

# National Federation of Municipal Analysts

## NFMA POSITION PAPER ON THE FORM INDENTURE PROJECT

### INTRODUCTION

The National Federation of Municipal Analysts (NFMA) is an organization composed primarily of research analysts who evaluate credit and other associated risks of tax-exempt securities. Established in 1983, the NFMA has roughly 1,000 members that represent, among others, broker/dealers, mutual funds, rating agencies and insurance companies. The constituent societies of the NFMA are the Boston Municipal Analysts Forum, California Society of Municipal Analysts, Chicago Municipal Analysts Society, Minnesota Society of Municipal Analysts, Municipal Analysts Group of New York, Southern Municipal Finance Society and affiliated members. The municipal analysts who constitute the members of the NFMA represent the perspectives and interests of a broad spectrum of market participants. The “buy-side” analysts who are members of the NFMA represent, in the aggregate, the purchasers of a very substantial portion of all tax-exempt bonds sold in the market today. Since the NFMA covers a broad spectrum of analysts and the needs and philosophies of their firms may differ, certain analysts or their employers may have different views from those stated in this report.

The NFMA applauds the efforts of the National Association of Bond Lawyers (“NABL”) to develop a standardized Form Indenture for use by the municipal bond market. We believe that having a Form Indenture will serve our common interests in containing issuance costs and in reducing the time for bringing bond issues to the market. In order to truly accomplish these goals, it is obviously imperative that the Form Indenture reflect the views and input of all segments of the municipal market. For this reason, the NFMA welcomes the opportunity to share its views regarding the September 22, 1999 draft of the NABL Form Indenture and associated Commentaries.

Bondholders are the end-users of the instruments drafted by bond counsel and other parties to bond financings and it is their economic interests which are most often affected by the technical language in the bond documents. And yet, their interests are rarely represented at the drafting sessions that produce the contractual infrastructure of bond offerings. Issuers, borrowers, trustees and underwriters each have their say in the development of the indentures, loan agreements and security instruments that govern bond issues, and their interests therefore are reflected in the issue as it is brought to market. Bondholders, on the other hand, frequently have to take the papers “as is” or forego participation in the transaction. Often, bond documents are drafted in a manner that disregards important interests of the bondholders. This occurs sometimes deliberately because the parties drafting the documents are beholden to the issuer, or borrower, or trustee, but more frequently because the drafters are unaware of the impact on bondholders of the insertion or omission of certain provisions. It is therefore critical that bondholder input be solicited and incorporated when NABL or any other organization purports to draft model bond documents. We therefore very much look forward to collaborating with NABL and other market participants in this Form Indenture project.



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## COMMENTS

The NFMA's comments on the Form Indenture focus particularly on the following provisions:

1. Redemptions
2. Debt Service Reserve Fund
3. Defaults and Remedies
4. Trustee Duties and Protections
5. Defeasance
6. Securities Depository
7. Bondholder Consents

### 1. Redemption Provisions

Redemption provisions directly affect the pricing and value of a bond, and there are many ways in which vague or inattentive drafting can adversely impact bondholders in a material way. The Form Indenture contains a variety of provisions that are potentially harmful to the interests of bondholders, and which should be reconsidered and improved.

#### a. “Conditional Redemption”

The NFMA is opposed to conditional redemption notices, under which an issuer or conduit borrower (herein collectively, the “Issuer”) may give notice of redemption before the receipt of proceeds of a refunding issue (or other source of funds for a redemption) is assured, and rescind such notice without consequence if the funds do not materialize on a timely basis. This type of provision leaves bondholders in a state of uncertainty as to whether a redemption will occur on a specified date, and accordingly restricts bondholders' ability to make efficient reinvestment plans. Since virtually all indentures can be defeased before the associated bonds are retired, there is no reason why an Issuer should not satisfy all conditions to a redemption, including availability of funds for such redemption, before notice of redemption is given, and, having satisfied all conditions, give an unconditional redemption notice. The NFMA disagrees with the suggestion in the Commentaries that an indenture's silence on the subject of the permissibility of a conditional redemption can be construed as authorization for a conditional redemption.

#### b. Tax Call Provisions

Tax call provisions raise numerous important issues that have received little scrutiny until recently. As the Internal Revenue Service steadily increases its audit and enforcement presence in the municipal bond arena, the details of tax calls have increased in practical importance to bondholders. Among the most important details are the timing of tax calls, and the redemption price.



