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Risk Management Tools for the Design Professional

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Design Professionals and the Dodd-Frank Act

(You aren't a Registered Municipal Advisor)

By Tom Waggoner and Drew Seaman

On September 18, 2013, the Securities and Exchange Commission adopted the final rule under the Dodd-Frank Act regarding the registration of municipal advisors. The new rules were published in the Federal Register and became effective on November 20, 2013. This article will provide a general discussion of how the Dodd-Frank Act and the final rules may impact engineers and other design professionals providing services to non-federal governmental clients. You should seek legal advice for your specific situation as this article only provides general information and is not intended to provide legal advice or interpretation of the Act for particular situations.

"Engineers providing engineering services" are specifically excluded from the statutory definition of "municipal advisor" set forth in the Dodd-Frank Act.¹ As such, engineers do not need to be registered as municipal advisors provided that they are not giving advice or making recommendations regarding municipal financial products or the issuance of municipal securities. Unfortunately the Act provides no clear line of demarcation of when an engineer's advice or recommendation falls outside of the "engineering services" exclusion. The final rule does provide some guidance as to the scope of the engineering services exclusion. Unfortunately, the exact location of the line separating permitted engineering advice from advice requiring the engineer to be a registered advisor remains blurred.² We suspect it will take several years before enough real world situations are evaluated by the SEC to provide effective guidance of how the SEC will interpret the statutory engineering exclusion. Unfortunately, this clarity will likely develop through the court system as suits are filed alleging that engineers crossed the line into giving prohibited advice on projects where the revenue streams or operating costs do not match the projections. Consequently, until the line is clarified, we recommend a cautious and conservative approach.

However, the SEC provides a number of examples to assist in clarifying the intent of this exclusion. Permitted activities that may fall within the scope of the exclusion for "engineering advice":

All Footnotes are located at the end of the newsletter.



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ProNetwork News

Risk Management Tools for the Design Professional

- (1) feasibility studies, cash flow analyses and similar activities “provided that the engineering exclusion does not cover activities in which an engineer provides advice to a municipal entity or obligated person regarding municipal financial products or the issuance of municipal securities.”
 - a. Example: An engineer who provides funding schedules and cash flow models that anticipate the need for funding at certain junctures in a project that are based on considerations involving engineering aspects of a project (e.g. projections on output capacity, utility project rates, project market demand, or project revenues, that are based on considerations involving engineering aspects of a project);
 - b. Example: An engineer who provides feasibility studies based on analysis of engineering aspects of the project such as a feasibility study that includes a discussion of how much power might be generated by the installation of solar panels, or about how to increase power output based on factors such as the placement of the panels or the number of panels;
 - c. Example: An engineer who provides estimates of water delivery capacity or a road’s traffic capacity;
 - d. Example: An engineer who reports on the physical condition of infrastructure, such as roads, bridges or water and sewer systems;
 - e. Example: An engineer’s use of assumptions provided by a municipal entity regarding interest rates or debt levels in preparing an engineering feasibility study or cash flow analysis alone may not result in giving municipal advice.
 - f. Example: An engineer can typically advise a municipal entity about whether a project could be safely or reliably completed with the available funds, and provide engineering advice about other alternative projects, cost estimates, or funding schedules;
 - g. Example: An engineer who informs a municipal entity of potential tax savings, discounts, or rebates on supplies may be acting within the scope of the exclusion; and
 - h. Example: giving out, non-particularized, general information (That is: information of a factual nature without subjective assumptions, opinions or views; information that is not particularized to a specific municipal entity or type of municipal entity; information that is widely disseminated for use by the public, clients, or market participants other than municipal entities or obligated persons; or general information in the nature of educational materials).

ProNetwork News

Risk Management Tools for the Design Professional

Activities that do not fall within the engineering advice exclusion:

- (1) Advice or recommendations regarding municipal financial products or the issuance of municipal securities, including advice with respect to the structure, timing, terms or other similar matters concerning such products or issuances (e.g. preparing revenue projects to support issuance of municipal securities, debt service coverage calculations);
- (2) Provision of particularized information and educational materials relating to municipal financial products or the issuance of municipal securities (i.e. information that includes past or projected performance figures, recommendations to utilize particular strategies, recommendations to purchase or sell any product, etc.); and
- (3) Preparation of feasibility studies concerning municipal financial products or the issuance of municipal securities.

This list of prohibited activities is not exhaustive. Broadly speaking, any advice that involves (1) a recommendation to a municipal entity or obligated person, (2) which is particularized to the specific needs of the municipal entity or obligated person, and (3) relates to municipal financial products or the issuance of municipal securities, is prohibited unless given by a registered municipal advisor.

It should be noted that architect is not referenced in the Act or the Rules. This will probably be construed to indicate that architects do not have the exemption afforded to engineers. In light of this it is recommended that on any non-federal governmental project that architects include a disclaimer similar to the one set out below and a contract provision clearly excluding any services required to be provided by a registered municipal advisor. Also, we would recommend that an internal review committee be established within the firm to review proposals and reports to make certain that recommendations concerning municipal financial products or the issuance of municipal securities are not included in any documents presented to the owner.

When in doubt as to whether the engineering service falls within the exception, you may attempt to utilize the limited safe harbor exemption set forth in the final rule. Specifically, advice given to non-federal governmental entities or obligated persons *in the presence* of an independent registered municipal advisor *who represents* the municipal entity or obligated person does not trigger the requirement to register as a municipal advisor.³

From a risk management perspective, it is recommended that a condition to any proposal for services or response to an RFP include a statement that the design professional will not be providing services or recommendation related to municipal financial products or the issuance of municipal securities and that client will retain a registered municipal advisor for the project who will be responsible for all services related to municipal financial products or the issuance of municipal securities.

