibosh on this type of "credit stacking." Instead, the rules generally mandate that Section 6417 elections must be made by the owners of the renewable energy assets that give rise to the credit.

This is just a brief run through the proposed regulations. Interested readers should review the entire regulatory package to get a fuller sense of their provisions. The IRS has invited the submission of written or electronic comments on the proposed regulations by August 14, 2023 and will hold a public hearing on them in August 21. I imagine that NABL's Tax Law Committee is hard at work on its submission already.

PLR 202309014—Long-Term Tax Exempt Bonds for Extraordinary Working Capital Costs

Let's turn now, if only briefly, to a recent Private Letter Ruling 202309014 (March 3, 2023). This PLR appears to be another in a line of occasional rulings permitting the issuance of tax-exempt bonds on a long-term basis to finance (or, here, to refinance) working capital costs, based on sympathetic facts. Here, the facts involve an "Occurrence" (apparently, a major winter storm) that caused unprecedented, apparently widespread, power loss within a particular state. Sounds familiar to those of us who were following the news in February 2021. As a result of the "Occurrence" the public power utility requesting the ruling incurred disruptively expensive costs to procure natural gas to carry on its operations, for which it did not have insurance coverage or a self-maintained reserve.

The IRS concluded that the utility's proposed issuance of tax-exempt bonds to refinance a portion of the taxable commercial paper borrowings it undertook to fund these extraordinarily costly natural gas supplies would not be subject to the proceeds-spent-last accounting rule of Treasury Regulations Section 1.148-6(d)(3)(i), which typically governs tax-exempt working capital borrowings. Instead, the Service determined that, based on the facts presented by the utility, the proposed issuance of bonds would be eligible for the exception available in Treasury Regulations Section 1.148-6(d)(3)(ii)(B) for tax-exempt issues that finance extraordinary, nonrecurring working capital items. Moreover, on the basis of the foregoing, and on its conclusion that the proposed maturity structure for the tax-exempt refinancing issue would afford the utility with a reasonable debt service expense over the term of the issue, without causing additional downgrades to the utility's credit rating, the IRS determined that the long-term nature of the bonds would not overburden the tax-exempt bond market in contravention of the anti-abuse rules of Treasury Regulations Section 1.148-10(a)(4).

Seems like the right outcome to me.

Annual Rite of (Late) Spring—NABL Requests for IRS 2023-2024 Priority Guidance Plan

On May 4, 2023, the IRS released Notice 2023-36 to solicit public input on recommended items for inclusion in its "Priority Guidance Plan" for FY 2023-2024. On June 7, in response to the solicitation, NABL's President, Jodie Smith, submitted the following five suggestions for inclusion in the IRS plan, in order of priority:

1. **Guidance on "Qualified Broadband Projects" and "Qualified Carbon Capture Facilities".** Reiterating NABL's request of a year ago for interpretative guidance with respect to the new (okay, now, not quite so new) categories of exempt facility bonds—for "qualified broadband projects" and "qualified carbon capture facilities"—provided in the Infrastructure Investment and Jobs Act of 2021. In his submission, President Smith noted that NABL submitted detailed commentary to the IRS regarding these new exempt facility categories in letters dated June 24, 2022 (with respect to qualified carbon capture facilities) and February 24, 2023 (with respect to qualified broadband projects).

2. **Modification and Finalization of Proposed Reissuance Regulations.** Reiterating NABL's request that the IRS modify and finalize its 2018 proposed regulations addressing the circumstances in which tax-exempt (and other tax-advantaged) bonds will be treated as reissued for federal tax law purposes. President Smith again reminded the IRS that, in NABL's view, the 2018 proposed regulations omitted several helpful principles found in the existing law of reissuance for tax-exempt and other types of tax-advantaged bonds (examples include principles in existing law that permit premium pricing, alterations of security and other "corrective" changes in connection with certain remarketings of outstanding bonds), and that

NABL submitted specific commentary on the 2018 proposed regulations to the IRS on March 1, 2019.

3. **Simplification and Expansion of Remedial Action Rules.**

NABL again offered a reminder that on February 1, 2019, in response to the release of Revenue Procedure 2018-26, which extended the availability of remedial action by means of alternative use of disposition proceeds to certain long-term, pay-as-you-go leases and for qualified tax credit bonds (including direct pay bonds), it submitted comments to the IRS to further clarify, simplify and expand the application of the remedial action rules. President Smith's letter repeats NABL's willingness to discuss its remedial action recommendations with the regulators.

4. **Clarification of the Final Allocation and Accounting Regulations.**

A reiteration (yet again) of NABL's request for additional clarification regarding the allocation and accounting principles of Treasury Regulations Section 1.141-6, which were promulgated in final form in October 2015. Here as well, the request is accompanied by an invitation (really, a re-invitation) for the IRS to sit down with NABL representatives to discuss specific comments on the 1.141-6 regulations that were offered by our membership in September 2018.

5. **Revision of Instructions to IRS Forms 8038 and 8038-G.**

President Smith noted that the current instructions to IRS Form 8038 and IRS Form 8038-G include provisions that are ambiguous, internally inconsistent and at odds with other published guidance and that NABL provided specific comments on these inconsistencies in a submission to the IRS dated September 29, 2020. Here again, NABL has offered its resources to the IRS to engage on this topic, for the good of all filers of these information returns.

Brief Remarks on the IRS TE/GE Secure Messaging Platform

Finally, a brief note on the "Secure Messaging" platform that was implemented sometime in 2022 by the Tax Exempt & Government Entities Division ("TE/GE") within the IRS. By TE/GE's own account, Secure Messaging is intended to be a fast and safe way to connect online with the IRS, permitting users to correspond with IRS agents and employees through a web browser interface, to exchange documents quickly and securely and thereby to reduce the need to call or wait for mail deliveries. Taxpayers and their authorized representatives are meant to access this messaging and document-sharing platform for all TE/GE "compliance activities" that began on or after June 22, 2022, according to an internal IRS memorandum (Control No. TEGE-04-0622-0018) that was circulated to TE/GE staff last year.

Anecdotally, I have heard good things from other NABL members about the ease of access to and ease of use of the Secure Messaging portal to communicate with IRS agents conducting examinations of tax-exempt bond issues. Also anecdotally, however, I have also observed first-hand that the use of the platform is highly variable from IRS agent to IRS agent; some appear to be stuck in the early 1980s, insisting on using fax machines to communicate (really). I have also noted that initiating access is liable to proceed in fits and starts, in my view because the system appears to offer access in the first instance to the "taxpayer" in a bond audit (that is, the bond issuer); the "taxpayer" in turn is supposed to share access with its authorized representative.

The problem appears to be, in some cases, that if the issuer's staff is unacquainted with IRS procedures (or if they generally don't care much to receive messages directly about bond-related matters), the "taxpayer" representative who is really responsible for handling the bond audit (typically, bond or special tax counsel, under a power of attorney that has been executed and shared with the IRS agent) may experience long delays before he or she can access the Secure Messaging platform. In fact, counsel may not even be aware for an extended period that the issuer has been provided access to the platform, particularly if an inattentive IRS agent does not follow up with the issuer if there is no response to the initial message confirming its access to the portal.

I hope that the vagaries of Secure Messaging access have not been a major problem for most NABL members. I am curious to hear whether any of the readers of this column have had glitchy experiences getting onto or using the platform, or if any of you are still having to figure out where your firm's last and only fax machine is hidden and what its telephone number is. Hopefully, this will all work itself out soon, and we will find the IRS joining us in the early 21st century, technologically speaking.

That's it for this column. Here's wishing all of you the best in the fast-approaching post-LIBOR era.

Municipal Market Evolution Reflecting the Constitutional Underpinnings of the Law of Public Finance

Ann D. Fillingham, Alexandra M. MacLennan, Joseph (Jodie) E. Smith, and Perry Israel*

The United States has one of the largest subsovereign debt markets in the world,[1] and the municipal securities market—its structure, and its regulation—is markedly different from the corporate securities market. Although the distinctions are readily apparent, the historical and legal basis for the distinctions is less so. All legal entities, public and private, are creatures of statute, but municipal entities, which include municipalities and other governmental entities, are units of government that derive their authority from state general laws and state and federal constitutions.[2] Many of the powers, privileges, and protections of municipal entities run deeper than the state laws that purport to define them, as they are firmly rooted in constitutional and common law and have essential attributes of sovereignty that cannot be transferred or encumbered. This history helps explain the different historic growth patterns of the corporate and municipal securities markets, and it should help inform future market evolution, whether designed to address the perceived lack of consistency in debt structure, transparency in terms of municipal entities disclosure, or otherwise. For those interested in pruning or shaping both markets, that same history is also instructive as to those actions likely to encourage core market strengths and those more likely to hinder them.

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1. In 2020, the U.S. municipal bond market had approximately $4.0 trillion of bonds outstanding and average daily trading of approximately $12 billion. SIFMA 2021 Capital Markets Fact Book (2021).

2. For purposes of this article, we use the U.S. Census Bureau's government categorizations: states, general purpose governments, and special purpose governments, the latter being established to fulfill only a limited number of purposes. U.S. Census Bureau, Government Finance and Employment Classification Manual 1-1 (2006). Similarly, to avoid using terms like "political subdivision," which have different meanings in different contexts, we sometimes use the term "municipal entity" to distinguish governmental units from private business corporations, even though the term is intended to include all forms of state and local government entities.

I. A SHORT REPRISE OF AMERICAN CONSTITUTIONAL HISTORY

A. Introduction

Before the adoption and ratification of the Constitution of the United States in 1789, the concept of "general purpose government" was already well entrenched in the daily lives of Americans.[3] The thirteen original colonies had been operating as independent states since the signing of the Declaration of Independence[4] and the adoption of the Articles of Confederation, under which state governments possessed plenary legislative power limited by applicable state constitutions or charters.[5] The federal Constitution, by comparison, is generally understood as a limited grant of express and implied powers (i.e., not plenary) to the national government by the states.

B. Rejection of England's Unitary System of Government, Failure of the Articles of Confederation, and Adoption of the U.S. Constitution

England's system of government was and remains centralized. In such a unitary system, large amounts of power reside with Parliament.[6] Replication of that concentration of power and its correlative risk of tyranny was deemed dangerous in 1777, and the original Articles of Confederation expressly rejected Britain's unitary system in favor of a confederation system, with strong states and a weak national government.[7] Indeed, the framers of the Articles of Confederation were so protective of the individual states' needs, as well as each state's independence, that the national government did not possess the

3. The first American municipalities arose in the colonies largely as an outgrowth of early settler history. The Mayflower Compact of 1620, signed by the Pilgrims and settlers before even reaching North American shores, established a set of rules based on the principle of self-governance. This notion of self-determination, and construction of a constitution as a compact among the people, is a cornerstone of the current governmental system. As the colonies evolved, all thirteen colonies began to formalize the structure for general purpose governments, generally following Virginia's lead and adopting the English system of counties (now called parishes in Louisiana and boroughs in Alaska). Establishment of general purpose township governments was less uniform. Following the end of the Revolutionary War and the signature of the Treaty of Paris, the young country struggled to plan for westward expansion through a series of land ordinances that ultimately became the Northwest Ordinance of 1787. Those ordinances established 6x6 square mile survey townships, which later served as the basis for many civil townships. Each township was divided into thirty-six sections with a sixteen-section center area generally reserved for school purposes to facilitate public education and make schools easily accessible on horseback to all township residents. Particularly in the Midwest, this system remains largely intact today. For more information, see, for example, *Creating the United States: Road to the Constitution*, Libr. of Cong., https://www.loc.gov/exhibits/creating-the-united-states/road-to-the-constitution.html (last visited Jan. 2, 2023) and *Foundations of American Government*, Indep. Hall Ass'n, https://www.ushistory.org/gov/2.asp (last visited Jan. 2, 2023).

4. The Declaration of Independence para. 32 (U.S. 1776) (declaring, interestingly, the independence not of the "United States of America" as a national entity but rather as "Independent States" with the right to, among other things, "levy War, conclude Peace, contract Alliances, establish Commerce, and to do all other Acts and Things which Independent States may of right do").

5. Thomas M. Cooley, A Treatise on the Constitutional Limitations Which Rest upon the Legislative Power of the States of the American Union (1903). It is an interesting historical note that Rhode Island and Connecticut each operated, initially and well into the 1800s, without a formal state constitution, relying instead on an English Royal Charter document and the "Fundamental Orders of Connecticut," respectively, to inform their republican forms of government. Additionally, the tax and debt limits of many current state constitutions are the result of the evolution of public policy and were not components of the initial versions of these documents.

6. Additionally, in a unitary system, the national government is sovereign, and states and other subsovereigns possess only delegated powers.

7. *See, e.g.*, *Foundations of American Government*, *supra* note 3.

power to regulate interstate commerce or collect taxes, among other things.[8] This confederation, or "firm league of friendship" as it is declared in the Articles,[9] failed in many respects. By 1787, the Constitutional Convention had been convened to replace it,[10] and the U.S. Constitution was drafted. With it, America's federal system was established. Some powers were delegated to the national government and simultaneously protected by principles of supremacy; other powers were reserved to the states.[11]

Support for this structure was initially neither unanimous nor uniform. The tensions within the compromises that the Nationalists and the Federalists made to draft the Constitution and form this system of government are evident in the Constitution itself and, in many respects, remain ongoing today.[12]

C. *Evolution of State and General Purpose Government Powers over Time*

Delineation of U.S. governmental power and authority began with debate and disagreement about the drafts of both the Articles of Confederation and the U.S. Constitution. Evolution of governmental power has continued since that time, and the paths taken, and reasons therefor, are instructive.