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With respect to the timing element, the Commentaries set forth both a “short form” and a “long form” version of the “Determination of Taxability” that triggers a tax call. The “short form” version contains alternative language which requires a final judicial or administrative determination, after all appellate review has been exhausted, that the bonds are taxable, while the “long form” version in some instances provides for a Determination of Taxability at an earlier stage. The NFMA believes that, once bonds have been “tainted” by an IRS determination of taxability, the bonds should be redeemed unless the Issuer or another responsible party (i) commits to paying the maximum potential closing agreement amount if necessary to avoid taxation of bondholders (as determined by a nationally recognized bond counsel selected by the owners of a majority in aggregate principal amount of the Bonds Outstanding) and (ii) sets aside with the Trustee funds or a letter of credit sufficient to pay such maximum exposure if and when required to prevent taxation of bondholders. The NFMA understands that the Issuer may wish to contest an adverse determination by the IRS, but bondholders (including many mutual funds and other investors that are not permitted to receive taxable income) should not be put in a position of holding bonds presumed to be taxable during a protracted contest proceeding while potentially taxable income continues to accrue. Accordingly, the NFMA favors a Determination of Taxability definition with an “early trigger” rather than a “late trigger.” In addition, the NFMA opposes the variations within the “short form” and “long form” versions that would not require a tax call unless the tax call results from an act or omission by the Issuer or Borrower. Once the bonds are presumed to be taxable, the basic premise of the bargain between the bondholders and the Issuer is in jeopardy, and the bonds should be redeemed.

The Form Indenture does not specify the redemption price for a tax call. It is important to acknowledge the differing functions of a premium payable upon a tax call. Certain premiums in the higher end of the premium range may be intended to serve as liquidated damages for the damages sustained by bondholders as a result of the taxability of interest on the bonds. Other premiums may serve to compensate for the early redemption of the bonds (if it occurs before the call protection period expires) without addressing the tax loss sustained by the bondholders. Some premiums are intended to act as a disincentive for the Issuer to permit the bonds to be become taxable, but are not intended to serve as compensation, or as sole compensation, to the bondholders for their damages. The NFMA believes that, unless the premium is set at a sufficiently high level to constitute a reasonable approximation of the damages sustained by the bondholders (e.g., a premium equal to three years of interest on the bonds times the highest marginal tax rate), language should be added to the tax call provisions expressly stating that payment of the redemption price is not intended to constitute liquidated damages and shall not affect any claims the bondholders may have at law for damages sustained as a result of the taxation of the interest on the bonds.

The Form Indenture should include a provision specifying that, whether or not bonds are redeemed upon a determination of taxability, the Issuer (or the Borrower) shall be obligated to enter into a closing agreement with the IRS if necessary to prevent taxation of interest on the Bonds, and that such obligation shall survive the discharge of the bonds.



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## c. Timing of Optional Redemptions

The Form Indenture departs from the traditional “in whole at any time and in part on any Interest Payment Date” formulation and permits partial optional redemptions at any time. This creates potential confusion for bondholders that may hold some bonds that are redeemed during an interest period and others that continue to accrue interest throughout the entire period. The NFMA opposes the revised approach adopted in the Form Indenture, and urges that the traditional formulation be retained.

## d. Extraordinary Redemptions

The Form Indenture leaves the substance of any extraordinary redemption provisions to the drafter, but the Commentaries include “a representative sample” of extraordinary redemption provisions. The sample redemption provisions include clause (c), which permits an extraordinary redemption “if unreasonable burdens or excessive liabilities shall have been imposed with respect to the Project” and clause (d), which applies if “technological or other changes shall have occurred which the Borrower cannot reasonably overcome or control and which in the Borrower’s reasonable judgment render the Project uneconomic....” These provisions are vaguely worded and are susceptible to abuse by entities seeking to circumvent optional call protections. The NFMA disfavors the use of such provisions. If they are used, they should be accompanied with language specifying that (i) the Project must cease operations at the time of such redemption, (ii) a specified premium shall be payable to the bondholders if the Project resumes operations within a specified time period, and (iii) the obligation to pay such premium shall survive defeasance.

