

WHAT ARE THE MAGIC WORDS?:  
DISCLAIMERS IN OFFICIAL STATEMENTS

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Official Statements often include disclaimers—attempts by issuers, underwriters, or other participants to minimize their exposure to lawsuits arising out of representations in the Official Statement by clarifying (or perhaps downplaying) their involvement in preparing the document. The Securities and Exchange Commission (SEC) has warned that general disclaimers of liability in Official Statements are ineffective and may be misleading.<sup>1</sup> Some participants in municipal securities offerings believe that carefully worded, non-general disclaimers may be appropriate in certain situations, and have sought additional guidance from the SEC on the issue.<sup>2</sup>

This essay explores why regulators have not developed cohesive guidance for the use of disclaimers in Official Statements by issuers and underwriters. Following an overview of disclosure obligations of participants in municipal bond offerings, the essay discusses issuer and underwriter disclaimers in turn. This brief analysis suggests that regulators' "failure" to develop cohesive guidance is a reflection of the futility of the undertaking. Finally, the inevitable reaction of issuers and underwriters to regulatory guidance leads to the conclusion that regulatory guidance on disclaimers would erode the quality of disclosure.

I. Disclosure Obligations of Issuers and Underwriters

Municipal securities and their issuers are exempt from the registration and reporting requirements of the federal securities laws.<sup>3</sup> Moreover, issuers are not obligated to provide any disclosure to the SEC or the Municipal Securities Rulemaking Board (MSRB).<sup>4</sup> Most municipal securities and participants, however, come within the SEC's regulatory scheme via Rule 15c2-12, which requires underwriters to obtain, review, and distribute to investors copies of the issuer's Official Statement.<sup>5</sup> The antifraud provisions of Section 17 of the Securities Act and Section 10(b) of the Exchange Act apply to Official Statements.<sup>6</sup>

While the Official Statement "is the issuer's document,"<sup>7</sup> Rule 15c2-12 requires underwriters to have a "reasonable basis for belief in the truthfulness and completeness of the key

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<sup>1</sup> ABA, DISCLOSURE ROLES OF COUNSEL IN STATE AND LOCAL GOVERNING SECURITIES OFFERINGS 211 (3d ed. 2009) [hereinafter DISCLOSURE ROLES OF COUNSEL].

<sup>2</sup> See *infra* Part II.

<sup>3</sup> Securities Act of 1933 § 3(a)(2), 15 U.S.C. 77c(a)(2); Exchange Act of 1934 § 3(a)(12), 15 U.S.C. 78c(a)(12).

<sup>4</sup> Exchange Act of 1934 § 15B(d)(2), 15 U.S.C. 78o(d)(2).

<sup>5</sup> 17 C.F.R. 240.15c2-12.

<sup>6</sup> Statement of the Commission Regarding Disclosure Obligations of Municipal Securities Issuers and Others, Rel. Nos. 33-7049, 34-33741, 59 Fed. Reg. 12748 (March 9, 1994); *In re Ames Dept. Stores, Inc. Stock Litig.*, 991 F.2d 953, 965-67 (2d Cir. 1993).

<sup>7</sup> Martha Mahan Haines, Attorney-Fellow, Office of Municipal Securities, SEC, Remarks before the Michigan Municipal Finance Officers Association (Sept. 19, 2000), available at [www.sec.gov/news/speech/spch400.htm](http://www.sec.gov/news/speech/spch400.htm).

representations made in any disclosure documents used in the offerings.”<sup>8</sup> Thus, both issuers and underwriters may be liable for material misstatements and omissions in the Official Statement.

## II. Disclaimers in Official Statements

The SEC has stated that general disclaimers of responsibility for the accuracy or completeness of information in the Official Statement are ineffective and can be misleading.<sup>9</sup> Nonetheless, Official Statements often contain disclaimers by issuers, underwriters, and others, “as to actions taken (or not taken) and information supplied (or not supplied).”<sup>10</sup>

For example, a disclaimer might state that the Official Statement does not constitute a contract between or among the issuer, underwriter, and any purchasers.<sup>11</sup> This type of disclaimer could preclude liability for unintentional, non-reckless misrepresentations that would otherwise be actionable under contract theories and could also weaken justifiable reliance on representations, which is an element of a private right of action under Rule 10b-5.<sup>12</sup>

While disclaimers of liability under contract law may be appropriate and effective, disclaimers of liability under the federal securities laws generally are not.<sup>13</sup> These disclaimers are examined first with respect to issuers, and then with respect to underwriters.

