UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

LeeAnne Walters, as Next of Friend for Two Minor Children, G.W. 1 and G.W. 2, et al.,

Plaintiffs,

v.

J.P. Morgan Chase & Co., et al.,

Defendants.

Case No. 5:20-cv-12726

Hon. Judith E. Levy

BRIEF OF *AMICUS CURIAE* SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION IN SUPPORT OF DEFENDANTS

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Amicus Curiae Securities Industry and Financial Markets Association, Inc. is a nonprofit corporation. It is not a subsidiary or affiliate of a publicly owned corporation, and knows of no publicly owned corporation or its affiliate, not a party to the case, that has a substantial interest in the outcome of the litigation.

INTEREST OF THE *AMICUS CURIAE*

The Securities Industry and Financial Markets Association ("SIFMA") is a securities industry trade association representing the interests of hundreds of securities firms, banks, and asset managers. Its mission is to support a strong financial industry, while promoting investor opportunity, capital formation, job creation, economic growth, and trust and confidence in the financial markets. SIFMA is the United States' regional member of the Global Financial Markets Association.

Many SIFMA members serve as underwriters, including of municipal bonds. Municipal bond underwriters assist municipalities with the issuance of bonds to generate capital for schools, hospitals, housing, and economic development projects. SIFMA has an interest in a legal environment that will facilitate successful bond issues at the lowest cost to governmental entities and their taxpayer/constituents. The beneficiaries of such a legal environment include governments, their taxpayers, and investors. SIFMA has a specific interest in this case because Plaintiffs' novel theory would severely destabilize bond markets by subjecting underwriters to liability under federal statute and common law for municipal decisions that they neither control nor supervise.

INTRODUCTION[1]

This action raises the question whether underwriters of municipal bonds—by purchasing securities from a government issuer in a federally-regulated arm's-length transaction—can be liable to members of the public under § 1983 and state common law for harms that result from government actions. Specifically, Plaintiffs contend that Defendants, by underwriting "the bond sale that financed and enabled Flint's participation in the Karegnondi Water Authority ('KWA')," assumed responsibility for future injuries resulting from the City of Flint's use of the Flint River as an interim water source. (PageID.62-65, ¶¶ 1-7.) But arm's-length underwriters unaffiliated with the issuer are not and cannot be liable to the public at large for actions of an issuer merely by underwriting bonds in the manner prescribed by federal law.

To hold otherwise would ignore and undermine the clearly specified role of an underwriter as defined by statute, regulation, and agency guidance. Underwriters cannot eliminate the risk of public injury without complete entanglement with the government issuer—entanglement that is prohibited by the

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[1] *Amicus* submits this brief in support of Motion to Dismiss by Defendants J.P. Morgan Securities LLC, Wells Fargo Bank, N.A., and Stifel, Nicolaus & Company, Inc. (PageID.821.) No counsel for a party authored this brief in whole or in part. No person other than *amicus* or its counsel contributed money to fund this brief's preparation or submission.

federal regulatory scheme. And were Plaintiffs to succeed in supplanting the detailed rules governing municipal underwriting with their strained interpretations of § 1983 and state tort law, the consequences would be catastrophic. Plaintiffs' theory has no limiting principle, and underwriters would face potential legal exposure in connection with every government decision that post-dates an underwritten bond issuance, even those with only the slightest connection to the funding. The inevitable consequence will be higher borrowing costs for capital projects such as schools, hospitals, and highways, an outcome disproportionately affecting governments that are already economically depressed. Thus, residents of Flint and similar struggling localities will ultimately pay the costs associated with underwriter liability through increased tax burden or aging infrastructure, or both. Moreover, were Plaintiffs to prevail, the logic of their argument could further extend underwriter liability to the corporate context, threatening the framework on which the regulation, stability, and efficient functioning of the U.S. capital markets is—and for decades has been—based.

But these consequences should not materialize. As Defendants persuasively argue in their motion to dismiss, Plaintiffs' claims fail as a matter of law, including because normal underwriting activity overlaid with conclusory allegations of conspiracy cannot support § 1983 liability against a private actor, and

because Plaintiffs' negligence claims are preempted by federal law. Plaintiffs' unprecedented theory of liability deserves no credence and should receive none.

