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# Dispatches from D.C.:
# Highlights of the NABL Tax and Securities Law Institute

On March 9-10, 2017, Pacifica public finance attorneys attended the National Association of Bond Lawyers ("NABL") Tax and Securities Law Institute ("TSLI") in Washington, D.C. Deanna Gregory chaired the Securities and Exchange Commission ("SEC") Enforcement panel and Alison Benge was a panelist for the Tax Hot Topics session. The SEC and the Internal Revenue Service ("IRS") have proposed or recently adopted a number of rules applicable to state and municipal bonds, and TSLI featured lively discussions of these developments, among others. The following highlights the topics discussed, from a tax law and securities law perspective.

**TSLI Tax Notes:**

New Information Document Request (IDR) Process for Audits

On April 1, 2017, a new IDR process will be put in place for tax-exempt bonds. According to the IRS, the new process is designed to expedite audits and increase communication with taxpayers. Currently, issuers generally receive a letter informing them that a particular bond issue is under audit with an IDR specifying the documents to be sent to the IRS agent and the required response date. Depending on the documentation requested and the tenor of the audit letter (i.e. depending on whether it is a random audit or targeted), the issuer may decide to engage counsel to assist with the IDR response.

Under the new process, IRS agents will send initial contact letters to issuers letting them know a bond issue has been selected for audit. The agent will then speak with issuers or their representatives to discuss a draft IDR to ensure everyone understands what documents are being requested. This change in procedure may mean that issuers will want their attorney to participate in the initial call. After the call, the agent will finalize the IDR and send it to the issuer.

The new procedures also contain guidelines for setting a response date for the issuer, for granting time extensions, and for involvement of the agent's manager and issuance of a pre-summons letter if the issuer does not reply to the IDR in a timely manner. The IRS Commissioner memorandum to IRS examiners regarding the new process can be found here.

Issue Price Documentation

In 2016, the IRS issued final Treasury Regulations relating to the calculation of "issue price" with respect to tax-exempt bonds (the "Issue Price Regulations"). The Issue Price Regulations were generally well-received by the tax-exempt bond community and are applicable to bonds sold after June 7, 2017. At TSLI, NABL members noted new documentation will be required to implement the Issue Price Regulations. The NABL tax committee has drafted some proposed form issue price certificates, and SIFMA has prepared revisions to its model forms of agreement among underwriters, the bond purchase agreement and the notice of sale. NABL and SIFMA are both accepting comments to the form documents. The form documents are available here (NABL) and here (SIFMA). The Issue Price Regulations can be found here.

Updated Management Contract Safe Harbors

The treatment of management, service and incentive payment contracts as a source of private business use has been a long-standing concern for issuers, and it remained a topic of discussion at TSLI this year. In 2016, the IRS released Revenue Procedure 2016-44 (Rev. Proc. 2016-44), which updated the safe harbors for management contracts with respect to facilities financed with tax-exempt bonds. While Rev. Proc. 2016-44 provided a more flexible approach to management contracts than previous guidance, it also raised questions in the bond community, particularly regarding the treatment of certain compensation arrangements. The IRS responded by releasing Revenue Procedure 2017-13 (Rev. Prov. 2017-13), which modifies, amplifies and supersedes Rev. Proc. 2016-44.

Rev. Proc. 2017-13 takes a flexible and less formulaic approach to long-term management contracts with various compensation arrangements. Generally, compensation must be reasonable and must not give the service provider a share of net profits or impose on the service provider the burden of sharing net losses. Rev. Proc. 2017-13 specifically addresses the treatment of capitation fees, periodic fixed fees, and per-unit fees, as well as the payment of certain expenses. The safe harbors also include limitations on the deferral of compensation, the term of the contract, risk of loss, control over rates and other provisions. The full text of Rev. Proc. 2017-13 can be found here, and is applicable to contracts entered into on or after January 17, 2017, and to certain modifications of existing contracts.

**TSLI Securities Law Notes:**

Proposed Amendments to SEC Rule 15c2-12

Representatives of issuers, lenders, bond counsel (NABL), underwriters, financial advisors, securities analysts, institutional investors and other parties, previously worked together to prepare "*Considerations Regarding Voluntary Secondary Market Disclosure About Bank Loans* " (available here), outlining considerations for issuers in completing voluntary disclosure filings about bank loans—including direct placements—to respond to investor concerns about having timely information as the use of bank loans has become more prevalent in the municipal market. The Electronic Municipal Market Access system ("EMMA") has recently added a "Bank Loan/Alternative Financing Filing" to facilitate voluntary filings on this topic.