## e. Selection of Bonds for Redemption

In the case of a partial redemption, the Form Indenture provides for redemptions pro rata by maturity or as selected by the Issuer or Borrower, and by lot within a maturity. Although this principle is equitable in most situations in which only the timing of prepayment is at stake, in default situations it may result in preferential payment to some bondholders at the expense of others who may sustain a loss. The Form Indenture should specify that in the case of a partial redemption during the continuance of an Event of Default, any redemption shall be applied on a pro rata basis to all Outstanding Bonds, without differentiation by maturity or within a maturity.

## 2. Debt Service Reserve Fund Provisions

The Debt Service Reserve Fund is generally funded from bond proceeds, and its use often involves the application of borrowed funds to stave off a payment default on bonds. Indentures should, at a minimum, clearly state the initial sizing of such reserve funds, the impact on such sizing of post-closing amortization of bonds and the issuance of additional bonds with a claim on the reserve, and the impact on the issuer/borrower and bondholders of an unscheduled use of the



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reserve fund to pay debt service. The Form Indenture provisions are unclear in this regard, and can be improved in various aspects.

### a. Debt Service Reserve Fund Requirement.

The Form Indenture contemplates a common reserve fund for various series of bonds issued under the same indenture. The sizing of the common reserve fund is determined by aggregating the amount required to be deposited in connection with the issuance of each series of bonds. The Form Indenture defines the “Series Required Reserve” as a specified dollar amount for the initial series of bonds, and, for subsequent series, as the lesser of the maximum amount that can be invested without yield restriction under current arbitrage regulations, or the amount which, together with amounts previously on deposit in the common reserve fund, equals maximum annual debt service on all outstanding bonds with a claim on the common reserve fund. Like many indentures, the Model Indenture is not entirely clear regarding whether the reserve requirement declines as bonds are amortized. Bondholders may have some preferences as to the formulation used to determine the size of a debt service reserve at different points in the life of a bond issue, but what is critical is that the principles be clearly articulated and understood. In the approach adopted by the Form Indenture, the Series Required Reserve is recomputed whenever Additional Bonds are issued. Because the incremental reserve deposit required upon issuance of Additional Bonds is capped at maximum annual debt service on then Outstanding bonds, amortization of previously issued bonds indirectly affects the size of the Required Reserve whenever Additional Bonds are issued, but by implication does not cause a reduction of the Required Reserve at other times. Put another way, because the definition of “Series Required Reserve” states that each “Series Required Reserve” is “determined at the time of issuance” of the applicable series of bonds, the amount on deposit in the reserve fund from each series appears to remain constant (presumably until that series is paid off.) The Required Reserve, on the other hand, which represents the aggregate of all the Series Required Reserves, changes over time as Additional Bonds are issued and series of Bonds are paid off. In this context, the wording of the sentence of the Form Indenture which provides that, upon the issuance of Additional Bonds, “the Series Required Reserve shall be recomputed for all Bonds then Outstanding,” is incorrect and confusing. It should read instead that, upon the issuance of Additional Bonds, “the Required Reserve shall be recomputed for all Bonds then Outstanding.” If the drafters’ intent is to have an ongoing recalculation of the debt service reserve fund requirement that takes into account the amortization of portions of a series of bonds, different language should be used that clearly specifies that the reserve requirement is recalculated at specified intervals to take into account the amount of bonds outstanding on each specified recalculation date.

### b. Replenishment Provisions

The Form Indenture provides for restoration by the Issuer of any amounts withdrawn from the Reserve Fund in substantially equal monthly installments over an unspecified period. In instances where the Issuer or Borrower is required to make monthly payments to fund semi-annual debt service on bonds, this provision creates confusion regarding the impact of a missed monthly debt service payment by the Issuer. The fair implication of most indentures, and the way



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bondholders interpret indentures, is that an Issuer's failure to make a scheduled monthly debt service payment from current revenues constitutes an Event of Default, and that such Event of Default is not cured or avoided by withdrawing money from the Debt Service Reserve Fund for purposes of paying the semi-annual bond payment. The concept of a permissible period for replenishing the Reserve Fund may suggest that the Issuer is authorized to make a "temporary" use of the Reserve Fund in lieu of making payments from current revenues, and may therefore suggest that failure to make scheduled monthly (or semi-annual) debt service payments from current revenues is not an Event of Default. Unless the bonds are marketed with clear and prominent disclosure that the Reserve Fund is intended to serve as an internal line of credit for the Issuer that "cures" the Issuer's failure to make debt service deposits on the required schedule, the replenishment provision should require immediate reimbursement of amounts withdrawn from the Reserve Fund (other than those in excess of the Reserve Requirement), as reflected in the Commentaries on Section 7.01. Alternatively, a proviso should be added to the effect that "neither the transfer of moneys from the Reserve Fund (other than moneys in excess of the Reserve Requirement) to the Debt Service Fund, nor the provisions hereof with respect to the timing of replenishment of withdrawals from the Reserve Fund, shall affect or cure any Event of Default arising from the Issuer's failure to make the deposits to the Debt Service Fund required under this Indenture and the Loan Agreement."