BACKGROUND

A. Overview of the Municipal Bond Market.

State and local governmental entities issue municipal bonds to finance capital projects such as highways, airports, hospitals, schools, and other infrastructure. Municipal bonds represent a promise by the governmental entity (the *issuer*) "to repay to lenders (*investors*) an amount of money borrowed, called *principal*, along with *interest* according to a fixed schedule." Judy Wesalo Temel, The Fundamentals of Municipal Bonds 1 (5th ed. 2001). The issuer generally agrees to repay municipal bonds anywhere from one to 40 years after the date they were issued. *Id.* Thus, the municipal bond market enables governmental entities to fund essential civic projects when those projects are most critical, without waiting to accumulate sufficient taxpayer revenue.[2] The size of this market reflects its

[2] Municipal bonds are especially critical to governmental entities during recessions and other times of financial need. For example, "[t]he municipal bond market grew in size by 24.9% from 2005 to 2010"—reflecting the impact of the 2008 financial crisis—"but decreased by 3.2% from 2010 to 2014." Darryl E. Getter & Raj Gnanarajah, Cong. Research Serv., R44146, The Demand for Municipal Bonds: Issues for Congress 2 (2015). Likewise, 2020, with COVID-19's devastating impact on local economies, was a "record year" for municipal bond issuance. *See* Fola Akinnibi & Danielle Moran, *Wall Street Muni Underwriters Poised for Record Year in 2020*, Bloomberg (Dec. 1, 2020), https://www.bloomberg.com/news/articles/2020-12-01/wall-street-muni-underwriters-poised-for-record-year-in-2020.

importance. In 2019, there were over $3.8 *trillion* in municipal securities outstanding nationwide.[3] In Michigan, bond funding accounted for about 12 percent of the State's $2.476 billion in capital expenditures in 2019.[4]

A municipal bond offering involves many participants. The issuer plans a project and sells bonds, counseled by a financial advisor who assesses funding needs and structures the securities and issuer's counsel who advise on securities, tax, and similar matters. Bond counsel represents the interests of the bondholders, including by opining that the bonds are valid; rating agencies rate the bonds based on credit quality; and trustees carry out administrative functions such as holding invested funds.[5] For infrastructure projects like the KWA pipeline, an engineer engaged by the municipal issuer produces a report that estimates the functioning and profitability of the project. (PageID.124.) In this case, the engineer's report explained that Flint's water treatment plant "currently provides treated water from the Flint River as a backup" water source and that "[a] significant

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[3] Fixed Income Outstanding, SIFMA (last visited Mar. 2, 2021), *available at* https://www.sifma.org/resources/research/fixed-income-chart/.

[4] *2020 State Expenditure Report*, Nat'l Ass'n of State Budget Officers, at 90 (2020), *available at* https://www.nasbo.org/reports-data/state-expenditure-report.

[5] Temel, *supra*, at 3-16; *Commentary: The Role of Issuer's Counsel in a Municipal Bond Offering*, The Bond Buyer (Nov. 8, 2013), https://www.bondbuyer.com/opinion/commentary-the-role-of-issuers-counsel-in-a-municipal-bond-offering%20.

upgrade ($48 million) . . . was completed in 2006 to meet state regulatory requirements," with additional upgrades planned. (PageID.338-39.)

With the many players involved, arrangements for the KWA pipeline began no later than 2009, years before the City of Flint approached the defendant underwriters in the "spring of 2013" (PageID.68-69, ¶¶ 22, 27) and the bonds were issued in April 2014 (PageID.70, ¶ 33 & n.5).

B. The Role of the Municipal Underwriter.

As one of many participants in a municipal bond offering, underwriters fill a specific role: reviewing an issuer's federally required "official statement" about the bonds and the issuer, marketing the bonds to investors, negotiating the price with the issuer, and ultimately purchasing the bonds and offering them for resale. Temel, *supra*, at 90-93, 100-03. This role is carefully circumscribed by law and regulation. As explained in detail below, underwriters must deal at arm's length with the issuer, to which they owe no fiduciary duties, and instead owe their primary responsibilities to investors who purchase municipal bonds. Thus, although underwriters review statements made by municipal issuers in connection with bond offerings, they play no role in planning the underlying municipal projects, nor do they exercise any oversight or control over the execution of those projects after purchasing the bonds. Instead, "[s]uccessful underwriters master the delicate balance of finding the yield that produces not only the lowest borrower cost for the

issuer but also the highest yield for the investor consistent with the issuer's credit and deal structure." *Id.* at 88.

Underwriters' compensation for any given offering is typically a small percentage of the value of the bond, out of which they must cover expenses such as their own counsel fees, investor meetings, travel, advertising, professional salaries, and costs of capital. *Id.* at 86-87. As of 2015, underwriters earned an average of $4.64 per $1000 face value of bond issues (approximately 0.46 percent). Aaron Weitzman & Kyle Glazier, *How Shrinking Spreads Are Making the Muni Underwriting Business Unsustainable*, The Bond Buyer (June 9, 2016), https://www.bondbuyer.com/news/how-shrinking-spreads-are-making-the-muni-underwriting-business-unsustainable. In the case of the KWA offering here, Defendants received compensation amounting to approximately 0.43 percent of the principal bond amount. (PageID.113, 135.) Underwriters bear the risk that they might not sell all of the bonds being underwritten right away or at the offering price. Temel, *supra*, at 87.

