

TEXAS LEGISLATION EXPANDS INTEREST RATE SWAP AUTHORITY OF STATE AGENCIES AND LOCAL GOVERNMENTS

Bill Summary

On June 15, 2007, Governor Rick Perry signed Senate Bill 968, amending Chapter 1371, Texas Government Code, effective immediately. The amendments expand the authority of Texas state agencies and local governments to issue variable interest rate and other debt obligations (“*obligations*”) and to enter into interest rate swaps and similar transactions (“*swaps*”) in connection with or in anticipation of the obligations. The amendments also establish additional procedural safeguards to be followed by most issuers when entering into swaps.

Expanded Authority to Issue Obligations and Enter Into Swaps

- ✔ **New Issuers:** The amendments authorize any investment grade “issuer” with \$100 million of outstanding or proposed debt to issue obligations and enter into swaps under Chapter 1371, even if they are not specifically listed among previously qualified issuers. Eligible “issuers” include an agency, authority, board, department, body politic, municipal corporation, instrumentality, political subdivision, public corporation, or subdivision of the State of Texas or a non-profit corporation acting on its behalf.
- ✔ **Authorized Derivative Transactions:** The amendments clarify Chapter 1371 to clearly authorize issuers to enter into interest rate basis swaps, caps, collars, and floors in addition to fixed versus floating swaps and rate lock transactions. (Under prior law, only interest rate locks, swaps, and hedges were expressly authorized, which led the attorney general in some instances to limit an issuer’s authority to enter into other interest rate derivative products.)
- ✔ **Anticipatory Swaps:** The amendments clarify Chapter 1371 to authorize issuers to enter into swaps in anticipation of obligations expected to be issued in the future. (The attorney general had interpreted prior law to permit an issuer to enter into a swap only in relation to an obligation that was currently outstanding or in process of issuance.)
- ✔ **Tax-Supported Obligations and Swaps:** Issuers may now issue tax-supported obligations as variable rate obligations under Chapter 1371, even if not voted, and enter into swaps in connection with or in anticipation of the obligations, if the issuer is otherwise authorized to issue tax-supported debt obligations and complies with the conditions of that authority. (The attorney general had interpreted prior law to limit tax-supported obligations to voted bonds.) For example, an issuer may issue certificates of obligation (COs) as variable rate demand obligations and enter into a swap to hedge its variable rate risk, if the issuer complies with applicable notice and referendum requirements before the COs are issued or the swap is entered into.
- ✔ **Swaptions:** Issuers may now terminate a swap, or authorize a swap to become effective, at the option of the other party to the swap, if the issuer’s governing body finds the option to be in the best interests of the issuer. For example, in return for an upfront payment an issuer may grant a dealer the option to “activate” an interest rate swap by a specified future date to hedge possible future variable rate current refunding obligations, if the issuer concludes that its net debt service obligations will be no worse if the option is exercised and the refunding obligations are issued.
- ✔ **Permitted Uses of Swap Settlements:** An issuer now may use payments received under or on termination of swaps (a) to pay related obligations (as under prior law), (b) to pay costs for which the obligations were or are to be issued, (c) to pay other liabilities or expenses secured on a parity with or senior to the obligations, and (d) if proceeds exceed the amounts required for those purposes and the swap is not payable primarily from ad valorem taxes, to make payments for any other purpose. Consequently, if an issuer enters into a fixed-paying forward swap to hedge, at low current rates, the net interest costs at which variable rate current refunding obligations could be issued at a future call date for outstanding bonds, then the issuer may choose to terminate the swap on the call date and use any

settlement payment received under the swap to pay part of the redemption price for the outstanding bonds. The issuer then could issue a smaller principal amount of fixed rate obligations to accomplish the refunding. (As under current law, additional fixed rate obligations may be issued to fund any swap settlement owed by the issuer.)

- ✔ **Waiver of Sovereign Immunity:** Under the amendments, most issuers may now agree to waive their sovereign immunity from liability or suit to enforce an obligation or swap. Under prior law, swaps may have benefited from a limited waiver of immunity from suit (if entered into by municipalities, school districts, and special districts, but not counties), but at the expense of a statutory limit on damages. The amendments resolve prior law uncertainty by clearly authorizing most issuers to voluntarily waive immunity from suit and liability without limit, but negate possible non-consensual waivers. All issuers except state agencies and the five most populous counties have been granted such power, which is intended to enable less-seasoned issuers to enter into and negotiate swaps on more favorable terms. The bill also ratifies prior contractual waivers of immunity by issuers (e.g., municipalities and school districts) with statutory authority to “sue or be sued” or to “plead and be impleaded,” since that authority had been interpreted to waive sovereign immunity from suit before last summer’s reversal of prior precedent in *Tooke v. City of Mexia*.

