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Underwriter's Counsel Roundtable (Advanced)

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This panel will consider several of the key developments that have affected the obligations of underwriters in the municipal securities market and how those developments should inform appropriate representation of underwriters by their counsel. This panel will focus on appropriate divisions of responsibilities between underwriters and their counsel with respect to due diligence, what underwriter's counsel should be aware of before undertaking a representation, and how to avoid some of the pitfalls that have occurred in the last several years.

The following outline provides background information pertinent to serving as underwriter's counsel. Reference should also be made to other NABL and industry resource materials cited herein, from which this outline draws with appreciation.

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UNDERWRITER'S COUNSEL

I. GENERAL OVERVIEW

A. Scope of Representation. As the role of underwriter's counsel continues to evolve, it is important for counsel to discuss and clearly establish the scope of their representation with the underwriter. Increasingly, underwriters have prepared guidelines and memoranda regarding the scope of services they expect from underwriter's counsel. Counsel should inquire whether the underwriter has such guidelines/memoranda and, if applicable, should review those materials to ensure their services conform or to agree upon deviations.

Generally, underwriter's counsel is expected to perform various tasks, which may include:

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

2. Preparing or reviewing a preliminary official statement (or similar offering document).

3. Delivering a 10b-5 assurance letter in connection with the offering document.

4. Assisting the underwriter in conducting its due diligence investigation.

5. Preparing a bond purchase agreement and ensuring that pre-conditions to closing set forth in the bond purchase agreement are satisfied.

6. Preparing an agreement among underwriters and selling group agreement (though in recent practice, these are typically prepared by the underwriter and/or participating underwriters accept terms of SIFMA's recently revised Master Agreement Among Underwriters).

7. Preparing a "blue sky" memorandum.

8. Reviewing investor presentations.

9. Reviewing bond documents and closing documents.

10. Reviewing bond counsel, supplemental bond counsel, borrower's counsel and other opinions.

B. SIFMA Model Memorandum to Underwriter's Counsel. In September of 2018, the Securities Industry and Financial Markets Association ("SIFMA") released its *Model Memorandum to Underwriter's Counsel*. Some practitioners have viewed the model memorandum as suggesting a scope services that is more expansive than what underwriter's counsel may have traditionally performed. Nevertheless, many underwriters have revised (and continue to further revise) their guidelines and/or their own memoranda to underwriter's counsel, prompted by the new model. These developments underscore the need for underwriter's counsel

to have a common understanding with their client regarding the scope of the underwriter's counsel's representation.

II. WHO IS THE CLIENT OF UNDERWRITER'S COUNSEL?

As discussed in the *Model Letter of Underwriters' Counsel* (NABL, June 2017) identifying the client in transactions with more than one underwriter may be a matter of firm or attorney practice, or of negotiation with the underwriter(s). There are several approaches, including that the client may be considered to be the underwriting syndicate as an entity, the managing underwriters or only the senior managing underwriter. Ideally, the client identification is confirmed in an engagement letter at the beginning of the representation. *See Model Letter* at 4 (quoting William H. McBride, *Who is the Client of Underwriter's Counsel*? 27 THE BOND LAWYER: THE JOURNAL OF THE NATIONAL ASSOCIATION OF BOND LAWYERS, 33 (no. 2, June 1, 2005)).

The above-cited materials highlight the fact that, because all clients of underwriter's counsel may not be identified at the beginning to a transaction, underwriter's counsel may need to address conflicts of interest well after commencement of work on the transaction. Both NABL's *The Function and Professional Responsibilities of Bond Counsel* (Third Edition, 2011) and NABL's *Model Engagement Letters* (1998 Edition) include a discussion of the American Bar Association's *Model Rules of Professional Conduct* as they relate to conflicts of interest.

Such materials also make the point that, depending on who the client is, and depending on arrangements regarding addressees of counsel's Rule 10b-5 negative assurance letter, such letter may be addressed to parties who are not the underwriter's counsel clients. Identification of the client does not control to whom the assurance letter is addressed, and vice-versa.

III. DUE DILIGENCE

A. Background. "The term due diligence refers to the investigation into the business, legal and financial affairs of the company concerned in connection with securities offerings or other corporate transactions. A reasonable investigation can provide a future defense in response to securities law claims or common law claims stemming from a transaction or offering that has gone 'bad.'" *Conducting Due Diligence 1997* at 209. By participating in an offering, an underwriter makes an implied recommendation about the securities it is underwriting[1] and makes a representation that it has a reasonable belief in the truthfulness and completeness of the key representations made in any disclosure document used in the offering.[2]

While the term "due diligence" is not defined in the federal securities laws, it has become an informal shorthand phrase by which to refer to <u>conduct and procedures</u> which, if followed, will (i) establish certain affirmative defenses set forth in the Securities Act of 1933, as amended (the "1933 Act" or the "Securities Act") and the Securities Exchange Act of 1934, as amended (the "1934 Act" or the "Exchange Act"), (ii) tend to negate scienter for purposes of Rule 10b-5 and certain other anti-fraud provisions and (iii) satisfy the general standard of professional

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[1] *See* Exchange Act Release No. 34-62184A (May 26, 2010), 75 FR 33100 (June 10, 2010).

[2] *See* Exchange Act Release No. 34.26100 (Sept. 22, 1988), 53 FR 37778 (Sept. 28, 1988) at 37786.

performance expected of the underwriter and certain other professionals. See *Conducting Due Diligence 1985* at 12. See Section III below; however, there is an expanding body of interpretive guidance and enforcement action issued by the U.S. Securities and Exchange Commission (the "SEC" or the "Commission") that is changing the underlying basis of "due diligence" from that of establishing due diligence defenses to the affirmative undertaking of certain due diligence responsibilities (primarily related to disclosure).

The 1933 Act, and Section 11 in particular, does not apply to participants in municipal securities offerings; only the antifraud provisions of Section 17 apply. As a result, the practice of "due diligence" developed under the provisions of the statute and application in case law followed in the corporate sector is a useful guide but is based on law that does not technically apply in the municipal world. In the municipal world, the conduct of all participants is based on the antifraud provisions, which for underwriters and other broker dealers includes Section 15(c) of the 1934 Act.

The SEC's 1988 and 1989 Interpretation of Municipal Underwriter Responsibilities is based on Section 15(c)(1) and (2), the broker dealer antifraud provision, as well as 1933 Act Section 17(a) and 1934 Act Section 10(b) and Rule 10b-5, and not 1933 Act Section 11. Rather than a "due diligence" obligation under 1933 Act Section 11, the SEC points to an underwriter's obligation as a broker dealer under 1934 Act Section 15(c)(1) and (2) to have a reasonable basis for belief in the key representations of the offering document before underwriting an offering of municipal bonds. It is this formation of a reasonable basis, which changes based on the circumstances of an underwriting, that is the legal foundation for the pre offering investigation by an underwriter of municipal securities.

B. Current Guidance. The SEC's Risk Alert, *Strengthening Practices for the Underwriting of Municipal Securities* (March 19, 2012) (the "2012 Risk Alert") continues to be perhaps the SEC's most useful summary of municipal underwriter's due diligence obligation, related supervisory obligations, and key factors the SEC believes are relevant to determining the reasonableness of the underwriter's due diligence. The 2012 Risk Alert remains essential reading for underwriter's counsel in current practice.

C. What Should Conducting Due Diligence Accomplish?

1. <u>Provide the Basis for the Disclosure Document</u>. Extensive document review and interviews with personnel knowledgeable about such matters during the course of preparing the disclosure document.

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

(b) It is important to "bring down" due diligence through continued investigation up to the respective dates of the preliminary official statement and final official statement to protect against failure to disclose late breaking news (a "bring down" conference call or some written or electronic form of verification before printing/posting is generally advisable). Ultimately, these "bring down"

matters are handled through the various closing certificates and opinion from various parties of the transaction.

(c) End Result for an Underwriter: Receipt of a 10b-5 letter (i.e., "Underwriter's Counsel" letter or opinion).

2. Review the Basis for the Tax-Exempt Status of the Bonds. Although underwriter's counsel usually assumes no responsibility for the validity or tax-exempt status of the securities in question (because those matters are the responsibility of bond counsel), underwriter's counsel generally does review the underlying support for bond counsel's opinion respecting those matters. In doing so, underwriter's counsel seeks to confirm that the bond counsel opinion:

(a) has a reasonable basis;

(b) addresses the issues necessary to be addressed in the transaction;

(c) is given by competent counsel; and

(d) is an opinion on which the underwriter may reasonably rely.

3. Address Federal and State Law Securities Questions.

(a) Federal securities registration and exemption.

(b) MSRB regulatory provisions and filings.

(c) State blue sky and legal investment laws.

4. Confirm Compliance with Existing Continuing Disclosure Obligations of the Issuer. Confirming the issuer's (or obligated party's) compliance with its continuing disclosure obligations is an essential element of due diligence, in particular in the aftermath of the SEC's MCDC initiative. In light of that initiative, underwriters and their counsel should affirmatively inquire whether the issuer participated in the MCDC program and, if so, whether the issuer entered into a cease and desist order – which, under the terms of the initiative, is required to be disclosed for the subsequent five year period.

(a) The definition of "final official statement" as set forth in Rule 15c2-12 requires that the offering document include a description of any instances in the previous five years in which the issuer or an obligated person failed to comply, in all material respects, with its continuing disclosure obligations as required under any previous continuing disclosure undertakings.

(b) A due diligence inquiry of the issuer's (and/or obligated person's) filings on the MSRB's Electronic Municipal Market Access ("EMMA") and/or a review of third-party vendor reports supports an underwriter's reasonable basis for reliance on the issuer's continuing disclosure representations in the offering document.

