



KEN PAXTON
ATTORNEY GENERAL OF TEXAS

December 1, 2017

To All Bond Counsel:

RE: Applicability and Scope of House Bill 89 and Senate Bills 252 and 253
and Administrative Matters for December Closings

The Public Finance Division (“PFD”) reviewed and considered bond counsel input regarding the applicability and scope of House Bill 89¹ and Senate Bills 252² and 253³ in our review of public securities. The purpose of this letter is to summarize the requirements of the legislation, identify the categories of public security contracts covered, and establish the procedures to evidence compliance. We will also address related bond counsel questions and administrative matters for December bond closings.

1. Two-Step Process for Entering into Covered Contracts

The legislation prohibits governmental entities from entering into certain contracts with companies⁴ unless two conditions are met. First, Senate Bill 252 prohibits a governmental entity from entering into a contract with a company listed by the Texas Comptroller of Public Accounts (the “Comptroller”) under Senate Bills 252 and 253.⁵ These bills collectively require the Comptroller to prepare a list of the following:

- (1) Companies known to have contracts with or provide supplies or services to a foreign terrorist organization;⁶

¹ Act of April 27, 2017, 85th Leg., R.S., ch. 1, 2017 Tex. Gen. Laws 1 (to be codified at Tex. Gov’t Code, chapters 808 and 2270).

² Act of May 15, 2017, 85th Leg., R.S., ch. 192, 2017 Tex. Gen. Laws 366 (to be codified at Tex. Gov’t Code, chapter 2252, subchapter F).

³ Act of May 9, 2017, 85th Leg., R.S., ch. 96, 2017 Tex. Gen. Laws 206 (to be codified at Tex. Gov’t Code chapter 2270, and as amendments to Tex. Gov’t Code §§ 404.024(b), 2256.017, and 2256.024(a)). For ease of use, we will refer to all three enacted bills collectively as the “legislation”, and for a particular provision, will cite to the section in the Government Code that is amended or added by the legislation.

⁴ Both HB 89 and SB 252 generally limit the definition of “Company” to for-profit business entities. Tex. Gov’t Code §§ 2270.001(2), 808.001(2), 2252.151(1), 2270.0001(2); Senate Bill 252 further limits the definition of company to be one whose securities are publicly traded. §§ 2252.151(1), 2270.0001(2).

⁵ Tex. Gov’t Code § 2252.152.

⁶ Tex. Gov’t Code § 2252.153.

-
- (2) Companies that engage in scrutinized business operations in Sudan;⁷
 - (3) Companies that engage in scrutinized business operations in Iran;⁸ and
 - (4) Companies that engage in scrutinized business operations with foreign terrorist organizations.⁹

Secondly, House Bill 89 prohibits governmental entities from entering into a contract with a company unless the contract contains written verification that the company does not and will not boycott Israel during the term of the agreement.¹⁰

As a whole, the legislation imposes a two-step process before any governmental entity, including an issuer, may enter into a contract. Under the first step, the issuer must determine that the counterparty is not a company identified on the list prepared by the Comptroller in one of the four categories described above. If the company is not on the Comptroller list, then the issuer may proceed to the second step by ensuring that the contract contains written verification that the company does not and will not boycott Israel during the term of the contract. Each step is a necessary condition before the issuer may enter into the contract.

2. Covered Contracts: Public Security Contracts Involving Services

We now consider what types of public security contracts are covered by the legislation. Although both House Bill 89 and Senate Bill 252 apply to more than one type of contract, the focus of this letter is limited to contracts for services because PFD views services as the only type of contract applicable in the public security context.¹¹ We will therefore require evidence of compliance with the two-step process described above for all contracts contained in the public security transcript that involve services as a component. This includes credit agreements, escrow agreements, paying agent agreements, private placement agent agreements, remarketing agreements, trust indentures, insurance policies purchased by the issuer, and similar agreements that provide a service. As underwriting includes a service component, this also extends to

⁷ Tex. Gov't Code §§ 2252.152, 2270.0201, 2270.0001(9)(A), 2270.0052 (note that SB 253 transferred provisions in chapter 806 of the Government Code to chapter 2270; therefore, the reference to § 806.051 in § 2252.152 is now § 2270.0201).