Procedural Safeguards

- ✔ **Authorizing Procedures:** Unless an issuer was a “seasoned swap issuer” before November 1, 2006, the issuer may enter into swaps only if:
 - ✔ its governing body has adopted, amended, or ratified (within the past two years) a risk management policy for swaps that addresses risks specified in the bill;
 - ✔ its governing body has approved the terms of the swap or delegated to one or more officers or employees of the issuer the authority to do so within specified limits on type, notional amount, term, rates, source of payment, security, identity or credit rating of the counterparty, duration of the authorization, economic consequences, early termination provisions, and costs;
 - ✔ the counterparty has made certain representations regarding pricing (unless the swap is awarded through competitive bidding) and payments to procure the swap; and
 - ✔ the governing body or authorized officer or employer of an issuer has determined that the swap conforms to the issuer’s swap policy after reviewing a report from the CFO of the issuer that identifies certain information specified in the bill.

A “seasoned swap issuer” is one that entered into at least three swaps before November 1, 2006, or one or more swaps with notional amounts totaling at least \$400 million before that date.

- ✔ **Biennial Policy Review:** An issuer’s governing body must review its swap policy at least every other year while a swap is outstanding.
- ✔ **Annual Swap Review:** Unless an issuer was a “seasoned swap issuer” before November 1, 2006, a designated officer must monitor and report to the governing body, at least annually, on all outstanding swaps. The report must cover information specified in the bill and state whether continuation of the swap is consistent with issuer’s swap policy.

Changes in Attorney General Approval

If the attorney general approves the proceedings authorizing a swap (e.g., the authorizing resolution, order, or ordinance, the terms of any master agreement, schedule, and credit support annex, and the parameters within which a swap transaction may be approved), a binding confirmation to evidence all authorized swap transactions may be executed and will then be incontestable without further attorney general approval. (Prior law required attorney general approval of confirmations as a condition to enforceability.) This change eliminates the period during which a dealer’s commitment is unilateral and the dealer is unhedged. However, to obtain approval of proceedings, it is likely that issuers must continue to submit to the attorney general the fully negotiated text of swap documents (except for provisions for which authorized

parameters have been established) and evidence of the issuer's ability to pay (and to comply with law and outstanding bond contracts) under the worst trade permitted by authorized parameters.

UT Specific Changes

The bill also amends Chapter 65, Texas Education Code, to extend to The Board of Regents of The University of Texas System the power to enter into swaps without attorney general approval on terms comparable to those extended to the Veterans Land Board under prior law.



This article was prepared by Fulbright's Public Finance Practice Group, which was actively involved in drafting the text of the bill on behalf of an industry-wide group. If you have questions about this recent development, please contact Fredric "Rick" Weber (713 651 3628 or fweber@fulbright.com) or your Fulbright public finance representative.

Fulbright & Jaworski's Public Finance Practice Group

Fulbright & Jaworski's Public Finance Practice Group collaborates with clients to help them achieve their objectives in the municipal securities marketplace. Our municipal securities practice annually ranks as one of the most active in the nation. In 2006, Fulbright & Jaworski ranked 7th in the nation as bond counsel helping to raise capital in more than 300 municipal securities offerings.

Our attorneys have extensive experience as counsel to issuers of tax-exempt obligations and as counsel to their underwriters, credit enhancers, derivatives dealers, and liquidity providers.

Issuers of tax-exempt obligations look to the Public Finance attorneys at Fulbright & Jaworski as bond, disclosure, swap counsel, and general counsel for:

- | | |
|-------------------------------|--|
| ✔ States and territories | ✔ Higher education facilities |
| ✔ Municipalities | ✔ Student loans |
| ✔ Counties | ✔ Housing |
| ✔ Schools | ✔ Land development infrastructure |
| ✔ Special purpose districts | ✔ Environmental facilities |
| ✔ Correctional facilities | ✔ Economic and industrial development |
| ✔ Health care facilities | ✔ Special facilities: sports stadiums and convention centers |
| ✔ Public-private partnerships | ✔ Public power |



Notice: We are providing the *Fulbright Briefing* as a commentary on current legal issues, and it should not be considered legal advice, which depends on the facts of each situation. Receipt of the *Fulbright Briefing* does not establish an attorney-client relationship. The listed attorneys and/or other attorneys may provide services in connection with a particular matter.

E-Mail Delivery of Future Issues? Would you prefer to receive the *Fulbright Briefing* by e-mail? If so, please send us your e-mail address to clientrelations@fulbright.com and specify "*Fulbright Briefing*" in your message.

Address Change or to Unsubscribe? Please forward your request to Client Relations, Fulbright & Jaworski L.L.P., Fulbright Tower, 1301 McKinney, Suite 5100, Houston, TX 77010-3095 USA or contact Client Relations by telephone at +1 866 385 2744 or by e-mail to clientrelations@fulbright.com.



Houston
New York
Washington, D.C.
Austin
Dallas
Denver
Los Angeles
Minneapolis
San Antonio
St. Louis
Beijing
Dubai
Hong Kong
London
Munich
Riyadh

www.fulbright.com

FULBRIGHT & *Jaworski* L.L.P.

866-FULBRIGHT
[866-385-2744]