(c) Rule 15c2-12 requires that the underwriter determine that the issuer has agreed to provide the disclosure documents to the MSRB in an electronic format. Secondary market disclosure documents will be required to be provided to the MSRB through EMMA.

(d) In 2010, in Adopting Release No. 34-62184A, the SEC provided additional guidance regarding its interpretations under the antifraud provisions of the federal securities laws to require municipal securities underwriters to have a reasonable basis for recommending any municipal securities. The adopting release reaffirms that, to have a reasonable basis to recommend a security, a municipal underwriter must carefully evaluate the likelihood that a municipality will make the ongoing disclosure called for by the amended rule. The adopting release further states that "it is doubtful that an underwriter could form a reasonable basis for relying on the accuracy or completeness of an issuer's or obligated person's ongoing disclosure representations, if such issuer or obligated person has a history of persistent and material breaches and has not remedied such past failures by the time the offering commences… In the Commission's view, it is also doubtful that an underwriter could meet the reasonable belief standard without the underwriter affirmatively inquiring as to that filing history." Adopting Release No. 34-62184A at page 92.

(e) Effective February 27, 2019, the SEC adopted amendments to Rule 15c2-12 (see Adopting Release No. 34-83885), expanding the Rule's "listed events" to include the incurrence of a material "financial obligation" (new event 15) and any default, event of acceleration, modification of terms or other, similar events under the terms of a "financial obligation" reflecting financial difficulties (new event 16). Underwriter's counsel assisting in the performance of due diligence with respect to compliance by an issuer/obligated party with continuing disclosure undertaking(s) entered into after the above effective date should review the issuer/obligated party's financial statements for such financial obligations, and should specifically query the issuer/obligated party regarding financial obligations that may have been entered into after the period covered by the financial statements. Underwriters are also increasingly inclined to encourage issuers/obligated parties to adopt policies and/or establish procedures to identify, monitor and disclose financial obligations; and would likely insist on such policies and procedures to address prior failures and thereby help establish the underwriter's reasonable belief as discussed in subparagraph (d) immediately above.[3]

(f) In March 2020, the SEC hosted a webinar that addressed, among other things, whether and how the COVID-19 crisis affects the obligation of issuers and obligated parties to make continuing disclosure filings. In short, the SEC stated that the pandemic does not change any of the consequences of missing a filing deadline. Issuers and obligated parties that miss a filing deadline should make the

[3] See *Crafting Disclosure Policies* (NABL 2015) and *An Update: Crafting Disclosure Policies* (NABL 2021).

relevant filing(s) as promptly as possible, and for annual filings, must also file a notice of their failure on EMMA (in addition to other contractual obligations that apply under the respective disclosure undertaking). If the failure to file is material, it would also need to be disclosed in subsequent offering documents during the next five years.

In April 2020 and May 2020, the SEC released public statements regarding COVID-19 and the importance of meaningful and forward-looking disclosure:

(1) "The Importance of Disclosure – For Investors, Markets and Our Fight Against COVID-19" (April 8, 2020) available at: https://www.sec.gov/news/public-statement/statement-clayton-hinman

(2) "The Importance of Disclosure for our Municipal Markets" (May 4, 2020) available at: https://www.sec.gov/news/public-statement/statement-clayton-olsen-2020-05-04

Fundamentally, issuers are not required to make a voluntary disclosure filing. The SEC could not mandate that municipal issuers make disclosure filings regarding the impact of COVID-19. However, the guidance did indicate that "in light of the potentially significant effects of COVID-19 on the finances and operations of many municipal issuers, we increase this focus and request that municipal issuers provide investors with as much information about their current financial and operating condition as is reasonably practicable."

Examples of information municipal issuers could provide include: (i) information regarding the impact of COVID-19 on operations and financial condition; (ii) information regarding sources of liquidity; (iii) information regarding availability of federal, state and local aid; and (iv) reports prepared for other governmental purposes.

While issuer's COVID-19 disclosure filings are not the responsibility of underwriter's counsel, the SEC's comments on the topic are useful tools to help guide due diligence efforts and evaluations regarding the sufficiency of the disclosure.

D. Explaining Due Diligence to Clients and Issuers/Conduit Borrowers.

1. The "Devil's Advocate" Role. It should be established at the beginning of the transaction that it is the underwriter's duty to dig into, probe and cross-check information relating to the issuer, the project and the security for the bonds. An issuer must understand that although the underwriter has been hired by the issuer to complete a successful financing, its interests are adverse to those of the issuer.

(a) It should be pointed out that disclosure documents may be prepared by the financial advisor, disclosure counsel, underwriter or its counsel, but the responsibility for material misstatements or omissions ultimately is the issuer's;

(b) Due diligence will help to identify problem areas, obstacles and "deal breakers" as soon as possible so that the underwriter can make an informed decision about continuing with the transaction;

(c) Generally, diligence will provide a complete picture of the issuer, the borrower (if applicable), the security, the underlying project, etc.; and

(d) The term "devil's advocate" as a description of due diligence originates in the 1933 Act Section 11 case *Feit v. Leaseco Data Processing Equipment Corp.,* 332 F. Supp. 544 (E.D.N.Y., 1971). In describing the role of the dealer-manager in an exchange offer, Judge Jack B. Weinstein wrote: "Tacit reliance on management assertions is unacceptable; the underwriters must play devil's advocate."[4] The term has been used in connection with the description of corporate due diligence ever since. Use of the phrase in the municipal market should be accompanied by an understanding that Section 11 liability, under which the phrase arose, does not apply to the municipal market.

2. What are the risks of inadequate due diligence? (See Section IV below.)

E. Conducting Due Diligence. The goal is to conduct a "reasonable investigation." What is "reasonable" depends on various factors (see Sections IV and V(F) below). At the very least, there should be independent verification of (verifiable) representations of an issuer, a cross-checking of outside sources, a review of internal documents and a physical inspection when appropriate.

1. Developing a "Due Diligence" list.

(a) There is no set of official "due diligence" guidelines or lists; ask the underwriter if his/her firm has a model for the particular transaction.

(b) Prepare it with the transaction "timeline" in mind (i.e., do not wait until the last minute).

(c) After having prepared a due diligence questionnaire and a document request list or checklist, send the documents to the underwriters to afford them an opportunity to review and add questions before providing the questionnaire and request to the issuer.

(d) It is helpful (although not mandatory) to ask for written responses from the issuer in advance of any scheduled due diligence call or meeting, as advance written responses afford underwriter's counsel and the underwriters an opportunity to review for any follow-up questions/inquiries in advance of the due diligence call or meeting.

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[4] *Feit v. Leaseco,* at 582.

(e) Think through which items on the due diligence list may be obtained from the issuer's website; however, in that case, underwriter's counsel should ask the issuer to confirm those items.

(f) Visit with underwriter on key issues to review on diligence call.

(g) Modern practice has evolved to regularly include internet searches, in particular with respect to news items, to identify issues which may need to be disclosed. Searches may cover the issuer (or conduit borrower) generally, as well as individual officers, large taxpayers, and the like, all depending on the circumstances. In this regard, notably, on February 7, 2020, the SEC's Office of Municipal Securities issued a Legal Bulletin entitled "*Application of Antifraud Provisions to Public Statements of Issuers and Obligated Persons of Municipal Securities in the Secondary Market*." This bulletin summarizes the SEC's past guidance regarding that the antifraud provisions apply to statements made by issuer officials reasonably expected to reach investors. Accordingly, practitioners would do well to search for and consider reported statements by such officials.

2. Prior to a site visit (if any) - Review the list with the issuer by telephone to make sure that all documents requested and key personnel will be available.

3. Visit with the Issuer (if any) - Review documents (and request that copies of certain documents be made) and discuss questions and answers with issuer.

4. Prepare summary of due diligence findings.

(a) Note that underwriters and their counsel may have different policies with respect to documenting and retaining due diligence findings. Most firms maintain detailed findings. While maintaining records is intended to demonstrate that a reasonable investigation was conducted, those records have the potential to show the opposite. *Conducting Due Diligence 1997* at 230. That said, in light of growing emphasis on conducting diligence and commensurate increased regulatory scrutiny, the modern practice is to maintain diligence materials sufficient to demonstrate the scope of the diligence investigation and to support material representations included in offering materials.

(b) "Underwriters sometimes give little thought to the kind of documentation that should be created and preserved to reflect their due diligence investigation. Some may have a packrat mentality that indiscriminately preserves every piece of paper. Others may throw out virtually everything as a matter of policy. And perhaps most commonly, what gets created and retained is a matter of chance, the habits of individual team members, or the vagaries of post-offering office moves or storage space requirements and costs."[5] In the 2012 Risk Alert, the

[5] Conducting Due Diligence 1997 at 417.

SEC staff identified some non-exclusive examples of due diligence practices, policies and procedures that evidence some due diligence and supervisory review.

(c) Be alert to attorney-client communication issues.

F. Due Diligence Checklists or Memoranda. In the 2012 Risk Alert, the SEC staff identified a variety of approaches to documenting due diligence that evidence some due diligence and supervisory review. In the 2012 Risk Alert, the SEC staff noted, however, that broker-dealers may identify and implement other practices or controls that they believe are reasonably designed to meet their obligations under the federal securities laws.

The Government Finance Officers Association ("GFOA") and the National Federation of Municipal Analysts ("NFMA")[6] have each developed voluntary disclosure guidelines for primary offerings of municipal securities. The GFOA guidelines may be accessed at http://www.gfoa.org and the NFMA guidelines at http://www.nfma.org.

G. Private Placements. Variation of Rule 506 exemption (see Section VI.B.4 below) and Rule 15c2-12(d)(1)(i).

1. In a private placement setting, due diligence is undertaken both by the seller\placement agent\underwriter and the purchaser\buyer\investor of the securities.

(a) From a seller's perspective, there are still 10b-5 concerns, as well as placement agreement liability.

