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November 9, 2010

Hon. Douglas Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Comments on Issue Price

Dear Commissioner Shulman:

Enclosed are comments on the determination of issue price applicable to tax-exempt bonds and tax credit and Build America bonds. These comments represent the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association, and should not be construed as representing the policy of the American Bar Association.

Sincerely,

Charles H. Egerton
Chair, Section of Taxation

Enclosure

cc: Michael F. Mundaca, Assistant Secretary (Tax Policy), Department of the Treasury
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ABA SECTION OF TAXATION COMMENTS ON ISSUE PRICE

These comments (“Comments”) are submitted on behalf of the American Bar Association Section of Taxation and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Winnie Tsien of the Committee on Tax Exempt Financing of the Section of Taxation. Substantive contributions were made by Frederic L. Ballard, Jr.; David J. Cholst; Maxwell D. Solet; Jeremy A. Spector; Stefano Taverna; and Lorraine Tyson. The Comments were reviewed by John Swendseid, Vice-Chair of the Committee. The Comments were further reviewed by Clifford M. Gerber and David C. Garlock of the Section’s Committee on Government Submissions and by Andrew J. Dubroff, Council Director for the Tax Exempt Financing Committee.

Although the members of the Section of Taxation who participated in preparing these Comments have clients who might be affected by the federal tax principles addressed by these Comments or have advised clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

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Date: November 9, 2010

Executive Summary

These Comments recommend that the determination of issue price under Regulation section 1.148-1(b) (the “Regulation”) be made permanently applicable to tax-exempt bonds and all tax credit and Build America Bonds.¹ Making the Regulation permanent, and clarifying several of its aspects, would facilitate the determination of issue price for all such bonds, which would enhance compliance with the various Code requirements that depend in whole or in part on the issue price of bonds. Two important themes discussed in these comments are that (i) the Regulation allows for issue price to be determined on the sale date, and (ii) the Regulation provides that issue price can be determined under a reasonable expectations standard or by the first price at which ten percent of each maturity is sold.²

These Comments recommend that issue price be established using the reasonable expectations of the managing underwriter in a negotiated sale (or of the successful bidder in a competitive sale) as of the time the prices of the bonds are agreed to by the issuer and the managing underwriter (or successful bidder). Those prices are appropriate because they best reflect the underwriter’s (or the successful bidder’s) expectations for the initial prices at which the bonds will be offered to the public and at which a substantial amount of each maturity of the bonds will be sold to the public. For this purpose, the expectations should relate to the sale price of the first ten percent of each maturity of the bonds.

The underwriting team is the most appropriate entity to determine the first price at which ten percent of each maturity of the bonds is actually sold to the public. The issuer has no contact with the buying public, and data that is available on public websites cannot be easily interpreted to identify the status of the buyers. Thus, these Comments recommend that the Regulation be interpreted to permit good-faith reliance on the certificate of the underwriting team as to first price at which ten percent of each maturity of the bonds was sold, or reasonably expected to be sold, to the public.

The process involved in a negotiated underwriting (or a competitive sale) supports a presumption that it reflects a bona fide public offering, absent actual knowledge by the issuer that a bona fide public offering was not made, or that clear abuse such as bid-rigging, pay-to-play, or price-fixing, occurred. Efforts by the issuer or underwriter to alter a bona fide process, by limiting its offering to only particular types of buyers, or by otherwise controlling the subsequent sales of bonds by the initial buyers, will increase inefficiencies and interest rates and likely harm taxpayers as much as the government. Thus, these Comments recommend that the Regulation support the presumption.

Financial institutions frequently buy bonds in a primary offering, and it is very difficult for the issuer to know whether those institutions (other than the members of the underwriting team with whom the issuer has a contract) are purchasing “in the capacity of underwriters or

¹ References to a “section” are to a section of the Internal Revenue Code of 1986, as amended (the “Code”), unless otherwise indicated.

² References to a “maturity” of bonds means the portion of a bond issue that consists of “substantially identical” bonds within the meaning of the Regulation.

wholesalers” within the meaning of the Regulation, or as investors on their own behalf. Thus, these Comments recommend that the Regulation permit financial institutions to be treated as public buyers (*i.e.*, not as underwriters or wholesalers) unless the underwriting team that has contracted with the issuer knows, based on a written contract or other agreement with the purchaser, that the purchaser is acting in the role as underwriter or wholesaler, and not as investor.