Evolution of Federalism. As originally envisioned in 1789, states and the national government were co-sovereign, each with their own powers and obligations. In the 1950s, Morton Grodzins was the first to use a layer cake metaphor to describe this early "dual federalism" period in our history.[13] Over time, the U.S. system became more complex. In response to the Great Depression, under the New Deal, many federal grant-in-aid programs were established at the federal level that were administered at the state level. The layer cake became a marble cake and an era of "cooperative federalism" began. The federalism pendulum has swung back and forth repeatedly in the last century.[14] The new constant, however, is strength through interdependence. The federal government now depends on states and their input to achieve its goals,[15] and state spending is now inextricably linked to federal matching funds and conditional grants.

8. Alfred H. Kelly & Winfred A. Harbison, The American Constitution: Its Origins and Development 76–81 (1991).

9. Articles of Confederation art. III (1781).

10. The period before, during, and after the Constitutional Convention was filled with public and private debate, with competing views espoused, most notably, by Alexander Hamilton, a committed Nationalist, and James Madison, a committed Federalist, coming together to publish a compilation of essays supporting the final U.S. Constitution, entitled *The Federalist: A Collection of Essays Written in Favour of the New Constitution, As Agreed upon by the Federal Convention September 17, 1787* (1788) (commonly referred to as the *Federalist Papers*).

11. Unlike the unitary system, states in the American federal system are not administrative units with delegated powers but independent polities with independent powers.

12. *See, e.g.*, Eugene Boyd & Michael K. Fauntroy, Cong. Rsch. Serv., RL30772, American Federalism, 1776 to 2000: Significant Events (2000).

13. *See, e.g.*, Paul E. Peterson, *The Changing Politics of Federalism*, *in* Evolving Federalisms: The Intergovernmental Balance of Power in America and Europe 25–42 (Craig Parsons & Alasdair Roberts eds., 2003).

14. *See* Boyd & Fauntroy, *supra* note 12.

15. *See, e.g.*, Miriam Seifert, *States, Agencies, and Legitimacy*, 67 Vand. L. Rev. 443, 443–59 (2014); David S. Rubenstein, *Administrative Federalism as Separation of Powers*, 72 Wash. & Lee L. Rev. 171, 171–255 (2015). The concept of subsidiarity provides a theoretical foundation for why it is important for the federal government to rely on states to achieve its goals. *See generally* Jerome M. Organ, *Subsidiarity and Solidarity: Lenses for Assessing the Appropriate Locus for Environmental Regulation and Enforcement*, 5 U. St. Thomas L.J. 262, 264 (2008) ("The principle of subsidiarity posits that the common good is best served when decision-making regarding actions and activities is delegated to the local entity—to the smallest organization—best able to make the decision."); George A. Bermann, *Taking Subsidiarity Seriously: Federalism in the European Community and the United States*, 94 Colum. L. Rev. 331, 339–41 (1994) (explaining that subsidiarity expresses a preference for governance at the most local level consistent

Evolution of State Sovereignty. The U.S. Constitution contemplates a system where police powers reside with sovereign states, not the federal government.[16] Following ratification of the Constitution in 1789, the principles of sovereignty and sovereign immunity charted an evolutionary course not dissimilar to that of federalism and one sometimes intertwined with public finance. For example, after the Revolutionary War, many states attempted to repudiate their war debts. In 1792, Alexander Chisholm attempted to sue the State of Georgia in the U.S. Supreme Court over payments due for goods supplied to Georgia during the American Revolutionary War. The State of Georgia claimed that, as a sovereign state, it could not be sued without granting its consent to the suit and refused to appear.[17] The Supreme Court disagreed in the 1793 decision *Chisolm v. Georgia*, holding that under Article III, Section 2 of the then relatively new Constitution, a state could be sued in federal court, thereby eliminating the claim of state sovereign immunity.[18] On the legal front, backlash against this decision led to adoption of the Eleventh Amendment, embedding the concept of state sovereign immunity firmly into the Constitution.[19] Simultaneously on the political front, the concept of a national bank and federal assumption of state debts was floated.[20]

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with achieving a government's stated purposes based on the values of self-determination and accountability, political liberty, flexibility, preservation of identities, diversity, and respect for internal divisions of component states). One scholar further explains subsidiarity in the following way:

According to the philosopher John Finnis, the principle of subsidiarity has its source in the fact that "[h]uman good requires not only that one receive and experience benefits or desirable states; it requires that one do certain things, that one should act, with integrity and authenticity; if one can obtain the desirable objects and experiences through one's own action, so much the better." Because of the danger that the political order or intermediary associations may stifle individual self-constitution, the principle

. . . affirms that the proper function of association is to help the participants in the association to help themselves or, more precisely, to constitute themselves through the individual initiatives of choosing commitments (including commitments to friendship and other forms of association) and of realizing these commitments through personal inventiveness and effort in projects (many of which will, of course, be co-operative in execution and even communal in purpose).

Subsidiarity informs not only the relationship between an individual and an association of which he may be a member. In the context of multiple layers of larger and smaller associations, the subsidiarity principle, as stated by John Paul II in the encyclical Centesimus annus, requires that "a community of a higher order should not interfere in the internal life of a community of a lower order, depriving the latter of its functions, but rather should support it in case of need and help to co-ordinate its activity with the activities of the rest of society, always with a view to the common good." Accordingly, "neither the state nor any larger society should substitute itself for the initiative and responsibility of individuals and intermediary bodies."

Peter Widulski, *Bakke, Grutter, and the Principle of Subsidiarity*, 32 Hastings Const. L.Q. 847, 854–55 (2005) (citations omitted). The concept of subsidiarity provides not only a theoretical foundation for coordination of relations between the federal government and the states but also a theoretical framework for coordination of relations between the states and their local units of government.

16. U.S. Const. amend X. It should be noted that "police" in eighteenth century vernacular did not just mean law enforcement but rather is derived from the Latin *polita*, meaning civil administration. For more historical and etymological information, see Santiago Legarre, *The Historical Background of the Police Power*, 9 U. Pa. J. Const. L. 745 (2007).

17. *See* Boyd & Fauntroy*, supra* note 12.

18. Chisolm v. Georgia, 2 U.S. 419 (1793).

19. *See* Cong. Rsch. Serv., The Constitution of the United States of America; Analysis and Interpretation (cent. ed.) (2017).

20. *See id.*; Boyd & Fauntroy, *supra* note 12.

The Alexander Hamilton (the first U.S. Secretary of the Treasury) contingent[21] prevailed, and the federal government assumed state debts.[22] Fears receded, and issues of state sovereign immunity lay largely dormant for many years. Following a second series of state repudiations of Civil War reconstruction debts, the Supreme Court again stepped into immunity issues, expanding interpretation of the Eleventh Amendment to bar federal question claims against states in *Hans v. Louisiana.*[23]

Fast forward to the Rehnquist Court, which significantly expanded state sovereign immunity concepts in *Seminole Tribe v. Florida*[24] and *Alden v. Maine*,[25] where the Court made it clear that Congress's Article I constitutional authority to abrogate immunity of the states under the Eleventh Amendment is limited.[26]

Evolution of the Republican States. Regarding state and general purpose governments, the Constitution requires only that the "United States shall guarantee to every State in this Union a Republican Form of Government."[27] To steal a phrase from biology: diversity begets stability; however, in the evolution of states' republican forms of government, it may be that diversity begets more diversity. The Constitution did not dictate the details of the republican form of government, and individual states were left to evolve on their own in a somewhat parallel but not identical manner. The thirteen original states evolved from the thirteen original colonial governments. Many subsequently admitted states began as organized territories created by the federal government,[28] while others began via separation from an existing state[29]

21. Alfred H. Kelly, Winfred A. Harbison, & Herman Belz, The American Constitution: Its Origins and Development 125 (7th ed. 1991).

22. It is interesting to note that Alexander Hamilton established the first national bank, which served as the vehicle to assume state debts. Following his election, in 1833 President Andrew Jackson caused all federal funds to be withdrawn from the national bank, and its federal charter expired in 1836. National banks did not exist again in any meaningful fashion until the New Deal. The transfer of deposits to state banks enabled credit-funded land and infrastructure speculation, fueling inflation, which ultimately led to the Panic of 1837. The demise of a national bank also necessitated the development of public debt markets at the state and local government level. By 1843, cities had $25 million in bonds outstanding, and the municipal securities market had emerged in a fashion that is still recognizable today.

23. Hans v. Louisiana, 134 U.S. 1, 14–15 (1890). It should be remembered that this immunity does not apply at the local government level. See Lincoln County v. Luning, 133 U.S. 529 (1890), for the correlative decision with respect to municipal bond repudiation. Per the Supreme Court, "The eleventh amendment limits the jurisdiction only as to suits against a state." *Id.* at 530.. For an interesting essay on state debt crises as potential drivers of sovereign immunity law, see Ernest A. Young, *Its Hour Come Round at Last? State Sovereign Immunity and the Great State Debt Crisis of the Early Twenty-First Century*, 35 Harv. J.L. & Pub. Pol. 593, 593–622 (2012).

24. Seminole Tribe of Fla. v. Florida, 517 U.S. 44 (1996).

25. Alden v. Maine, 527 U.S. 706 (1999).

26. *Id.* at 758.

When Congress legislates in matters affecting the States, it may not treat these sovereign entities as mere prefectures or corporations. Congress must accord States the esteem due to them as joint participants in a federal system, one beginning with the premise of sovereignty in both the central Government and the separate States. Congress has ample means to ensure compliance with valid federal laws, but it must respect the sovereignty of the States.

Id.

27. U.S. Const. art. IV.

28. One example is the Nebraska Territory, which became Kansas, Nebraska, Montana, and the Dakotas.

29. Maine separated from Massachusetts in 1820, and West Virginia was separated from Virginia at the beginning of the Civil War.

or entered statehood already as a sovereign entity.[30] One state, California, entered statehood as a result of the ceding of land from Mexico to the United States.[31]

From these varied origins, state constitutions and legislative structures were formed, some following the lead of earlier states and some creating a different path based upon influences of early settlers.[32] While republican in form, the distinctions among the states are many, including the fact that four states are called commonwealths and that state legislative bodies may be known as "legislatures," "assemblies," or in the case of Nebraska (the only unicameral legislature), the "senate." The states each have their own constitutions, many of which are similar to the U.S. Constitution. While that similarity aids understanding of where state constitutional rights are grounded, the relationship between each state and its political subdivisions is not always consistent with the Tenth Amendment. This dichotomy is discussed later in more detail.[33]

Implications for Municipal Securities Markets. The municipal securities markets are fundamentally different than the corporate markets.[34] First, in the corporate arena, there is a level of general legislative uniformity not found in the municipal arena. This uniformity allows for a level of homogenization of standard types of corporate securities not seen with municipal securities. Second, due to different state constitutions, fundamental differences exist in the power and authority of the same units of government (such as cities) in different states. A city in one state may be authorized to issue bonds for purposes prohibited for a city in a different state. These differences are not oversights or mistakes. They are the natural outgrowth of fundamental principles of our federal Constitution. They are also premised on the truth that, as governments, certain essential attributes of sovereignty cannot be conveyed or hypothecated.[35] As noted above, certain aspects of government are more than just property rights, and

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30. The Republic of Texas and the Vermont Republic. For more information on the history of state and state constitutional development, see Randy J. Holland, Stephen R. McAllister, Jeffrey M. Shaman, & Jeffrey S. Sutton, State Constitutional Law: The Modern Experience (2010).

31. Peverill Squire, The Evolution of American Legislatures: Colonies, Territories, and States, 1619–2009, at 1–10 (Janet M. Box-Steffensmeier & David Canon eds., 2012).

32. Louisiana, for example, which the U.S. purchased from France in 1803, fashioned its state laws after the civil law system used by European countries and colonies not founded under British law, hence these laws are not based upon English Common Law. *See, e.g.*, Holland et al., *supra* note 30.

33. *See* discussion *infra* Section II.B.

34. For a good discussion on the fundamental differences between business corporations, states, and general purpose governments in the area of finance, see Robert A. Fippinger, The Securities Law of Public Finance ch. 1 (3d ed. 2011) (updated Nov. 2020); *see also* Gov. Acct. Stds. Bd., Concepts Statement No. 1 Objectives of Financial Reporting (1987), https://gasb.org/page/PageContent?pageId=/standards-guidance/pronouncements/summary-of-concepts-statement-no-1.html&isStaticPage=true; Gov. Acct. Stds. Bd., Why Governmental Accounting and Financial Reporting Is—And Should Be—Different (2017), https://www.gasb.org/page/PageContent?pageId=/reference-library/whitepaper.html&isPrintView=true.