### c. Use of Credit Facilities

The Form Indenture authorizes the substitution of a letter of credit, surety bond or other credit enhancement for funds on deposit in the Reserve Fund. The NFMA is opposed to such provisions, primarily for the reason that experience indicates that trustees may fail to draw on such credit facilities prior to their expiration, thereby leaving bondholders with a disputed claim against the trustee instead of a funded reserve. Accordingly, if credit facility substitutions are permitted, the indenture should either require that the credit facility be coterminous with the applicable Series Reserve Requirement, or language should be included to the effect that "notwithstanding any other provision of this Indenture to the contrary, the Trustee shall be liable for its failure to comply with the provisions hereof with respect to draws on the credit facility prior to its scheduled expiration or termination date, without regard to a finding of negligence or culpability." Moreover, if credit facility substitutions are permitted, a clear floor rating for the credit facility provider should be specified, rather than general concepts such as the "investment grade" terminology employed by the Form Indenture. The Form Indenture permits the granting to the credit facility provider of a parity lien on the Trust Estate securing its reimbursement rights; this effectively creates a phantom reserve fund, since moneys drawn on the credit facility to pay debt service on the bonds are required to be repaid from moneys that would otherwise be available to pay debt service on the bonds. The Form Indenture should be revised to state that the credit facility provider shall not receive any lien on or payments from the Trust Estate while the Bonds are Outstanding. In addition, provisions should be added requiring the Trustee to draw upon the credit facility on the first business day after the Trustee receives notice that the credit facility provider's rating has been downgraded below the specified floor rating.



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## d. Investment of Funds

The Form Indenture should contain provisions designed to avoid extreme volatility in the market value of the Reserve Fund. The Form Indenture should require that the Reserve Fund be invested in either (i) Eligible Investments permitting withdrawals without penalty at any time for the purposes of the Reserve Fund, or (ii) Eligible Investments with a weighted average maturity not exceeding a specified term.

## 3. Default and Remedies Provisions

Events of Default are “red flags” that trigger the right of bondholders to exercise remedies, and, of equal importance, the right of bondholders to participate in discussions with the Issuer to ensure that steps are being taken to avoid further credit deterioration. By the time a payment default occurs on the bonds, or the Issuer declares bankruptcy, the horse is out of the barn. Accordingly, it is of singular importance to bondholders that Events of Default and related provisions be drafted in a manner that gives bondholders notice and leverage when there are indicia of material credit deterioration or Issuer inattention to financial covenants, whether or not an actual payment default has occurred.

### a. Definition of Events of Default

Contrary to the alternative provisions of the Form Indenture, there should be no grace period for a missed interest payment on the bonds. As noted in the Commentaries, the deposits to the Debt Service Fund should be scheduled in advance of the payment dates on the bonds. Any grace period should be measured relative to the deposit dates, but should not extend beyond the scheduled payment date on the bonds.

As previously discussed, absent explicit disclosure that use of the debt service reserve fund to make payments when debt service payments from current revenues are insufficient “cures” the default arising from the Issuer’s non-payment, unscheduled draws on the debt service reserve fund should be added as an Event of Default. As discussed above, the Issuer’s use of the debt service reserve fund is a clear sign of financial difficulty, and bondholders should not have to wait until an actual payment default on the bonds to have a role in addressing such financial difficulty.

An outside limit (which may vary depending on the transaction and the particular covenants) should be added to the cure period for technical defaults that cannot be cured within 30 days of notice of default.

The Commentaries on Section 7.01 of the Form Indenture include the Committee’s “representative example” of Loan Agreement Events of Default. The list is a truncated list, and does not include many typical Loan Agreement defaults, such as events of default under other indebtedness instruments to which the Issuer is a party, adverse judgments that are not satisfied or



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insured, and violations of various key covenants for which the cure period otherwise available for covenant defaults is not available. With regard to those events of default that are listed in the Commentaries, an outside limit (which may vary depending on the transaction and the particular covenants) should be added to the cure period for covenant defaults that cannot be cured within 30 days of notice of default. Similarly, the Force Majeure exemption for technical defaults should be limited to a specified period.