Issue Price

I. Introduction.

The issue price for tax-exempt bonds is determined pursuant to the Regulation. In 2009, Congress enacted legislation authorizing the issuance of Build America Bonds (“BABs”), of which certain BABs (“Direct Pay BABs”) are eligible to receive a subsidy payment from the U.S. Government pursuant to section 6431.³ In 2010, Congress extended the same type of subsidy to “specified tax credit bonds” (collectively, with Direct Pay BABs, the “Direct Pay Bonds”).⁴ In response to questions regarding the rules applicable to determine the issue price of the Direct Pay Bonds, the Internal Revenue Service (the “Service”) issued Notice 2010-35 (the “Notice”), stating, in part, that the Regulation will be used to determine the issue price of all Direct Pay Bonds until further notice.⁵

These Comments urge that the Regulation be permanently applied to determine the issue price of all Direct Pay Bonds as well as tax-exempt bonds. These Comments also recommend that the interpretation of certain components of the Regulation be confirmed.

II. Establishing Issue Price under Regulation section 1.148-1.

A. Permanent Application of the Regulation to Establish Issue Price for All Bonds.

Section 148(h) provides that “yield on an issue shall be determined on the basis of the issue price (within the meaning of sections 1273 and 1274).” The Regulation further defines issue price as follows:

Issue price means, except as otherwise provided, issue price defined in section 1273 and 1274. Generally, issue price of bonds that are publicly offered is the first price at which a substantial amount of bonds is sold to the public. Ten percent is a substantial amount. The public does not include bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters or wholesalers. The issue price does not change if part of the issue is later sold at a different price. The issue price of bonds that are not substantially identical is determined separately. The issue price of bonds for which a bona fide public offering is made is determined as of the sale date based on reasonable expectations regarding the initial public offering price. If a bond is issued for property, the applicable Federal tax-exempt rate is used in lieu of the Federal rate in determining

³ Pub. L. No. 111-5, 123 Stat. 115 (American Recovery and Reinvestment Act of 2009, or the “Act”).

⁴ Pub. L. No. 111-147, 124 Stat. 1029 (Hiring Incentives to Restore Employment Act of 2010). Such bonds include new clean renewable energy bonds defined in section 54C, qualified energy conservation bonds defined in section 54D, qualified zone academy bonds defined in section 54E and qualified school construction bonds defined in section 54F.

⁵ Notice 2010-35, 2010-19 I.R.B. 660 (citing Notice 2009-26, 2009-1 C.B. 833, for further information regarding the tax character and procedural framework for refundable credit payments under section 6431).

the issue price under section 1274. The issue price of bonds may not exceed the fair market value as of the sale date.⁶

The Notice states that the Regulation will apply to Direct Pay Bonds for purposes of determining issue price. The Notice, however, also states that the Department of Treasury (the “Treasury”) and the Service continue to review the definition and may issue prospective guidance or changes to the definition. These Comments urge that the Regulation be permanently applied to determine the issue price of tax-exempt bonds and Direct Pay Bonds. In addition, if there are to be changes to the Regulation, tax-exempt bonds and Direct Pay Bonds should be subject to the same rules and the same changes.

Because issuers of Direct Pay Bonds and tax-exempt bonds are generally the same entities, providing the same issue price rule for them would enhance certainty and administrability. They are often issued at or about the same time to finance different portions of the same overall project and uniform rules will enhance compliance.

For tax-exempt bonds and Direct Pay Bonds, the issue price is the starting point for determining compliance with all arbitrage-related matters. It is also the starting point for certain other key requirements applicable to tax-exempt bonds, including those relating to volume cap, limitations on “private business use” and the limitation on costs of issuance with respect to private activity bonds (including qualified section 501(c)(3) bonds). For Direct Pay Bonds, the issue price determines whether an issuer is entitled to receive the subsidy from the U.S. Treasury by virtue of several additional requirements. Similar to tax-exempt private activity bonds, section 54A incorporates a limit on costs of issuance that may be financed with proceeds from the sale of an issue of Direct Pay Bonds.⁷ While issue price is not specifically mentioned, most practitioners apply the section 54A limit by reference to issue price. The Act further imposes a premium limit on BABs⁸ (and, under the Notice, to all Direct Pay Bonds), and this limit also applies by reference to issue price. Further, most practitioners use the issue price for measuring compliance with the volume cap limits applicable to Direct Pay Bonds other than BABs.