35. In *A.L.A. Schechter Poultry Corp. v. United States*, the Supreme Court stated that "Congress is not permitted to abdicate or to transfer to others the essential legislative functions with which it is thus vested." A.L.A. Schechter Poultry Corp. v. United States, 295 U.S. 495, 529 (1935). Particularly when it comes to state and local governmental powers constituting the residual sovereignty retained under the Tenth Amendment, a large body of state-level, private non-delegation doctrine law prohibits or significantly restricts the delegation of these powers to private parties, especially legislative, taxation, police (in the broad original constitutional sense of the word), and eminent domain powers not based in contract or real property rights. *See* James M. Rice, *The Private Nondelegation Doctrine: Preventing the Delegation of Regulatory Authority to Private Parties and International Organizations*, 105 Calif. L. Rev 540, 539–72 (2017). The impact of this limit in the municipal securities market is sometimes self-evident and sometimes more

their delegation is therefore significantly limited. Furthermore, the U.S. securities markets rely heavily on the unique U.S. interrelationships among the different layers of American governments. As U.S. Supreme Court Justice Anthony Kennedy so eloquently described it, "The Framers split the atom of sovereignty."[36] What is important in the evaluation of the municipal securities market today, however, is not the exact boundaries of national or state powers on any given day, but the undeniable conclusion that these powers are stronger when deployed together, and stronger when deployed consistently with fundamental constitutional principles of governmental power and authority.

II. A BRIEF CONSTITUTIONAL LAW REFRESHER

A. Constitutional Principles Particularly Relevant to the Development of U.S. Governmental Structures and the Law of Public Finance

The United States has one of the most complicated systems of national, state, and local governments anywhere in the world,[37] with levels of autonomy, power, and control varying widely by jurisdiction. This complexity did not happen by accident. It is firmly embedded in important principles of republicanism and the U.S. Constitution, and the intentional outgrowth of this system's original dual federalism construct, including, in particular, intentional tensions between and among certain constitutional and pre-ratification sovereignty principles.

Both constitutionally based and non-constitutional legal principles are referenced in this article. The following terminology is important to aid further discussion:

Non-Constitutional Principles.

Fundamental State Sovereign Immunity. Sovereign immunity is the inability of a governmental unit to be sued without its consent. The sovereign immunity of *states*, a common law principle that pre-dates the Constitution,[38] which is generally understood to apply in *state* court, as federal courts frequently deal with both constitutional and common law immunity under the Eleventh Amendment label described below.

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obtuse. For instance, market participants cannot short positions in the municipal securities market like the corporate securities market, as tax exemption is not an assignable contract right. It is an attribute of essential sovereignty. See*, e.g.*, Securities Exchange Act Release No. 33743 (Mar. 9, 1994), 59 Fed. Reg. 12767, 12769 n.24 (Mar. 17,1994) (citing I.R.C. § 6045(d)).

36. U.S. Term Limits, Inc. v. Thornton, 514 U.S. 779, 838 (1995).

37. *See, e.g.*, Steven G. Calabresi & Nicholas K. Terrell, *The Number of States and the Economics of American Federalism* (Nw. Univ. Sch. of Law Faculty Working Paper No. 187, 2009), https://scholarlycommons.law.northwestern.edu/cgi/viewcontent.cgi?article=1186&context=facultyworkingpapers.

38. State sovereign immunity is a pre-ratification attribute of sovereignty, described by the U.S. Supreme Court as extending "to everything which exists by its own authority, or is introduced by its permission . . . ." McCulloch v. Maryland, 17 U.S. 316, 429 (1819). It is a doctrine of English law originating in medieval theories that the "king could do no wrong." The rights of American colonies were first derived from the authority of the British king. When the king's authority was extinguished with the Revolution, the new states rose to the level of sovereigns. The essential attributes of sovereignty, separate and distinct from the Constitution, were recognized by Justice Holmes in *Kawanakoa v. Polyblank*. Kawanakoa v. Polyblank*,* 205 U.S. 349, 353–54 (1907). "[T]he rights that exist are not created by Congress or the Constitution, except to the extent of certain limitations of power." *Id.*; *see also* Alden v. Maine*,* 527 U.S. 706 (1999). For a more robust discussion of these nuanced principles, see Fippinger, *supra* note 34, § 16:1 *et seq.*

Comity Doctrine. Also a concept external from the Constitution, the international law principle that co-equal sovereigns respect each other's laws, judgments, and interests.[39]

The Right to a Remedy. With roots in the Magna Carta, the principle that "it is a general and indisputable rule, that where there is a legal right, there is also a legal remedy by suit or action at law, whenever that right is invaded."[40]

Express Provisions and Constitutionally Based Principles.

Bankruptcy Clause. The provision of the Constitution that provides "[t]he Congress shall have Power [t]o . . . establish . . . uniform Laws on the subject of Bankruptcies throughout the United States . . . ."[41]

Commerce Clause. The provision of the Constitution providing that Congress shall have power "[t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes . . . ."[42]

Contracts Clause. Applicable only to *states and local governments*, the provision of the Constitution providing that "[n]o State shall . . . pass any . . . law . . . impairing the Obligation of Contracts."[43]

Due Process Clause. Derived from the Fifth (generally) and Fourteenth (states, specifically) Amendments, the provisions of the Constitution providing that no person shall be deprived "of life, liberty, or property, without due process of law."[44]

Enforcement Clause. The provision of the Fourteenth Amendment to the Constitution providing that "[t]he Congress shall have power to enforce, by appropriate legislation, the provisions of this article,"[45] giving it power to adopt laws aimed at ensuring due process and equal protection, also commonly referred to as its Fourteenth Amendment section 5 power.

Equal Protection Clause. Derived from the Fifth and Fourteenth Amendments, the provisions of the Constitution providing people with "the equal protection of the laws."[46]

Supremacy Clause. The provision of the Constitution providing that "[t]his Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land. . . ."[47]

Takings Clause. Derived from the Fifth Amendment, made applicable to states through the Fourteenth Amendment, the provisions of the Constitution affirming that private property shall not "be taken for public use, without just compensation."[48]

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39. For an interesting discussion of application of the principles of comity to federal-state relations, see Gil Seinfeld, *Reflections on Comity in the Law of American Federalism*, 90 Notre Dame L. Rev. 1309, 1309–43 (2015).
40. Marbury v. Madison, 5 U.S. 1, 163 (1803) (quoting 3 William Blackstone, Commentaries *23).
41. U.S. Const. art. I, § 8.
42. *Id.* art. I, § 8, cl. 3.
43. *Id.* art. I, § 10, cl. 1.
44. *Id.* amend. XIV, § 1, cl. 2.
45. *Id.* amend XIV, § 1, cl. 5.
46. *Id.* amend XIV, § 1, cl. 2.
47. *Id.* art. VI, cl. 2.
48. *Id.* amend. V.

Tenth Amendment. The provision of the Constitution providing that "[t]he powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."[49]

Eleventh Amendment Sovereign Immunity. The provision of the Constitution providing that "[t]he Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State."[50] Eleventh Amendment sovereignty applies in *federal* court, though it is often conflated with pre-ratification principles of state sovereign immunity in *state* court. The Eleventh Amendment does not apply to a municipal government or other government entity, unless either (a) such entity is deemed to be an "arm of the State" or (b) it is determined that the State is the real party in interest.[51]

Reserved Powers Doctrine. The judicial doctrine, based on constitutional sovereignty concepts, that a government cannot surrender essential attributes of its sovereignty, such as police or eminent domain powers.

Reciprocal Immunity Doctrine. The historical judicial doctrine, based on constitutional sovereignty concepts that, just as a state may not tax the federal government, the federal government may not tax the means and instrumentalities of a state.

Anti-Commandeering Doctrine. The judicial doctrine, based on constitutional Tenth Amendment concepts, that a government cannot impose affirmative duties on state legislative or executive branch officials.

B. Constitutional Tensions Particularly Relevant to the Development of U.S. Governmental Structures and the Law of Public Finance

The law of public finance is replete with examples of the counter-balancing tensions embedded in the U.S. Constitution by its framers. The current law of public finance is a complex weave, but four repeating threads, plaited in two distinct directions, are identified and described here.

The Tenth Amendment and the Supremacy Clause, Often in Conflict.

As noted above, the exact boundaries of federalism have shifted in both directions over time. In a string of cases beginning with *National Labor Relations Board v. Jones and Laughlin Steel Corp*, the Supreme Court expanded federal power in 1937.[52] In 1976, in *National League of Cities v. Usery*, the Supreme Court, by a majority opinion penned by future Chief Justice Rehnquist, checked this expansion, limiting the power of Congress under the Commerce Clause to impair state sovereignty.[53] Less than ten years later, in *Garcia v. San Antonio Metropolitan Transit Authority*, the Supreme Court overruled *Usery.*[54] Fast-forwarding to the 1990s, the federalism landscape again shifted with decisions in *New York v. United States* (invalidating a federal law requiring states with inadequate environmental laws to "take title" to certain radioactive waste),[55] and *Printz v. United States* (a 1997 decision invalidating a provision of the

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49. *Id.* amend. X.

50. *Id.* amend XI.

51. For an excellent description of the history and scope of the sovereign immunity defense as applicable to public finance, see Fippinger, note 34, § 16:1 *et seq.*

52. N.L.R.B. v. Jones, 301 U.S. 1 (1937); *see also* United States v. Darby, 312 U.S. 100 (1941).

53. Nat'l League of Cities v. Usery, 426 U.S. 833 (1976).

54. Garcia v. San Antonio Metro. Transit Auth., 469 U.S. 528 (1985).

55. New York v. United States, 505 U.S. 144, 175 (1992).

Brady Handgun Violence Prevention Act requiring state officials to run background checks on prospective handgun purchasers).[56] These latter cases generally stand for the principle that the federal government cannot affirmatively commandeer state legislative or executive branches. In 2018, in *Murphy v. NCAA*,[57] the Court invalidated a federal law prohibiting states from authorizing sports gambling, clarifying that anti-commandeering rules apply equally to both affirmative requirements and prohibitions adopted by Congress under its Commerce Clause powers. In Justice Alito's majority opinion, he notes, "The anti-commandeering doctrine may sound arcane, but it is simply the expression of a fundamental structural decision incorporated into the Constitution, i.e., the decision to withhold from Congress the power to issue orders directly to the States."[58]

There will always be Federalists and Nationalists. For purposes of this article, the exact boundaries at any given time are largely irrelevant. Rather, what is interesting is the impact that this ever-present tension has had historically in the development of the municipal securities market and assessing the tensile strength of future developments.

Sovereign Immunity and the Commerce Clause, Often in Conflict.

The principles of sovereign immunity embodied in both common law and the Eleventh Amendment have faced challenges under competing constitutional concepts, including the Bankruptcy Clause, the Enforcement Clause, and the Commerce Clause. The tension, obviously, is between the respected sovereign rights of states and the counterbalancing supreme rights of the federal government, under the Constitution, to abrogate those rights.

The case law is clear that when the tension is between the Eleventh Amendment and the Bankruptcy Clause[59] or between the Eleventh Amendment and the Due Process or Equal Protection Clauses,[60] sovereign immunity generally does not withstand the challenge. The tension between the Eleventh Amendment and the Commerce Clause, however, is a more interesting story[61] and one unique to public finance that does not have a real parallel in corporate finance.[62] From *Hans v. Louisiana*[63] through *Seminole Tribe of Florida v. Florida*[64] and Justice Kennedy's majority opinion in *Alden v. Maine*,[65] it has been clear that "the powers delegated to Congress under Article I of the United States Constitution do not include the power to subject nonconsenting States to private suits for damages in state courts.[66] Sovereign immunity boundaries are still being defined today, with the Supreme Court, in 2020, striking down a federal copyright law abrogating state sovereign immunity in *Allen v. Cooper*.[67] These boundaries will

56. Printz v. United States, 521 U.S. 898, 944–45 (1997).

57. Murphy v. Nat'l Collegiate Athletic Ass'n, 138 S. Ct. 1461 (2018).

58. *Id.* at 1475.

59. *See, e.g.*, Cent. Va. Cmty. Coll. v. Katz, 546 U.S. 356 (2006).

60. *See, e.g.*, Fitzpatrick v. Bitzer, 427 U.S. 445 (1976).

61. *See, e.g.*, Miles McCann, *State Sovereign Immunity*, Nat'l Ass'n of Att'ys Gen. (Nov. 11, 2017), https://www.naag.org/attorney-general-journal/state-sovereign-immunity.

62. Chapter 16 of Fippinger, *supra* note 34, is entitled "The Sovereign Immunity Defense." A portion, § 16:2:2, has a thorough and thoughtful analysis of abrogation powers, before and after 1996, under the Commerce Clause, together with a discussion of abrogation powers, by contrast, under the Bankruptcy Clause and under section 5 of the Fourteenth Amendment. The reader is encouraged to review these materials, which are not repeated here.

63. Hans v. Louisiana, 134 U.S. 1 (1890).

64. Seminole Tribe of Fla. v. Florida, 517 U.S. 44 (1996).

65. Alden v. Maine, 527 U.S. 706 (1999).

66. *Id.* at 712.

67. Allen v. Cooper, 140 S. Ct. 994 (2020).

continue to have an interesting impact on the continued evolution of the municipal market regulatory framework.

III. HISTORICAL EVOLUTION OF THE PUBLIC FINANCE MARKET

The Constitutional principles and tensions outlined in Part II above have informed development of key aspects of public finance law from the beginning, as detailed below in this Part III, including a proliferation of differing state approaches to general law matters, as well as the evolution of the federal bankruptcy, securities, and tax laws applicable to the municipal securities market.