### b. Notice of Events of Default

The NFMA opposes the suggestion in the Commentaries that an indenture should not require that the Trustee notify bondholders of events of default, but should leave such notice to the Trustee's discretion. The NFMA likewise disagrees with the suggestion in the Form Indenture's alternative provision authorizing the Trustee to withhold notice of technical defaults or an Issuer bankruptcy if the Trustee in good faith determines that such withholding is in the interests of the bondholders should be deleted. The bondholders are best suited to determine what is in their interests, and cannot do so effectively if material information, such as the existence of an event of default, is withheld.

### c. Acceleration

The requirement that the Trustee receive indemnification before accelerating the bonds should be eliminated. Giving an acceleration notice involves no material expense or risk, and the acceleration should not be delayed by an indemnification requirement.

### d. Bondholders May Direct Proceedings

In Section 7.02 and 7.03, the 25% standard for initiating acceleration or remedies, rather than a majority standard, should apply in widely distributed public offerings. Section 7.09 of the Form Indenture should be revised to permit the owners of a majority in aggregate principal amount of the Bonds Outstanding to direct the Trustee "whether to undertake remedial proceedings, and, if so, the type, method, place and timing of such remedial proceedings." The provisions under which the Trustee may disregard the directions of the majority bondholders if in the Trustee's opinion such directions would be "unduly prejudicial" to the minority bondholders should be deleted. Under the indenture, anything that majority bondholders do has the same impact on majority bondholders as on minority bondholders, so the likelihood that the majority bondholders can direct an action that is "unduly prejudicial" to minority bondholders is extremely remote; however, such language can be seized upon by a passive or nervous Trustee to avoid taking action directed by the majority bondholders.

### e. Retaining of Consultant

In addition to acceleration and remedies against particular collateral, a standard remedy upon an Event of Default should be the ability of the Trustee to retain, at the expense of the Issuer a consultant with expertise in the operations from which the bonds are to be repaid, and a





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covenant by the Issuer to implement the consultant's recommendations to the extent permitted by law. Often, what is needed in a default situation is not drastic action such as acceleration or foreclosure against assets, but rather the right to suggest and enforce the implementation of improved operations.

## f. Trustee's Right to Bring Securities Lawsuits

The NFMA supports the inclusion of express authorization for the Trustee to bring securities lawsuits, as provided in the last paragraph of Section 7.04. The concept should be expanded to tort actions, contract actions and other claims on behalf of the bondholders. However, the Trustee should only be authorized to bring such actions if directed to do so by at least 25% in principal amount of the bondholders, subject to override by a majority. Division of proceeds should be pro rata among current and former bondholders in proportion to their allocable damages.

## 4. Trustee Duties and Protections

The Trustee is the sole representative of the bondholders' interests after the bonds are issued. Trustees are represented by counsel prior to the offering and take great pains to limit their duties and liabilities to the maximum extent feasible. The NFMA does not expect the Trustee to ferret out all defaults and other developments that may adversely impact the bondholders, but by the same token the Trustee should not be authorized to turn a blind eye to red flags. The NFMA believes the Form Indenture should take a more balanced approach that protects the Trustee from unwarranted liability while ensuring that the Trustee is not inattentive to the legitimate expectations and interests of bondholders.

### a. Standard of Care

The NFMA objects to the insinuation (as a permissible alternative) of a gross negligence standard for Trustees in a Form Indenture. As the Commentaries note, the Trust Indenture Act prohibits the exculpation of trustees for their own negligence. Although the TIA is inapplicable, there is no justification (other than the fact that Trustees are represented when indentures are drafted and bondholders are not) for Trustees to be exculpated for their negligence in municipal transactions.

### b. Exculpatory Provisions; Indemnification

The provisions of the Form Indenture that exculpate the Trustee if it acts on advice of counsel should require that the Trustee use due care in selecting such counsel.