The Regulation provides a method of determining the issue price as of the sale date of bonds. This methodology is very important for issuers of tax-exempt bonds and Direct Pay Bonds as well as their advisors. It enables the parties to know, on the sale date, whether the sale of bonds will satisfy the many requirements for Direct Pay Bonds that depend on the issue price. Finality regarding issue price on the sale date also enables the issuer to make many calculations required for compliance with tax law (*e.g.*, the yield on the bonds), which can be critical if yield-restricted investments are being purchased.

Allowing the long-established issue price rule under the Regulation to be used for all bonds would be consistent with the stated Congressional intent of assisting municipal issuers in their financial planning and operations. It would also avoid the market uncertainty that would

⁶ Reg. § 1.148-1(b).

⁷ I.R.C. § 54AA(e)(4)(A)(ii).

⁸ I.R.C. § 54AA(d)(2)(C).

result from a different rule for Direct Pay Bonds that would perhaps threaten the continued viability of such bonds in some situations, even if based on an existing rule under another Code provision.

B. Reasonable Expectations Regarding the Initial Public Offering Price.

In addition to providing a general framework for establishing issue price, the Regulation provides a narrow, specific safe harbor through a series of declaratory rules. One such safe harbor in the Regulation, but not in section 1273, is that “the issue price of bonds for which a bona fide public offering is made is determined as of the sale date based on reasonable expectations regarding the initial public offering price.”

“Reasonable expectation” is provided as an alternative to the actual sales price rule set out in the second sentence of the Regulation. The use of reasonable expectations in establishing the issue price of tax-exempt bonds has been vital in many instances. Reasonable expectations are especially important where the actual sale price of the bonds cannot be obtained or accurately determined on the sale date (*e.g.*, if ten percent of a maturity of the bonds was not sold on the sale date).

1. Reasonable Expectations Are Established at the Time of Offering.

While the Regulation permits the use of reasonable expectations to establish the issue price of publicly offered bonds, it does not provide further guidance or limits on which expectations are the most reasonable. Underwriting or selling the bonds is a fluid process. An underwriter or a bidder in a competitive sale—which is the entity on whose expectations an issuer will be relying—may change its expectations as to the offering prices of bonds throughout the process, and all of the different expectations may be reasonable. These Comments recommend that the proper time to measure one’s reasonable expectations as to the *initial* offering price for purposes of establishing the issue price of bonds is when the issuer’s representative and the managing underwriter agree to a price in a negotiated sale (or when the issuer’s representative in a competitive offering has agreed to the prices in the successful bid), rather than any other time (*e.g.*, the time of execution of a bond purchase agreement, the formal award of bonds at a competitive sale, or the end of the day of sale).

As part of the typical underwriting process in a negotiated sale, an underwriter conducts its due diligence on the market in which the bonds will be offered, in large part through conversations with potential buyers. This “pre-sale” period can vary in time and scope, depending on the bonds to be sold, the timing and any factors unique to the issuer or the underwriter. Practitioners generally understand that the following events occur on the sale date (albeit, not always in this order): (i) the bond offering prices are established, sometimes as adjusted from the prices previously considered during the pre-sale period, and at other times by confirming expected trades between the underwriter and buyers; (ii) the issuer and the underwriter execute a bond purchase agreement (“BPA”), agreeing to the prices at which the underwriter will acquire the bonds from the issuer; and (iii) sales are “ticketed” (*i.e.*, bonds are promised to be delivered to the buyers). In the typical series of events, the public offering could be viewed as occurring as early as the beginning of the sale date, and any subsequent period prior to the execution of the BPA.

Potential purchasers in a typical competitive sale will bid individually or as part of a syndicate. There are often no pre-sale orders because there is no assurance any one bidder will win the bid. Bidders put forth their best bid, usually in the form of the lowest interest cost, and the issuer selects the winner based on the lowest cost, taking into account premium credited to, or discount charged to, the issuer. There is no requirement that compensation be disclosed before the winning bid is awarded. A purchaser will normally bid the lowest cost possible to win the bid and still resell the bonds to the public at a reasonable profit.