⁸ Tex. Gov't Code §§ 2252.152, 2270.0201, 2270.0001(9)(B), 2270.0102 (note that sections 5 and 6 of SB 253 repealed chapter 807 and transferred powers, duties and functions of the State Pension Review Board imposed by chapter 807 to the Comptroller; therefore, the reference to section 807.051 in section 2252.152 is now to section 2270.0201).

⁹ Tex. Gov't Code §§ 2252.152, 2270.0201, 2270.0001(9)(C), 2270.0152 (see note 7 regarding transfer of 806.051 to 2270.0201).

¹⁰ Tex. Gov't Code § 2270.002.

¹¹ House Bill 89 applies to contracts for goods or services (§ 2270.002), and Senate Bill 252 applies to a contract "awarded by a governmental entity for general construction, an improvement, a service, or a public works project or for a purchase of supplies, materials, or equipment" (§ 2252.151(3)). Although "goods" is not defined in § 2270.002, when read in the context of § 2252.151(3), which only describes tangible goods (supplies, materials, equipment), we view the reference to goods as limited to tangible items. As a public security is not tangible property, we do not view a contract to purchase public securities to be a contract for goods.

bond purchase contracts, whether the underwritten bonds are negotiated or competitively bid.

Various public financing statutes recognize that public security related contracts may involve services as a component. For example, the Legislature characterizes a credit agreement¹² as an agreement for professional services.¹³ The Public Security Procedures Act provides issuers the exclusive authority to select, contract with, and determine the basis for compensation of a person to provide “legal and *other services*” in connection with a public security issuance.¹⁴ With respect to underwriting, reoffering premium is recognized as a form of compensation for underwriting for which the issuer does not have to deduct voted authorization.¹⁵ Moreover, a statute governing state securities expressly provides that “[t]his chapter does not affect the right of an issuer of state securities to select its own *bond counsel, underwriter, financial advisor, or other service provider* in connection with the issuance of state securities.”¹⁶ The use of “other service provider” indicates that the Legislature views “bond counsel, underwriter, and financial advisor” as specific categories of service providers.

3. Requirements Evidencing Compliance

For purposes of complying with House Bill 89, the written verification that the company does not and will not boycott Israel during the term of the contract must be contained in the contract itself. In competitively bid financings, the offer of sale and the accepted bid comprise the binding contract and the written verification should be required in the notice of sale and included in the submitted bid. For insurance purchased by the issuer, the verification should be included in the insurance policy or, if there is no policy, in the insurance commitment. For negotiated or competitive bond sales, the verification in the bond purchase agreement or accepted bid may clarify that the term of contract is for the underwriting period.

To satisfy the requirements of Senate Bill 252, the issuer should certify in the general certificate that it has not entered into and will not enter into a contract with a counterparty that is a company identified on a list prepared and published by the Comptroller pursuant to sections 2270.0201 and 2252.153 of the Government Code. The use of the phrase “has not entered into and will not enter into” recognizes that the issuer enters into some contracts prior to closing and enters into others at closing. For example, an issuer enters into a binding bond purchase contract with the underwriter at pricing; however, the issuer

¹² As credit agreements are broadly defined in § 1371.001(1), please note that all contracts comprising the record of proceedings under chapter 1371 will need to comply with HB 89 and SB 252 to the extent the issuer is a “governmental entity” and the counterparty is a “company” as specifically defined in each statute.

¹³ Tex. Gov’t Code § 1371.056(e).

¹⁴ Tex. Gov’t Code § 1201.027(a) (emphasis added).

¹⁵ Tex. Gov’t Code § 1201.029.

¹⁶ Tex. Gov’t Code § 1231.002.

enters into the credit agreement upon our approval of the bonds.¹⁷ In lieu of certification, the issuer may include in the contract itself verification that the counterparty is not a listed company.

We recognize that bond counsel may have differing views as to which contracts are covered by the legislation. Issuers may certify that the conditions precedent to entering into the contract have been met without conceding that the contract is covered by the legislation. Additionally, please note the certification or verification may also be made subject to federal law, as applicable.

4. Related Questions Regarding the Legislation

Below we address some additional questions asked by bond counsel about the requirements of the legislation under specific scenarios unique to public finance. To better address these questions, the investment requirements of the legislation should be briefly summarized.