A. Differing State Approaches to the Power and Authority of Political Subdivisions and Local Governments

Introduction

The framers of the Constitution designed a federal government that is dependent on the states, while the states are free to self-govern (with certain limitations).[68] The federal government derives its power from those expressly listed (or implied) in the Constitution, and the Tenth Amendment reserves to the states all the powers that are not given to (or prohibited by) the federal government in the Constitution. Most state constitutions are consistent with the U.S. Constitution; however, with respect to the concept of state sovereignty, some states did not take the same approach to their political subdivisions that the federal Constitution took toward states. Through adoption of the Constitution, the federal government was created by and empowered by the states. Likewise, through the fifty state constitutions and state laws, political subdivisions of the states (and other local government entities) were created and empowered, but not on a consistent basis across jurisdictions. The U.S. Supreme Court in *Atkins v. Kansas* stated that local governments are mere political subdivisions of the states for the purpose of exercising a part of the states' powers.[69] Understanding that local governments are creatures of state governments, the next two sections discuss the existing dichotomy in local governments' powers and authority.

History of Dillon's Rule

The doctrine commonly referred to as Dillon's Rule is based on decisions by Justice Dillon, including the Supreme Court of Iowa decision in 1868, *City of Clinton v. Cedar Rapids and the Missouri River Railroad Co*.[70] The City of Clinton filed an injunction in Iowa state court to restrain the Cedar Rapids and the Missouri River Railroad Company from building a railroad line through any city streets. The railroad company argued it was acting under the power granted to it by the state, which permitted it to construct a railroad line across the entire State of Iowa. The Supreme Court of Iowa ruled that the city did not possess the power to prevent the construction of a railroad and that the railroad company did not need to obtain the city's consent to build the railroad line.[71] Iowa Supreme Court Justice John Dillon stated:

> A municipal corporation possesses and can exercise the following powers and no others: First, those granted in express words (from the state); second, those necessarily implied or necessarily incident to the powers expressly granted; third, those absolutely essential to the declared objects and purposes of the corporation-not simply convenient, but indispensable; and fourth, any fair doubt as to the

68. Jon D. Russell & Aaron Bostrom, Federalism, Dillon Rule and Home Rule (Jan. 2016), https://alec.org/wp-content/uploads/2016/01/2016-ACCE-White-Paper-Dillon-House-Rule-Final.pdf.

69. Atkins v. Kansas, 191 U.S. 207, 220 (1903).

70. City of Clinton v. Cedar Rapids & Mo. R.R. Co., 24 Iowa 455 (1868).

71. Id.

existence of a power is resolved by the courts against the corporation.[72]

To summarize, under Dillon's Rule, local governments possess only the power that the state governments specifically give them and whether such authorization exists is likely to be construed against the local government.

Under Dillon's Rule, states give local governments the power to take actions, such as zoning, planning, parts of taxation, and other activities where government closest to the people is most effective. If a local government wants to exceed the scope of power delegated by the state, the local government will have to ask the state for permission to do so. Some local government leaders contend that they are handcuffed by Dillon's Rule and that it prohibits and hinders growth within the municipality. Others contend that Dillon's Rule provides consistency in law across the state and avoids renegade local political legislation.[73]

History of Home Rule (the Cooley Doctrine)

The origin of Home Rule in the United States can be traced to Judge Thomas Cooley of the Michigan Supreme Court who, in 1871, stated that local governments possess some inherent rights of self-government. This sentiment was included in Judge Cooley's concurring opinion in *People ex rel. Leroy v. Hurlburt*,[74] where the court invalidated a state law that purported to appoint members to a board of public works for the City of Detroit. The court found that while the state had the power to legislatively dictate whether the board members would be elected by local citizens or appointed by the local government, the state had no power to actually appoint members of that board.[75]

Home Rule generally permits local governments the authority to self-govern to the extent that enacted local laws do not conflict with and are not prohibited by state laws and constitutions. Under Home Rule, local governments can make a wide range of legislative decisions that have not been addressed by the state. The first state to pass a Home Rule charter was Missouri in 1875.[76] During the next few decades, states such as California, Washington, Minnesota, Colorado, Virginia, Oregon, Oklahoma, Michigan, Arizona, Ohio, Nebraska, and Texas all adopted some form of the Home Rule. Currently, more than forty states have adopted some form of Home Rule.[77]

In Florida, the adjustment from Dillon's Rule to Home Rule for cities and charter counties came at a time after World War II, during which the population began to drastically increase. The legislature was flooded with local legislative bills asking for permission from municipalities to solve local issues.[78] This surge led to a Home Rule provision being included in the 1968 constitutional revision, but the conversion to Home Rule did not apply uniformly to all local governments. In Florida, only cities and counties that have adopted charters (so-called "charter counties") possess expansive Home Rule powers. Other local government bodies in Florida possess only those powers that are bestowed upon them by the Florida Legislature. In fact, at least thirty-one states apply a combination of Dillon's Rule and Home Rule.[79]

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72. Russell & Bostrom, *supra* note 68, at 2 (referencing 1 John F. Dillon, Commentaries on the Law of Municipal Corporations 173 (2d ed. 1873)).

73. *Id.*

74. People *ex rel.* Leroy v. Hurlburt, 24 Mich. 44, 93–113 (1871).

75. *Id.*

76. Russell & Bostrom, *supra* note 68, at 6.

77. *Id.*

78. City of Boca Raton v. State, 595 So. 2d 25, 27 (Fla. 1992).

79. Russell & Bostrom, *supra* note 68, at 8.

The Value and Challenge of Divergent State Approaches

Understanding the diversity of state approaches to delegating power to local governments to govern within their borders helps to explain the tremendous diversity that developed in the U.S. municipal securities market. Because the scope of powers, privileges, and protections for any given public corporation is a function not only of its authorizing statute but also its particular state's constitution and constitutional delegation of taxing, spending, and police powers; Home Rule principles; and Dillon's Rule scope, municipal securities issuers have widely divergent powers with respect to a number of seemingly unrelated matters today. Examples include (1) the meaning of "general obligation" indebtedness;[80] (2) the ability of states, general purpose governments, and special purpose governments to execute bank loans;[81] (3) the availability of securitization and monetization authority;[82] (4) the availability of bankruptcy protection;[83] and (5) the availability and scope of statutory lien protections. The rationale for a particular state's approach is often found in the state's constitution and its case law.

The lack of uniformity in these and other areas prevents credit "homogenization" and requires municipal bond investors to review the provided disclosure with respect to each particular issuer, as well as to understand the distinctions between similarly titled bond issues of different issuers in different states. Ultimately, however, this diversity of legal premise and scope of authority among various states and their local jurisdictions is fundamentally intertwined with the very deliberate constitutional definition of federalism.

The diversity of state law approaches to a myriad of legal issues has been a challenge since the Declaration of Independence. In an effort to bring some uniformity to laws among the various jurisdictions, a group of lawyers met in the late 1890s to discuss the prospect of "a greater unanimity of law throughout the country in those matters in which such unanimity is both desirable and possible."[84] Their quest became the basis for the creation of the Uniform Law Commission in 1892.[85] The Commission released the first uniform act, the "Uniform Negotiable Instruments Law" in 1896.[86] Since its establishment, the Commission has published more than 300 uniform laws and model legislation, more than 100 of which have been adopted in at least one state.[87] Perhaps the most widely adopted uniform law is the Uniform

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80. *See, e.g.*, Nat'l Ass'n of Bond Laws., General Obligation Bonds: State Law, Bankruptcy and Disclosure Considerations (2014), https://www.nabl.org/wp-content/uploads/2023/02/20140831-NABL-Report-on-General-Obligation-Bond-Considerations.pdf.

81. *See, e.g.*, Nat'l Ass'n of Bond Laws., Municipal Bankruptcy: A Guide for Public Finance Attorneys (3d ed. 2015), https://www.nabl.org/wp-content/uploads/2023/02/20150827-NABL-Primer-on-Municipal-Bankruptcy_3rd-Edition.pdf.

82. *See, e.g.*, *P3 Infrastructure Delivery: Principles for State Legislatures*, Nat'l Conf. of State Legislatures (July 2017), https://www.ncsl.org/Portals/1/HTML_LargeReports/P3_Infrastructure_1.htm.

83. *See, e.g.*, Nat'l Ass'n of Bond Laws., Direct Purchases of State or Local Obligations by Commercial Banks and Other Financial Institutions (2017), https://www.nabl.org/wp-content/uploads/2023/02/20170720-NABL-Direct-Purchase-Report.pdf.

84. Robert A. Stein, Forming A More Perfect Union: A History of the Uniform Laws Commission (2013), https://higherlogicdownload.s3.amazonaws.com/UNIFORMLAWS/b7c515db-1895-4387-bb2d-ee99e58c0066/UploadedFiles/z2VTbVJSwqAhFymN7LnQ_Forming%20a%20More%20Perfect%20Union.pdf.

85. *Id*.

86. *Uniform Commercial Code*, Unif. L. Comm'n, https://www.uniformlaws.org/acts/ucc (last visited Jan. 13, 2023).

87. 2020–2021 Guide to Uniform and Model Acts, Unif. L. Comm'n (2022), https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=a3443fdb-39c0-dd91-b9b9-ef7405181b6f&forceDialog=0.

Commercial Code, some version of each article of which has been adopted in every state.[88] The goal of uniform laws is not necessarily that the laws of all states will be identical because each state, when considering and adopting a version of a uniform law, will make adjustments for its particular jurisdiction. The value of a uniform law (to lawyers in particular) is, very simply, the ability to understand how the laws of each state vary from the uniform law. The uniform laws that have been the most widely adopted govern areas where predictability and fairness are viewed as necessary in the context of the growing mobility of people and commerce in the country.[89]

Consider the value of uniform laws such as the Uniform Commercial Code and the Uniform Enforcement of Foreign Judgments Act, but also the value of such socially related acts as the Uniform Child Custody Jurisdiction and Enforcement Act and the Uniform Interstate Family Support Act, all of which have been adopted in most states (with some variations).[90] Does the diversity of public finance laws across the country raise such challenges that a set of uniform laws would be desirable? Is organic law diversity so great as to make such a uniform approach impossible? Would some aspect of public finance laws be more manageable in the context of a uniform or model law, such as enforcement provisions and/or statutory lien laws?[91]

Development and Expansion of the U.S. Municipal Securities Market

The first reported issuance of municipal bonds in the United States was by the City of New York in 1812, when it issued general obligation bonds to finance the construction of a canal, followed by forty-two separate bond issues to fund construction of the Erie Canal.[92] Over the next fifty or so years, municipal bonds were issued to fund other infrastructure projects, such as public education facilities and railroad construction across the country.[93] The railroad bonds were, perhaps, the first "public-private partnership" bonds issued, with the primary obligor being the railroad company with municipal assistance through the local government's credit or guarantee.[94] The economic downturn (or "panic") in 1873 resulted in numerous railroad insolvencies and municipal bond defaults.[95] In 1870, total local government debt is estimated to have been around $500 million, with twenty percent in default as a result of the economic downturn and railroad defaults.[96] In the reaction to the assistance provided by local governments to private companies and the resulting fiscal difficulties, a flurry of state constitutional limitations and prohibitions were enacted across the country, not all with the same degree of restriction. These constitutional restrictions included prohibiting the pledging of public credit to private entities, limiting tax millage rates or budgetary expenditures, and limiting debt maturities, among others.[97] As an alternative to outright prohibitions, some states enacted procedural requirements, such as voter approval, as a means to restrict local government debt issuance.[98]

88. *Id.* at 44–51.

89. Id.

90. Id.

91. *See* discussion *infra* Section III.C.

92. Jenna Ross, *From Coast to Coast: How U.S. Muni Bonds Help Build the Nation*, Visual Capitalist (Nov. 4, 2019), https://www.visualcapitalist.com/municipal-bonds-build-nation.

93. *Id.*; John A. Dove, *Financial Markets, Fiscal Constraints, and Municipal Debt: Lessons and Evidence from the Panic of 1873*, 10 J. Inst. Econ. 71, 71–106 (2014).

94. Dove, *supra* note 93.

95. *Id.* at 75.

96. *Id.* at 76.

97. *Id.* at 78.

98. *Id.* at 79.

Although these restrictions did somewhat slow the growth of the municipal securities market, they did not curtail its growth, and, in some respects, the restrictions enhanced the municipal securities market by encouraging more conservative fiscal debt policies, thus enhancing investor confidence.[99] Restrictions on tax millage also cleared the path for non-tax supported debt (e.g., revenue bonds). From that first reported issuance in 1812 through 1890, the total volume of outstanding state and local government obligations grew to $2 billion.[100] In 1996, the total volume of outstanding municipal debt was $1.26 trillion, and in 2019 it was $3.85 trillion.[101] The following table reflects the growth of the municipal securities market since 1950.

B. Growth of the Municipal Securities Market

The growth in the size of the municipal securities market has also been a function of the growth in the number of municipal issuers, as well as the transition from primarily general-obligation debt to predominately revenue-backed debt. With the introduction of special purpose governmental entities (e.g., special districts), the number of municipal issuers is estimated by various regulatory agencies at approximately 50,000 in 2020.[102]

State and Local Debt Outstanding[103]

Year	$ in billions
1950	24.4
1960	70.8
1970	144.4
1980	350.3
1989*	784.0
2000	1,480.7
2005	3,099.3
2010	3,968.3
2015	3,840.4
2020	3,949.9

*1990 data not available

C. Bankruptcy Law

Municipal bankruptcy is another legal arena where constitutional principles and tensions have driven legislative evolution in a direction quite different than that applicable in the corporate markets. Governmental units cannot liquidate under federal bankruptcy, and a municipal bankruptcy under

99. *Id.* at 97.

