SQUIRE SANDERS

MSRB Requests Comments on Proposed Notice Regarding Underwriter Consent to Document Amendments

Common method of document amendment called into question

On February 7, 2012, the Municipal Securities Rulemaking Board published Notice 2012-04 requesting comment on its draft interpretive notice. In the notice the MSRB states its proposed interpretation that an underwriter who consents to amendments to bond documents may be in violation of the underwriter's "fair dealing" duties under MSRB Rule G-17. This notice, if made final in the form proposed, would interpret Rule G-17 to prohibit an accepted market practice and would likely restrict the ability of governmental issuers and conduit borrowers to use an accepted and cost-effective method of amending bond indentures and bond resolutions.

This accepted method to effect amendments to existing bond documents is for the purchasers of new bonds issued, from time to time, to be deemed to have consented to the proposed amendments by virtue of their purchase of the new bonds. This is accomplished by the official statement for the new bonds including both (1) a description of the proposed amendment (including, in many instances, the actual text of the amendment) and (2) a conspicuous notice that purchasers of the new bonds will be deemed to consent to the amendment. Once the requisite number of consents have been (or are deemed to be) received (typically bond documents require consent from a majority of holders of outstanding bonds), the amendments become effective and binding on all holders of outstanding bonds, including holders of bonds that were issued prior to the beginning of the consent process. Notice of the effectiveness of the amendments typically is sent to existing bondholders in due course.

Virtually all bond indentures and bond resolutions include provisions for amendments. Some expressly require signed consents to amendments. Some can be interpreted to permit consent to be evidenced in other ways, without the necessity for signed consents.

Amendments that do not change key financial terms (such as the interest rate or , principal or interest payment dates, for example) generally require the consent of bondholders representing a majority in principal amount of bonds outstanding in order for the amendments to become effective. In most cases, there is no contractual right of any particular bondholder to consent to an amendment. Majority consent can be achieved in any number of ways; however, very few issuers actually seek written consent from existing bondholders. This is due in part to the fact that bonds are almost universally issued in book-entry form only. Therefore, there is no simple way to communicate with the beneficial owners of the bonds or to confirm who actually owns the bonds, except at the time an underwriter purchases the bonds at initial issuance and prior to the bonds being resold to the underwriter's customers.

Currently, the most common methods of effecting amendments are (1) obtaining the consent of a credit enhancer (if the bond documents provide that the credit enhancer may consent in lieu of the owners of the bonds it enhances, as is often the case) and (2) delaying the effective date of the amendment until a sufficient amount of new bonds are issued, whose holders are deemed to consent in the manner described above (sometimes referred to as "springing amendments"). It is in connection with such springing amendments that underwriters are typically asked to sign a consent to document amendments.

As noted above, "springing amendments" are not unusual in the market today and are routinely disclosed in official statements. The execution of a written consent by an underwriter, as the owner of the newly issued bonds, in these situations is a ministerial matter to memorialize in a written document the deemed consent of the holders of the principal amount of new bonds being issued. As the MSRB concedes in its draft notice, the underwriter is technically the holder of the bonds at the time the consent is signed. The underwriter's consent is intended to evidence the deemed consent by the ultimate purchasers, who clearly indicate their consent by their voluntary purchase decision, based on disclosure of the amendments in the official statement for the new bonds.

Nonetheless, the MSRB draft interpretive notice states that it would be a violation of Rule G-17 for an underwriter to consent to an amendment that changed the security for the bonds unless both of the following requirements were met: "(i) the authorizing document expressly provided that an underwriter could provide bondholder consent and (ii) the offering documents for the existing securities expressly disclosed that bondholder consents could be provided by underwriters of other securities issued under the authorizing document." Neither of these conditions can likely be satisfied for outstanding bonds, since the governing documents predate the MSRB's proposed interpretation. It is the underwriter's status as the owner of bonds upon their initial issuance that allows its consent to be effective under existing governing bond documents, not its status as an underwriter.

If this draft notice from the MSRB is adopted in the proposed form, it is likely that underwriters will refuse to sign such consents in the future. Issuers and conduit borrowers will have to find other means to document the "deemed consent" of new bond owners, which may include a requirement that underwriters require each of their customers sign an acknowledgement of the amendment or an instrument appointing the bond trustee as the new owners' agent for purposes of signing a consent, where the governing documents require a signed consent. It is unclear whether underwriters will be willing to, or be able to, obtain such written consents or acknowledgements from their customers. Neither of these alternatives is as simple and cost effective as the current practice. Further, in instances where consents simply cannot be obtained as a result of the MSRB's interpretive notice, issuers and conduit borrowers may be forced to refund or defease outstanding bonds even if not otherwise economic.

Squire Sanders is submitting its comments to the MSRB regarding this draft notice addressing these concerns. Comments are due March 6, 2012 and may be submitted on the MSRB's website at. Comments are due March 6, 2012.

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February 2012