C. Municipal Underwriting Is Heavily Regulated and the Duties of Municipal Underwriters are Well Defined.

1. *MSRB and SEC Rules*

Underwriters of municipal securities typically must register with the Securities Exchange Commission ("SEC"), the Municipal Securities Rulemaking Board ("MSRB"), and in many cases, the Financial Industry Regulatory Authority

("FINRA").[6] "Registration of the firm automatically results in the firm being subject to recordkeeping, financial compliance, and financial reporting requirements." Fippinger, *supra*, at § 10A:2.1; *see also* 15 U.S.C. § 78q.

In 1975, Congress established the MSRB and authorized it to "propose and adopt rules" (subject to SEC approval) that govern transactions in municipal securities. *See* 15 U.S.C. §§ 78o-4(b)(2), 78s(b). The MSRB has exercised that delegated authority by adopting robust guidance governing the conduct of municipal financial professionals. The MSRB's rules are enforced by the SEC, FINRA, and the federal bank regulatory agencies, *see* 15 U.S.C. §§ 78o(b)(4)(D), 78o-3(b)(7), 78o-4(c)(5), and a willful violation may be the basis for criminal proceedings, 15 U.S.C. § 78ff.

Many MSRB rules govern the relationship between underwriters and investors, *i.e.*, the end-customers that purchase municipal bonds from the underwriters.[7] For example, Rule G-17 requires an underwriter "to disclose to its customer all material information about the transaction known by the dealer, as well

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6 *See* 15 U.S.C. § 78o(a) (securities brokers and dealers); 15 U.S.C. § 78o-4(a) (municipal securities dealers); MSRB Rule A-12 (brokers, dealers and municipal securities dealers); 15 U.S.C. § 78o(b)(8) (non-bank broker dealers); Robert A. Fippinger, The Securities Law of Public Finance §§ 10A:2.1, 10A:2.2, 10A:2.3 (3d ed. supp. Nov. 2020).

7 All MSRB rules cited herein are available at http://msrb.org/Rules-and-Interpretations/MSRB-Rules.aspx.

as material information about the security that is reasonably accessible to the market." MSRB, Guidance on Disclosure and Other Sales Practice Obligations to Individual and Other Retail Investors in Municipal Securities (July 14, 2009). Underwriters also must transact with investors at "fair and reasonable" prices. MSRB Rule G-30. And the MSRB has long required underwriters to determine that a security is "suitable" to an investor's "financial status, tax status and investment objectives" before recommending it. MSRB, Guidance on Disclosure and Other Sales Practice Obligations to Individual and Other Retail Investors in Municipal Securities, *supra*. More recently, under the SEC's "Regulation Best Interest," effective September 10, 2019, broker-dealers are required to act in the "best interest" of retail customers in recommending a "securities transaction or investment strategy." 17 CFR § 240.15l-1.[8]

The MSRB has also dictated narrowly circumscribed obligations that underwriters owe to municipal issuers. Specifically, Rule G-17 requires the underwriter to "deal fairly" with issuers, and to disclose its limited role and potential conflicts of interest. Among other things, underwriters must disclose to issuers that:

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[8] The Rule does not extend to bank dealers registered under Exchange Act Section 15B(a)(2). *See* MSRB Notice, MSRB Harmonizes Rules with Requirements of Regulation Best Interest, at 2 n.3 (June 26, 2020), *available at* http://www.msrb.org/~/media/Files/Regulatory-Notices/Announcements/2020-13.ashx?.

- "the underwriter's primary role is to purchase securities with a view to distribution in an arm's-length commercial transaction with the issuer and it has financial and other interests that differ from those of the issuer;"

- "unlike a municipal advisor, the underwriter does not have a fiduciary duty to the issuer under the federal securities laws and is, therefore, not required by federal law to act in the best interests of the issuer without regard to its own financial or other interests;"

- "the underwriter has a duty to purchase securities from the issuer at a fair and reasonable price, but must balance that duty with its duty to sell municipal securities to investors at prices that are fair and reasonable; and"

- "the underwriter will review the official statement for the issuer's securities in accordance with, and as part of, its responsibilities to investors under the federal securities laws, as applied to the facts and circumstances of the transaction."