Potential bidders undergo a process similar to a negotiated sale, although it may involve less effort because no bidder knows whether it will be the actual underwriter until the bids are opened and the bonds are awarded. Each bidder formulates a bid based on its own reasonable expectations regarding the initial public offering price at which it expects to sell the bonds. The bidder hopes to make a profit by buying from the issuer and selling at a higher price in the market. The bid, if accepted, establishes the prices at which the bidder will buy the bonds from the issuer. Once the bids are opened, the successful bidder is notified that the formal award has been made to that bidder, and that bidder can formally offer the bonds in the market (*i.e.*, sales can be “ticketed”).

Both underwriters in negotiated sales and purchasers in competitive sales typically re-offer bonds to investors pursuant to procedures that are transparent and intended to comply with securities laws. They establish the reoffering prices of the bonds based on their reasonable expectations as to the sale prices. Purchasing through a competitive process ensures that bonds are sold at the lowest cost to the issuer, hence reducing yield to the most competitive level.

The foregoing underwriting and competitive sale processes imply that reasonable expectations as to the issue price are the prices incorporated into the BPA or accepted in a competitive sale. The time to measure whether those prices reflect reasonable expectations should not be the end of the sale date, as that can be many hours after the underwriter or the bidder has established the *initial* offering prices. The time of actual execution of a BPA is also an inappropriate measure of reasonable expectations because execution is usually driven by the availability of someone authorized to sign the contract, and this timing has no connection to expectations regarding how the bonds will be sold to the public.

These Comments recommend that the Regulation be interpreted to provide that the issue price is established using the reasonable expectations of the managing underwriter in a negotiated sale, or of the successful bidder in a competitive sale, as of the time the prices of the bonds are agreed to by the issuer’s representative and the managing underwriter or successful bidder.

2. Reasonable Expectations to Sell First Ten Percent of Each Maturity.

The Regulation, which permits the use of reasonable expectations of an underwriter (or a bidder) for purposes of establishing issue price of a publicly offered debt instrument, does not provide guidance on the scope of applicability of the expectations. Based on the entire context of the Regulation, the issue price should be established using the price at which an underwriter (or a successful bidder) reasonably expects to sell a substantial amount (*i.e.*, at least ten percent) of each substantially identical group (or each maturity) of bonds to the public.

C. The First Ten Percent Sale Price to Establish Issue Price.

The Regulation also provides that issue price may be established using the first price at which a substantial amount of each maturity of the bonds is sold to the public. While not addressed in section 1273, the Regulation affirmatively states that a “substantial amount” is ten percent. Therefore the bright line of ten percent is available to unequivocally establish the issue price of bonds that are eligible for this rule. Indeed, the Regulation states that, once the issue price is established, a subsequent sale at a different price does not affect the issue price.

Publicly available trade data is imperfect. In addition to the Municipal Securities Rulemaking Board’s Electronic Municipal Market Access System (“EMMA”) website,⁹ which is specifically referenced in IRS Form 14127, the “investinginbonds” website¹⁰ is a source of trading data and financial professionals also often subscribe to the Bloomberg wire services for trade information on bonds. Each website has its own independent reporting and posting rules, but each depends on financial institutions to timely supply complete and accurate trade information. In addition, different websites provide different and limited information. For example, EMMA only identifies whether a sale is one made to a “customer” or is an “inter-dealer trade.” Inter-dealer trades on EMMA do not distinguish between trades with the intention to hold for investment purposes and trades for immediate resale. In some cases, trades recorded as “inter-dealer” trades are, in fact, trades to the “public” because the dealer-purchaser is purchasing on behalf of a true investor that is not a bond house. Sales to the public are complicated because they may have varying, embedded commissions, and the failure of the fixed income bond market to require separate reporting of commissions adds to the complexity and lack of transparency. Therefore, interpretational leaps are required for a user to draw conclusions from the publicly available data.

