Revised Proposed Issue Price Regulations Would Look to Actual Sales Instead of Reasonable Expectations

After significant criticism from the public finance community, on June 24, 2015, the US Treasury withdrew controversial 2013 proposed regulations on the definition of issue price and issued new proposed regulations in their place.

These new proposed regulations make many improvements over the 2013 proposed regulations, but they retain the feature that generated the most controversy – they would, if finalized, require issuers to look to the first price at which at least 10% of each maturity of bonds actually sells to the public in a bona fide public offering to determine the issue price of the bond issue, even if that price is different from the price at which the underwriter reasonably expected to sell the bonds to the public when it purchased them from the issuer.

The New Proposed Regulations Are Just That – A Proposal

Issuers and conduit borrowers can continue to rely on the approach of the existing regulations, where the issue price of a publicly offered bond issue is established by the reasonable expectations, as of the date the underwriter purchases the bonds from the issuer, of the first price at which the underwriter will sell at least 10% of each maturity to the general public (i.e., the initial offering price), even if less than 10% of a given maturity actually sells to the public at the reasonably expected initial offering price.

The New Proposed Regulations Abandon the Increased Threshold From the 2013 Proposed Regulations for a "Substantial Amount" of Bonds, Which Sets the Issue Price

The 2013 proposed regulations would have increased the threshold amount of bonds of a maturity that set the issue price from 10% (under the existing regulations) to 25%. Treasury did not explicitly state the rationale for this increase in the 2013 proposed regulations, although one presumes that it would further Treasury's goal of trying to find the "true" issue price of an issue of bonds. In response to comments, the new proposed regulations would keep the threshold at 10%, as it is under the existing regulations.

An "Alternative Method" for Maturities Where Less Than 10% Actually Sells

Under the new proposed regulations, if less than 10% of a maturity of publicly offered bonds actually sells in a bona fide public offering, then the issuer can still rely on the initial offering price to set the issue price of that maturity, if the following requirements are met:

- The underwriter fills all of the orders placed on or before the sale date (i.e., the date on which the underwriter contractually agrees to purchase the bonds from the issuer) at the initial offering price and not at a higher price.
- The lead underwriter certifies and provides supporting documentation showing:
  - The initial offering price;
  - That the underwriter filled all of the orders placed on or before the sale date at the initial offering price and not at a higher price; and
  - That no underwriter will fill an order placed by the public between the sale date and the closing date at a price higher than the initial offering price unless interest rates fall (in which case, the underwriter must provide supporting documentation for the bonds sold at a price in excess of the initial offering price).

The proposed regulations make clear that an issuer must not know or have reason to know, after exercising due diligence, that the foregoing certifications of the underwriter are false.

The New Proposed Regulations Would Sharpen the Definition of "Underwriter"

Another criticism of the 2013 proposed regulations was that it expanded the definition of "underwriter" to include entities that were not part of the actual underwriting syndicate. Because these entities were not treated as part of the "public" so that sales to them would be treated as sales in the secondary market that, by definition, do not change the "issue price" of an issue of bonds, the price at which bonds were sold to these entities would have been relevant under the 2013 proposed regulations, and there was no way for issuers to track sale prices to these entities.

In response to comments, the new proposed regulations would narrow the definition of underwriter to mean:

- Persons that contractually agree to participate in the initial sale of the bonds to the public by entering into a contract with the issuer or with the lead underwriter (as part of a syndicate); and
- Any person that, on or before the sale date, directly or indirectly enters into a contract or other arrangement to sell the bonds with any such person (for example, a retail distribution contract between a member of an underwriting syndicate or selling group and another dealer that is not in the syndicate or selling group).

Conclusion

Although these new regulations are merely proposed and do not yet have legal effect, and Treasury has again requested comments (as it did with the 2013 proposed regulations), it seems increasingly likely that final regulations may someday require issuers to look to actual sale prices, instead of reasonably expected sale prices, to set the issue price of an issue of publicly offered tax-exempt bonds. For now, however, the existing regulations remain in force and issuers can continue to rely on reasonable expectations to establish the issue price of such bonds.

For a more in-depth look at this topic (and many others), please visit us at The Public Finance Tax Blog.

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