MSRB Interpretive Notice Concerning the Application of MSRB Rule G-17 to Underwriters of Municipal Securities (Aug. 2, 2012) ("2012 Interpretive Notice").

2. *Antifraud Provisions of the Federal Securities Laws*

Because municipal bonds are generally exempt from the registration requirement of the 1933 Act, underwriters of municipal bonds may not be sued under the antifraud provisions of Sections 11 or 12(a)(2), with their accompanying strict liability regime. *See* 15 U.S.C. § 77c(a)(2) (exempting municipal securities); Fippinger, *supra*, at § 7:6.4. However, municipal underwriters are subject to potential liability under other provisions of the securities laws for making misstatements to investors or otherwise engaging in fraud. The SEC may proceed against municipal underwriters, for example, under Section 17(a) of the 1933 Act,

which prohibits negligent or intentional untrue statements or omissions of material fact made to investors. *See* 15 U.S.C. § 77q; *S.E.C.* v. *Ginder*, 752 F.3d 569, 574 (2d Cir. 2014) (negligence sufficient for violation of Section 17(a)(2) and (3)). Investors also may seek to sue under Section 10(b) of the 1934 Act and Rule 10b-5, which create an implied private right of action for reckless or intentional fraud in connection with the purchase or sale of a security. *See* 15 U.S.C. § 78j; 17 CFR § 240.10b-5; *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 193 (1976) (establishing scienter requirement); *Lorenzo* v. *S.E.C.*, 139 S. Ct. 1094, 1100-01 (2019) (potential liability under Rule 10b-5 for disseminators of fraudulent statements "even if the disseminator did not 'make' the statements").

In practice, these provisions operate to impose an implied duty on the underwriter, for the benefit of investors who purchase municipal bonds, to exercise "due diligence" in its review of the information contained in offering documents—here, the official statement prepared by the issuer—such that the underwriter has a "reasonable basis for belief in the truth of key representations" contained therein. Municipal Securities Disclosure, 53 Fed. Reg. 37778-01, 37787-91 (Sept. 28, 1988); *see also* Fippinger, *supra*, at § 7:3.1. The only private parties who may bring suit are investors, and only if they can prove something very specific—that the underwriters intentionally or recklessly made or disseminated materially false or misleading statements—not negligence or any other theory of liability.

ARGUMENT

I. UNDERWRITERS ARE NOT AND CANNOT BE LIABLE FOR THE ACTIONS OF BOND ISSUERS MERELY BY UNDERWRITING MUNICIPAL BONDS.

A. Plaintiffs' Novel Theory of Liability Undermines the Role of the Underwriter.

In an effort to ascribe the actions of government officials to private actors, Plaintiffs posit a theory of liability for municipal underwriters that is inconsistent with the role of the underwriter and imposes duties incompatible with those set forth in the federal securities laws and accompanying rules.

As detailed above, municipal underwriters are subject to a comprehensive regulatory regime that clearly delineates their specific obligations, to whom they owe those obligations, and their potential liabilities. Investors may sue municipal underwriters under SEC Rule 10b-5 for reckless or intentional fraudulent acts, 17 CFR § 240.10b-5, but not in strict liability under Sections 11 and 12(a)(2) of the 1933 Act. *See* pp. 10-11, *supra.* Issuers are entitled to fair dealing from underwriters, *see* MSRB Rule G-17, but underwriters owe them no "fiduciary duty" or obligation to act in the issuer's "best interest." 2012 Interpretive Notice. To the contrary, the underwriter must carry out an "arm's-length commercial transaction," *id.*, a term that has been interpreted in the larger securities context to require that "the issuer and underwriters each act[] in their own interest rather than in concert," *In re Wicat Sec. Litig.*, 600 F. Supp. 1236, 1240 (D. Utah 1984), and are

not "intertwined" such that one party exercises a "major" and "influential" role in the operations of the other. *In re Refco Inc. Sec. Litig.*, 2010 WL 11475742, at *22-23 (S.D.N.Y. Mar. 2, 2010), *report and recommendation adopted*, 2011 WL 13168455 (S.D.N.Y. May 4, 2011). Moreover, the MSRB has emphasized that underwriters must remain independent of issuers, and has disapproved of practices (such as the involvement of the issuer in selecting underwriter's counsel) that might erode underwriter independence. *See*, *e.g.*, MSRB Regulatory Notice 2017-14, Market Advisory on Issuer's Designation of Underwriter's Counsel (July 17, 2017). Indeed, an underwriter who undercuts the arm's-length relationship with the issuer is "deemed to be a financial advisor" and "precluded from underwriting that issue" by MSRB Rule G-23(d). MSRB, Guidance on the Prohibition on Underwriting Issues of Municipal Securities For Which A Financial Advisory Relationship Exists Under Rule G-23 (Nov. 27, 2011). Necessarily, then, this complex regulatory scheme does not afford underwriters the right or responsibility to control the issuer's future conduct.

