The Role of Local Counsel in a Bond Transaction

Eric Shytle, General Counsel, Municipal Association of South Carolina

Ray Jones, Partner, Parker Poe Adams & Bernstein LLP

IMLA Webinar - April 22, 2020

State and local laws vary by jurisdiction. The federal tax and securities laws are uniform throughout the nation.



Section 1: Bond Basics

Section 2: Regulatory Environment

Section 3: The Local Counsel Opinion

Section 1:
Bond Basics

Types of Bond Issues

1

General Obligation

Involve a pledge of the "full faith and credit" of the municipality, which means the municipality could be forced to levy taxes to retire the debt. Debt limit, perhaps voter approval.

2

Revenue Bonds

Secured by revenues of a "system" or "systems." Not subject to a legal debt limit but contains coverage requirements in the issuing instrument.

3

Lease-Purchase

A lease under which payments include a principal and interest component. At the end of the lease, the lessee owns the asset. Includes a non-appropriation clause.

4

Other

Special source revenue bonds, bond anticipation notes, tax anticipation notes, grant anticipation notes, conduit bonds….

Methods of Sale

1

Public

Public sale raises disclosure issues, increases costs of issuance, and requires greater effort by the issuer. Public markets generally offer more competitive interest rates.

2

Private

Sold directly to a bank to hold in its portfolio or to assign or re-sell. Less costly, less complex, generally higher interest rates. Also banks generally have size and term limitations (For example, $10mm and 10 years).

Market Participants

Issuer. The public entity issuing the bond or, as we would normally say, borrowing the money.

Underwriters. In issues sold to public markets, the entity that "purchases" the bonds from the issuer and then resells them to the public.

Financial Advisor. An independent firm that assists and advises the issuer in structuring the bonds, selecting an underwriter, securing ratings, acquiring credit enhancement, etc.

Credit Enhancer. An entity that "enhances" the rating of the bonds, either by insuring their payment or by supporting them with a letter of credit.

Trustee. Serves the interest of bondholders to receive payments from the issuer, make payments to the bondholders, enforce rights under the bond documents, etc.

Bond Counsel. Opines that the bonds are legal, valid, binding, enforceable, payable from the pledged source of funds, and exempt from federal and state income taxation. Usually drafts the documents.

Issuer's Counsel or **Local Counsel**. Most likely, you. In any event, the lawyer or law firm that represents the issuer.

Underwriter's Counsel. Separate legal counsel representing the underwriter.

Section 2: Regulatory Environment

Overview, pt. I

- Municipal bond deals are undertaken in compliance with several legal frameworks: federal law, state law and, occasionally, local law.
- Federal law includes both the tax and securities aspects of municipal bond deals.
- The tax aspects are administered by the IRS and are highly complex. The IRS is active in auditing tax-exempt municipal bond deals.
- For public bond offerings, the securities law aspects are administered by the Securities and Exchange Commission (SEC). Since 2012, there is a heightened "liability environment" for municipal issuers stemming from securities laws violations.

Overview, pt. 2

- Securities and Exchange Commission (SEC) has led this charge to ensure that the buyers of governmental debt have similar protection against false or misleading statements as that provided to the buyers of corporate debt.
- The results have included increased SEC enforcement actions against the issuers of governmental debt and, in some cases, have involved personal liability for governmental officials.
- We will focus on a few of these decisions and their implications for local counsel.

SEC Enforcement

https://www.sec.gov/municipal/oms-enforcement-actions.html

- Rule10b-5 - The Gold Standard: It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce…To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.
- SEC Enforcement Actions: Oyster Bay, NY (Town Supervisor), City of Miami, FL (Budget Director), Rampano, NY (multiple officials), Harvey, Illinois (Comptroller), Allen Park, MI (Mayor and City Administrator), City of Harrisburg, PA (City Administrators) and Orange County, CA

Liability for Public Officials…

- ✓ Personal liability (civil penalties, etc) for providing fraudulent information or failing to disclose material information.
- ✓ Prohibition from participation in municipal bond deals, including, in some cases, lifetime bans.

Advice for Local Counsel

1

Inform

Ensure your municipal clients understand the risks and standards associated with a public bond offering.

2

Observe

If there are financial troubles, ethics investigations/violations or economic instabilities, then it may not be the right time to issue bonds.

3

Report

Relay any of the foregoing conditions to Bond Counsel and other members of the financing team. If not permitted to do so, document your file.

Section 3:
Local Counsel Opinion

What is it?

- The local counsel opinion will vary according to the complexity of the deal, the firm serving as bond counsel, whether the issue is sold to the public or to a bank, and so on.
- Therefore, local counsel should ask early and often about the expected content of his or her opinion at closing.
- I have included a sample local counsel opinion (**Exhibit A** to the written materials). You may be asked to provide much more, or much less, but this is a fairly standard opinion for a revenue bond transaction.

First: Upon What Did You Rely?

- The sample opinion lists the sources upon which the opinion writer relies or has consulted.
- Generally, these sources will be the Federal and State Constitutions; applicable laws; local proceedings such as ordinances, resolutions, or even minutes; and documents specific to the deal.
- If you DIDN'T review something, or cannot speak to its reliability, then disclaim it. See SEC Enforcement Actions above.

Sample Conclusions, pt. I

1

Existence and Power

The type of entity issuing the bonds; whether it exists and is in good standing; whether it has the power to do what it is purporting to do.

2

Authorization and Execution

Whether the issuing entity has lawfully authorized all parts of the deal; whether the right person has executed (and perhaps attested) the documents.

3

Valid and Binding

Whether the documents, even if properly authorized and executed, are binding and valid.

Sample Conclusions, pt. 2

4

No Conflict

Whether entering into the documents or transaction will conflict with other applicable provisions; for example, a covenant against additional borrowing.

5

No Default

Qualify by your knowledge, perhaps after appropriate inquiry; rely on certificates.

6

Consents and Approvals

Whether all other consents and approvals have been obtained.

Sample Conclusions, pt. 3

7

No Litigation

Whether there is litigation pending (or, in some cases, threatened) that would jeopardize the transaction or the security.

8

Disclosure

The disclosure does not contain any "untrue statement of material fact" and does not "omit any material fact necessary to make the statements contained therein not misleading."

LIMIT THE SCOPE!

9

Procurement

For deals in which the security depends on collateral, whether the issuing entity complied with its procurement procedures.

CAUTION!

1

Sunshine Laws

When considering due authorization, you must be sure that the meeting at which the matter was approved was duly noticed and conducted in accordance with your State's freedom of information statute(s).

2

The Form is not Your Friend

It is often the case that you will be provided a form of local counsel opinion that is prepared by another attorney in the deal. Review the form! If you are not comfortable with something, speak up.

3

Opining over Disclosure

Are you being asked to confirm that the bond offering document complies with Rule 10b-5? Are you validating the statement of others? Do you knowledge to do so? Avoid if possible.

Thank You

CONTACT:
Eric Shytle, eshytle@masc.sc, 803.933.1214
Ray Jones, Rayjones@parkerpoe.com, 803.253.8917