100. Pub. Secs. Ass'n, Fundamentals of Municipal Bonds (Gordon L. Calvert ed., 3d ed. 1990).

101. *Fixed Income Outstanding*, SIFMA, https://www.sifma.org/resources/research/fixed-income-chart (last visited Jan. 13, 2023).

102. See, for example, the May 4, 2020, joint statement by then U.S. Security and Exchange Commission Chairman Jay Clayton and Office of Municipal Securities Director Rebecca Olson, *The Importance of Disclosure for Our Municipal Markets*, SEC (May 4, 2020), https://www.sec.gov/news/public-statement/statement-clayton-olsen-2020-05-04.

103. Compiled from Pub. Secs. Ass'n, *supra* note 100, and SIFMA, *supra* note 101. Data based upon fixed income account information compiled by the Federal Reserve System.

Chapter 9, Title 11, of the United States Code, is quite different in scope than a corporate bankruptcy under Chapter 11, Title 11, of the United States Code. These differences are based in part on the fact that municipalities are not simply creatures of statute. Their organizational status runs deeper and is rooted in federal and state constitutional tenants creating them as stewards of the people's public property and limiting their power and authority by the public purpose doctrine, that is, that public monies can only be used for public purposes. It is in the municipal bankruptcy context that these differences and the further balancing of state and federal sovereignty is perhaps most visible, in part because it was the subject of litigation since inception. Since the nineteenth century, the judicial system has made clear a fundamental distinction between public and private corporations; property held by municipalities for public purposes generally cannot be attached for the payment of municipal debts.[104] Furthermore, even given broad constitutional authority, there are significant subject areas in which the federal government is without authority to act. The first municipal bankruptcy statute, adopted in 1934, was invalidated by the U.S. Supreme Court in the *Ashton* case, on grounds that it violated the Tenth Amendment.[105] In response to *Ashton*, Congress tweaked the legislation's contents and adopted a new municipal bankruptcy statute in 1937. The 1937 statute was upheld by the U.S. Supreme Court two years later in *United States v. Bekins*.[106] The *Bekins* Court, quoting extensively from the House of Representatives Committee Report on the 1937 Act,[107] blessed a framework that is still in existence today, affirming the primacy of a federal framework of adjustments in voluntary bankruptcy proceedings adopted by Congress not under Commerce Clause powers but under the Bankruptcy and Supremacy Clauses, which contain limitations designed to assure that the federal process does not unduly interfere with independent states' rights and powers to legislate policy with respect to the making and enforcement of contracts.[108]

The structural differences between corporate and municipal bankruptcies are striking and reflective of constitutional rights and powers differences. Among the most fundamental in a current-day Chapter 9 case are the following: (1) only a debtor[109] can initiate a Chapter 9 case and only can do so if there is authority at the state level; (2) no creditor can force a filing; (3) municipalities cannot be liquidated; (4) there is no bankruptcy estate in a Chapter 9 case; (5) there is an "insolvency" requirement that does not exist in other chapters of the Bankruptcy Code;[110] (6) post-petition (after the filing of the bankruptcy petition), municipalities, not judges or creditors, control operations, decisions, finances, and restructuring plans (subject to applicable law); and (7) post-petition, with a few minor exceptions, there is no creditor access to general municipal assets and no ability to force creditor distributions.[111] Three particular attributes warrant further discussion here.

104. "Property held for public uses . . . and generally everything held for governmental purposes, cannot be subjected to the payment of the debts of the City. . . . The power of taxation is legislative and cannot be exercised otherwise than under the authority of the legislature. . . . If no such authority exists, the remedy is by appeal to the legislature." Meriwether v. Garrett, 102 U.S. 472, 501 (1880).

105. Ashton v. Cameron Cnty. Water Imp. Dist. No. 1, 298 U.S. 513, 532 (1936).

106. United States v. Bekins, 304 U.S. 27, 54 (1938).

107. *Id.* at 51 ("It is the opinion of the committee that the present bill removes the objections to the unconstitutional statute, and gives a forum to enable those distressed taxing agencies which desire to adjust their obligations and which are capable of reorganization, to meet their creditors under necessary judicial control and guidance and free from coercion, and to affect such adjustment on a plan determined to be mutually advantageous.").

108. Id.

109. States themselves cannot file for bankruptcy under Chapter 9, and local governments can only pursue Chapter 9 relief if authorized by their host states.

110. 11 U.S.C. § 109(c)(2).

111. *Id.* § 109(c)(3); 11 U.S.C. §§ 903, 941.

First and most importantly, Chapter 9 is permissive (i.e., left to state law). As of 2012, twenty-seven states had granted some access channels (state law authorization for federal bankruptcy) for certain types of municipalities, and twenty-three states had not authorized access at all.[112] In his *Opinion Regarding Eligibility*,[113] relating to the City of Detroit bankruptcy, Judge Steven W. Rhodes sets forth a thorough analysis of the importance of this permissiveness to the conclusion that Chapter 9 does not violate the Tenth Amendment. He highlights that "[t]he federal government cannot and does not compel states to authorize municipalities to file for chapter 9 relief, and municipalities are not permitted to seek chapter 9 relief without specific state authorization."[114] Judge Rhodes distinguishes the holdings in *New York v. United States*[115] and *Printz v. United States*,[116] noting that state consent differentiates unconstitutional commandeering from federal programs where states voluntarily agree to legislate according to federal terms in exchange for federal benefits or forbearance. Through this consent, states have access to an impairment of contract remedy not otherwise available. Judge Rhodes quotes the *Bekins* Court, in part, as follows: "The State acts in aid, and not in derogation, of its sovereign powers. It invites the intervention of the bankruptcy power to save its agency which the State itself is powerless to rescue. Through its cooperation with the national government the needed relief is given."[117]

Second, Section 903 of the Bankruptcy Code expressly provides that the Bankruptcy Code "does not limit or impair the power of a State to control, by legislation or otherwise, a municipality of or in such State in the exercise of the political or governmental powers of such municipality, including expenditures for such exercise . . . ."[118] Legislative history on the scope of this provision is sparse, but, in the City of Stockton, California, and Detroit bankruptcies, the courts helped clarify, distinguishing state laws establishing pension protections, categorized in each case as *contracts* subject to impairment under the Supremacy Clause, from voting, taxing, and regulatory approval laws, categorized as sovereign *powers*, protected and preserved even within a Chapter 9 proceeding.[119]

Third, Section 904 of the Bankruptcy Code expressly provides that "the court may not, by any stay, order, or decree, in the case or otherwise, interfere with . . . any of the *property or revenues* of the debtor; or . . . the debtor's use or enjoyment of any income-producing property."[120] In connection with the Puerto Rico PROMESA[121] proceeding and treatment of its Highways and Transportation Authority, the First Circuit

112. H. Slayton Dabney, Jr., et. al, Municipalities in Peril: The ABI Guide to Chapter 9 (2012).

113. *In re* City of Detroit, Mich., 504 B.R. 191 (Bankr. E.D. Mich. 2013).

114. *Id.* at 241.

115. *See* New York v. United States, 505 U.S. 144, 175 (1992); Printz v. United States, 521 U.S. 898, 944–45.

116. See id.

117. *In re City of Detroit, Mich.*, 504 B.R. at 241.

118. 11 U.S.C. § 903.

119. "While § 903 protects the basic incidents of state sovereignty—described as 'political and governmental' powers—from encroachment, contractual relations as between state and municipality are generally outside the ambit of 'political or governmental' powers." See *In re* City of Stockton, 526 B.R. 35, 38 (Bankr. E.D. Cal. 2015). Similarly, "[b]ecause the state and local officials must authorize the filing of a chapter 9 petition, 11 U.S.C. §109(c)(2), and because they retain control over 'the political and governmental powers' of the municipality, these state officials remain fully politically accountable to the citizens of the state and municipality. *See* New York v. United States, 505 U.S. at 186 ('The States thereby retain the ability to set their legislative agendas; state governmental officials remain accountable to the local electorate.')." *In re City of Detroit, Mich.*, 504 B.R. at 242.

120. 11 U.S.C. § 904.

121. PROMESA is not a Chapter 9 case, but many of the Chapter 9 (and other bankruptcy provisions) were incorporated into PROMESA.

U.S. Court of Appeals issued an opinion,[122] concluding that the Bankruptcy Code, *in and of itself*, does not mandate the application of pledged special revenues to debt during the pendency of a proceeding. In other words, the Bankruptcy Code (as incorporated into PROMESA), in and of itself, does not provide the mandated payment protection of "special revenue" bonds that many in the municipal bond market had presumed existed. Section 928 preserves the prepetition pledge lien but does not mandate bond payments. In light, perhaps, of the unique nature of Puerto Rico's local Moratorium Act (normal local statutory payment obligations were not fully applicable thereunder), the question with respect to special revenue was whether Sections 922 and 928 (as incorporated into PROMESA) mandated, *in and of themselves*, application of special revenues during pendency. The decision, though initially contrary to the expectations of some regarding the protection of special revenue bonds, can be read as generally consistent with the deference of Chapter 9 to sovereignty principles and applicable local laws.

As a result of these constitutionally based principles and unlike in the corporate bankruptcy context, other than through its general ability to withhold plan confirmation, the federal system can do little to compel particular municipal behavior. Rather, the Bankruptcy Code, through the power of the Supremacy Clause, shares with local governmental units a federal power that states are prohibited under the Contracts Clause from giving local governmental units the power to impair contracts.[123] The sovereign rights of our constitutional democracy instruct and inform this unique structure and balance.

D. Securities Law: The 1933 and 1934 Act Exemptions, Prior Crises, the Tower Amendment, and Evolution of the Current Regulatory Approach

In his magisterial *The History of the Decline and Fall of the Roman Empire*, Edward Gibbon describes Rome's steady loss of hegemony in Europe, Africa, and Asia as stemming from a series of sieges and sacks on Rome by the Visigoths, the Vandals, and other uncivilized bands of invaders.[124] The gradual regulation of the municipal securities market over the last century, too, can be said to be marked by a series of sieges on the largely unregulated market mounted in response to four crises in the market—namely, the New York City debt default[125] of the 1970s, the Washington Public Power Supply System debt default[126] of the 1980s, the Orange County debt default[127] of the 1990s, and the Jefferson County debt default (and subsequent bankruptcy)[128] of the 2000s. Four sieges but—thus far—no sack. What is the explanation for this? The explanation lies in the constitutional principles outlined above and the defense of the market mounted by stakeholders through a battlement known as the Tower Amendment.[129] The size and diversity of the municipal market itself also account for its steadfastness against regulatory encroachment.

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122. *In re* Fin. Oversight & Mgmt. Bd. for Puerto Rico, 919 F.3d 121 (1st Cir. 2019).

123. For a more thorough analysis, see Nat'l Ass'n of Bond Laws., *supra* note 83.

124. *See generally* 4 Edward Gibbon, The History of the Decline and Fall of the Roman Empire (John B. Bury ed., 1986).

125. *See* SEC, Staff Report on Transactions in Securities of the City of New York (1977), https://www.sec.gov/info/municipal/staffreport0877.pdf.

126. *See* SEC, Staff Report On the Investigation in the Matter of Transactions in Washington Public Power Supply System Securities (1988).

127. *See* SEC, Report on Investigation in the Matter of County of Orange, California as it Relates to the Conduct of the Members of the Board of Supervisors (1996), https://www.sec.gov/litigation/admin/3436761.txt.

128. Jim White, *The Municipal Advisor Under Dodd-Frank*, Porter White, & Co. (Sept. 8, 2016), https://pwco.com/the-municipal-advisor-under-dodd-frank.

129. The Tower Amendment is part of Section 15B(d) of the Securities Exchange Act of 1934, is codified at 15 U.S.C. § 78o-4(d), and provides as follows:

The importance of the Tower Amendment in the history of municipal securities market regulation is best understood in the context of the history of regulation of all U.S. securities markets. An avalanche of securities laws was enacted by the U.S. Congress in the 1930s after collapse of the U.S. stock market in 1929, including the Securities Act of 1933,[130] the Securities Exchange Act of 1934,[131] and the Trust Indenture Act of 1939.[132] Municipal securities were exempt from the 1933 Act, and the legislative history does not contain an extensive debate on the exemption's propriety. The December 1933 *Yale Law Journal* (Volume XLIII, No. 2) states simply, "Constitutional problems and political expediency may have dictated the exemption of securities issued by states and their political subdivisions and certain instrumentalities thereof."[133] This is consistent with the doctrine of reciprocal tax immunity which existed at the time. The 1933 Act House Report provides:

> The line drawn . . . corresponds generally with the line drawn by the courts as to what obligations of States, their units and instrumentalities created by them are exempted from Federal taxation. By such a delineation, any constitutional difficulties that might arise with reference to the inclusion of State and municipal obligations are avoided.[134]

The 1934 Act excludes municipal securities from the registration requirement.[135] Further, the Trust Indenture Act of 1939 exempts municipal bonds as securities exempt from the 1933 Act.[136]

The 1975 amendments to the Securities Acts were drafted in response to the New York City financial crisis. Notwithstanding that crisis, the Senate committee report on the amendments provides that, apart from the anti-fraud provisions, municipal securities remain exempt from substantive requirements, "for the Committee is not aware of any abuses which would justify such a radical incursion on states' prerogatives," a clear reference to the underlying constitutional threads.[137]

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(1) Neither the [U.S. Securities and Exchange] Commission nor the [Municipal Securities Rulemaking] Board is authorized under this chapter, by rule or regulation, to require any issuer of municipal securities, directly or indirectly through a purchaser or prospective purchaser of securities from the issuer, to file with the Commission or the Board prior to the sale of such securities by the issuer any application, report, or document in connection with the issuance, sale, or distribution of such securities.