Only the underwriting team knows if at least ten percent of a maturity has been first sold at a specific price, because some informational websites do not track sales of specific bonds within each maturity, and some sites (including EMMA) only report trades of bonds by date, amount and type of transaction.¹¹ Therefore, only the underwriter, as the initial seller of the bonds to the marketplace, knows the identities of the purchasers and the first price at which at least ten percent of a maturity is sold. Given the underwriter’s access to information and control over the process, a certification by the underwriter regarding the first ten percent sale price should establish the issue price of bonds that are publicly offered, absent abuse, such as bid-rigging. While a review of public trade data may lead to further conversations with an underwriter, that data alone should not overcome the presumption of the underwriter’s certification. These Comments recommend that the Regulation be interpreted to allow the issuer to rely on a certificate of the underwriter as to its reasonable expectation to sell at least ten percent of each maturity of the bonds to the public at its initial offering price, absent abuse such as bid rigging or lack of a bona-fide, public offering (discussed below).

⁹ This site can be found at <http://www.emma.msrb.org>.

¹⁰ This site can be found at <http://www.investinginbonds.com>.

¹¹ Trades posted at the same time on EMMA are sometimes re-ordered when reviewed at a later time or date.

D. Definition of “Public” in Public Offering and Sale

The recommendations regarding reliance on the issue price rules in the Regulation and section 1273 are premised on the bonds being “publicly offered.” The sale process, as previously described, encourages a public offering, and a public offering is commonly required in the BPA between the issuer and an underwriter, or as a term in the notice of sale for a competitive sale. An issuer may be unable to do anything further to ensure a public offering.

1. Presumed Public Offering Absent Abuse or Knowledge.

An underwriter (or the winning bidder in a competitive sale) commonly is subject to an obligation or covenant to publicly offer the bonds it purchases from the issuer. Given the transparency of the process, a sale of bonds by an issuer through a negotiated underwriting (or a competitive bid) should be presumed to be a bona-fide public offering, absent clear abuse or actual contrary knowledge by the issuer. For example, practices such as bid-rigging, pay-to-play, or price-fixing would overcome the presumption, as would the issuer’s actual knowledge that a public offering did not occur (*e.g.*, where the cover page of the Official Statement lists one or more maturities as “not re-offered” (or “NRO”)), but the mere sale of a bond at a price different from the offering price should not be viewed as evidencing the absence of a bona-fide public offering.

One indicator of a public offering is whether the public¹² was actually able to purchase the bonds at the offering prices. Actual sales of bonds to the public would confirm that bonds were indeed offered to the public. It is customary for underwriters to send out an “offering wire” to the market, offering bonds at stated prices for anyone to buy at those prices. But offering the bonds for sale is not the same as actually selling the bonds. A public offering can occur without regard to the actual results. Public buyers can acquire and resell bonds on the sale date or other dates; financial institutions can acquire bonds for their own investment purposes for a short, intermediate or long timeframe; and, financial institutions can also buy for resale. It is important to re-emphasize that trades at different prices, alone, do not evidence lack of a public offering.

Absent a contractual agreement or understanding with the buyer, the underwriter cannot control the resale prices. The issuer has no control over the prices at which anyone other than the underwriter sells the bonds, because it only has a contract with the underwriter. The underwriter may be able to control the prices at which others in the underwriting syndicate or distribution group sell the bonds for a relatively short period of time. But, after the bonds leave the underwriter (and any syndicate or distribution group), even the underwriter loses control over prices, and market conditions thereafter dictate price increases or decreases. Bond prices can also be influenced by a particular seller’s need to sell quickly, a particular buyer’s need to purchase at a particular price or on a particular date, and a variety of other factors.

The Treasury and the Service might be concerned that an underwriter will intentionally withhold bonds from the initial sale, or sell them to select wholesaler buyers that will resell them (perhaps immediately) at higher prices. An issuer’s only recourse is based on its BPA with the

¹² The meaning of the term “public” is discussed further in the “Definition of the Public” discussion, below.

underwriter (or agreement with a bidder in a competitive sale—through contract or through the notice of sale) in which the underwriter (or the winning bidder) commits to publicly offer the bonds. The issuer’s lack of control necessitates its reliance on the underwriter’s certification and the prices shown on the official statement or other publically disseminated offering documents for the bonds. We understand that organizations such as the Municipal Securities Rulemaking Board (the “MSRB”) and the Financial Industry Regulatory Authority have jurisdiction to monitor fairness of pricing of underwriters.¹³