(b) From a purchaser's perspective, the purchaser will want to know whether the seller will be able to satisfy any statutory or contractual liabilities that may arise.

2. Several factors are relevant to the scope of a diligence investigation in the context of a private placement. First, the diligence investigation should investigate material representations in the offering materials (e.g., the private placement memorandum or term sheet). This aspect of the investigation may be narrower than in a public offering (with a customary, fulsome official statement) to the extent that the private placement memorandum contains less information compared to an official statement. Similarly, to the extent Rule 15c2-12 does not apply, related continuing disclosure issues are typically not investigated. Beyond this, however, the customary practice is for the scope of the diligence investigation in a private placement to cover largely the same concerns as are relevant in a public offering. For example, at their client's direction, placement agent's

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[6] NFMA is an organization of nearly 1,000 members, consisting mostly of research analysts who evaluate credit and other risks of municipal securities. One of NFMA's main initiatives is to promote timely and complete disclosure of the financial and operating information needed to analyze the credit quality and risk of a municipal debt issue. To that end, NFMA has published the White Paper on Swaps, a draft White Paper on Project Finance Risk Assessment and Disclosure and thirteen sector-specific "Recommended Best Practices in Disclosure" documents, all of which are available at no charge from the NFMA website (www.nfma.org).

counsel typically utilize diligence questionnaires in private placements to identify and confirm matters such as absence of material litigation, the appropriateness of current financial disclosures, and the like.

3. The SEC charged a Rhode Island issuer and a placement agent with defrauding investors in a conduit bond financing, where the borrower was a video game company, and in which the bonds were privately placed. In *SEC v. Rhode Island Commerce Corporation (f/k/a Rhode Island Economic Development Corporation), et al.* (Litigation Release No. 24428, March 20, 2019) (the "38 Studios Bond Offering"), the bonds were offered pursuant to a Private Placement Memorandum as the transaction was not subject to Rule 15c2-12. The primary basis for the SEC's charge was that the Private Placement Memorandum "failed to disclose that the project being financed by the Bonds, the development of a video game, could not be completed with the financing the Bonds would provide. The document did not disclose that even with the proceeds of the loan financed by [the bonds], [the video game company] faced a known shortfall in funding." The litigation garnered considerable press and has stimulated discussion regarding the nature and scope of disclosure required in private placements, with the important take-away that diligence remains vital in a placement.

IV. BRIEF OVERVIEW OF DUE DILIGENCE LIABILITY THEORIES

A. Reference Materials. See 2021 NABLU: The Workshop "SEC Enforcement" and Disclosure Roles of Counsel in State and Local Government Securities Offerings, 3rd Ed. (2009), Section of Urban, State and Local Government Law, American Bar Association.

B. Section 11 of the Securities Act of 1933.

1. For registered securities, Section 11 of the 1933 Act establishes the affirmative due diligence defenses available to an underwriter of securities subject to registration with the SEC ("Corporate Underwriters"). Municipal securities generally are not subject to registration and thus municipal underwriters ("Municipal Underwriters") generally are not subject to liability under Section 11, but Section 11 enforcement actions and case law are instructive.

2. Analysis of Section 11 of 1933 Act. Section 11 of the 1933 Act provides for an express, private right of action (in contrast to the remedies under SEC Rule 10b-5 that have been implied by case law) against every underwriter with respect to a security subject to registration if any part of the registration statement contains material misstatements or omissions.

(a) Even if there were a material misleading statement or omission, however, an underwriter would <u>not</u> be liable if it could sustain the burden of proof that it conducted a proper due diligence investigation.

(1) Elements of a proper due diligence investigation depend on who prepared the portion containing the misleading statement or omission.

(A) If it's an "expertised" portion (e.g., certified financial statement) or a portion "made on the authority of a public official document or statement," it is sufficient to have the negative assurance of no reasonable ground to believe and not believe that a statement is untrue; otherwise, it is necessary to have conducted a *reasonable investigation* and to have reasonable ground to believe and believe that statements are true. (emphasis added)

(B) The court in Escott v. BarChris Construction Corp., 283 F. Supp. 643, 697 (S.D.N.Y. 1968) found that:

> The phrase 'reasonable investigation' must be construed to require more effort on the part of the underwriters than the mere adequate reporting in the prospectus of 'data presented' to them by the company. . . . In order to make the underwriters' participation in the enterprise of any value to the investors, the underwriters must make some reasonable attempt to verify the data submitted to them. They may not rely solely on the company's officers or on the company's counsel. A prudent man in the management of his own property would not rely on them. Escott v. BarChris Construction Corp. at 697.

(2) Note: The issuer is not entitled to a due diligence defense.

(b) Analogous standards for municipal underwriters: The SEC has stated that it is appropriate to determine "the extent to which the underwriter relied upon municipal officials, employees, experts, and other persons whose duties have given them knowledge of particular facts." Municipal Securities Disclosure, Exchange Act Release No. 34-26100 (September 28, 1988). In the 2012 Risk Alert, the SEC staff reiterated prior guidance from the SEC identifying a non-exclusive list of six factors that it believes generally would be relevant in determining the reasonableness of an underwriter's basis for assessing truthfulness of key representations in a final official statement. These factors are: (i) the extent to which the underwriter relied on municipal officials and other persons whose duties have given them knowledge of particular facts; (ii) the role of the underwriter (e.g., manager, syndicate member, selling dealer); (iii) the type of bonds being offered (general obligation, revenue, or private activity); (iv) the past familiarity of the underwriter with the issuer; (v) the length of time until maturity of the securities; and (vi) whether the bonds are competitively bid or are distributed in a negotiated offering.[7]

[7] *See also* Exchange Act Release No. 34-62184A (May 26, 2010), 75 FR 33100 (June 10, 2010)

C. Sections 10(b) and 17 of the 1933 Act.

1. Rule 10b-5 requires proof of scienter.

(a) Rule 10b-5 of Section 10(b) of the Exchange Act makes it unlawful to "make any untrue statement or to omit to state a material fact" in connection with the offer or sale of any securities.

(1) Actions by SEC - The SEC's power to bring enforcement actions against any person involved in the sale of a securities transaction under 10b-5 is broader than in a private action. SEC need only prove three elements: (i) a material misrepresentation, (ii) made in connection with the purchase or sale of security, and (iii) scienter. SEC v. Rana Research, Inc., 8 F.3d 1358, 1364 (9th Circ. 1993)

(2) Private cause of action – A private cause of action can be based on material misrepresentation or omission, but a plaintiff in a private action has a higher burden of proof than the SEC in an enforcement action. The Supreme Court, in Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc. 128 S. Ct. 761, 768 (2008), held that a plaintiff in a private action must prove six elements, including reliance and causation: "(1) a material misrepresentation or omission; (2) scienter; (3) a connection between misrepresentation or omission and the purchase or sale of a security by the defendant; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation."

2. Sections 17(a)(2) and 17(a)(3) - negligence is sufficient for liability, proof of scienter is not required.

(a) Section 17(a)(2) is substantially similar to Rule 10b-5, but requires that a person have obtained money or property by means of the untrue statement of material fact or omission.

(b) Negligence threshold was established by the Supreme Court in Aaron v. SEC, 446 U.S. 680, 695-97. (1980). In 2001, the Ninth Circuit Court of Appeals articulated the negligence threshold for underwriters in SEC v. Dain Rauscher, Inc. 254 F.3d 852, 856-857 (9th Circ. 2001): "Threshold is one of reasonable prudence for which the industry standard is but one factor to consider. Evidence of compliance with custom or industry practice is a relevant, but not a determinative factor, in determining whether the appropriate standard of care has been met."

(c) Most Federal circuit courts do not permit a private implied right of action under Section 17(a) because of express remedies under Sections 11 and 12 of the 1933 Act.

D. MSRB Rule G-17

1. The MSRB issued an Interpretive Notice 2012-25 Regarding the Application of MSRB Rule G-17 to Underwriters of Municipal Securities, which was effective August 2, 2012. The Notice concerns the duties of underwriters to municipal entity issuers of municipal securities (Issuers). The Notice provides for robust disclosure by an underwriter as to its role, its compensation, and actual or potential material conflicts of interest. The disclosure builds on the disclosure already required by the MSRB Rule G-23 interpretive notice approved by the Commission in May of 2011. The Notice also prohibits an underwriter from recommending that the issuer not retain a municipal advisor.

2. The required disclosures must generally be made at the time the underwriter is engaged to provide underwriting services and be made to an official of the issuer with the power to bind the issuer by contract with the underwriter. The disclosure concerning the arm's-length nature of the underwriter-issuer relationship must be made at the earliest stages of the underwriter-issuer relationship, as required by the Rule G-23 interpretive notice. In the case of disclosures triggered by recommendations as to particular financings, the disclosures must be provided in sufficient time before the execution of a contract with the underwriter to allow the official to evaluate the recommendation. The underwriter must attempt to obtain the written acknowledgement of the issuer to the required disclosures and, if the issuer will not provide such acknowledgement, to document that fact.

In practice, the underwriter provides this requisite notice and disclosure through the delivery of the G-17 letter and the incorporation of the requisite disclosures in the bond purchase agreement.

3. The Notice provides that an underwriter of a negotiated issue that recommends a complex municipal securities transaction or product (e.g., a variable rate demand obligation with a swap) to an issuer has an obligation under MSRB Rule G-17 to disclose all financial material risks (e.g., in the case of a swap, market, credit, operational, and liquidity risks) known to the underwriter and reasonably foreseeable at the time of the disclosure, financial characteristics (e.g., the material economic terms of the swap, the material terms relating to the operation of the swap, and the material rights and obligations of the parties during the term of the swap), incentives, and conflicts of interest (e.g., payments received from a swap provider) regarding the transaction or product. Underwriters are also required to inform the issuer that there may be accounting, legal, and other risks associated with a swap and that the issuer should consult with other professionals concerning such risks. Such disclosure must be sufficient to allow the issuer to assess the magnitude of its potential exposure as a result of the complex municipal securities financing. Disclosures concerning swaps are also required to be made only as to the swaps recommended by underwriters. If an issuer decides to accept the recommendation of a swap provider other than the underwriter, the underwriter has no disclosure obligation with regard to that other provider's swap.