ProNetwork News

Risk Management Tools for the Design Professional

An issue may arise if a State offers a particular type of grant for certain types of projects. If the engineer proposes to a municipality that it apply for the grant and does engineering projections to support the project this may fall outside the exemption as it recommends use of a particular financial product and potential financing of the project.

Since there is not clear line of what is and what is not exempted advice you should consider placing a disclaimer in your proposal and communications. The final rule does not indicate that such a disclaimer would be effective. But if a legal dispute arises between you and a client or obligated person concerning whether prohibited advice was given the disclaimer may work to your benefit. Also, if the contract between the owner and you specifically provides that you are not providing services required to be provided by a registered municipal advisor, this should hopefully reduce any exposure you might have. The exact verbiage of the disclaimer and contract provision may vary from State to State and project to project. However, something along the following lines may be effective:

Disclaimer:

NOTICE: Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, and the rules promulgated thereunder by the Securities and Exchange Commission, the content of this communication is not intended to be advice or recommendations regarding municipal financial products or the issuance of municipal securities. You should consult an independent municipal advisor registered with the Securities and Exchange Commission for any such advice or recommendations. Any information provided by engineer is solely provided for the purpose of providing engineering advice and is not to be considered advice concerning municipal financial products or the issuance of municipal securities.

Contract Provision:

It is agreed between the Owner and Engineer/Architect that Engineer/Architect is not providing services pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, and the rules promulgated thereunder by the Securities and Exchange Commission, that are intended to be or considered to be advice or recommendations regarding municipal financial products or the issuance of municipal securities. Owner is responsible for contracting separately with a registered municipal advisor to provide all services required by the Dodd-Frank Wall Street Reform and Consumer Protection Act and applicable SEC rules.

It appears that the best way to ensure that the line is not crossed is to adopt an internal company policy that attempts to follow the guidance set forth in the SEC final rule. Broadly speaking the final rule excludes from the definition of municipal advisors, engineers "to the extent that the engineer is providing engineering advice." Unfortunately, given the manner in which the SEC rule is drafted development of such a policy would require that virtually every communication which discusses funding options, interest rates or return on investment be qualified by indicating that the client needs to retain the services of a registered municipal advisor.



ProNetwork News

Risk Management Tools for the Design Professional

It is anticipated that the issue of the nature and extent of the advice provided by the design professional will probably not arise unless the project fails to meet the economic and financial projections and/or the governmental client is unable to meet its financial obligations. In those instances, the safest position of the design professional is to make certain that the client retained a registered municipal advisor at the time the project was developed. The inclusion of a disclaimer in the proposal, contract and any project cost or financing projections will certainly assist in defending such a claim. However, it is possible, if not probable, that a claim will be asserted against the design professional asserting that the information provided by the design professional concerning the cost, financing, financial return, and cost of borrowing for the project required that he be a registered municipal advisor. In that regard, remember, that "obligated person" means the party to whom the money is owed and they don't care where the money comes from, only that they get their money.

¹ Exchange Act Section 15B(e)(8) provides that the term "municipal entity" means "any State, political subdivision of a State, or municipal corporate instrumentality of a State, including - (A) any agency, authority, or instrumentality of the State, political subdivision, or municipal corporate instrumentality; (B) any plan, program, or pool of assets sponsored or established by the State, political subdivision, or municipal corporate instrumentality or any agency, authority, or instrumentality thereof; and (C) any other issuer of municipal securities." (This definition includes, but is not limited to, public pension funds, local government investment pools, and other state and local governmental entities or funds, as well as participant-directed investment programs or plans).

Exchange Act Section 15(B)(e)(10) provides that the term "obligated person" means "any person, including an issuer of municipal securities, who is either generally or through an enterprise, fund, or account of such person, committed by contract or other arrangement to support the payment of all or part of the obligations on municipal securities to be sold in an offering of municipal securities." (This definition includes, but is not limited to, entities acting as conduit borrowers such as private universities, non-profit hospitals and private corporations)

² The SEC acknowledges, "that the term 'advice' is [not] susceptible to a bright-line definition. Instead the Commission believes that 'advice' can be construed broadly and that, therefore, the determination of whether a person provides advice to or on behalf of a municipal entity or an obligated person regarding municipal financial products or the issuance of municipal securities depends on all the relevant facts and circumstances." (SEC Release No. 34-70-462 at pp. 43-44).

³ To take advantage of the exemption set forth in Rule 15Ba1-1(d)(3)(vi), several requirements must be met: (1) First, an independent registered municipal advisor must be providing advice with respect to the same aspects of the municipal financial product or issuance of municipal securities as the person seeking to rely on the exemption; For purposes of the exemption, the term "independent registered municipal advisor" means a municipal advisor registered pursuant to Section 15 B of the Exchange Act and the rules and regulations thereunder and that is not, and within at least the past two years was not, associated with the person seeking to rely on the exemption; Second, a person seeking to rely on the exemption must receive from the municipal entity or obligated person a representation in writing that it is represented by, and will rely on the advice of, an independent registered municipal advisor, and such person as a reasonable basis for relying on the representation; Third, the person seeking to rely on the exemption must *timely* provide certain required disclosures to the municipal entity or obligated person in writing, and provide a copy of the disclosures to the municipal entity's or obligated person's independent registered municipal advisor (See Rule 15Ba1-1(d)(3)(vi)(C) for the specific disclosures).

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ProNetwork News

Risk Management Tools for the Design Professional

BROKER'S NOTES



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