Indeed, the MSRB has recently promulgated new amendments to MSRB Rules G-8 and G-11 to assist in assuring public access to bonds in initial offerings and fairness in the public offering process.¹⁴ According to the release (the “Release”) by the Securities and Exchange Commission (the “SEC”) approving the amendments, the “proposed amendments to Rule G-11 would: (1) apply the rule to all primary offerings, not just those for which a syndicate is formed; (2) require that all dealers (not just syndicate members) disclose whether their orders are for their own account or a related account; and (3) require that priority be given to orders from customers over orders from syndicate members for their own accounts or orders from their respective related accounts, to the extent feasible and consistent with the orderly distribution of securities in the offering, unless the issuer otherwise agrees or it is in the best interests of the syndicate not to follow that order of priority.”¹⁵ Moreover, “[t]he Commission believes the proposal will help achieve a broader distribution of municipal securities while still providing sufficient flexibility to syndicate managers and sole underwriters, and further believes that investors would benefit from a broader distribution of securities that is fair and reasonable and consistent with principles of fair dealing.”¹⁶

In addition, a competitive sale that meets all of the state law and securities law requirements for competitive bidding should by itself establish a “public offering” of all of the bonds, at least in the absence of a clear abuse (*e.g.*, bid-rigging, pay-to-play, or price-fixing) or actual contrary knowledge by the issuer. A competitive sale should eliminate a possible Service concern that, in a negotiated sale, bonds may be held back by the underwriter for later resale or for sale to preferred customers who might be brokers.¹⁷ The bidder in a competitive sale has no assurance that it will be able to buy the bonds from the issuer. This uncertainty reduces the likelihood that a bidder will have side arrangements that are contingent upon winning the bid when any other broker or wholesaler can also bid on the issuer’s sale. Accordingly, these

¹³ Also, section 6700 provides that penalties may be imposed on any person who participates in, among other things, an investment plan or arrangement and makes a “statement with respect to the allowability of any deduction or credit, the excludability of any income, or the securing of any other tax benefit by reason of holding an interest in the entity or participating in the plan or arrangement which the person knows or has reason to know is false or fraudulent as to any material matter. . . .”

¹⁴ See File No. SR-MSRB-2009-17 (November 8, 2009), *as amended by* Amendment 1 to File No. SR-MSRB-2009-17 (August 4, 2010). Both documents were approved by the Securities and Exchange Commission August 16, 2010, and are effective October 12, 2010.

¹⁵ SEC Release No. 34-62715, File No. SR-MSRB-2009-17 (August 13, 2010).

¹⁶ *Id.*

¹⁷ See Proposed Internal Revenue Service Form 14127, Question 4.

Comments recommend that, absent clear abuse or actual contrary knowledge by the issuer, a competitive sale be treated as a bona-fide public offering, with the reasonable expectations of the winner of the competitive bid to sell at least ten percent of each maturity of the bonds it was awarded establishing the issue price.

2. Public Offering Should Not Exclude Anyone.

Neither the Regulation, nor the issue price rule in section 1273 and its underlying Regulations, requires that a public offering exclude bond houses, brokers or others that are not considered part of the public. While the only sales that establish issue price are sales to the public, the offering should be open to all buyers. The issue price can still be properly established under the Regulation in such a public offering.

An issuer has limited options to control the underwriting and selling process, and any controls might disrupt the market and result in unintended consequences. If an issuer narrowed its pool of purchasers to those covenanting not to resell their bonds for a specified time period, the issuer's cost (and the corresponding subsidy paid by the Treasury with respect to the Direct Pay Bonds) would increase. Alternatively, if an issuer limited the prices at which the underwriter or the initial purchaser may sell or resell their bonds, again, the issuer's cost (and the corresponding subsidy paid by the Treasury) would increase. These limitations would create further inefficiencies by being less "public," due to participation being restricted to only select or pre-screened parties. Moreover, state law often requires the issuer in a competitive sale to accept the lowest interest-rate bid, thereby depriving the issuer of legal authority to impose conditions on the bond purchasers.