4. The disclosures must be made in writing to an official of the issuer whom the underwriter reasonably believes has the authority to bind the issuer by contract with the underwriter (i) in sufficient time before the execution of a contract with the underwriter to

allow the official to evaluate the recommendation and (ii) in a manner designed to make clear to such official the subject matter of such disclosures and their implications for the issuer. If the underwriter does not reasonably believe that the official to whom the disclosures are addressed is capable of independently evaluating the disclosures, the underwriter is required to make additional efforts reasonably designed to inform the official or its employees or agent.

E. SEC Interpretative Guidance and Enforcement Actions.

The following lists helpful references for interpretative guidance and enforcement actions from the SEC.

1. SEC Rule 176, "Circumstances Affecting the Determination of What Constitutes Reasonable Investigation and Reasonable Grounds for Belief Under Section 11 of the Securities Act" (1981).

In determining whether or not the conduct of a person constitutes a reasonable investigation or reasonable grounds for belief meeting the standard set forth in Section 11(c), relevant circumstances include, with respect to a person other than the issuer:

(a) The type of issuer;

(b) The type of security;

(c) The type of person;

(d) The office held when the person is in office;

(e) The presence or absence of another relationship to the issuer when the person is a director or proposed director;

(f) Reasonable reliance on officers, employees, and others whose duties should have given them knowledge of the particular facts (in the light of the functions and responsibilities of the particular person with respect to the issuer and the filing);

(g) When the person is an underwriter, the type of underwriting arrangement, the role of the particular person as an underwriter and the availability of information with respect to the registrant; and

(h) Whether, with respect to a fact or document incorporated by reference, the particular person had any responsibility for the fact or the document at the time of the filing from which it was incorporated.

2. Washington Public Power Supply System Report (1988).

3. SEC Proposing Release (SEC Release No. 26100) (accompanying Rule 15c2-12) (1988).

4. SEC Adopting Release (SEC Release No. 34-26985) (accompanying Rule 15c2-12) (1989).

5. SEC Proposing Release (SEC Release No. 34-33742) (accompanying Rule 15c2-12 amendments) (1994).

6. SEC Adopting Release (SEC Release No. 34-34961 (accompanying Rule 15c2-12 amendments) (1994).

7. SEC Interpretive Release (SEC Release No. 33-7049, 34-33741 (accompanying Rule 15c2-12 amendments) (1994).

8. SEC Proposing Release (SEC Release No. 34-60332) (accompanying Rule 15c2-12 amendments) (2009).

9. SEC Adopting Release (SEC Release No. 34-62184A) (accompanying Rule 15c2-12 amendments) (2010).

10. **Underwriting**. An underwriting constitutes an implied recommendation about the underwritten securities, and such a recommendation cannot be made without an adequate basis: "In both negotiated and competitively bid municipal offerings, the Commission expects, at a minimum, that underwriters will review the issuer's disclosure documents in a professional manner for possible inaccuracies and omissions." *Disclosure Roles* at 128-9.

(a) Negotiated. In negotiated municipal offerings, where the underwriter is involved in the preparation of the official statement, the development of a reasonable basis for belief in the accuracy or completeness of the statements therein should involve an inquiry into the key representations in the official statement that is conducted in a professional manner, drawing on the underwriter's experience with the particular issuer, and other issuers, as well as its knowledge of the municipal markets. *Disclosure Roles* at 131.

(b) Competitive. In a normal competitively bid offering involving an established municipal issuer, a municipal underwriter generally would meet its obligation to have a reasonable basis for belief in the accuracy of the key representations in the official statement when it reviewed the official statement in a professional manner, and received from the issuer a detailed and credible explanation concerning any aspect of the official statement that appeared on its face, or on the basis of information available to the underwriter, to be inadequate. *Disclosure Roles* at 131.

11. **Case law and enforcement actions**

(a) According to *Fippinger*, the SEC has developed two independent theories as sources of the affirmative obligation to perform a due diligence investigation. In re: Richmond Corporation, 41 S.E.C. 398 (1963).

(1) "Fair dealing" theory (a standard of conduct developed within the securities industry as a matter of self-regulation). Fippinger at 7-10.

(2) "Implied representation" theory (derived from common law tort).

(b) The South Carolina National Bank v. Stone, 139 F.R.D. 335 (D.S.C. 1991): "It was the underwriter's responsibility, more so than any other party to the bond issue, to conduct 'due diligence' to investigate and disclose all material facts surrounding the issuance of the bonds. Although underwriter's counsel may have acted as the agent for [the underwriter] in connection with the due diligence investigation and preparation of the Official Statement, [the underwriter] remained the principal and cannot delegate away its responsibility under the law."

(c) Note that the SEC may take injunctive action under Section 20 of the 1933 Act for violations of the 1933 Act, and also under Section 21 of the 1934 Act for violations of MSRB Rules.

F. Disclosure Opinion.

1. National Association of Bond Lawyers, Model Letter of Underwriter's Counsel, Second Edition, 2017.

(a) Typical disclosure opinion is directed to the "client of the underwriter's counsel" (see discussion above regarding who is the client of underwriter's counsel).

(b) The Model Letter includes discussion of reliance letters to other parties, and notes that such letters should clearly identify who the underwriter's counsel's client is, to prevent the recipient from assuming an attorney-client relationship that does not exist.

2. "Negative Assurance." The disclosure opinion typically provides "negative assurance" regarding disclosures in the official statement that counsel helped to prepare (no material misstatements or omissions). Negative assurance should be based on specific investigations, and should be given only with respect to those sections of the offering documents that are within the knowledge of underwriter's counsel.

(a) Purpose of negative assurance is to help underwriters establish their due diligence defense. Consequently, negative assurance should only be provided to "underwriters or third parties that can avoid liability in securities offering by

establishing such a defense." It is not appropriate to provide this opinion to parties that do not have liability under the securities law (e.g., ultimate purchasers). *Negative Assurance in Securities Offerings* (2008 Revision) at 398.

(b) Although, commonly referred to as an "opinion", <u>negative assurance is not a legal opinion</u>: "Negative assurance is not a 'legal opinion.' Rather, it is a statement of belief unique to securities offerings, based principally on counsel's participation in the process of preparing and discussing the registration statement or other offering document with the various participants in the process." *Negative Assurance in Securities Offerings* (2008 Revision) at 397.

(c) For more information, see *Negative Assurance in Securities Offerings* (2008 Revision).

G. Reliance on Other Opinions. Duty of underwriter's counsel depends on the scope of the representation made as to the opinion of other counsel.

1. The Collected ABA and TriBar Opinion Reports §5.1 (ABA 2005).

(a) Satisfactory in Form and Scope? Reliance by underwriter's counsel must be "reasonable".

(b) Satisfactory in Form and Substance? Reliance must be reasonable AND underwriter's counsel must make an independent investigation of the law involved.

V. THEORIES OF DUE DILIGENCE AS A DEFENSE

A. Corporate Underwriters. For corporate underwriters, the burden is on the underwriter that it conducted a reasonable investigation or acted with reasonable care.

1. Under Section 11 of the 1933 Act, once a plaintiff has proven that a registration statement contains a material misleading statement or omission, the underwriter is liable for damages unless it can prove that (with respect to the non-expertised, non-official portion) it performed a "reasonable investigation" and had reasonable grounds to believe in the accuracy of the registration statement.

2. Under Section 12 of the 1933 Act, once a plaintiff has proven that a prospectus or oral communication contains a material misleading statement or omission, the underwriter is subject to rescission of the sale of the underwritten security unless it can prove that it did not know and in the exercise of *reasonable care* could not have known of the misleading statement or information. (Emphasis added)

B. Municipal Underwriters. For municipal underwriters, under Section 10(b) of the 1934 Act and Rule 10b-5, the plaintiff must prove not only a material misleading statement or

omission in the disclosure document, but also that the defendant acted with scienter, i.e., with recklessness or intent to deceive.

1. A thorough due diligence investigation therefore would serve to defeat a claim that the underwriter acted with scienter and also that the underwriter was negligent.

2. It would also establish a defense to a Section 17(a) action, whether under 17(a)(1)(which requires a showing of scienter) or 17(a)(2) or (3)(which do not).

3. Howard v. SEC, 376 F.3d 852, 856-857. (9th Cir. 2001): "Reliance on the advice of counsel need not be a formal defense; it simply is evidence of good faith, a relevant consideration in evaluating a defendant's scienter."

C. Two Critical Distinctions. Who bears the burden of proof, and what is the standard of liability?

1. For registered securities: Upon a showing of a material misleading statement or omission in a prospectus, the defendant underwriter must prove that it did not act in a negligent manner.

2. For municipal securities: The plaintiff must prove, among other things, that the defendant underwriter acted with scienter.

If a municipal underwriter has performed procedures which would establish a due diligence defense under Section 11 of the 1933 Act, then those procedures should be sufficient to defeat a claim that the underwriter acted with scienter. A failure to follow those procedures, however, would not result in liability under Section 10b-5 unless each of the elements of a Rule 10b-5 cause of action is proven by a plaintiff.

D. Potential Liabilities of Principals and Their Counsel. Generally, under Rule 10b-5 there is both *primary* liability and *aiding-and-abetting* liability. The difference between the two kinds of liability is important because, while the government may seek redress for both kinds of liability, private plaintiffs have claims only with respect to primary liability. There have been many cases defining and refining the respective scope of, and relationship between, primary and aiding-and-abetting liability, including recently *Lorenzo v. SEC*, 587 U.S., No. 17-1077 (U.S. Mar. 27, 2019).