A. Investment Requirements

The legislation not only imposes conditions precedent to entering into certain contracts, it also imposes investment duties on entities governed by the Public Funds Investment Act.¹⁸ Senate Bill 253 amends the Public Funds Investment Act to require investing entities to liquidate certain investments that were authorized at the time of purchase but are now triggered by the requirements of chapter 2270.¹⁹ Under the chapter, the Comptroller must prepare the list of companies engaging in certain scrutinized business operations.

After preparing the initial list, the Comptroller will provide the list to the investing entities. Within thirty days after receiving the list, the investing entity must notify the Comptroller of listed companies in which the entity owns holdings.²⁰ Of those listed companies identified to the Comptroller, the investing entity must send a written notice to those engaged in scrutinized active business operations, warning the company of its listed status and that it may become subject to divestment.²¹ The notified listed company then has 90 days to clarify its activities, as applicable, and to either cease all its scrutinized business operations or convert to inactive business operations in order to avoid divestment.²² Unless a certain exception applies, if the listed company continues to

¹⁷ See Tex. Gov't Code § 1371.057(b), providing that after "approval, the obligation or credit agreement may be executed and delivered . . . from time to time in accordance with the authorizing proceedings."

¹⁸ Section 4 of SB 253 defines "investing entity" in § 2270.0001(7)(A) to include "an entity subject to Chapter 2256."

¹⁹ See section 2 of SB 253, amending § 2256.017 to provide "Except as provided by Chapter 2270, an entity is not required to liquidate investments that were authorized investments at the time of purchase."

²⁰ Tex. Gov't Code § 2270.0202.

²¹ Tex. Gov't Code § 2270.0204.

²² See *Id.*

engage in scrutinized active business operations, the investing entity must follow a specified divestment procedure and schedule.²³

Although simplified, the above summary shows that the Legislature has provided a clear divestment²⁴ procedure for an investing entity that holds an investment qualified at the time of purchase but now disqualified because the holdings are in a listed company. Having considered the context of investment duties imposed by the legislation, we now address additional questions asked by bond counsel under specific scenarios unique to public finance.

B. What happens if a company was not listed when the issuer enters into the contract but the company becomes listed before closing?

Bond counsel have expressed concern about the scenario in which the issuer enters into a bond purchase agreement with an unlisted company at pricing but the company becomes listed before closing. After considering bond counsel analysis and viewing the language of Senate Bill 252 in the context of the entire legislation, we believe that Senate Bill 252 only imposes a duty on the issuer to confirm that the company is not listed at the time the issuer enters into the contract. Unlike Senate Bill 253, which provides a clear divestment procedure when formerly qualified investments become disqualified, we note Senate Bill 252 provides no remedy for such a situation. This is also in contrast to House Bill 89, which requires the company to verify in the contract that it will not boycott Israel during the term of the contract. Once the company becomes listed, however, the issuer is barred from entering into any future contracts with the listed company, unless and until the company ceases to be on the list.

C. When Must Issuers Submit an Investment Report to the Attorney General?

Senate Bill 253 also requires investing entities to file a publicly available report with the presiding officer of each house of the legislature and the attorney general for certain investment actions. Bond firms for municipal utility districts have asked for clarification about what investment actions trigger an annual report to be filed with this Office.

Section 2270.0252 provides that not later than December 31 of each year, each investing entity shall file a report that: (A) identifies all investments sold, redeemed, divested, or withdrawn in compliance with section 2270.0206; (B) identifies all prohibited investments under section 2270.0209; and (C) summarizes any changes made under section 2270.0207.²⁵ Construed in isolation, the initial clause of section 2270.0252

²³ See *Id.* and § 2270.0206. Please note the divestment procedure only applies when an investing entity directly holds the investment in the listed company. See § 2270.0207, regarding investments exempted from divestment.

²⁴ See note 23 regarding divestment procedure.

²⁵ Section 2270.0252(2) also requires a report to be filed with the United States presidential special envoy to Sudan when a report is required under subsection (1) and the report identifies investments in Sudan. We merely address when the initial report is required to be filed to this Office under subsection (1).

would appear to require an investing entity to file a report annually. However, when considered in the context of subparagraphs (A) through (C), we believe the proper construction is that an investing entity only files a report at the end of a year for which an investing entity takes action under one of the sections specified in subparagraphs (A) through (C).