3. Definition of Public.

There has historically been some uncertainty about what constitutes the public in the context of a public offering. The term "public" is explained in the Regulation by reference to what is *not* the public. The Regulation excludes "bond houses, brokers, or similar persons or organizations *acting in the capacity* as underwriters, or wholesalers."¹⁸

The "acting in the capacity" requirement in the Regulation can be interpreted either (i) to apply to bond houses, brokers and all other persons or organizations similar to bond houses or brokers that have the capacity to act as underwriters or wholesalers, or (ii) to apply only to entities (bond houses, brokers or "other persons or organizations") actually acting in the capacity of underwriters or wholesalers in a particular bond sale (and, presumably, other bond houses and brokers are not excluded from the "public" in that transaction).¹⁹ These Comments recommend that the phrase "acting in the capacity of an underwriter, or wholesaler" be interpreted as modifying "bond houses", "brokers," and "other persons or organizations" so that a sale to a bond house or broker is disregarded only if the bond house or broker is actually acting in such capacity or it is acting as a member of the underwriting syndicate or distribution group. A

¹⁸ (Emphasis added.)

¹⁹ For example, a bond house can be both an investor and an intermediary, and its role, from the time of bond sale, may not be clear and also may change quickly thereafter.

contrary reading would exclude all financial institutions that have trading capacity, even if the buyer intends to hold the bonds for investment rather than resale. But as described above regarding publicly available information on actual trades, an issuer generally cannot distinguish between bond houses that are holding bonds for investment or for resale, because services such as EMMA only identify sales to a bond house as an “inter-dealer” trade.

Even the underwriter’s opportunity to assess the identity of the buyer and the buyer’s intent is limited to the initial offering. Without a written agreement or direct knowledge, the underwriter cannot be certain about whether a trade executed, likely by computer, with another dealer is for the dealer’s investment or resale. In our experience, investment banking firms often purchase debt instruments for their own account; in such cases, disregarding these original sales in calculating issue price could lead to an inconclusive result.

The Service has publicly asked about trades to affiliates of the underwriter or their “affiliated accounts,” with no guidance provided for how the scope of “affiliate” is to be determined.²⁰ Members of an underwriting syndicate or distribution group are clearly acting in concert during the term of the syndicate or group, but the extent of any remaining rights or obligations between the members following dissolution of the syndicate or group is unclear. A similar question arises for entities that submit a joint bid in a competitive sale, although the rights or obligations between these entities may be even more informal.

The concept of the “public” is even more fluid when subjective considerations are taken into account. For example, an initial buyer may view itself differently from time to time, or disagree with how its role is being characterized by others. Moreover, a buyer’s intent might shift over time, perhaps having an initial intention to sell the bonds but subsequently deciding to retain the bonds for a period of time.

In light of the interpretative difficulties with respect to website information, the multiple roles a financial institution could assume, and the fluid intention of participants, these Comments recommend that the scope of the “public” should be presumed to include financial institutions unless the underwriter knows, from a written contract or other agreement, that the financial institution is acting in the capacity of underwriter or wholesaler.

III. Conclusions.

The concerns of the government, bond issuers, underwriters and bond lawyers over the issue price of tax-exempt bonds and Direct Pay Bonds can be best addressed by making the Regulation permanently applicable to tax-exempt bonds and Direct Pay Bonds, with certain clarifications.

Specifically these Comments recommend that:

1. The Regulation be permanently applicable to tax-exempt bonds and Direct Pay Bonds.

²⁰ See Proposed Internal Revenue Service Form 14127, Question 1, part 3.

2. The Regulation be interpreted in formal guidance (*e.g.*, a Notice) as follows:
 - a. Establish issue price using the reasonable expectations of the managing underwriter in a negotiated sale (or of the successful bidder in a competitive sale) as of the time the prices of the bonds are agreed to by the issuer's representative and the managing underwriter (or successful bidder) and using expectations as to the price at which the first ten percent of each maturity is to be sold.
 - b. Permit good-faith reliance on the certificate of the underwriting team as to first price at which ten percent of each maturity of the bonds was sold, or reasonably expected to be sold, to the public.
 - c. Presume that a public negotiated offering or competitive bid that contractually requires a public offering of all of the bonds is a bona fide public offering, absent clear abuse (*e.g.*, bid-rigging, pay-to-play, or price-fixing) or actual contrary knowledge by the issuer.
 - d. Permit the "public" to include financial institutions, unless the underwriting team that has contracted with the issuer knows, based on a written contract or other agreement with the bond purchaser, that the bond purchaser is acting in the role as underwriter or wholesaler, and not as investor.