### A. Issuer Disclaimers

Municipal bond issuers have no formal framework to follow in preparing offering disclosure because municipal securities are not subject to registration requirements. Instead, issuers rely on their own judgment and a hodge-podge of “unofficial” guidance: best practices recommendations from industry groups, market practices, and direction from the SEC and the MSRB in the form of interpretive releases, enforcement proceedings, comments, and statements. Additionally, issuers may draw analogies from the specifically prescribed disclosure requirements applicable to registered securities. Issuers may rely on these same sources in determining whether and how to use disclaimers in their Official Statement.

#### 1. Third-Party Statements

Though many statements in an Official Statement come from third parties, such as bond insurers, conduit borrowers, and land developers, the issuer may be liable under the antifraud provisions

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<sup>8</sup> Amendment to Municipal Securities Disclosure, Exchange Act Rel. No. 34-62184, 2010 WL 2148628, at \*38 n.337 (May 26, 2010).

<sup>9</sup> DISCLOSURE ROLES OF COUNSEL, *supra* note 1 at 211.

<sup>10</sup> *Id.*

<sup>11</sup> *Id.* at 214 n.42.

<sup>12</sup> *Id.* at 212–13.

<sup>13</sup> Amendment to Municipal Securities Disclosure, *supra* note 8 at \*38 n.337.

of the securities laws for any material misstatements or omissions.<sup>14</sup> Issuers have no statutory duty to inquire into the accuracy or completeness of a third-party statement, unless the issuer has adopted the representation, implies that it has inquired into the accuracy or completeness of the representation, or knows that the representation is materially inaccurate or misleading.<sup>15</sup>

The National Association of Bond Lawyers (NABL) called third-party statements “most troubling to issuers” and advocated disclaimers to “identify those portions of an official statement that are under the direct control of the issuer (such as its financial statements), and those portions for which it must rely on third parties (such as population and other demographic information.)”<sup>16</sup> It suggested that a disclaimer of implied adoption or verification of third-party information could shield the issuer from liability for third-party representations, and sought guidance from the SEC:

We suggest that the Commission clarify that official statement disclaimers, in certain instances, could be used to appropriately limit the disclaiming party’s liability, provided that (1) the disclaimer is specific and appropriately tailored as to the information disclaimed, (2) the disclaiming party does not know, and is not reckless in not knowing, that the statements disclaimed are materially false or misleading, and (3) the disclaimer does not materially mislead investors as to the disclaiming party’s responsibilities under the federal securities laws.<sup>17</sup>

The SEC has not clarified its position, leaving open the question of whether disclaimers may protect issuers from liability for third-party information.

In the view of some, an issuer’s properly worded disclaimer stating that it does not adopt the third-party statement as its own would not be an improper attempt to waive a preexisting duty,<sup>18</sup> it would merely avoid the creation of a duty.<sup>19</sup> But a disclaimer of third-party information provides, at best, an uncertain benefit to issuers given the absence of regulatory approval. Moreover, such a disclaimer may harm the issuer, because it “may also estop the issuer from later asserting that it exercised the diligence required under the circumstances, if a court were to hold that it has some duty to check the information included in its Official Statement.”<sup>20</sup>

## 2. Forward Looking Statements

Issuers of registered securities who optimistically predict corporate performance may avoid fraud liability by incorporating “meaningful cautionary statements” that identify the risks which might

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<sup>14</sup> That is because all statements in the Official Statement are presumptively made by the issuer in connection with the purchase or sale of a security. DISCLOSURE ROLES OF COUNSEL, *supra* note 1 at 77.

<sup>15</sup> *Id.* at 213.

<sup>16</sup> Letter to Commissioner Elisse B. Walter from Kathleen C. McKinney, President of NABL (May 14, 2010) at 18, <http://www.nabl.org/uploads/cms/documents/NABLSuggestionsforInterpretiveGuidanceUpdate.pdf>.

