KING & SPALDING

Client Alert

Finance Practice Group

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Rule G-17 One Year Later – *Understanding the Relationship between Governmental Issuers and the Underwriter*

In the spring of 2012, the Securities and Exchange Commission approved the release of MSRB Notice 2012-25, which provided interpretive guidance on how SEC Rule G-17 applied to underwriters of municipal securities transactions. Under the "fair dealing" provisions of Rule G-17, the MSRB Notice imposes code of conduct and disclosure requirements on underwriters working with governmental issuers. As many of our issuer clients have experienced, the expanded Rule G-17 has raised many questions that issuers have not faced on prior issues of municipal bonds. Under Rule G-17, on any municipal securities transaction sold after August 1, 2012, an issuer should receive a disclosure letter from its underwriter on a negotiated sale transaction that is meant to clarify the nature of the transaction as well as the relationship between the issuer and the underwriter. Unfortunately, many issuers are now more confused than ever regarding the role of the underwriter in their transaction.

Required Disclosure Content. Many issuers are shocked when receiving a disclosure letter from its underwriter due to a number of required disclosures that must be made in writing under the Notice. These disclosures must be made to an official with the power to bind the issuer, and include the following:

- *Underwriter is entering into an arm's-length commercial transaction with the issuer and it has financial and other interests that differ from those of the issuer.*

- *Underwriter does not have a fiduciary duty to the issuer and is not required by federal securities law to act in the best interest of the issuer.*

- *Underwriter is obligated to purchase and sell securities at fair and reasonable prices in an arm's length transaction.*

It is important to note that the underwriter's role in a negotiated transaction has not changed, it is now simply required to state affirmatively what has always been the case. Many of our governmental issuer clients are surprised to learn that an underwriter of municipal securities does not have such a fiduciary duty to the issuer. However, in our experience, the investment banking community on negotiated sale transactions is very

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competitive in nature, and the vast majority of underwriters are interested in ensuring that issuers are comfortable with, not only the fees the underwriter is charging, but also the interest rates at which the debt is sold.

Let's assume that you are in the process of structuring a new municipal securities offering as the issuer and have received a multi-page detailed letter from an underwriter required under Rule G-17 that includes confusing legal jargon with a request to sign an acknowledgement to the content included. What do you do next?

Rule G-17 was intended to increase the flow of information from an underwriter to its client, not to change the nature of the relationship between underwriters and issuers.

- ***Talk to your underwriter***. Much of the disclosure require by Rule G-17 will be boilerplate and information-dense. Any concerns you may have regarding what is disclosed can easily be addressed by most underwriters.

- ***Contact your bond counsel***. We have spoken to many of our issuer clients regarding Rule G-17 required disclosures and have found that many simply needed to talk through the issues with counsel. We can parse through the words and tell you exactly what it means and why certain items are written in a certain manner. We can also assist you in how to best acknowledge the receipt of the disclosures included in the letter.

- ***Consider a financial advisor***. If you are not a frequent debt-issuer and are still uncomfortable with the role of an underwriter, discuss your transaction with a financial advisor, who will have a fiduciary duty to you and whose interests in the transaction may be more closely aligned with yours. Some of our issuer clients have determined that the peace of mind in having a financial advisor involved in the transaction outweighs any added cost concerns that may (or may not) exist.

- ***Contact the MSRB***. Many issuers have complained about the new requirements under Rule G-17. The MSRB's guidance was designed to protect issuers not confuse them. The more issuers that contact the MSRB, the more likely changes may be made regarding the required disclosures under Rule G-17 so that any new required disclosures are more easy to understand.

If you would like to discuss any of the issues addressed in this Client Alert or have any other questions regarding our public finance practice, please contact Woody Vaughan, Allison Dyer or any other attorney in King & Spalding's public finance practice.