The indemnification provisions should be revised to specify that institutional investors and other creditworthy bondholders need not post indemnity bonds in connection with their indemnification of the Trustee for remedial actions. A proviso should be added to the effect that "in the case of a Bondholder which demonstrates that it has assets of at least \$50,000,000, a



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written undertaking by such Bondholder to indemnify the Trustee for its proportionate share (relative to other indemnifying Bondholders) of any liabilities incurred by the Trustee shall suffice and no indemnity bond shall be required.”

The provisions of the Form Indenture that assert that the Trustee is “not required to make any inquiry or investigation into the facts or matters stated” in any certificate, opinion, direction or other document or paper delivered to the Trustee should be revised to condition such exculpation on the absence of manifest error or inaccuracy. A Trustee should not be entitled to ignore obvious defects in materials presented to it by the Issuer to demonstrate compliance with Indenture requirements.

The Form Indenture extends to the Trustee’s counsel the benefits of the immunities and protections and indemnification it provides to the Trustee. This leaves the bondholders without any recourse in a situation where the Trustee relies on a defective opinion. If the Trustee is exculpated by virtue of relying on counsel’s opinion, the counsel must be responsible to the bondholders for any negligence in rendering such opinion.

The language in the Form Indenture permitting the Trustee to disregard directions that in its opinion would subject the Trustee to personal liability should be limited to situations in which the Trustee has not been adequately indemnified for such potential liability. The provisions dealing with the Trustee’s right to select counsel of its own choosing should be revised to read: “The Trustee shall have the right to select and retain Counsel of its own choosing to represent it in any such proceedings, provided that if the Trustee has been adequately indemnified for any liabilities that may be incurred by the Trustee arising from such remedial proceedings, the Trustee shall, if so directed by the owners of a majority in aggregate principal amount of the Bonds Outstanding, retain Counsel designated by such owners.”

### c. Conflicts of Interest.

Section 8.04 authorizes the Trustee bank to engage in commercial banking transactions with the Issuer. The Commentaries should indicate that these provisions are subject to negotiation on individual transactions; particularly on secured bond issues, the bondholders may object to a Trustee that retains the right to have a lending relationship with the Issuer that may create a conflict of interest.

### d. Duty to File Continuation Statements

The Trustee’s duties should expressly include the timely filing of UCC continuation statements by the Trustee. In the NFMA’s experience, Trustees frequently permit UCC financing statements to lapse, thereby converting bondholders from secured to unsecured creditors, even though Trustees, as the secured party and with their elaborate “tickler systems,” are, as a legal and practical matter, uniquely positioned to ensure that continuation statements are filed every five years or when otherwise required by applicable state law.



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## e. Trustee Removal and Appointment

Section 8.07 of the Form Indenture should provide that a majority of bondholders has the right at all times to remove the Trustee and to appoint a successor Trustee upon a removal, resignation or insolvency of the Trustee.

## 5. Defeasance Provisions

### a. Definition of Defeasance Obligations

The Commentaries suggest that the definition of defeasance obligations should be determined on a case-by-case basis after consultation by the drafter with the underwriter. The NFMA believes that this is not a provision in which creativity should be encouraged, and that the only acceptable defeasance obligations are direct obligations of the United States, or obligations guaranteed by the full faith and credit of the United States.

### b. Defeasance Conditions.

The defeasance language should clarify that extraordinary redemption rights cease upon a defeasance, to eliminate frequent uncertainty on this subject. The legal opinion requirements should include, in the case of taxable bonds, an opinion that the defeasance will not cause the bondholders to realize gain or loss under Section 1001 of the Internal Revenue Code. Provisions should be added requiring the Issuer to obtain a AAA rating of the defeased bonds from a nationally recognized rating agency if they will not be redeemed within six months of the defeasance date.

### c. Survival of Certain Provisions

Language should be added specifying that tax covenants, indemnification covenants and other provisions that by their terms cannot be satisfied upon defeasance survive defeasance.

## 6. Securities Depository Provisions

Use of DTC is important to bondholders from a liquidity perspective, but has well-known drawbacks in terms of delayed receipt of notices and delayed response by beneficial owners when bondholder decision-making is required. The NFMA suggests that Section 2.12 of the Form Indenture be revised to require the Issuer to terminate the book-entry-only registration of the bonds after an Event of Default upon a determination by the holders of a majority in principal amount of any series of bonds that continuation of the book-entry system is not in the best interest of the bondholders. The NFMA supports provisions such as those set forth in the second paragraph of Section 8.10 of the Form Indenture, requiring the Trustee to maintain a register of beneficial owners of the bonds that provide satisfactory evidence of their status as beneficial owners and requiring the Trustee to send to such identified beneficial owners copies of notices sent by the Trustee to DTC; however, the provision should be expanded to authorize the Trustee



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to accept the direction of such beneficial owners on matters requiring bondholder consent or other bondholder action. (Section 2.12 of the Form Indenture as drafted permits the Trustee to recognize votes by beneficial owners pursuant to DTC's omnibus proxy procedures, but that process may also entail substantial delays that can be avoided through the suggested change to Section 8.10.)