<sup>17</sup> *Id.* at 4–5.

<sup>18</sup> Section 14 of the Securities Act and section 29(a) of the Exchange Act void attempts to waive compliance with the securities laws.

<sup>19</sup> DISCLOSURE ROLES OF COUNSEL, *supra* note 1 at 213–14.

<sup>20</sup> *Id.* at 214.

derail the projections.<sup>21</sup> The theory is that cautionary language that is substantive and tailored to the specific future projections render misrepresentations or omissions immaterial and/or unreasonable for an investor to rely upon.<sup>22</sup> The “meaningful cautionary statements” are, in effect, disclaimers.<sup>23</sup>

The statutory safe harbor for forward-looking statements is not available to municipal securities issuers.<sup>24</sup> However, municipal securities issuers may avail themselves of the common law “bespeaks caution” doctrine from which the statutory safe harbor is derived.<sup>25</sup>

Issuers should not presume that disclaimers accompanying forward-looking statements insulate them from liability for those statements. Vague or boilerplate disclaimers are not sufficient to invoke the doctrine.<sup>26</sup> Moreover, in some jurisdictions the doctrine will not immunize projections if the plaintiff sufficiently alleges that the issuer knew the projections were unreasonable.<sup>27</sup>

## B. Underwriter Disclaimers

Rule 15c2-12 obligates underwriters to obtain, review, and distribute to investors copies of disclosure documents. SEC interpretations emphasize the underwriter’s duty to have “a reasonable basis for belief in the truthfulness and completeness of the key representations made in any disclosure documents used in the offering” and to review these documents for omissions and misstatements.<sup>28</sup> Thus, underwriters have an affirmative duty to inquire into the accuracy and completeness of information in the Official Statement.

Though attempts to obtain a waiver of compliance with the securities laws are void,<sup>29</sup> the statutory duty of inquiry does not categorically preclude an underwriter from using a disclaimer that is not an attempt to disclaim its duty.<sup>30</sup>

In 1951, the SEC stated that general disclaimers of liability by underwriters violate the primary purpose of the securities laws.<sup>31</sup> In the decades since then, the SEC has offered little additional

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<sup>21</sup> Private Securities Litigation Reform Act of 1995, 15 U.S.C. 78u-5(c)(1)(A)(i) (2006); *SEC v. Meltzer*, 440 F. Supp. 2d 179, 191 (E.D.N.Y. 2006).

<sup>22</sup> Safe Harbor for Forward-Looking Statements, SEC Rel. No. 7101, 57 S.E.C. Docket 1999 (Oct. 13, 1994).

<sup>23</sup> R. George Wright, *Your Mileage May Vary: A General Theory of Legal Disclaimers*, 7 PIERCE L. REV. 85, 110.

<sup>24</sup> Securities Act of 1933 § 27A, 15 U.S.C. 77z-2; Exchange Act of 1934 § 21E, 15 U.S.C. 78u-5.

<sup>25</sup> DISCLOSURE ROLES OF COUNSEL, *supra* note 1 at 226.

<sup>26</sup> *In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357, 371 (3rd Cir. 1993).

<sup>27</sup> *See, e.g., Allstate Life Ins. Co. v. Robert W. Baird & Co.*, 756 F. Supp. 2d 1113, 1129 (D. Ariz. 2010).

<sup>28</sup> Proposed Amendment to Municipal Securities Disclosure, Exchange Act Rel. No. 34-60332, 96 S.E.C. Docket 1163 (July 17, 2009); Municipal Securities Disclosure, Exchange Act Rel. No. 34-26985, 54 Fed. Reg. 28799 (June 28, 1989); Municipal Securities Disclosure, Exchange Act Rel. No. 34-26100, 53 Fed. Reg. 37787 (Sept. 22, 1988).

<sup>29</sup> *See supra* note 18.

<sup>30</sup> In contrast, *any* attempt at disclaimer by an issuer of a registered security is void because section 11 of the Securities Act creates absolute liability for material misstatements and omissions in prospectuses. 15 U.S.C. 77k.