1. Primary Liability: Antifraud

(a) Section 10(b) and 17(a)(1): Scienter required; reckless conduct may suffice.

(1) In SEC v. Robert Kasirer, SEC Litig. Rel. No. 19131 (N.D. Ill. 2005)(No. 04-CV-04340), the United States District Court for the Northern District of Illinois ruled that underwriter's counsel, Joel T. Boehm, violated Sections 10(b) and 17(a) of the Securities Act for issuing favorable legal opinions despite his knowledge that bond proceeds were being wrongfully diverted. The enforcement action arose out of a series of 11 healthcare

facility financings from 1996-1999. In the related complaint, the SEC alleged that the costs of each financing (including payments to the controlling party of the company developing such facilities) significantly outweighed the bond proceeds. As a result, the SEC alleged that the controlling party of the company, the underwriter, and underwriter's counsel engaged in a "Ponzi type scheme" - diverting bond proceeds from more recent financings to cover the cash shortfalls from earlier financings. In the action against Boehm, the SEC concluded that: he (1) issued favorable legal opinions despite his knowledge that funds were being wrongfully committed and diverted, (2) knowingly or with a reckless disregard for the truth took part in writing, reviewing or disseminating bond prospectuses which misled investors, and (3) personally profited from the scheme. Boehm was ordered to pay disgorgement of his fees plus prejudgment interest.

(2) In a civil action related to Jefferson County, Alabama, SEC v. Langford (N.D. Ala. April 8, 2008)(No. CV-08-B-0761-S), the District Court granted summary judgment in favor of the SEC finding that Larry Langford, the former president of the County Commission of Jefferson County, Alabama; accepted an undisclosed amount of cash and benefits from William Blount, the chairman of broker-dealer Blount Parrish & Co., Inc. In exchange for these cash payments, it is alleged that Langford selected Blount Parrish and Inc., Co. to participate in "$6.4 billion of Jefferson County bond offerings and swap agreement transactions from March 2003 to December 2004." The court permanently enjoined Langford, Blount and Blount Parrish from further violations of Section 17(a) and Sections 10(b) of the Securities Acts. Regarding materiality to investors of the alleged biased selection of underwriters, in Plaintiff's Response to Motion to Dismiss, SEC v. Langford (No. CV-08-B-0761-S (N.D. Ala. July 14, 2008), the SEC asserted that the facts related to the biased selection of underwriters are "not so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of their importance." The Court found Langford's conduct egregious and if he was given the opportunity would likely repeat the wrongs.

(3) City of San Diego, SEC. Rel. Nos. 33-8751, 35-54-475 (Nov. 14, 2006). On November 14, 2006, the SEC entered an order sanctioning the City of San Diego for committing securities fraud by failing to disclose to the investing public important information about its pension and retiree health care obligations in the sale of its municipal bonds in 2002 and 2003. In particular, the SEC found that "the City failed to disclose material information regarding substantial and growing liabilities for its pension plan and retiree health care and its ability to pay those obligations in the future in the disclosure documents for its 2002 and 2003 offerings, in its continuing disclosures filed in 2003, and in its presentation to the rating agencies." The Order required the City to cease and desist from committing violations of the antifraud provisions and to retain an independent

consultant for three years to foster compliance with its disclosure obligations under the federal securities laws. In addition, in 2008, the SEC charged five former San Diego city officials with fraud for their involvement in the transactions. The SEC alleged that the officials knew the city had been intentionally under-funding its pension obligations so that it could increase pension benefits but defer the costs. They also were aware that the City would face severe difficulty funding its future pension and retiree health care obligations unless new revenues were obtained, benefits were reduced, or City services were cut. On October 27, 2010, four former officials agreed to settle the SEC's charges without admitting or denying the allegations and consented to the entry of final judgments that permanently enjoin them from future violations of Securities Act of 1933 Section 17(a)(2). Under the settlement terms, penalties ranged from $5,000 to $25,000. This case is the first in which the SEC secured financial penalties from municipal officials in a municipal bond fraud case. Charges are still pending against the fifth official.

(4) In the matter of the State of New Jersey, Admin. Proc. File No. 3-14009 (August 18, 2010). In its first case against a state, the SEC determined that New Jersey had violated securities fraud laws for its failure to disclose to bond investors that it was underfunding the state's two largest pension plans in connection with bond issuances from 2001 to 2007. More specifically, the state did not adequately disclose that it was underfunding the pension plans, why it was doing so, or the potential effects of the underfunding. The SEC concluded that the state made material misstatements and omissions in preliminary official statements, official statements and continuing disclosures regarding the state's underfunding of its pension plans.

(b) Section 17(a)(2) or (a)(3): Negligence sufficient in SEC injunctive actions under (a)(2) or (a)(3). In Ira Weiss v. SEC, 468 F. 3d 849, the United States Court of Appeals for the District of Columbia Circuit, upheld the SEC finding that Ira Weiss, bond counsel, violated Sections 17(a)(2) and 17(a)(3) of the Securities Act for failing to fully inform investors of the substantial risk that interest on general obligation notes issued by a local school district would be deemed taxable. In this case, the local school board issued bonds to finance certain potential school construction projects that never occurred. According to the SEC, "Weiss's failure to look for even minimal objective indicia of the School District's reasonable expectations to spend Note proceeds on projects was *at least negligent.*" (emphasis added)(for further information and details about the Weiss case, refer to BAW 2008 *"Municipal Securities Law 101").*

2. Secondary Liability: Aiding and Abetting.

(a) "Although the focus of the law of disclosure is on the principals involved in a securities law offering, liability under antifraud provisions also exist for (1) secondary actors who commit primary violations (See Section 4.C.1 above),

and (2) in an SEC enforcement action, but not in a private action, secondary actors as aiders and abettors, under the Private Securities Litigation Reform Act." *Disclosure Roles* at 86-87. Section 104 of the Private Securities Litigation Reform Act, among other things, amended Section 20 of the 1934 Act, and provides that "for purposes of any action brought by the Commission under paragraph (1) or (3) of Section 21(d), any person that knowingly provides substantial assistance to another person in violation of a provision of the [1934 Act], or any rule or regulation issued under [the 1934 Act], shall be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided."

(b) In *Lorenzo v. SEC*, 587 U.S., No. 17-1077 (U.S. Mar. 27, 2019), that a person who did not "make" a false statement under Rule 10b-5(b) may nonetheless be liable under Rule 10b-5(a) or (c) if he or she disseminates a false statement with intent to defraud. Prior to the *Lorenzo* decision, several circuit courts held that only "makers" of a false statement were liable under Rule 10b-5, because subsection (b) of that Rule specifically addresses "untrue statement[s]." In *Lorenzo*, an investment banker sent an email to investors authored and directed by his boss that that the banker knew to be false. The Supreme Court ruled that dissemination of someone else's false statement falls within subsections (a) and (c) of Rule 10b-5, which prohibit "devices," "schemes," and "artifices to defraud," as well "act[s], practice[s], or course[s] of business" that "operate . . . as a fraud or deceit." Accordingly, although the Court reaffirmed that only "makers" of a false statement can be primarily liable under Rule 10b-5(b), the Court held that one who with scienter disseminates a false statement that is "made" by another can be *primarily* liable under Rule 10b-5(a) and (c) and may also be secondarily liable as an aider and abettor of the "maker's" primary violation of Rule 10b-5(b).

E. What Should an Underwriter and Their Counsel Do?

1. Recognize that each issue (and thus the methods of verification) in a disclosure document will come under scrutiny.

2. Due diligence is evaluated at the time of the investigation, not with the benefit of hindsight.

3. Independent verification of issuer representations.

(a) Note: It is not unreasonable to rely on management representations re: information that is solely in possession of the issuer and cannot be reasonably verified by third parties.

(b) Should reference outside information sources.

(c) Representations and warranties of issuer (in bond purchase agreement).

4. Follow up on information that doesn't make sense (red flags).

5. "Bring-Down" Due Diligence

6. Delegate to Outside Professional (e.g., "Agreed-Upon Procedures" letter for interim financial statements prepared by internal finance officers). *Conducting Due Diligence 1997* at 399.

(a) Cold comfort letters from independent auditors are intended to demonstrate the reasonableness of the investigation of the requesting party.

(1) When used in conjunction with unaudited financial data, it is expected that they enhance the reliability of the information, but they are not reports by auditors on the unaudited financial statements, but merely confirmations of certain findings resulting from limited investigatory steps taken subsequent to the period covered by the most recent audited statements.

(b) Problem: Statement on Auditing Standards No. 72, Letters for Underwriters and Certain Other Requesting Parties (1993) requires that accountants receive a written representation from a requesting broker-dealer in an exempt securities offering that the broker-dealer:

> [W]ill be reviewing certain information relating to [issuer] that will be included...in the document...which may be delivered to investors...This review process applied to the information relating to the issuer, is...substantially consistent with the due diligence review process that we would perform if this placement of securities were being registered pursuant to the 1933 Act. We are knowledgeable with respect to the due diligence review process that would be performed if this placement of securities were being registered pursuant to the Act.

(c) Compromise: An "agreed-upon procedures" letter, which provides a more limited review.

(d) Consent of auditors to the inclusion of audited financial statements in Official Statements. Because consents of experts and counsel are required to be filed in connection with registered offerings (*see* 1933 Act Rule 436), underwriters are often more comfortable obtaining such consents for inclusion in the municipal bond transcript. These consents are not, however, specifically required in connection with offerings that are exempt from 1933 Act registration.

7. Documentation. Underwriters need to establish through written documentation that they performed an adequate due diligence investigation.