(2) The Board is not authorized under this chapter to require any issuer of municipal securities, directly or indirectly through a municipal securities broker, municipal securities dealer, municipal advisor, or otherwise, to furnish to the Board or to a purchaser or a prospective purchaser of such securities any application, report, document, or information with respect to such issuer: Provided, however, that the Board may require municipal securities brokers and municipal securities dealers or municipal advisors to furnish to the Board or purchasers or prospective purchasers of municipal securities applications, reports, documents, and information with respect to the issuer thereof which is generally available from a source other than such issuer. Nothing in this paragraph shall be construed to impair or limit the power of the Commission under any provision of this chapter.

130. Thomas L. Hazen, Treatise on the Law of Securities Regulation §§ 1:16 –1:20 (May 2021 update).

131. Id.

132. Id.

133. William O. Douglas & George E. Bates, *The Federal Securities Act of 1933*, 43 Yale L.J. 171, 183 n.53 (1933).

134. H.R. Rep. No. 73-85 (1033), *reprinted in* Legislative History of the Securities Act of 1933 and Securities Exchange Act of 1934 (J.S. Ellenberger & Ellen P. Mahar eds., 1973).

135. *Cf.* Fippinger, *supra* note 34, § 10A:2.

136. S. Rep. No. 76-1016 (1939).

137. S. Rep. No. 94-75, at 95 (1975).

The U.S. Congress has enacted other federal securities laws since the 1930s in response to perceived abuses (e.g., the Sarbanes-Oxley Act of 2002 was enacted in response to the Enron, Worldcom, and other corporate scandals,[138] and the Dodd-Frank Act of 2010 was enacted in response to the 2007–2008 financial crisis[139]). Full and fair disclosure is the guiding principle of the federal securities laws; no assessment of meritworthiness of securities is made under the federal securities laws.[140]

Although securities issued by corporate issuers have been subjected to almost all federal securities laws since 1933,[141] securities issued by the U.S. government have almost completely escaped regulation,[142] and securities issued by state and local governments (that is, municipal securities) occupy a middle ground, as they generally are exempt from the registration requirements of the federal securities laws but are subject to the antifraud provisions of the federal securities laws.[143]

Although there may be debate over the extent to which issuers of municipal securities were covered by the federal securities laws prior to the mid-1970s,[144] and although it enacted the Tower Amendment as part of the same legislative package, the U.S. Congress's enactment of other provisions in the Securities Acts Amendments of 1975 in response to the New York City fiscal crisis clearly was a congressional incursion on the municipal securities market. Market observer Robert Doty explains the legislative bargain of the Securities Acts Amendments of 1975 in the following way:

> In those Amendments, which among other things, created the Municipal Securities Rulemaking Board (MSRB), Congress enacted the Tower Amendment. The Tower Amendment prohibits the [U.S. Securities and Exchange Commission (SEC)] (and the MSRB) from requiring pre-sale filings of municipal bond offerings and imposes more stringent prohibitions on the MSRB.
>
> At the same time, as a part of the bargain, Congress also amended the definition of "person" in Section 3(a)(9) of the Securities Exchange Act of 1934 to extend the definition to "a government or political subdivision thereof." What may appear to have been a minor statutory change gave affirmative congressional authority—a green light—to the SEC for post-offering pursuit of state and local governmental entities and their officials not only for acts of fraud in violation of SEC Rule 10b-5, but also pursuant to Section 17(a)(2) and (3) of the Securities Act of 1933 for negligence.[145]

Doty goes on to say that "[i]n the absence of affirmative authority to regulate municipal securities issuers directly—through pre-offering review and pre-offering disclosure mandates or more than generalized guidance—the Commission is now, both in effect and in reality, "regulating" by enforcement—post-offering review."[146] In other words, a Congressional sacking of the municipal securities market (that is, grant of authority to the SEC to undertake pre-offering review and/or to promulgate pre-offering

138. Hazen, *supra* note 130, § 1:22.
139. *Id.* § 1:23.
140. *Id.* § 1:17.
141. *Id.* § 1:12. For a humorous angle on what an offering document for securities issued by the U.S. government might look like, see Philip R. Davis, *U.S. Treasury Bonds Prospectus, Would You Invest?*, Mkt. Oracle (Apr. 14, 2010), http://www.marketoracle.co.uk/Article18633.html.
142. Hazen, *supra* note 130, § 4:11.
143. Id.
144. Robert Doty, *Expanding Municipal Securities Enforcement: Profound Changes for Issuers and Officials*, page 12, Bond Buyer (July 12, 2016).
145. *Id.* at 2.
146. *Id.* at vi–vii.

disclosure mandates) was averted only by furnishing the SEC's Enforcement Division with legislative tools to lay siege to the market through post-offering enforcement proceedings.[147] In 2007, in the aftermath of the SEC's enforcement actions against the City of San Diego and Orange County in his native California, SEC Chairman Christopher Cox summarized the post-1975 regulatory environment of the municipal securities market in the following way:

So while the SEC has anti-fraud authority—allowing us to come in and clean up messes like these after the fact—neither we nor any other federal regulator has the authority in the municipal market that we have in the corporate securities market to insist on full disclosure of all material information to investors at the time the securities are being sold. . . . We'd all prefer a sign saying "Bridge Out Ahead" to an ambulance at the bottom of the canyon. Yet our current tools in the area of municipal offerings are more like the ambulance that arrives to pick up the pieces.[148]

Although the Tower Amendment limits the SEC's authority to regulate municipal securities issuers directly, the Securities Acts Amendments of 1975 created the MSRB and granted new authority to the SEC that has been used to regulate brokers, dealers, and municipal securities dealers directly. As illustrated by the second and third sieges on the municipal securities market (that is, the SEC's rulemaking in response to the Washington Public Power Supply System debt default of the 1980s and the Orange County debt default of the 1990s, respectively), the SEC also has used its authority under the 1975 Amendments to regulate municipal securities issuers indirectly.

In response to the Washington Public Power Supply System debt default, the SEC in 1989 promulgated the primary market disclosure rules of SEC Rule 15c2-12, which generally require brokers, dealers, and municipal securities dealers to obtain, review, and deliver to investors official statements in connection with primary offerings of municipal securities.[149] In response to the Orange County debt default, the SEC in 1994 amended and expanded SEC Rule 15c2-12 to require brokers, dealers, and municipal securities dealers to ensure, in connection with primary offerings of municipal securities, that issuers and certain other obligated persons agree to make periodic financial and event filings first with the cumbersome and now obsolete Nationally Recognized Municipal Securities Information Repositories (NRMSIRs) and, since 2009, with the MSRB's Electronic Municipal Market Access (EMMA) system.[150]

Congress got back into the business of laying siege to the municipal securities market with its enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010. The act's nearly 900 pages overhauled many aspects of the U.S. financial and securities markets in response to the financial

147. *Cf. id*. at vii.

148. Christopher Cox, *Speech by SEC Chairman: Integrity in the Municipal Market, Address at the Biltmore Hotel*, SEC (July 18, 2007), https://www.sec.gov/news/speech/2007/spch071807cc.htm; *see also* SEC, Disclosure and Accounting Practices in the Municipal Securities Market (2007), https://www.sec.gov/news/press/2007/2007-148wp.pdf. Chairman Cox's comparison of the municipal securities market with the corporate securities market needs to be tempered with an understanding of two principal differences between these markets, namely, (1) as a result of the constitutional principles discussed in this paper, municipal securities by their nature are far less standardized than the financial products that have evolved in the corporate securities market, and, as a result, the prospect of meaningful municipal securities standardization across the municipal market may well be a practical impossibility; and (2) municipal issuers generally are creditworthy and stable and issue only debt securities.

149. SEC Release 34-26100, Proposed Rule: Amendments to Municipal Securities Disclosure – Rule 15c2-12 (Sep. 22, 1988); SEC Release 34-26985, Final Rule: Amendment to Municipal Securities Disclosure – Rule 15c2-12 (Jul. 10, 1989); *see* Fippinger, note 34, § 9:4.

150. Id.

crisis beginning in 2007,[151] and, although numerous municipal securities market participants, including Jefferson County, Alabama,[152] were players in this crisis, the Dodd-Frank Act effected few changes in the municipal securities market. The principal changes included (1) protection of municipal issuers through regulation of municipal advisors;[153] (2) protection of municipal issuers participating in interest rate and other derivatives transactions;[154] (3) modification of the composition of the MSRB's board of directors;[155] (4) expansion of the MSRB's mission to include issuer protection;[156] and (5) expansion of aider and abettor liability from an actual-knowledge standard to a recklessness standard.[157]

Although the Dodd-Frank Act did not effectuate a sack of the municipal securities market (that is, grant authority to the SEC to undertake pre-offering review and/or to promulgate pre-offering disclosure mandates), the act mandated studies of the market that may, ultimately, lead to an attempted sack.[158] One of these studies, the U.S. Government Accountability Office (GAO) Municipal Securities: Options for Improving Continuing Disclosure,[159] reported that one path for improvements would be to repeal the Tower Amendment and repeal the exemption of municipal securities from the registration requirements under the 1933 Act.[160] This report ignores the constitutional principles outlined both in this article and by the Congressional Research Service.[161] It also ignores the interrelationship between public and private securities enforcement[162] and the fact that a true public finance parallel to corporate market enforcement could not be created legislatively due to the sovereign immunity of all states. On or about the date that the GAO released its study, the SEC released its *Report on the Municipal Securities Market*,[163] in which

151. *See* Fippinger, *supra* note 34, § 1:7.6.

152. White, *supra* note 128.

153. *See* Fippinger, *supra* note 34, § 1:7.6.

154. *Id.* § 4:4.

155. *Id.* § 10:3.2[B].

156. *Id.* § 10:3.2[D].

157. *See* Doty, *supra* note 144.

158. Dodd-Frank Wall Street Reform and Consumer Protection Act, H.R. 4173, 111th Cong. §§ 976, 977 (2010).

159. U.S. Gov't Accountability Off., GAO-12-265 Municipal Securities: Overview of Market Structure, Pricing, and Regulation (2012); https://www.gao.gov/products/gao-12-265.

160. U.S. Gov't Accountability Off., *supra* note 159, at 23–26.?

161. *See* Kenneth R. Thomas, Cong. Rsch. Serv., RL30315, Federalism, State Sovereignty, and the Constitution: Basis and Limits of Congressional Power (2013), https://sgp.fas.org/crs/misc/RL30315.pdf.

162. *See* Elisse B. Walter, *The Interrelationship Between Public and Private Securities Enforcement*, Harv. L. Sch. F. on Corp. Governance & Fin. Regul. (Dec. 11, 2011), https://corpgov.law.harvard.edu/2011/12/11/the-interrelationship-between-public-and-private-securities-enforcement. Then SEC Commissioner Elisse B. Walter stated, "The impact of changes in the parameters or existence of private actions on the enforceability of the federal securities laws is simply not well understood. And yet, it is critical to investors, our securities markets, and our economy overall that these laws remain fully enforceable." *Id.*

163. SEC, Report on the Municipal Securities Market (2012), https://www.sec.gov/news/studies/2012/munireport073112.pdf [hereinafter 2012 SEC Report].

the SEC outlined both legislative[164] and regulatory[165] proposals for overhauling the municipal securities market. Finally, in 2016, perhaps responding to the GAO study and the SEC report, legislation was introduced in the U.S. Congress that would overhaul the municipal securities market.[166]

The 2016 legislation received very little support in the U.S. Congress,[167] but calls for legislative overhaul of the municipal securities market have, at times, gained widespread congressional support since the New York City debt default of the 1970s.[168] Market stakeholders typically have been able to defeat these legislative efforts by demonstrating that, through voluntary efforts,[169] market participants do a more than passable job policing themselves. But what if members of the U.S. Congress no longer believed market participants were capable of regulating themselves? What if a siege turned into a sack and the SEC was granted authority to undertake pre-offering review and/or to promulgate pre-offering disclosure mandates? Would the sack succeed in the face of a constitutionally mounted defense?

SEC Commissioner Elisse B. Walter addressed this constitutional question in 2009, remarking, "No one seriously questions anymore the Constitutional right of the federal government to regulate municipal issuers."[170] In light of recent U.S. Supreme Court jurisprudence on states' rights, is Commissioner Walter

164. The SEC Report outlines legislation that would (1) authorize the SEC to regulate disclosure and financial statements; (2) authorize the SEC to require municipal securities issuers to have their financial statements audited; (3) provide a mechanism to enforce compliance with continuing disclosure; and (4) amend the municipal securities exemptions in the Securities Act and Exchange Act to eliminate the availability of such exemptions to conduit borrowers who are not municipal entities under Section 3(a)(2) of the Securities Act. 2012 SEC Report, *supra* note 163, at 134–39.