Citing its concern that investors still may not have timely access to information about the incurrence of "financial obligations" by issuers and obligated persons, the SEC is proposing indirectly requiring such disclosure through amendments to Rule 15c2-12, the municipal securities ongoing disclosure rule. On March 15, 2017, the SEC published its proposed amendments, starting the clock on the comment period required prior to final adoption. See Release No. 34-80130, 82 Fed. Reg. 13928, available here.

The proposed amendments would add a 15th and a 16th "listed event" to the current list of 14 events that require notice within 10 business days. Notably, these additional listed events go beyond mandating bank loan disclosure. The proposed amendments would require that issuers file notice, within 10 business days, of the occurrence of the following events:

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

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

The proposed amendment also adds a definition of the term "financial obligation." The term is broadly defined to include:

- debt obligations
- leases
- guarantee
- derivative instrument or
- monetary obligation resulting from a judicial, administrative, or arbitration proceeding.

The SEC Release describes this term broadly, indicating for example that it intends to capture short-term and long-term debt obligations within the phrase "debt obligations" and intends to capture capital and even operating leases as "leases". The term "derivative instrument" is meant to include any swap, security-based swap, futures contract, forward contract, option, or similar instrument entered into by the issuer or obligated person. As proposed, the listed events would require filing if the obligation is "material," in the case of the 15th event, and, in the case of the 16th event, if the event reflects "financial difficulties," but the proposed amendments do not define either term.

Comments on the proposed rule are due on or before May 15, 2017. NABL is submitting (and Pacifica attorneys are participating in drafting) comments on the amendments and is encouraging issuers also to consider submitting comments. We also would be happy to assist you in preparing comments on the proposed rule.

Enforcement Continues to be a Priority of the SEC

Bond lawyers and representatives from the SEC discussed the SEC's recent focus on the municipal bond market and the SEC's reliance on enforcement as an industry-regulating tool, including through voluntary initiatives and "first of their kind" enforcement actions. The SEC confirmed that from its perspective the Municipalities Continuing Disclosure Cooperation ("MCDC") initiative has concluded, as it does not expect to recommend any further settlements under the initiative. A summary of the settlements with 72 underwriting firms and 71 issuers and obligated parties can be found here. As part of the settlement, each respondent neither admitted nor denied the findings and agreed to cease and desist from future violations and to adopt or enhance written disclosure-related policies and procedures. Financial penalties were imposed on underwriters only. The SEC has now turned its focus to issuers and underwriters who did not self-report, in which case any settlements may include greater penalties than the standardized terms offered under the MCDC initiative.

Participants also discussed recent enforcement actions in the municipal arena and settlement terms, including imposing financial penalties (against issuers and individuals), finding individuals liable under a "control person" liability theory, banning issuers and individuals from participating in the municipal market, obtaining emergency injunctions to halt a bond offering, and referring matters to the Department of Justice to seek criminal fraud charges. The discussion heated up when it turned to the January 10, 2017 Port Authority of New York and New Jersey settlement, in which the SEC asserted that

the Port was negligent when it failed to disclose to investors the legal uncertainty of the Port's authority to finance certain roadway projects. As part of the settlement, the Port agreed to pay a $400,000 penalty and to take remedial and corrective actions, including adopting disclosure-related policies and procedures.

Enforcement proceedings involve a post-issuance review of disclosure, and the majority of enforcement actions focus on *omitted* (as opposed to misstated) information that the SEC found would have been material for an investor to have known at the time of making an investment decision. Further, the SEC has made it clear that it is not necessary for a default to occur or for an investor to be harmed for the SEC to pursue an enforcement investigation. A state or municipal issuer may be liable in connection with an intentional or even reckless material misstatement or omission in its disclosure, or when an issuer is negligent by failing to take reasonable care in reviewing its disclosure documents for accuracy and completeness. It is unknown what the SEC's focus will be under the new administration, but Jay Clayton (President Trump's nominee for SEC chair) has stated that if confirmed by the Senate he would continue the practice of seeking enforcement actions against individuals. Regardless of the focus of future enforcement actions, recent settlement actions underscore the importance of adopting written disclosure policies and procedures that prompt a careful review of disclosure documents and the importance of periodic training regarding the issuer's responsibilities under the federal securities laws.

If you have any questions on these tax and securities law topics of interest to state and municipal bond issuers, please contact any of our public finance attorneys.

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