<sup>31</sup> Opinion of the General Counsel Relating to Use of “Hedge Clauses” by Brokers, Dealers, Investment Advisers, and Others, Exchange Act Rel. No. 34-4593, 1951 WL 1362 (Apr. 10, 1951).

guidance. Like issuers, underwriters must look to “unofficial” guidance including recommendations from industry groups and SEC enforcement proceedings.

### 1. Third-Party Information

While issuers may, in certain circumstances, disclaim liability for third-party statements, it appears that underwriters may not. The SEC stated that “disclaimers by underwriters of responsibility for the information provided by the issuer or other parties, without further clarification regarding the underwriter’s belief as to accuracy, and the basis therefor, are misleading and should not be used in official statements.”<sup>32</sup>

The Bond Market Association (BMA, predecessor to SIFMA) responded to the SEC’s statement by recommending that underwriters use a disclaimer referencing their due diligence responsibilities.<sup>33</sup> It proposed the following standard disclaimer:

The Underwriter has reviewed the information in this Official Statement in accordance with, and as a part of, its responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriter does not guarantee the accuracy or completeness of such information.<sup>34</sup>

After the BMA released its proposal, the SEC reaffirmed that attempts by underwriters to disclaim third-party information are inappropriate and ineffective.<sup>35</sup> In addition, Paul S. Maco, the director of the SEC’s Office of Municipal Securities, publicly condemned underwriter disclaimers.<sup>36</sup>

Underwriters should also take notice of *In the Matter of County of Nevada*. A financial advisor who “took on the underwriter’s duty to make full and accurate disclosure of material information to the investing public” was liable for material misstatements and omissions in the Official

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<sup>32</sup> Statement of the Commission, *supra* note 6. Some suggest that by including the qualifier “without further clarification,” the SEC implies that a properly worded disclaimer of responsibility for third-party information may be effective and appropriate. *See, e.g.* John M. McNally, Remarks at Municipal Market Roundtable (Oct. 14, 1999), <http://www.sec.gov/info/municipal/roundtables/panel1.htm>.

<sup>33</sup> Disclosure Roles of Counsel, *supra* note 1 at 211.

<sup>34</sup> Lynn Hume, *TBMA Issues Draft Underwriters’ Disclosure Disclaimer*, BOND BUYER, Oct. 7, 1999, at 29. The National Federation of Municipal Analysts (NFMA) responded with its own proposed disclaimer: “The underwriter has taken such steps as are required of it under the applicable securities laws with respect to the disclosure contained in the official statement but does not guarantee its accuracy or completeness.” Letter to Lynnette Hotchkiss, TBMA, from Mary Metastasio, Chariman, NFMA (Dec. 9, 1999), available at <http://www.nfma.org/assets/documents/tbma.pdf>.

<sup>35</sup> Amendment to Municipal Securities Disclosure, *supra* note 8 at \*38 n.337.

<sup>36</sup> Paul S. Maco, Director, Office of Municipal Securities, *Securities Laws and the Municipal Market: Points Every Market Participant Should Keep in Mind*, speech before the Florida Government Finance Officers Association (June 7, 1999), <http://www.sec.gov/news/speech/speecharchive/1999/spch281.txt>.

Statement.<sup>37</sup> Though drafting was a collaborative effort, the financial advisor's attempted disclaimer of information obtained from the County did not protect her.<sup>38</sup>

In light of the underwriters' statutory duty to have a reasonable basis for the key information in the Official Statement, prudent municipal bond participants should follow the "best practices" prescribed by the Government Finance Officers Association (GFOA):

[I]nclusion of an underwriter disclaimer creates more concerns about obligations under the securities laws than it resolves, and could consequently increase the risk of confusing investors. . . . [I]ssuers [should] not include underwriter disclaimer language in official statements. GFOA further recommends that in the preparation of official statements, issuers should undertake an affirmative review to ensure that any such disclaimer language has not been included.<sup>39</sup>