F. Systemic Procedures to Prevent and Detect Securities Law Violations.[8]

1. "Section 15(b) of the 1934 Act authorizes the Commission to impose sanctions on a firm or any person that fails to reasonably supervise a person subject to their supervision that violates the federal securities laws. Section 15(b)(4)(E) provides an affirmative defense against a charge of failure to supervise where reasonable procedures and systems for applying the procedures have been established and effectively implemented with reason to believe that such procedures are not being complied with."[9]

2. A claim that due diligence activities are not "industry practice" or that an underwriter is following advice from counsel are not likely to be sufficient to support a defense.[10]

3. The Commission has provided a non-exclusive list of six factors that would be relevant in determining the reasonableness of an underwriter's basis for assessing truthfulness of key representations in a final official statement:

   (a) Extent to which the underwriter relied on municipal officials and other persons whose duties have given them knowledge of particular facts;

   (b) The role of the underwriter (i.e. manager, syndicate member, selling dealer);

   (c) The type of bonds being offered (general obligation, revenue or private activity);

   (d) The past familiarity of the underwriter with the issuer;

   (e) The length of time until maturity of the securities; and

   (f) Whether the bonds are competitively bid or are distributed in a negotiated offering.[11]

4. To demonstrate compliance, underwriters should have adequate policies and procedures in place to ensure that due diligence is adequately completed and documented and that there is adequate follow-up if issues are detected.

5. Examples of Due Diligence Practices, Policies and Procedures

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[8] *See* Securities and Exchange Commission National Examination Risk Alert, Volume II, Issue 3, March 19, 2012.

[9] Id at page 3.

[10] *See* id, footnote 13.

[11] Exchange Act Release No. 34-62184A (May 26, 2010), 75 FR 33100 (June 10, 2010) at 91-92.

(a) Clear Explanation of Regulatory Requirements and Firms' Expectations

(1) Detailed written policies and procedures.

(b) Commitment Committees

(1) Firm-wide, senior-level commitment committees that review and approve underwritings.

(2) Submissions to the committee may include a due diligence memorandum describing the diligence that was done, diligence calls that were completed and certain portions of the official statement.

(c) Diligence Checklists

(1) May require substantial narrative describing due diligence steps or past familiarity with the issuer.

(d) Due Diligence Memoranda

(1) Describing diligence calls, issues noted and how they were resolved.

(2) Include review of final or deemed final official statement.

(3) May be used in conjunction with checklists described above.

(e) Outlines for Diligence Calls

(f) On-Site Examination Activities

(1) Meetings with municipal officials, visits to facilities and examination of issuer's records.

(g) Recordkeeping Checklists

(1) To assist personnel in maintaining records that evidence due diligence was performed.

VI. PREPARATION OF OTHER DOCUMENTS

A. Bond Purchase/Private Placement Contract. Traditionally, the primary responsibility of underwriter's counsel or placement agent's counsel; specifies the various conditions that must exist before the underwriter will accept and pay for the securities; represents the allocation of risks and responsibilities in the transaction and serves to facilitate the

underwriter's allocation of responsibilities in the transaction and the identification of legal issues that may be present in the offering.

1. Representations and warranties contained in the Bond Purchase Contract can help define the scope of due diligence responsibilities.

2. Forms of opinions contained as exhibits to the Bond Purchase Contract should carefully delineate the areas of responsibility for disclosure.

3. Underwriter "out" clauses in the Bond Purchase Contract should be designed to relieve the underwriter of its obligations upon the occurrence of events beyond the underwriter's control, including outbreaks or escalations of hostilities, banking moratoriums and suspensions of trading.

4. Specifies "firm underwriting" or "best efforts" undertaking by Underwriter.

5. In September, 2008, the Securities Industry and Financial Markets Association ("SIFMA") published a Model Bond Purchase Agreement. The SIFMA Model Bond Purchase Agreement is comprised of three parts: (i) terms and acceptance, (ii) general provisions and conditions and (iii) instruction and commentary.

A unique component of the terms and acceptance in the Model Bond Purchase Agreement is the emphasis on the separate roles of underwriters and municipal issuers. In particular, the Model BPA provides for a paragraph "intended to specifically clarify the nature of the relationship between the Underwriters and the Issuer – that the Underwriters and the Issuer are acting on an arm's-length, commercial basis and that no Underwriter is acting as a fiduciary or agent of the Issuer." The SIFMA Model Agreement can be located on the SIFMA website at http://www.sifma.org.

B. Agreement Among Underwriters/Selling Group Agreement. The Agreement Among Underwriters is an agreement setting forth the legal relationships between syndicate members that allows execution of one standardized agreement rather than the execution of separately negotiated legal contracts each time a firm joins a syndicate.

On July 16, 2018, SIFMA's Municipal Securities Division announced implementation of a new structure for its Master Agreement Among Underwriters ("MAAU"). Per SIFMA's website, participating firms sign an acceptance letter to sign on to the MAAU, and SIFMA publishes a list of firms that have accepted the terms of the MAAU. SIFMA has also fully revised the MAAU for the first time in 16 years and released the new version in conjunction with the offering of this new structure.

A selling group agreement is used to form one or more selling groups in connection with the negotiated purchase and public offering of securities. SIFMA similarly maintains a form of master selling group agreement.

VII. OTHER TOPICS

A. Federal Registration and Exemptions. The 1933 Act (codified at 15 U.S.C. § 77a *et seq.*) generally requires that securities must be registered with the SEC before they are offered to investors.

1. The term "security" includes, bonds, notes, certificates of participation, other evidences of indebtedness and investment contracts, together with guarantees of the foregoing. 1933 Act, § 2(a)(1). This definition encompasses not only the primary instruments in most municipal financings—*i.e.* bonds, notes and COPs—but also such collateral documents as guaranteed investment contracts (GICs), letters of credit, bond insurance policies and debt service reserve surety bonds.

2. Section 5 of the 1933 Act is the primary enforcement tool: It generally prohibits any person to use the mail or other forms of interstate commerce to offer to sell, offer to buy, sell, buy or deliver any security unless a proper "registration statement" has been filed with the SEC and is in effect.

3. Most municipal securities are <u>not</u> registered because Section 3(a) of the 1933 Act provides that, for most purposes, certain enumerated classes of securities are not subject to the 1933 Act. These include:

(a) Any security issued or guaranteed by the United States or any Territory thereof. 1933 Act, §3(a)(2).

(b) Any security issued or guaranteed by any State of the United States, or by any political subdivision of a State or Territory, or by any public instrumentality of one or more States or Territories. 1933 Act, §3(a)(2).

(1) Includes most municipal securities, but does not include securities issued by Indian tribes or 63-20 corporations.

(c) Any security issued or guaranteed by a national bank or a banking institution organized under the laws of any State, Territory or the District of Columbia, the business of which is substantially confined to banking and is supervised by the state or territorial banking commission or similar official. 1933 Act, §3(a)(2).

(1) Includes most, *but not all*, letter of credit banks; may cover COPs issued by banks.

(2) Letters of credit issued by domestic branches of foreign banks may qualify for a Section 3(a)(2) exemption on the basis of Interpretive Release No. 33-6661.

(d) Any security which is an "industrial development bond" (within the meaning of Section 103(c)(2) of the 1954 Tax Code, *as in effect in 1970*) the interest on which is excludable from gross income under Section 103(a)(1) of the 1954 Tax

Code (other than multi-family housing bonds and bonds issued to finance industrial parks). Watch for taxable IDBs, which aren't covered by this exemption.

(1) Includes most "exempt facility bonds" issued under Section 142 of the 1986 Tax Code and "qualified small issue bonds" issued under Section 144(a) of the 1986 Tax Code. This exemption was added in 1970 to mitigate the impact of SEC Rule 131, which generally provides that the obligations of the ultimate obligor in a conduit bond issue, if an "industrial or commercial enterprise," are deemed to be separate securities (and thus would be subject to the 1933 Act registration requirements).

(2) Multi-family housing bonds were specifically excluded from this exemption. While the bonds themselves will usually qualify under the Section 3(a)(2) exemption, the underlying conduit loan and related guarantees must be analyzed as potential separate securities.

(A) Under Rule 131(b), the obligation(s) underlying bonds, including multi-family housing revenue bonds will not be deemed to be a separate security if: (i) the obligation is payable from the general revenues of a governmental unit specified in Section 3(a)(2) of the 1933 Act; or (ii) the obligation relates to a public project owned and operated by or on behalf of and under the control of a governmental unit; or (iii) the obligation relates to a facility that is leased to and under the control of an industrial or commercial enterprise but is part of a public project that is owned by a governmental unit.

(B) SEC no action letters indicate that housing projects owned and operated by private developers may satisfy the Rule 131(b) requirements set forth in Section VI.B.3.d.(2)(a) above if adequate governmental "control" is demonstrated. Factors showing governmental control include: (i) the right to access to the project; (ii) the right to inspect books and records; (iii) the right to receive periodic reports relating to project operations; (iv) the right to obtain possession of the project in the event of a material default under the mortgage; (v) approval of the timing of construction; and (vi) approval of plans and specifications.

(e) Any security issued by an entity organized and operated exclusively for religious, educational, benevolent, fraternal, charitable or reformatory purposes and not for pecuniary profit, and no part of the net earnings of which inures to the benefit of any person, private stockholder or individual (which should include most 501(c)(3) corporations and 63-20 corporations).

(f) Any insurance policy issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner or other similar officer of a State or Territory or the District of Columbia.

(1) Covers bond insurance policies of major bond insurers.

(g) Securities offered and sold only to persons resident within a single State or Territory by an issuer that is resident of (or incorporated by) and doing business with such State or Territory.

4. Section 4 "Transactional" Exemptions. If the securities being issued do not qualify as exempt securities under Section 3(a) of the 1933 Act (*e.g.* Indian bonds), the issuer must register the securities or qualify the offering and sale of the securities as an exempt transaction under Section 4 of the 1933 Act. Note that separate exemptions under Section 4 are required for each transaction, unlike the "securities" exemptions provided by Section 3.