165. The SEC Report outlines changes to SEC Rule 15c2-12 that would (1) amend the definition of "final official statement" to include required disclosure about the terms of the offering, including the plan of distribution, any retail order period, and the price of the municipal securities in the initial issuance; (2) mandate more specific types of disclosures in municipal securities official statements and ongoing disclosures, including event disclosures relating to issuance of new debt, primary offering disclosures relating to risks of the municipal securities, and disclosures about underlying obligors; (3) provide a method to address noncompliance issues regarding continuing disclosure undertakings, including possibly by adding conditions that would require issuers to have disclosure policies and procedures in place regarding their disclosure obligations, including those arising under continuing disclosure undertakings; and (4) improve the accessibility of disclosures, including the use of shortened or summary official statements and increased use of websites. *Id.* at 139–40.

166. H.R. 6488 was introduced by Rep. Gwen Moore (D-WI) and adopted some of the proposals advanced in the 2012 SEC Report, including eliminating registration exemptions for conduit borrowers; having direct SEC regulation of annual disclosures and event filings, offering document content, and accounting methods; and establishing mandatory disclosure controls and systems. The legislation also granted the SEC broad discretion to establish exemptions and standards and permitted the SEC to recognize standard-setting bodies for municipal disclosure and accounting standards. H.R. 6488 (114th): Municipal Securities Disclosure Act of 2016 (Dec. 8. 2016), *H.R. 6488*, GovTrack.us, https://www.govtrack.us/congress/bills/114/hr6488 (last visited Jan. 13, 2023).

167. Id.

168. *See* Fippinger, *supra* note 34, §§ 1:7.1, 9:2.2; Am. Bar Ass'n Section of State & Local Gov't L., Am. Bar Ass'n Section of Bus. L. Comm. on Fed. Regul. of Sec., & Nat'l Ass'n of Bond Laws., Disclosure Roles of Counsel in State and Local Government Securities Offerings 21–22 (2009).

169. *See* 2012 SEC Report, *supra* note 163, at 56–58.

170. Elisse B. Walter, SEC Commissioner, Regulation of the Municipal Securities Market: Investors Are Not Second-Class Citizens, Speech at Tenth Annual A. A. Sommer, Jr. Corporate, Securities and Financial Law Lecture New York, New York (Oct. 18, 2009) (transcript available at https://www.sec.gov/news/speech/2009/spch102809ebw.htm).

correct? The answer to this question depends on the answer to two subsidiary questions. First, what is a "municipal issuer"? Second, what does Commissioner Walter mean by the term "regulate"?

On the question of what constitutes a municipal issuer, interpreting Eleventh Amendment sovereign immunity principles, the courts generally have distinguished between states and their departments and agencies on the one hand and states' political subdivisions (for example, cities and counties) on the other hand. Courts have concluded that, in the federal courts, the former enjoy Eleventh Amendment sovereign immunity and the latter do not.[171] However, even with respect to states, the courts generally have found that, although states are not subject to suit by private litigants in the federal courts, they are subject to administrative and enforcement actions brought by the SEC in the federal courts.[172] Hence, both states and their political subdivisions should be viewed as municipal issuers.

On the question of what constitutes regulation, the courts generally have found that the SEC has the authority to regulate municipal issuers (both states and their political subdivisions) through post-offering review of their actions and inactions (that is, through administrative and enforcement actions brought by the SEC).[173] However it is unclear, whether, by rule or legislation, the SEC could regulate municipal issuers through pre-offering review and/or promulgation of pre-offering disclosure mandates.

Inclusion of the Tower Amendment provisions in the 1975 amendments to the Securities Acts was premised, in part, on Congress's policy determination that there were no widespread abuses in the municipal securities market that necessitated a radical departure from the historical approach to regulating the market.[174] But that is not the full story. There is evidence that Congress also expressed concerns about limits on its power to regulate municipal issuers through pre-offering review and/or promulgation of pre-offering disclosure mandates.[175] These limits are most likely embodied in the U.S. Supreme Court's Tenth Amendment anti-commandeering caselaw.

In the most recent of these cases, the Supreme Court explained the anti-commandeering principle in the following way:

The legislative powers granted to Congress are sizable, but they are not unlimited. The Constitution confers on Congress not plenary legislative power but only certain enumerated powers. Therefore, all other legislative power is reserved for the States, as the Tenth Amendment confirms. And conspicuously absent from the list of powers given to Congress is the power to issue direct orders to the governments of the States. The anticommandeering doctrine simply represents the recognition of this limit on congressional authority.[176]

The Court went on to explain that adherence to the anti-commandeering principle is important for the following three reasons: (1) it serves to protect liberty by creating a healthy balance of power between the states and the federal government that reduces the risk of tyranny and abuse from either front; (2) it

171. Fippinger, *supra* note 34, § 16:4.

172. *Id.* § 16:2.6.

173. *Id.*

174. *Id.* §§ 9:4, 10:3.6[D].

175. Note, *Federal Regulation of Municipal Securities: Disclosure Requirements and Dual Sovereignty*, 86 Yale L.J. 919 (1977).

176. *See* Murphy v. Nat'l Collegiate Athletic Ass'n, 138 S. Ct. 1461 (2018).

promotes political accountability; and (3) it prevents Congress from shifting the costs of regulation to the states.[177]

In another of these anti-commandeering cases involving the Brady Handgun Violence Prevention Act, the Supreme Court amplified the political accountability and cost-shifting point when it noted:

> By forcing state governments to absorb the financial burden of implementing a federal regulatory program, Members of Congress can take credit for 'solving' problems without having to ask their constituents to pay for the solutions with higher federal taxes. And even when the States are not forced to absorb the costs of implementing a federal program, they are still put in the position of taking the blame for its burdensomeness and for its defects. . . . Under the present law, for example, it will be [the county sheriff involved in the litigation] and not some federal official who stands between the gun purchaser and immediate possession of his gun. And it will likely be [the sheriff], not some federal official, who will be blamed for any error (even one in the designated federal database) that causes a purchaser to be mistakenly rejected.[178]

Based on these arguments, the Court held that "[t]he Federal Government may neither issue directives requiring the States to address particular problems, nor command the States' officers*, or those of their political subdivisions*, to administer or enforce a federal regulatory program."[179]

Given the logic of the anti-commandeering cases, federal legislation granting authority to the SEC to undertake pre-offering review and/or to promulgate pre-offering disclosure mandates without concomitant federal funding could well face constitutional scrutiny. It would force state governments and their political subdivisions to absorb the financial burden of implementing a federal regulatory program and would command the states' officers, or those of their political subdivisions, to administer or enforce a federal regulatory program. Such legislation could also be subject to scrutiny under principles of state sovereign immunity, in light of issues regarding private rights of action.

There is an understandable logic in the desire to have components of the capital securities markets regulated similarly. When it comes to the municipal and corporate securities markets, however, that logic fails when countered with a nuanced understanding of the unique constitutional underpinnings of the municipal securities market. The call for further regulation of the municipal market is not grounded in market realities. Rather, it is largely a symmetrical solution in search of a problem.

E. Tax Law: Imposition of a Federal Income Tax, Reciprocal Immunity, South Carolina v. Baker and Evolution of the Current Approach

The United States Constitution, as originally adopted (including the Bill of Rights), barely addresses taxes that may be imposed by the national government. Congress is given the power to lay and collect taxes, duties, imposes, and excises to pay debts and provide for the common defense and general welfare of the country,[180] and "direct taxes"[181] must be apportioned among the several states according to their respective

177. *Id.* at 1477.

178. Printz v. United States, 521 U.S. 898, 930 (1997) (citations omitted).

179. *Id.* at 935 (emphasis added).

180. U.S. Const. art I, § 8; *see also id.* § 9, cl. 4.

181. This is hardly a clear term. The holding in *Pollock v. Farmers' Loan & Trust Co.,* 157 U.S. 429 (1894), discussed below, apparently rests, in part, upon a conclusion that a "direct tax" is a tax upon a person, while an "indirect

numbers (e.g., population).[182] By contrast, the states' reserved powers, including taxation, were recognized in the Tenth Amendment.[183]

The limits of the state's authority to impose taxes was at issue in the 1819 Supreme Court case *McCulloch v. Maryland*.[184] In that case, Chief Justice John Marshall held that the State of Maryland could not impose taxes on a congressionally chartered bank (the Second Bank of the United States) because the "power to tax involves, necessarily, a power to destroy."[185] Marshall stated that the creation of the bank was an appropriate and legitimate exercise of power by Congress pursuant to Article I, Section 8, of the Constitution and that, although the states retained the power of taxation, the Constitution and the laws made in pursuance thereof are supreme and cannot be controlled by the states. And so, the Supreme Court recognized the doctrine of mutual or reciprocal immunity.[186]

Although the doctrine of immunity recognized by *McCulloch* only applies to immunity of the federal government and was designed to prevent the states from destroying the federal government through taxation, it quickly led to an understanding of the mutual doctrine of immunity. In *Collector v. Day*,[187] the Court held that the taxing power of the national government could not be used to interfere with the essential workings of state governments and stated that a tax created by Congress on incomes of over $1,000 could not be imposed on a state judge in Massachusetts because it constituted a burden on an instrumentality of the state government.

As described earlier in this article, municipal bonds have been issued since the early 1800s, and the tax exemption for interest on municipal bonds predates the first Internal Revenue Code in 1913. The question of whether the federal government should tax interest on municipal bonds was first raised following the passage of the Wilson-Gorman Tariff Act of 1894, which imposed the first general income tax, including on interest income from state and local bonds. It has been argued[188] that the doctrine of mutual immunity was a basis for the decision in *Pollock v. Farmers' Loan & Trust Co.*, in which the Supreme Court held that the 1894 federal income tax was invalid as applied to income derived from municipal bonds. In fact, a close reading of *Pollock* suggests that the problem was that these taxes were a direct taxation scheme—taxes imposed upon persons and not property—and not properly apportioned among the states as required by Article I, Section 2.[189]

Nonetheless, *Pollock* created a problem for proponents of a federal income tax—if incomes taxes were required to be apportioned based upon population, one could readily imagine that the tax rate paid by

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tax" is a tax upon property. *See, e.g.*, Flint v. Stone Tracy Co., 220 U.S. 107 (1911) (holding that a tax on corporate income was an indirect tax).

182. U.S. Const. art I, § 2.

183. Apparently, the states also reserved the power to incur debt and to control how subsovereigns, such as cities and counties, incurred debt.

184. McCulloch v. Maryland, 17 U.S. 316 (1819).

185. *Id.* at 327.

186. Congress later provided for State non-discriminatory taxation on shares of national banks held by individuals. H.R. 395, 38th Cong. (1864).

187. Collector v. Day, 78 U.S. 113 (1870), *overruled by* Graves v. People of State of New York *ex rel.* O'Keefe, 306 U.S. 466 (1939); *see also* Ambrosini v. United States, 187 U.S. 1 (1902).

188. *See, e.g.*, Carter Glass, III, *A Review of Intergovernmental Immunities from Taxation*, 4 Wash & Lee L. Rev. 48 (1946).

189. Pollock v. Farmers' Loan and Trust Co., 158 U.S. 601, 695 (1871) (Brown, J., dissenting) (stating that the majority's "decision involves nothing less than the surrender of the taxing power to the moneyed class").

persons in states with higher per capita incomes would be less than the tax rate paid by persons in states with lower incomes and that national taxes would be perceived as being unfairly imposed. Accordingly, in 1913 the Sixteenth Amendment was proposed and adopted. The Sixteenth Amendment states that "[t]he Congress shall have the power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."[190]

It was noted by several state governors at the time the Sixteenth Amendment was proposed that the language "from whatever source derived" might allow the federal government to impose taxes on income derived from municipal bonds, with some arguing that, if the language could be so interpreted, the amendment should be defeated.[191] The language "without apportionment among the several States" would have been sufficient to overrule *Pollock*. Still, the Sixteenth Amendment was adopted with the language "from whatever source derived," and there have been arguments since then as to whether the Sixteenth Amendment would override the concept of mutual immunity.[192] It is interesting to note that there was a proposal, commented on by Andrew Mellon, Secretary of the Treasury, to amend the Constitution to specifically permit Congress to tax municipal bonds, which was adopted by the House but defeated in the Senate in 1924.[193]

Over the next several decades, the doctrine of mutual immunity took a number of hits in the courts. Some of the decisions rested upon the taxed activity's remoteness from essential state or local governmental services, while other decisions focused on the relative burden imposed on the state or local government as a result of the tax. In *South Carolina v. United States*, the Supreme Court held that a federal liquor license tax could be imposed on a liquor dispensary system conducted by the State of South Carolina, apparently because the operation of package liquor stores was not an ordinary function of government.[194] In *Metcalf & Eddy v. Mitchell*, the Court held that the salary of an engineer employed by a state is subject to federal income taxation.[195] There, the Court noted that the taxing power of either a state or the federal government, when exercised in an admittedly necessary and proper manner, unavoidably has some economic effect upon the other. The Court concluded that the burden imposed upon the state was remote and could be ignored. Other cases drastically limited the immunity of states from federal taxation.[196] In *Helvering v. Gerhardt*, the Court, when discussing taxation of New York Port Authority employee salaries, said that it should be left to Congress to delineate the scope of a state's immunity from federal taxation and that any implied immunity from federal taxation should be narrowly limited.[197] Finally,

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190. U.S. Const.amend XVI.