## 2. Disclaimers of Lack of Involvement in Competitive Bids

Some participants suggest that underwriters should use disclaimers to reflect the nature of their involvement (or rather, the lack thereof) in preparing the Official Statement. In a competitive transaction, the Official Statement is often complete before the underwriter becomes involved.<sup>40</sup> The SEC has said, "in both negotiated and competitively bid municipal offerings, the Commission expects, at a minimum, that underwriters will review the issuer's disclosure documents in a professional manner for possible inaccuracies and omissions."<sup>41</sup>

Participants in the 1999 Roundtable expressed discomfort that underwriters may be liable for statements in an Official Statement which they did not prepare and which they had limited opportunity. Mr. Smitherman said, "[W]e'll get an offering document, be expected to make a bid on it the next day. And in that case, you know, I can't see how we're supposed to be able to pass judgment on any part of that document."<sup>42</sup>

He posited that a disclaimer explaining the underwriter's lack of involvement would "bring uniformity and a bright line to the issue of the standard of care that's required of underwriters in the disclosure process."<sup>43</sup>

While the abbreviated timeline of a competitive bid is problematic for the underwriter, a disclaimer is not an effective tool for limiting the underwriter's liability; a disclaimer simply

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<sup>37</sup> County of Nevada, Release No. 153, 70 S.E.C. Docket 2535, 1999 WL 982426, at \*17 (ALJ Oct. 29, 1999) (initial decision).

<sup>38</sup> *Id.* at \*21-22.

<sup>39</sup> GOVERNMENT FINANCE OFFICERS ASSOCIATION, ADVISORY: UNDERWRITER DISCLAIMERS IN OFFICIAL STATEMENTS (Jan. 2000), <http://www.gfoa.org/sites/default/files/debt-underwriter-disclaimers.pdf>.

<sup>40</sup> William W. Cobbs, Chairman, Public Resources Advisory Group, Remarks at Municipal Market Roundtable (Oct. 14, 1999), <http://www.sec.gov/info/municipal/roundtables/panel1.htm>.

<sup>41</sup> Proposed Amendment to Municipal Securities Disclosure, *supra* note 28.

<sup>42</sup> Barry T. Smitherman, Remarks at Municipal Market Roundtable (Oct. 14, 1999), <http://www.sec.gov/info/municipal/roundtables/panel1.htm>.

<sup>43</sup> *Id.*

cannot alter an underwriter's statutory duty.<sup>44</sup> Moreover, such disclaimers may harm investors, because they may infer from a disclaimer that they have waived any right of action against the underwriter. Thus, the nature of competitive transactions does not justify attempts by underwriters to disclaim responsibility.

#### IV. Regulatory Guidance is Not the Answer

In its 2012 Report on the Municipal Securities Market, the SEC acknowledged the NABL's suggestion that the Commission recognize circumstances where disclaimers may be appropriate.<sup>45</sup> The Report restated the warning that disclaimers of liability are "contrary to the policies underpinning the federal securities laws," but offered no additional guidance. The MSRB has also abstained from offering guidance on the disclaimer issue.

The difficulty of the task may explain the reluctance on the part of regulators to give issuers and underwriters a framework for using disclaimers. Whether a particular disclaimer is appropriate and effective depends on the specific facts and circumstances of the deal. Drafting a standard disclaimer, or even a set of standard disclaimers, then, is impossible.

More importantly, uniform guidelines would not improve disclosure. Even if regulators released only general guidance with non-exclusive examples of effective disclaimer language, those examples would inevitably be viewed as a "safe harbors." In this way, the examples would devolve into boilerplate, without adding any meaningful insights for investors.

Participants preparing the Official Statements would naturally adopt the "example" language as standard disclosure, which would, at best, fail to reflect the degree to which investors should rely on the information, and at worst, imply that investors have waived their rights.

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<sup>44</sup> J. Ben Watkins III, Remarks at Municipal Market Roundtable (Oct. 14, 1999), <http://www.sec.gov/info/municipal/roundtables/panel1.htm> (noting that disclaimers are "completely ineffectively to change anyone's legal liability" but "will be defense exhibit 1.>").

<sup>45</sup> U.S. SECURITIES & EXCHANGE COMMISSION, REPORT ON THE MUNICIPAL SECURITIES MARKET 100-01 (2012).