(a) Section 4(6) exemption: Transactions involving offers or sales by an issuer solely to "accredited investors" if (i) the aggregate offering price is $5 million or less, (ii) there is no advertising or public solicitation in connection with the transaction, and (iii) the issuer files a Form D with the SEC.

(b) Section 4(2) exemption: "transactions by an issuer not involving any public offering." The issuer may either do a "statutory" private placement by utilizing Section 4(2) as interpreted by SEC staff no-action letters or utilize the safe harbor provided by SEC Rules 501 through 508 ("Regulation D").

(1) Exemption for offerings of $1 million or less (a "Rule 504 offering").

(2) Exemption for offerings of $5 million or less sold to not more than 35 purchasers (a "Rule 505 offering").

(3) Exemption for offerings sold to not more than 35 purchasers, regardless of dollar amount (a "Rule 506 offering"). Among the requirements for meeting this exemption is that each purchaser (other than accredited investors) must have "such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment." Such securities may be sold to an unlimited number of accredited investors.

5. Section 4 "Purchaser" Exemptions. If the securities being issued do not qualify as exempt securities under Section 3(a) of the 1933 Act (*e.g.* Indian bonds) and have not been registered, the purchaser can qualify subsequent resale of the securities as exempt transactions under Section 4 of the 1933 Act. The exemption afforded by Section 4(2) and the related safe harbor of Regulation D is only available to the "issuer" by the terms of Section 4(2), and therefore each subsequent resale must find its own transactional exemption.

(a) Section 4(1) exemption: "transactions by any person other than an issuer, underwriter, or dealer."

(1) The term, "underwriter" is broadly defined to include any person who (i) has purchased securities from an issuer with a view to distribute such securities, or (ii) offers and sells securities for an issuer in connection with the distribution thereof.

(2) "Dealer" means a person who works as an agent, broker or principal in the business of offering, buying, selling or otherwise dealing and trading in securities issued by another person.

(b) Section 4(3) exemption: Transactions by a dealer (but not in the capacity of an underwriter), so long as the transactions (i) do not take place within 40 days after the initial public offering of the security by the issuer or an underwriter, or (ii) do not take place within 40 days after the effective date of a registration statement, or (iii) do not involve an unsold subscription or allotment to such dealer in connection with the distribution of the securities by the issuer or an underwriter. To qualify for this exemption, investment bankers must avoid activities that will cause them to be "underwriters" within the meaning of Section 2(a)(11) of the 1933 Act. SEC Rules 144 and 144A provide safe harbors in this regard.

(1) If the requirements of Rule 144 are satisfied, the seller of the securities (not including the issuer) will not be deemed to be engaged in the "distribution" of the securities, and thus not an "underwriter." Rule 144 imposes a one-year holding period on the securities. Once held for that period, a seller is no longer considered an "underwriter".

(2) The result is the same under Rule 144A—*i.e.* the resale of securities by an investment banker (or other person) will not cause the investment banker to be an "underwriter."

(A) Rule 144A involves the sale of securities *only* to if a qualified institutional buyers by persons other than the issuer. Rule 144A(d)(1). Rule 144A provides that even if securities are purchased with an intent to resell, such seller will not be deemed an underwriter if sales are limited to QIBs.

(B) The term "qualified institutional buyer" is defined in Rule 144A(a)(1). Most QIBs will qualify as "accredited investors" under Section 2(a)(15) of the 1933 Act and Rule 215, but not all accredited investors will qualify as QIBs.

(C) The seller of the securities is allowed to rely on a certificate from the purchaser, among other things, to determine whether the purchaser is a QIB, and must notify the purchaser that the seller is relying on Rule 144A for an exemption from Section 5 of the 1933 Act. Rule 144A(d)(2).

B. Trust Indenture Act of 1939. Many "supplemental" legal opinions by bond counsel, and most underwriter's counsel letters, include an opinion that the indenture, bond ordinance or bond resolution need not be qualified pursuant to the Trust Indenture Act of 1939 (15 U.S.C. § 77aaa *et seq.*; also known as the "Trust Indenture Act").

1. The Trust Indenture Act applies specifically to notes, bonds, other evidences of indebtedness, certificates of participation in such instruments, and guarantees of debt instruments (Trust Indenture Act, §304(a)(1)), and generally requires that any "indenture" under which securities are issued be qualified by the SEC. Trust Indenture Act, §§305 & 306.

(a) The term "indenture" is broadly defined to include indentures, mortgages, deeds of trust and similar instruments under which debt instruments are issued. Accordingly, bond ordinances and bond resolutions are potentially subject to the indenture qualification requirements.

2. As is the case with the registration requirements of the 1933 Act, certain securities and transactions are exempt from the indenture qualification requirements of the Trust Indenture Act. These include:

(a) Any security exempted from the provisions of the 1933 Act by means of Sections 3(a)(2) through (8), 3(a)(11) or 3(a)(13) of the 1933 Act. These securities are exempted from the Trust Indenture Act in its entirety.

(1) Includes most municipal securities, but does not include securities issued by Indian tribes.

(b) Securities issued under an indenture that limits the aggregate principal amount of such securities to $10 million. These securities are exempted from the Trust Indenture Act in its entirety.

(c) Securities issued in a transaction that is exempted from the requirements of Section 5 of the 1933 Act or by Section 4 of the 1933 Act. These securities are exempted only from the indenture qualification requirements of the Trust Indenture Act.

C. State Blue Sky Laws

1. <u>Introduction</u>

Municipal bonds are subject to regulation by state securities or "blue sky" laws. All 50 states, the District of Columbia, the Commonwealth of Puerto Rico, Guam and the U.S. Virgin Islands have enacted blue sky laws. Among other things, blue sky laws require (a) the registration of broker-dealers who sell municipal bonds and (b) registrations of or notice filings for municipal bonds before they may be offered and sold to the public, unless exemptions from one or more of these requirements are available.

Failure to comply with state blue sky law broker-dealer registration and municipal bond registration and notice filing requirements (collectively, the "Blue Sky Requirements") before offering municipal bonds for sale to the public exposes an underwriter to risks of (a) enforcement actions by state securities commissions, including cease and desist orders and law suits for injunctive relief, and (b) in most jurisdictions, bondholder suits for refunds for the purchase price. Subsequent compliance with Blue Sky Requirements does not cure an offer made prior to satisfying Blue Sky Requirements.

Law firms that represent underwriters provide blue sky memoranda to underwriter clients as part of the their professional services. A blue sky memorandum lists (a) in the "exempt securities" section, those jurisdictions in which action (i.e., registrations and notice filings) must be completed before the bonds may be offered to the public by registered broker-dealers and (b) in the "exempt transactions" section, those types of institutional investors to whom offers may be made by unregistered sellers without the need for registrations and notice filings.

Thus, the blue sky memorandum is a road map of where action needs to be taken before offers are made, so that the underwriter can avoid needless state securities enforcement actions and bondholder suits for refunds.

2. Common Misconceptions

(a) *Misconception #1*. Compliance with state blue sky laws is no longer necessary because the National Securities Markets Improvement Act of 1996 ("NSMIA") completely pre-empted state blue sky laws. *Reality:* NSMIA's pre-emption was only partial, as evidenced by states' continuing ability to impose registration on issuers located within their boundaries, the imposition by various states of notice filing requirements on bonds issued by out-of-state issuers, states' continuing ability to bring enforcement actions to enforce the Blue Sky Requirements and bondholders' continuing ability to sue for a refund when Blue Sky Requirements have not been satisfied.

(b) *Misconception #2*. Variable rate demand bonds that are exempt from the continuing disclosure requirements under SEC Rule 15c2-12 are, by definition, also exempt from state blue sky laws. *Reality:* SEC Rule 15c2-12 and state blue sky laws are grounded in different bodies of law (federal v. state) and no state blue sky law provides an exemption from registration for bonds that are exempt under Rule 15c2-12.

(c) *Misconception #3*. Last year's blue sky memorandum will do just fine for this year's reoffering and conversion of last year's bonds. *Reality:* Blue sky laws – just like other laws – are amended, repealed and revised from time to time, so last year's advice may no longer be accurate. In addition, conversions often result in changes in security (letter of credit v. bond insurance v. no credit

enhancement) and ratings for the bonds, either of which can eliminate previously available exemptions from registration and notice filings.

3. Statutory Framework for Blue Sky Laws

The first blue sky law was enacted in Kansas in 1911, ostensibly to protect investors from unscrupulous promoters who, left to their own devices, "would sell building lots in the blue sky in fee simple." Subsequent to 1911, several states followed Kansas in enacting blue sky laws. In 1956, the National Conference of Commissioners on Uniform State Laws ("NCCUSL") promulgated the Uniform Securities Act of 1956 (the "1956 Act"), which provided an across-the-board exemption from registration for all types of municipal bonds. The 1956 Act was ultimately enacted in 37 jurisdictions.

In response to the increasing issuance of conduit bonds in the 1980s to finance manufacturing plants, health care facilities, etc., in 1985 NCCUSL promulgated amendments to the 1956 Act which provided an exception to the municipal bond exemption from registration for bonds payable from payments to be made by a "nongovernmental industrial or commercial enterprise" (the "1985 Amendment"). The 1985 Amendment exception to the municipal bond exemption, together with comparable exceptions for "industrial bonds" and "industrial development bonds," was ultimately enacted in Arizona, Maine, Minnesota, Montana, New Hampshire, New Mexico, North Dakota, Rhode Island, South Dakota, South Carolina, Texas, Vermont, Washington and Wisconsin.