191. *See, e.g.*, Edward S. Corwin, *Constitutional Tax Exemption: The Power of Congress to Tax Income from State and Municipal Bonds*, 13 Nat'l Mun. Rev. 51, pt. 4 (1924). To complete the history lesson, it is important to note that, following adoption of the Sixteenth Amendment, the Revenue Act of 1913 (ch. 16, 38 Stat. 114), establishing the Internal Revenue Code, was adopted, excluding municipal bond interest from gross income for purposes of income taxation. The exclusion has remained a feature of the Internal Revenue Code ever since.

192. It is interesting to note that the doctrine arose in the context of trying to prevent the states from destroying the federal government, while the arguments that have been made against taxation of interest on municipal debt by the federal government are largely based on the idea that the federal government would otherwise destroy the states.

193. Andrew W. Mellon, Taxation: The People's Business ch.VIII (1924).

194. South Carolina v. United States, 199 U.S. 437 (1905).

195. Metcalf & Eddy v. Mitchell, 269 U.S. 514 (1925).

196. *See supra* text accompanying note 188.

197. Helvering v. Gerhardt, 304 U.S. 405 (1938); *see also* Graves v. People of State of New York *ex rel.* O'Keefe, 306 U.S. 466 (1938).

in *New York v. United States*, the Court ruled that the State of New York was not immune from taxes imposed by Congress upon mineral waters.[198]

As stated earlier, the Internal Revenue Code of 1913 provided a specific exemption from taxation of interest on state and local government bonds.[199] This exemption was carried through to the Internal Revenue Code of 1954 with little or no restrictions on the extent of the exemption. In the late 1960s, the section was amended to prevent states from borrowing funds at a lower tax-exempt interest rate for the purpose of (a) investing the proceeds at a higher taxable investment rate ("tax arbitrage") or (b) making loans for private business use ("industrial development bonds" or, later, "private activity bonds"), in each case with a slew of exceptions and special rules. However, these restrictions did not give rise to general concerns about the exempt status of municipal debt.

In 1982, however, the Internal Revenue Code of 1954 was amended by the Tax Equity and Fiscal Responsibility Act (TEFRA) [200] to, among other things, restrict the use of so-called "bearer bonds" in an effort to combat income-tax evasion and money laundering. Prior to TEFRA, corporate and government debt could be issued in "bearer" form, meaning that whoever possessed the bond was the owner and thus entitled to payment, and no record of ownership or transfer of ownership was required to be maintained. TEFRA restricted the ability of corporate debt issuers to deduct interest payments on bearer debt obligations and also imposed an excise tax on the unregistered obligation.[201] With regard to municipal bonds, TEFRA required that in order for interest on a municipal bond to be exempt, it must be issued in registered form.[202] The imposition of this seemingly minor restriction led to a challenge by the State of South Carolina and provided the opportunity for the Court to finally and directly address the ability of the federal government to tax interest derived from municipal bonds.

In *South Carolina v. Baker*, South Carolina brought suit against the federal government, claiming that the federal government did not have the power to tax interest on unregistered bearer bonds issued under TEFRA.[203] The state argued that its ability to issue tax-free bonds was guaranteed by *Pollock.* In a seven to one decision, the Court found that its decisions since *Pollock* had weakened *Pollock*, that *Pollock* should be explicitly overruled, and that state bond interest is not immune from a nondiscriminatory federal tax. The Court noted that TEFRA imposed no direct tax upon the states, but rather upon the bondholders, and that the tax was nondiscriminatory because the restrictions on unregistered bearer bonds were imposed upon private corporations and the federal government, as well as state governments.

Four attributes of the *South Carolina v. Baker* case are worthy of note and dissection: (1) the factual issue at hand; (2) the two distinct holdings; (3) the different perspectives of the justices comprising the majority; and (4) how the holdings fit in the constantly evolving fabric of constitutional law.

1. The *South Carolina v. Baker* decision includes the broad finding that a nondiscriminatory tax on the interest earned on state bonds does not violate the intergovernmental tax immunity doctrine.[204] At issue before the Court, however, was only the taxation of the interest on municipal bonds issued as unregistered bearer instruments. The Court noted that the TEFRA registration requirement was intended to address income tax evasion concerns posed by unregistered bearer bonds and that the

198. New York v. United States, 326 U.S. 572 (1946).
199. See *supra* note 191.
200. Pub. L. 97–248, 96 Stat. 324 (1982).
201. Id.
202. Id.
203. South Carolina v. Baker, 485 U.S. 505 (1988).
204. *Id.* at 526.

requirement encompassed debt obligations issued by the United States, states, and private corporations. The TEFRA provision was non-discriminatory and affected all unregistered debt obligations, not just municipal bonds.[205]

2. The *South Carolina v. Baker* decision has two separate holdings. The first is that the TEFRA registration requirement does not violate the Tenth Amendment by effectively compelling states to issue bonds in registered form.[206] The second holding is that taxing interest on unregistered state bonds does not violate the doctrine of intergovernmental tax immunity.[207]
3. The *South Carolina v. Baker* decision was 7–1, with the four-justice majority decision written by Justice Brennan, coupled with partial concurrences by Justices Scalia and Rehnquist whose perspectives were different. In his concurrence, Chief Justice Rehnquist observed that the conclusion that the TEFRA registration would have a *de minimis* impact on the states "should end, rather than begin, the Court's constitutional inquiry" and that "the Court unnecessarily casts doubt on the protective scope of the Tenth Amendment."[208] In his concurrence, Justice Stevens observes that "neither the Court's decision today nor what I have written in the past expresses any opinion about the wisdom of taxing the interest on bonds issued by state or local governments."[209]
4. The *South Carolina v. Baker* decision was issued just three years after the Court in *Garcia* overruled *National League of Cities.* The Court cites *Garcia* as holding that Tenth Amendment limits on congressional powers are structural and that states must find their protection through the national political process,[210] a holding that Justice Scalia did not read in *Garcia*. Fast-forward a decade and, regardless of its then-implied scope, the Court's decisions in *New York*[211] and *Printz*[212] walk *Garcia* back, establishing clear anti-commandeering limitations on Commerce Clause powers. Fast-forward to 2018, and the Court further flushes out the anti-commandeering standards in *Murphy v. NCAA*.[213]

It is clear the doctrine of full reciprocal tax immunity did not survive *South Carolina v. Baker* intact. What was historically viewed by some as a constitutionally protected municipal bond tax exemption became, at some level, merely a statutorily protected one. *South Carolina v. Baker* did not, however, change the fundamental structure of dual sovereignty in this country. In her dissent, Justice O'Connor, stated:

> The Court never expressly considers whether federal taxation of state and local bond interest violates the Constitution. Instead, the majority characterizes the federal tax exemption for state and local bond interest as an aspect of intergovernmental tax immunity, and it describes the decline of the intergovernmental tax immunity doctrine in this century. But constitutional principles do not depend upon the rise or fall of particular legal doctrines. This Court has a continuing responsibility "to oversee the Federal Government's compliance with its duty to respect the legitimate interests of the states." *Garcia, supra,* at 469 U.S. 581 (O'CONNOR, J., joined by Powell and REHNQUIST, JJ., dissenting).[214]

205. *Id.* at 508–10.
206. *Id.* at 515.
207. *Id.* at 526.
208. *Id.* at 529.
209. *Id.* at 528.
210. *Id.* at 512.
211. New York v. United States, 505 U.S. 144 (1992).
212. Printz v. United States, 521 U.S. 898 (1997).
213. *See supra* note 57 and accompanying text.
214. *Baker*, 485 U.S. at 530.

So, after *South Carolina v. Baker*, does anything remain of a constitutionally implied exemption for interest on municipal bonds from federal taxation? The immediate consequence of *South Carolina v. Baker* was confirmation of the federal requirement that only registered municipal bonds would have the benefit of tax exemption. Would the Court's decision have been the same if the question presented was full federal taxation of interest on all municipal bonds, thus leaving states and local governments unable to finance essential governmental improvements without diverting additional resources away from other governmental services to pay the increased interest costs? Does the "power to tax" really provide the unfettered "power to destroy" when applied in the dual sovereignty context? Would the current Supreme Court, with some members ostensibly following the lead of Justices Scalia, Rehnquist, and Stephens, resuscitate the implied exemption and draw a line against the full elimination of the federal income tax exemption for all municipal bonds?

It can be argued that the Sixteenth Amendment was not intended to specifically allow taxation of municipal bond interest given the speeches and writings at the time of its adoption and at the time of the proposed amendment specifically allowing Congress to tax municipal interest.[215] Nevertheless, the Sixteenth Amendment's language and its interpretations in the courts are mostly clear that in general terms, the Amendment means what its text says—that Congress may tax income "from whatever source derived."

IV. WHERE DOES THE MUNICIPAL MARKET GO FROM HERE?

As outlined in this article, the structure and regulation of the U.S. subsovereign debt market is largely the result of the power-sharing dual sovereignty envisioned by the framers of the U.S. Constitution. The deliberate tension inherent in this latticework generally creates a strong, counter-balanced governmental system, and its related subsidiarity generally creates efficient, effective, and locally endorsed taxing and spending decisions. Constitutional federalism protects this structure. Administrative federalism, the consideration of state input by federal agencies,[216] informally reinforces the strength that is built when state and national powers are deployed collaboratively.

The municipal bond market is strong,[217] but future demands on the market will arise from the need to make substantial investments in public infrastructure[218] to providing flexible funding for cash flow needs.

215. *See, e.g.*, Evans v. Gore, 253 U.S. 245, 260–61 (1920):

> True, Governor Hughes of New York, in a message laying the amendment before the legislature of that state for ratification or rejection, expressed some apprehension lest it might be construed as extending the taxing power to income not taxable before, but his message promptly brought forth from statesmen who participated in proposing the amendment such convincing expositions of its purpose, as here stated, that the apprehension was effectively dispelled, and ratification followed.

216. Exec. Order No. 13,132, 3 C.F.R. 206 (1999) requires agencies to consult with states when developing regulations with federalism impacts. Some scholars argue that courts should limit deference to federal agencies made without such state input.

217. In its 2012 report entitled *Municipal Securities—Overview of Market Structure, Pricing and Regulation*, the United States Governmental Accountability Office estimated the size of the entire market for municipal securities at $3.7 trillion, with individuals holding seventy-fiver percent of the total debt outstanding. 2012 SEC Report, *supra* note 163. According to SIFMA, in comparison, the corporate bond market is approximately $4.0 trillion, and the entire corporate securities market is approximately $47.2 trillion. SIFMA, 2021 Capital Markets Fact Book (2021).

218. According to the Congressional Budget Office, in the decade from 2007 to 2016, states and local governments invested $64 billion (in 2017 dollars) in transportation and water infrastructure, averaging $43 billion in tax-exempt bonds, $9 billion in loans by state banks, $8 billion (in 2009–2010) in tax credit bonds, and $4 billion

Given the significant need for capital, structural and regulatory expansion of the market's financing mechanisms to address this need should be tailored to promote economic efficiency, market capacity, and reliable legal enforceability. A learned student of American history will understand that these ends are dependent on the combined, coordinated efforts of federal, state, and local governments.

Accordingly, any legislation or regulation to further shape municipal markets necessarily involves a nuanced analysis of dual sovereignty and a focus on the valuable benefits of encouraging core municipal bond market strengths. In *Preserving the Federal-State-Local Partnership: The Role of Tax-Exempt Financing*, an October 1989 report to Congressman Beryl F. Anthony, Jr. by the Anthony Commission on Public Finance, the Commission noted:

> The Anthony Commission believes the federal government should establish a policy to work with state and local governments in a partnership to provide public services. The federal government must recognize that its judicially unfettered power to control the tax exemption of state and local government bonds must be exercised with the full recognition of the impact on state and local taxpayers as well as on the federal Treasury. State and local governments cannot fulfil their responsibilities to provide public services and meet federal standards and mandates without the cooperation of the Congress and the Administration. Specifically, the federal government should preserve tax exemption so that public services and projects can be provided at the lowest possible cost.[219]

Homogenous corporatization of public finance is neither viable[220] nor optimal. After all, when states and municipal governments are able to effectively access an efficient municipal finance market and issue debt at an attractive cost, they are able to finance more infrastructure and programs than they could otherwise, relieving a burden on the United States government. In addition, it continues to allow the states to determine how best to operate and where best to apply the subsidy received from tax-exemption and registration exemption, to continue to operate as the laboratories of self-government across the nation.

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in federal credit programs. Cong. Budget Off., Federal Support for Financing State and Local Transportation and Water Infrastructure (2018), https://www.cbo.gov/system/files/2018-10/54549-InfrastructureFinancing.pdf. Despite these investments, the American Society of Civil Engineers has given the U.S. infrastructure a cumulative grade of C-. *2020 Infrastructure Report Card*, ASCE, www.infrastructurereportcard.org (last visited Nov. 29, 2022).

219. Anthony Commission on Public Finance, Preserving the Federal-State-Local Partnership: The Role of Tax-Exempt Financing 12 (1989).

220. As noted earlier, alignment of the municipal bond market with the corporate securities market is essentially untenable. Even if identical regulatory frameworks existed, the distinct constitutional nature of individual states and municipalities, as detailed in this article, means that identical bond markets could not exist. Public-private partnership transactions and municipal bankruptcy-remote transactions look quite different both from state to state, and between the United States and other countries. Public purpose and reserved powers doctrines inform the primary role of governments and would slow down corporatization.