

# California Debt and Investment Advisory Commission

## Mechanics of a Bond Sale: The Legal Documents

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# I. INTRODUCTION

This presentation covers the roles and responsibilities of the Issuer and financing team in the preparation of legal documents for debt issuance, the process of negotiating terms of the documents, importance of issuer involvement in drafting the Preliminary and Final Official Statements, and the commitments contained in these documents.

## II. THE LEGAL DOCUMENTS

### Two Primary Categories

- Bond Issuance Documents
- Bond Sale Documents

# III. BOND ISSUANCE DOCUMENTS

## A. Depends on Type of Issue

- General Obligation Bonds; Short-Term Notes
- Lease Revenue Bonds  
Lease Certificates of Participation
- Enterprise Fund Revenue Bonds
- Conduit Financing (IDB's, Multifamily Housing, 501(c)(3), etc.)
- List is not exhaustive

## B. G.O. Bonds; Short-Term Notes

- Bond Issuance Resolution provides for issuance of securities and basic terms such as interest rate, interest payment date, maturity dates and covenants.
- Simplest form of bond issuance document.

## C. Lease Revenue Bonds, Lease COPs

- Trust Indenture, Trust Agreement with Trustee (contract between a bank or trust company, holding property on behalf of bondholders, and the Issuer: establishes security, covenants, interest rates, maturities, bondholder rights and remedies upon default)
- Site Lease, Facilities Lease, Assignment Agreement (leaseback structure with JPA or nonprofit corp.)
- Debt Limit Rationale
- Authorizing Resolutions for Issuer and Lessee/Obligor

## D. Enterprise Fund Revenue Bonds, COPs (Water Revenues, Electric Revenues)

- Trust Indenture, Trust Agreement
- Installment Purchase Agreement (key covenants: minimum rate covenant, additional bonds test)
- JPA Issuer, City Obligor
- Authorizing Resolutions for JPA Issuer and City



## E. Conduit Financing

- Trust Indenture
- Loan Agreement between Conduit Issuer and Borrower
- Authorizing Resolutions for Issuer and Borrower

## F. Variable Rate Demand Obligations and Commercial Paper

- Letter of Credit Reimbursement Agreement
- Remarketing Agreement
- CP Dealer Agreement

## G. Characteristics of Bond Issuance Documents

- Resolutions provide legal authorization to enter into Bond Issuance Documents, establish sale parameters and delegate signing authority.
- Bond Issuance Documents establish the terms of the securities issued.
- Typically drafted by Bond Counsel (exceptions: Bank Counsel drafts Letter of Credit Reimbursement Agreement and Underwriter's Counsel drafts Remarketing Agreement or Dealer Agreement for variable rate or CP transactions).

# IV. BOND SALE DOCUMENTS

## A. Primary Documents

- Bond Purchase Agreement
- Continuing Disclosure Agreement, for issues subject to continuing disclosure requirements of SEC Rule 15c2-12
- Preliminary and Final Official Statements

## B. Bond Purchase Agreement

- In negotiated transactions, contract between the Issuer and the Underwriter setting the price and other terms of the sale of the Bonds.
- Typically, Bonds are priced on date that Bond Purchase Agreement is signed, and purchase price is paid at a later date, when all conditions to closing are met.
- Includes representations and warranties regarding the security for the Bonds and the Issuer's financial condition.
- Specifies conditions to closing, including delivery of required bond ratings, closing certificates and legal opinions.
- Specifies Underwriter's "outs" – circumstances letting Underwriter walk away from obligation to purchase the Bonds without penalty.
- New development: good faith deposit to secure Underwriter's performance.

## C. Continuing Disclosure Agreement

- For transactions subject to Rule 15c2-12, typically between Issuer (or obligated party in conduit financing) and Trustee or Dissemination Agent.
- Provides for delivery to MSRB of Annual Reports and notification of certain Listed Events (Eleven Deadly Sins).
- Can also take the form of a unilateral undertaking, i.e., Continuing Disclosure Certificate.

## D. Preliminary Official Statement (“POS”) and Final Official Statement (“OS”)

- Primary disclosure document for publicly offered municipal securities.
- POS used for marketing Bonds; after pricing, final OS is prepared and delivered to investors.
- Can be prepared by Issuer’s Disclosure Counsel, Underwriter’s Counsel or Financial Advisor (or even Issuer itself).
- Typically includes description of securities offered, sources and uses of funds, revenues pledged for repayment, Issuer’s financial condition, underwriting information and Issuer’s audited financials.
- Material misstatements or omissions in OS can get you in trouble with the SEC, the class actions plaintiff’s bar and worst of all, the DOJ: both civil and CRIMINAL liability.

## E. SEC Rule 10b-5



## F. Key SEC Enforcement Actions against Municipalities

- Orange County, California
- City of Syracuse, New York
- Maricopa County, Arizona
- City of Miami, Florida
- City of San Diego, California

## G. Orange County, California

- False and misleading statements in connection with investments in County Pool.
- SEC reserved special criticism for County Board of Supervisors, who failed to read or formally approve content of POS.
- Bottom line: issuers have primary responsibility for false or misleading statements in POS and OS.
- Municipal officials cannot blindly rely on the professionals they have engaged.

SEC Release No. 34-36761 (January 24, 1996)

## H. City of Syracuse, New York

- Falsely claimed a surplus in its general fund and debt service funds.
- Described certain unaudited financial information as audited.

SEC Release No. 34-39149 (September 30, 1997)

## I. Maricopa County, Arizona

- Failed to disclose a material decline in financial condition and operating cash.

SEC Release No. 33-7354, 34-37779  
(October 3, 1996)

## J. City of Miami, Florida

- Failed to disclose cash flow shortfall.
- Audited financials were correct at time of audit, but materially misleading when appended to OS with no mention of subsequent cash flow shortfall.

SEC Release No. 34-47552 (March 21, 2003)

## K. City of San Diego, California

- Failed to disclose severe underfunding of pension obligations.
- SEC took unusual step of holding San Diego's outside auditor liable for securities fraud, not as an aider or abettor, but as a primary actor.

SEC Release No. 34-54745 (November 14, 2006)

# L. Lessons Learned

Director of SEC Enforcement Division stated on December 11, 2007 that the municipal securities market is a “top priority” for the SEC, and provided five lessons for cities:

- Have accurate and complete internal controls and systems for producing financial reports and disclosure documents.
- Provide training to officials and employees regarding disclosure requirements of federal securities laws and GASB financial reporting provisions.
- Comply with specific rules and regulations, but also keep in mind the big picture – overarching goal is to provide full and fair disclosure to investors buying the bonds.
- Disclose bad news, don't hide it.
- Hire auditors and other professionals who have the technical skills and resources to do the job.

# Thank You

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