D. Do governmental entities include non-profit corporations acting on behalf of public issuers?

No. House Bill 89 defines a governmental entity to mean a state agency or political subdivision of this state.²⁶ Senate Bill 252 defines a governmental entity to include the state, a municipality, county, public school district, or special-purpose district or authority, and state agencies.²⁷ Neither definition includes a non-profit corporation created by a governmental entity. Nor do we believe that a non-profit corporation falls within the definition of a company under either statute because both definitions are based on the entity existing to make a profit.²⁸ Please note, however, that to the extent that there are covered contracts of the sponsor governmental entity in the record of proceedings for the non-profit corporation's bond issuance, the sponsor will need to provide the necessary certification and contract verification.

5. Administrative Procedures for December Closings

Due to certain external forces, there will be a heavy volume of bond financings for review and approval prior to the end of the year. Based on those who responded to our inquiry about upcoming filings, we anticipate at least 210 bond closings in December. To ensure that we can efficiently review and issue opinions for your bond financings, please note the following:

- A. When scheduling bond closing dates, please be aware of the attached holiday schedule for both the Office of the Attorney General and the Comptroller of Public Accounts.
- B. Please provide all required documentation (including initial bonds for proofing) with your initial submission and as soon as possible.
 - i. For bonds being priced after submission, please provide red-line documents reflecting changes to the initial bond and form of bond from original submission.
 - ii. Please ensure the form of bond provides all the information needed for the legal secretary to proof the bond. There will not be time for support staff to

²⁶ Tex. Gov't Code §§ 2270.001(3), 2251.001(3).

²⁷ Tex. Gov't Code §§ 2252.151(4), 2252.001(2); note that subsections (C) – (F) of § 2252.001(2) specify a district, county, or justice of the peace court, an agency of the executive branch, including an agency of higher education as defined by Section 61.003, Education Code, the legislature, a legislative agency, and a judicial agency having statewide jurisdiction.

²⁸ See Tex. Gov't Code §§ 2252.151(1), 2270.0001(2), 2270.001(2), 808.001(2).

look through other documents in the transcript to find where additional paragraphs are to be inserted into the initial bonds.

- C. Absent unforeseen circumstances, when final outstanding requirements are submitted after 12:00 p.m., approving opinions will not be issued until the following day. This ensures that we will have sufficient time to review the final requirements and get the opinions ready for the runner to take to the Comptroller for registration. This also ensures that the Comptroller's Office will have sufficient time to process and register the initial bonds and, as applicable, the proceedings.
- D. We will endeavor to issue opinions once the transcript is complete to avoid too many opinions having to be issued in one day. However, we cannot guarantee that opinions will go out early just because the transcript is complete.
- E. Our first responsibility is to review and approve pending transcripts. Therefore, for the month of December, we will not field general questions unrelated to transcripts currently under review. For legal questions regarding a pending transcript, please call the attorney who has been assigned that transcript.
- F. For refunding bonds, please email the reviewing attorney the final verification report once received. This will allow the reviewing attorney the opportunity to review the final report prior to receiving the hard copy for inclusion in the transcript.
- G. In your cover letter submitting the transcript:
 - i. Please provide the email address for those you wish to be copied on the preliminary approval letter.
 - ii. Please indicate whether the issuer is seeking special language to be included in the opinion, such as the approval of proceedings under chapter 1371, or approval of a contract under a specific statute.
 - iii. Please indicate whether the transcript documents are based on a prior approved financing; if so, please provide the title of the prior issuance for reference.
- H. We welcome any suggestions you may have to facilitate an efficient review of your bond financings. Thank you in advance for your cooperation regarding these matters.

Sincerely,



Leslie Brock
Assistant Attorney General
Chief, Public Finance Division

December 2017 Holiday Closures

Office of the Attorney General

- Monday, December 25th – agency closed
- Tuesday, December 26th – agency closed
- Wednesday, December 27th – agency closed

Comptroller's Office

- Monday, December 25th – agency closed
- Tuesday, December 26th – agency closed