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SEC Amends Rule 15c2-12

On May 26, 2010, the Securities and Exchange Commission unanimously approved amendments to its municipal securities disclosure rule, Rule 15c2-12 [Release No. 34-62184A, available on the Commission's website at <http://www.sec.gov/rules/final/2010/34-62184a.pdf>]. The amendments:

- eliminate the principal continuing disclosure exemption for variable rate demand obligations ("VRDOs");
- add to the list of post-issuance events that are required to be reported in "material event" notices;
- require event notices to be filed for certain post-issuance events, such as rating changes, regardless of whether such events are deemed to be material; and
- require all event notices to be filed within 10 business days after occurrence of the event.

The amendments become effective on December 1, 2010 and apply to continuing disclosure undertakings entered into on or after that date. Existing continuing disclosure undertakings do not need to be revised to conform to the amendments.

The Commission included with the amendments interpretative guidance regarding the obligations of municipal securities underwriters to confirm the reasonableness of issuers' representations regarding their compliance with previous continuing disclosure undertakings.

Amendments Affecting Variable Rate Demand Obligations

Previously, primary offerings of VRDOs in minimum denominations of \$100,000 that could be tendered for purchase at par at least as frequently as every nine months were exempt from the primary offering requirements of Rule 15c2-12 (*i.e.*, the requirement that an underwriter obtain and review a "deemed final" preliminary official statement) as well as the continuing disclosure requirements of the Rule. The amendments repeal the continuing disclosure exemption for VRDOs while retaining the primary offering exemption. Except as discussed in the following paragraphs, the filing of annual financial information and material events notices will be required for every "primary offering" (described below) of VRDOs on or after December 1, 2010.

VRDOs that are outstanding on November 30, 2010 are grandfathered from the continuing disclosure requirements of the Rule, as long as they *continuously* (a) remain in authorized denominations of \$100,000 or more and (b) may be tendered by their holders for redemption or purchase at par at least as frequently as every nine months. Thus, once a grandfathered VRDO is subject to a mode change that would cause it

not to meet the \$100,000 minimum denomination requirement or the optional tender every nine months requirement (e.g., a conversion to an annual mode), the continuing disclosure exemption for such VRDO is forever lost.

Rule 15c2-12 defines a “primary offering” as “an offering of municipal securities directly or indirectly by or on behalf of an issuer of such securities, including any remarketing” that is accompanied by a decrease in (a) minimum denominations to below \$100,000 or (b) the frequency of bondholder tenders to periods greater than nine months. Prior guidance by the Staff emphasized the breadth of the “by or on behalf of an issuer” text in the definition of “primary offering,” and found that other types of remarketings could constitute primary offerings for purposes of the Rule. While the specific requirements of the grandfathering provision described above should control in most situations, care will need to be taken to confirm that a remarketing of outstanding VRDOs does not inadvertently result in a primary offering that destroys the availability of the continuing disclosure exemption. Additional guidance from the Commission may be necessary in this area.

Lastly, it should be noted that the amendments left intact the existing exemption for municipal securities in minimum denominations of at least \$100,000 that are sold to no more than 35 sophisticated retail investors. New issues and other primary offerings of VRDOs that occur on or after the effective date of the amendments may continue to qualify for this exemption.

Material Event Amendments

Prior to the amendments, underwriters were required to determine that an issuer or obligated person (in either case, an “Obligated Person”) had undertaken to provide timely notice of 11 listed events. Each of these 11 events was subject to a materiality qualifier—disclosure was required only if the Obligated Person determined that the event was material to investors.

Additional Material Events. Four new material events have been added to the original 11 events and one of the original events was amended. The additional events are as follows:

- tender offers;
- bankruptcy, insolvency, receivership or similar events;
- merger, consolidation, acquisition or sale of assets events involving an Obligated Person; and
- appointment of a successor or additional trustee or the change of name of a trustee.

The existing event requiring reporting of adverse tax opinions or other events affecting the tax status of the security was expanded to include the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue or other material notices or determinations with respect to the tax status of the security.

Mandatory Material Event Disclosures. The amendments require the filing of a notice of the occurrence of the following events, regardless of whether such events are determined to be material:

- principal and interest payment delinquencies;
- unscheduled draws on debt service reserves or credit enhancements reflecting financial difficulties;

- substitution of credit or liquidity providers or their failure to perform;
- adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability or Notices of Proposed Issue or other material notices or determinations with respect to the tax status of the security;
- tender offers;
- defeasances;
- rating changes; and
- bankruptcy, insolvency, receivership or similar events.

Ten Business Days for Material Event Disclosure. Obligated Persons were previously required to file notice of a material event in a “timely” manner. The amendments require that all notices of material events be filed within ten business days after the occurrence of the event, regardless of whether the Obligated Person has actual notice of the event. For those events that are outside of an Obligated Person’s control and/or its actual knowledge (e.g., rating changes, trustee name changes, etc.), compliance with the ten business day notice requirement may require agreements with third-party monitoring services, contractual notice provisions with appropriate parties or other arrangements.

Interpretive Guidance with Respect to Underwriters’ Obligations

In the Release, the Commission reaffirmed its previous interpretations and provided additional guidance with respect to underwriters’ responsibilities under the antifraud provisions of the federal securities laws.

The Commission expects, at a minimum, that underwriters will review the Obligated Person’s disclosure documents in a professional manner for possible inaccuracies and omissions. The Commission reiterated its list of non-exclusive factors it believes to be relevant to such review, including:

- the extent to which the underwriter relied upon municipal officials, employees, experts and other persons whose duties have given them knowledge of particular facts;
- the role of the underwriter (manager, syndicate member or selected dealer);
- the type of bonds being offered (general obligation, revenue, or private activity);
- the past familiarity of the underwriter with the Obligated Person;
- the length of time to maturity of the bonds; and
- whether the bonds are competitively bid or are distributed in a negotiated offering.

It is not sufficient for an underwriter to rely solely on representations of the Obligated Person.

The Commission placed particular emphasis on the importance of an underwriter’s careful evaluation of the likelihood that an Obligated Person will comply timely with its continuing disclosure undertakings and expressed doubt that an underwriter could form a reasonable basis for believing an Obligated Person’s continuing disclosure representations

where there is a history of persistent and material breaches or if past failures have not been remedied by the time the offering commences. The Commission stated that it was also doubtful that an underwriter could meet the reasonable belief standard without the underwriter making affirmative inquiries as to that filing history.

In the Commission's view, an underwriter should obtain evidence reasonably sufficient to determine whether and when annual filings and event notices were, in fact, provided. For annual filings and event notices due prior to July 1, 2009, an underwriter could reasonably rely upon information obtained from nationally recognized municipal securities information repositories and state information depositories. In addition, an underwriter could rely upon evidence that such information was provided, such as a certified copy of the annual filing or an event notice from a responsible official or representative of an Obligated Person, or a designated agent and a receipt from a delivery service or other evidence that the information had, in fact, been sent. For filings made on or after July 1, 2009, an underwriter should examine filings available on the Municipal Securities Rulemaking Board's EMMA system. If the underwriter finds that some annual filings or event notices appear to be missing, it may request the Obligated Person to provide a written certification and evidence showing whether and when such information was provided to the MSRB.

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