### 7. Bondholder Consents

The NFMA strongly objects to provisions that permit bonds to be sold to bondholders based on specified covenants and other terms and conditions and then amended without the bondholders' consent in a manner that weakens the structure on which bondholders relied when purchasing the bonds. For example, indentures sometimes include provisions permitting amendments based on a rating agency's determination that the amendment will not adversely impact the rating on the bonds; in other instances, consents of non-bondholders are used, in contravention of the requirements of the indenture, as though they were bondholder consents. The Form Indenture encourages this trend through express provisions that encourage so-called "swamping" of the votes of existing bondholders with the votes of underwriters or "implied" votes of purchasers of parity bonds. The NFMA urges that these provisions be revised to ensure that the structure on which bondholders rely is not weakened without their consent.

#### a. Supplemental Indentures and Supplemental Loan Agreements Without Bondholders' Consent

The Form Indenture should require that bondholders be notified of all supplemental indentures and supplemental loan agreements, even if their consent is not required.

All provisions for amendment without bondholder consent should be subject to a requirement that such amendment not be adverse to the interests of the bondholders. The phrase "materially adverse" should not be used.

Provisions permitting supplements without bondholder consent in connection with the issuance of Additional Bonds should state that "such supplement shall be limited to the specific terms of the Additional Bonds and shall not otherwise amend the Indenture."

#### b. "Swamping" Consent Provisions

The last paragraph of Section 10.03 of the Form Indenture permits the adoption of supplements based on the consent of underwriters or purchasers of Additional Bonds obtained on the date of delivery of Additional Bonds. The use of such "swamping" techniques should not be encouraged in a Form Indenture. The NFMA does not believe that the consent of an underwriter that does not own the bonds after they are issued is a valid bondholder consent for amendment purposes, nor does it believe that "deemed consents" written into official statements for Additional Bonds constitute valid bondholder consents for amendment purposes. The NFMA



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believes that only bondholders who have owned the bonds while the provisions that are being amended were in effect can consent to the amendment of such provisions.

## **OTHER PROVISIONS**

The Form Indenture principally addresses what should be boilerplate provisions in indentures, leaving most of the more substantive provisions to the discretion of individual drafters in the context of particular transactions. While the NFMA understands the need to preserve the flexibility to custom-tailor financing documents to fit the particulars of a transaction, we believe that there are other provisions which should become standardized across the industry and thus included in any Form Indenture. For example, the NFMA suggests a standardized approach to reporting requirements, including quarterly financial and operating reports to the Trustee and bondholders, as well as material events affecting a particular Issuer. We also suggest that it would be helpful to the municipal marketplace to standardize the granting language for collateral such as gross receipts (including accounts receivables, contract rights and cash) and mortgages on real and personal property.

## **CONCLUSION**

Given the variety of types of bond issues, a Form Indenture is an ambitious undertaking. No one instrument is likely to address all of the provisions important to holders of general obligation bonds, revenue bonds, conduit bonds, rated bonds, unrated bonds, insured bonds, secured bonds, letter of credit backed bonds, variable rate bonds, obligated group bonds and lock box bonds, not to mention variations based on the particular sector in which the Issuer operates. However, to the extent that incremental consensus can be reached among the members of the bond issuing and bond purchasing community as to the contours of at least some provisions used in indentures and related financing instruments, the efficiency and reliability of the bond issuance process will be enhanced.

As this paper demonstrates, even purported boilerplate provisions raise issues of importance to bondholders and should recognize the interests of bondholders in their formulation and drafting. The NFMA encourages NABL to continue a dialogue with the NFMA and other representatives of the bondholder community to ensure that the Form Indenture and future attempts to standardize provisions not dealt with by the Form Indenture address the interests of the parties who are most reliant on the soundness of the bond documents.

Dated December, 1999

