Engineers and the Municipal Advisor Quandary

Dodd-Frank creates potential liability for engineers providing services to municipalities. But there are ways to continue to work with these entities without opening yourself up to a whole new set of claims.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) was a landmark legislative stroke intended to provide checks and balances to the financial services industry while also protecting consumers from predatory lending and investment schemes. The U.S. Securities and Exchange Commission (SEC) and the Municipal Securities Rulemaking Board (MSRB), in their efforts to enforce Dodd-Frank and regulate municipal advisors, may have an impact on the engineering community, particularly those firms that provide services to municipalities.

Effective July 1, 2014, the SEC's final rules on municipal advisors set forth regulations for and filing requirements of municipal advisors. While the definition of “municipal advisor” is quite broad under the regulation, engineers were exempted from the definition and filing requirements. According to Joe Reynolds, Executive Underwriter for XL Group’s Design Professional unit, “Despite the commission’s best intentions, there’s still some ambiguity as to what constitutes engineering activities and which activities, if conducted by an engineer, would require an engineer to file as a municipal advisor with the SEC.”
Under the ruling, an engineer could provide a "municipal entity or obligated person with advice on new project specifications, including overall cost, a projected construction schedule, anticipated funding requirements, and a projected in service date. The municipal entity…in turn, could use such information to structure the related issuance of municipal securities, including determining the length of any capitalized interest period and amount of capitalized interest to be financed from bond proceeds."

“However,” Reynolds says, “the moment an engineer provides advice on how to actually structure the issuance of the municipal securities in support of the project, including the length of capitalized interest period and amount of capitalized interest to be financed, the engineer loses the engineering exemption. In such an instance, the engineer is required to file with the SEC as a registered municipal advisor. While the majority of our insured firms that provide municipal services confine their activities to those of a traditional engineer, the risk of ‘crossing the line’ should give any engineer pause.” It’s important to know what that line is so that a well-meaning engineer doesn’t venture into giving financial advice to the municipal client.

Why Does It Matter?

Reynolds explains that an engineering firm acting as a municipal advisor would be held to a fiduciary duty, a higher standard of care than that traditionally defined by the negligence standard. “Further,” he notes, “engineering firms would be wading into services more akin to those offered by a financial advisor or underwriter of municipal securities than those typically offered by an engineering firm. In this role, engineering firms may be liable for breaching a fiduciary duty to the municipality for acts, errors and
omissions while providing advice on structuring complex municipal bond offerings.”

Aside from the fact that those activities are outside the traditional scope of design professional services, it’s important to note that claims for a breach of fiduciary duty are not covered under a design professional liability policy.

**How Can Engineers Minimize Their Risk?**

In the event engineering firms act as municipal advisor, they may still be exempt under the Independent Municipal Advisor Exception. In their recent article in the *May/June 2014 issue of Engineering Inc.* (pgs. 52-53), Bingham McCutchen LLP’s Amy Natterson Kroll and Elizabeth A. Marino provide valuable insight into how engineers can utilize this exception to provide their normal services without fear of having to file as a municipal advisor.

Kroll and Marino write that “Although persons are prohibited from providing certain ‘advice’ to municipal entities without registering as a municipal advisor, engineers and others are exempt from registration if they provide advice to a municipal entity regarding municipal securities and the municipal entity has an ‘independent registered municipal advisor’...An independent registered municipal advisor is a ‘municipal advisor registered pursuant to section 15B 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 exception].”

“In order to rely on this exception,” Kroll and Marino write, "the engineering firm must receive a written representation from the municipal entity that the municipal entity has an independent registered municipal advisor and that the entity will rely on the advice of
such advisor, among other things. As long as the conditions of the Independent Municipal Advisor Exception are met, engineers can provide certain advice without triggering the municipal advisor registration requirement."

“Regardless of a firm’s scope of services,” Reynolds says, “Design Professional recommends that all engineering firms who provide municipal services engage legal counsel to integrate these exemption requirements into their professional services agreements.” (The current EJCDC E 500 has language that clarifies the engineer’s role in project planning and “…establishes a scope of work that does not include regulated municipal financial advisor activities.”)

The SEC and the MSRB will likely offer further clarifications over time, and engineering firms will want to stay current. (See the link to MSRB’s website below.) Professional associations and Design Professional will continue to respond, too, by developing additional guidance to address this important topic.

**How Should Engineers Interact with Municipal Clients?**

Due to these new regulations, Kroll and Marino suggest it may not be business as usual when providing services to your municipal clients. For instance, they write, “When engineering firms meet with municipal entities regarding financing options, even generally, the engineering firms must make certain oral disclosures to the municipal entity regarding [the firm’s] role and what [the firm] may and may not provide to [the municipal entity]. Likewise, when engineering firms provide any written materials to a
municipal entity, the materials must include certain disclosures intended to clarify the roles of the parties.”

When in doubt, Design Professional recommend firms work with legal counsel to make sure that such standard disclosures are explicitly set forth in communications with their municipal clients. “While the new regulations under Dodd-Frank provide potential challenges to doing business with important municipal clients,” Reynolds says, “engineering firms should proceed with confidence once they’ve put these critical risk management controls in place.”

*For more information on the new regulations regarding municipal advisors, see the section of the Municipal Securities Rulemaking Board’s website entitled, “News and Resources for Municipal Advisors.”*