NSMIA re-wrote Section 18 of the Securities Act of 1933 (the "Securities Act"), and provided a partial, but not complete, pre-emption of state blue sky laws. NSMIA provides that no state may: (a) require registration for, (b) impose conditions on the use of an offering document (for example, official statements) for, or (c) impose merit conditions on the offering or sale of a "covered security."

NSMIA provides for several categories of covered securities. Municipal bonds that constitute covered securities are: (a) municipal bonds which are exempt from registration under Section 3(a)(2) of the Securities Act of 1933 (except that a municipal bond is not a covered security in the state in which the issuer is located), and (b) municipal bonds that are exempt from registration under SEC rules promulgated pursuant to Section 4(2) of the Securities Act, i.e., Rule 506 of SEC Regulation D. The Rule 506 exemption is rarely used for municipal bonds.

Notwithstanding NSMIA's prohibition of states imposing registration, offering document and merit condition requirements on covered securities, NSMIA permits states to impose notice filing requirements on covered securities.

In response to NSMIA, NCCUSL promulgated amendments to state blue sky laws which, among other things, defined the term covered security and authorized state securities commissions to impose notice filing requirements on covered securities (the "1997 Amendments"). Most of the states that enacted the

1956 Act and/or the 1985 Amendments enacted the 1997 Amendments. As of July 1, 2011, NSMIA-inspired notice filing requirements were in effect in Arizona, Maryland, Montana, Nevada, New Hampshire, New York, North Dakota, Ohio and Washington for various types of municipal bonds that derive their covered security status from Section 3(a)(2) of the Securities Act and are issued by out-of-state issuers, unless the bonds are otherwise exempt from the state's registration, offering document and merit condition requirements.

In 2002, NCCUSL promulgated the Uniform Securities Act of 2002 (the "2002 Act"), which reinstated the 1956 Act's across-the-board exemption from registration for municipal bonds and also exempted municipal bonds from NSMIA-inspired notice filings. As of July 1, 2011, the 2002 Act, with occasional local variations, was in effect in Georgia, Hawaii, Idaho, Indiana, Iowa, Kansas, Maine, Michigan, Minnesota, Mississippi, Missouri, New Mexico, Oklahoma, South Carolina, South Dakota, the U.S. Virgin Islands, Vermont and Wisconsin. Notice filings for bonds issued by out-of-state issuers are no longer required in those states which had originally imposed notice filings pursuant to NSMIA and subsequently enacted the 2002 Act (for example, Minnesota).

In varying degrees, Illinois, Maryland, Montana, Pennsylvania, Tennessee, Texas and Washington apply the "separate security" analysis, i.e., even though the bonds in question are exempt from the state's registration, offering document and merit condition requirements, some other security that is part of the bond issue must be evaluated to determine if it is exempt from such requirements. The need for separate security analysis typically arises when credit enhancement (for example, a letter of credit or a bond insurance policy) provides security for the payment of the bonds. In many cases, the separate security qualifies for its own exemption from state blue sky law registration, offering document and merit condition requirements or qualifies as a covered security under NSMIA. When the separate security is not a municipal security, covered security status applies in all jurisdictions (i.e., NSMIA's exclusion from covered security status for municipal securities issued by issuers located within the boundaries of the jurisdiction in question does not apply). However, a separate security that is also a covered security may be subject to a NSMIA-inspired notice filing requirement if the separate security does not qualify for its own exemption from state blue sky law registration, offering document and merit condition requirements.

4. Effect of NSMIA on State Blue Sky Laws

State blue sky laws provide (either explicitly or because of federal pre-emption) that it is illegal to sell securities in the state in question unless the security either: (a) is registered, (b) qualifies for a state blue sky law exemption from registration, or (c) constitutes a covered security, for which the applicable notice filing, if any, has been completed.

Because of the enactment of NSMIA, there are now two non-registration routes to blue sky compliance, i.e., (a) qualifying for a state blue sky law exemption

from registration, without taking NSMIA into account, and (b) determining whether the bonds in question enjoy covered security status and, if so, whether they are subject to a notice filing requirement.

Because municipal bonds that derive their federal exemption from registration under Section 3(a)(2) of the Securities Act are not covered securities in the state in which the issuer is located, states may still impose registration, offering document and merit condition requirements on bonds issued by issuers located within their boundaries, i.e., the NSMIA route to compliance is not available to in-state issuers. Florida, New Hampshire, Pennsylvania, West Virginia and Wisconsin have imposed registration, offering document and/or merit condition requirements on various types of bonds issued by in-state issuers.

D. Swaps and VRDOs. Disclosure content varies not only with respect to the type of issuer, but also with respect to the type of security (*e.g.,* fixed vs. variable rate, long-term vs. short-term) and any associated swaps or other derivatives and/or credit enhancements.

1. Some guidance for swap disclosure is provided in the White Paper on Disclosure for Swap Transactions published in February 2004 (the "White Paper on Swaps") by the NFMA. The White Paper on Swaps offers specific guidance with regard to such areas as the issuer's risk management, the issuer's debt profile, swaps summaries and disclosure of economic terms, authorization and ISDA Events of Default and Early Termination Events. Other considerations include the impact of FASB 133 or GASB Technical Bulletin 2003-1, as applicable.

2. Level of issuer-specific disclosure required when a bond issue is credit-enhanced.

(a) The SEC has indicated that the borrower's disclosure in issues that are credit enhanced should be essentially the same as in non-credit enhanced issues. Interpretive Release No. 34-26985 (June 28, 1989).

(b) In the case of credit-enhanced tender option bonds, some practitioners believe and the market accepts that the creditworthiness relevant to investors in these credit enhanced bond issues is that of the credit enhancer and not that of the borrower.

3. Transparency of Municipal Auction Rate Securities and Variable Rate Demand Obligations. Since 2008, the MSRB has issued a series of notices, including MSRB Notice 2008-46 to MSRB Notice 2010-06 (March 10,2010), which has resulted in the creation of the Short-term Obligation Rate Transparency ("SHORT") System Facility, to collect and disseminate information about variable rate securities. Information generally is required to be reported to the SHORT system by no later than 6:30 p.m. Eastern time on the day that an ARS auction or VRDO interest rate reset occurs and all collected information is made available to market participants for free in real-time on EMMA.

E. Disclosure of Conflicts of Interest. The Commission has indicated that investors must be informed of actual and potential conflicts of interest among participants in a bond offering, including among the underwriters, financial advisors, consultants and lawyers. Despite any legal or factual analysis counsel must analyze whether information regarding actual or potential conflicts would be material to investors (as distinguished from taxpayers). "The critical disclosure question is simple to state but not simple to answer: might a reasonable investor believe that the relationship would call into question the objectivity, independence, or competence of the services being provided by a professional in a way adverse to bondholders? When in doubt, disclose." See *Pope* at 46.

1. Distinction of Roles. Pursuant to MSRB Notice 2011-29 (May 31, 2011), the MSRB revised MSRB Rule G-23 to prohibit a broker, dealer, or municipal securities dealer that serves as financial advisor to an issuer for a particular issue from switching roles and underwriting the same issue.

2. Issuer Designation of Underwriter's Counsel. SIFMA has issued a best practices paper recommending that underwriters disclose in an official statement when issuers designate firms to serve as underwriter's counsel. Issuers have a legitimate but limited role in the selection of underwriter's counsel, ensuring that underwriter's counsel is competent, has no conflicts of interest and that the costs are reasonable, but any undue influence can call into question the independence of the underwriter's counsel, creating risk to the issuer and the underwriter because of increased potential of inadequate disclosure.[12]

F. Disclosure of Financial Obligations; Voluntary Disclosure. As discussed above, effective February 27, 2019, the SEC adopted amendments to Rule 15c2-12, expanding the Rule's "listed events" to include the incurrence of a material "financial obligation" (new event 15) and any default, event of acceleration, modification of terms or other, similar events under the terms of a "financial obligation" reflecting financial difficulties (new event 16). Pursuant to the related Adopting Release (No. 34-83885), event notices relating to the incurrence of a material financial obligation "generally should include a description of the material terms of the financial obligation . . . . The Commission believes that, depending on the facts and circumstances, it could be consistent with the requirements of the Rule for issuers and obligated persons to either submit the material terms of the financial obligation, or alternatively, or in addition, submit related materials, such as transaction documents, term sheets prepared in connection with the financial obligation, or continuing covenant agreements or financial covenant reports to EMMA." See *Adopting Release* at 33-34.

2. The above-described new listed events apply in the context of continuing disclosure undertakings entered into on or after February 27, 2019. Issuers and obligated parties subject only to continuing disclosure undertakings entered into before that date have been encouraged to voluntarily post information about bank loan financings to EMMA.

[12] *See* SIFMA Best Practice Recommendation on Disclosures Regarding Choice of Underwriters' Counsel in Municipal Securities Transactions (March 2013).

See, e.g., MSRB Notice 2012-18, *Notice Concerning Voluntary Disclosure of Bank Loans to EMMA*.

G. Municipal Advisors as "Placement Agents. "1. On October 2, 2019, the SEC issued a proposed exemptive order that would grant exemptive relief pursuant to Section 15 the Exchange Act to permit a registered Municipal Advisor, acting on behalf of a municipal issuer client, to solicit specified institutional investors (such as commercial banks) in connection with the direct placement of municipal securities without registering as a broker-dealer when certain conditions are met. The proposed order addresses a controversial area of the existing Municipal Advisor regulation. The SEC issued its proposal in response to letters seeking this exemption from both the National Association of Municipal Advisors and PFM**,** a large independent Municipal Advisor firm. Responses were submitted by representatives of the broker-dealer community as well as Securities and Financial Markets Association (SIFMA) and Bond Dealers of America ("BDA"), who have also stated their intention to lobby against implementation of the order. This subject matter should be monitored for continued developments. See 2021 NABLU: The Workshop " Role of the Municipal Advisor."

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