The duty Plaintiffs purport to identify—one that extends far beyond the issuer and investors, to the public at large, to ensure that the issuers "agree[d] to immediately upgrade the Flint WTP so that it could function safely" (PageID.102, ¶ 247)—is wholly incompatible with the underwriter's role as party to an arm's-length financing transaction. An underwriter cannot guarantee the safety of

municipal decisions related to capital expenditures absent complete entanglement with the government issuer. Not only do underwriters have no *right* to supervise or direct municipal decisions (and Plaintiffs point to none), but they could not do so without compromising the federally mandated arm's-length nature of bond underwriting, an unacceptable result. As courts have observed, the securities laws represent a "delicate balance" struck by Congress that should not be upset by imposing new duties or divining new liabilities. *Warner Commc'ns, Inc.* v. *Murdoch*, 581 F. Supp. 1482, 1491-92 (D. Del. 1984); *see also Automated Matching Sys. Exch., LLC* v. *S.E.C.*, 826 F.3d 1017, 1023 (8th Cir. 2016) (interpretation of 1934 Act "would contradict the careful balance prescribed by Congress to protect the public interest and investors"). Plaintiffs' novel theory would have just this kind of destabilizing effect.

The limited role of the underwriter in dealings with the issuer is underscored by the distinct set of duties and responsibilities allocated to another professional role, the municipal advisor, which "provides advice to or on behalf of a municipal entity . . . with respect to municipal financial products or the issuance of municipal securities." 15 U.S.C. § 78o-4(e)(4)(A).[9] In contrast to underwriters, municipal advisors have a "fiduciary duty" to the issuer, and in recommending a

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[9] Underwriters are explicitly excluded from the definition of municipal advisors. *See* 15 U.S.C. § 78o-4(e)(4)(C); MSRB Rule G-42(f)(iii).

transaction, must evaluate the "the material risks, potential benefits, structure, and other characteristics of the recommended municipal securities transaction or municipal financial product." MSRB Rule G-42. That the MSRB, acting with statutory authority, imposed a duty of care and oversight responsibilities on municipal advisors but *not* underwriters is further evidence that Plaintiffs' theory would impose duties that are incompatible with the role of the underwriter. *See Smith* v. *Comm'r of Soc. Sec.*, 482 F.3d 873, 876 (6th Cir. 2007) ("When an agency includes a requirement in only one section of a regulation, we presume the exclusion from the remainder of the regulation to be intentional.").

Against the weight of a carefully crafted and scrupulously overseen regulatory regime, Plaintiffs strain to impose on underwriters a new duty to protect the non-investor public at large from future harm at the hands of the municipal issuer and other government actors. If allowed to press this theory under the guise of § 1983 and state common law, Plaintiffs will have circumvented Congress' carefully balanced system for overseeing municipal finance.

B. Plaintiffs' Novel Theory of Liability Has No Limiting Principle.

If Plaintiffs prevail on their argument that the underwriter defendants are liable because they did not ensure that the City of Flint would, in the future, provide safe water to its residents, the potential liability of municipal underwriters will know no bounds. A flood of lawsuits could be commenced against underwriters

for collateral decisions made by government decision-makers in connection with capital projects—interim choices over which the underwriters exercised no control and had no oversight. Underwriters would suddenly be responsible to a municipality's residents for judgments made by elected officials as to how best to govern, manage, and operate their own city, town, or state—matters over which the underwriters have no control. Several hypotheticals illustrate both the potential breadth of underwriter liability under Plaintiffs' approach, and the absurdity of that theory.

- A city raises funds to upgrade its power lines because the existing lines create a wildfire risk. Could the underwriter be liable for damages from a fire that occurs because the upgrade plan did not include a provision to secure the power lines in the interim? What if the upgrade turns out to be insufficient to eliminate the risk and a fire later occurs?

- A state issues bonds to add lanes to a highway. Could the underwriter be liable for accidents that result from confusingly placed detour signs or because the state creates a dangerous condition by electing to keep the road open while construction is underway and accidents occur?

- A state raises money to build a new wind turbine power project. While the project is being built, the state decides to supply its residents with power from a more convenient aging nuclear power plant rather than purchase power from a neighboring utility; and the nuclear reactor has a leak resulting in contamination. Could the underwriters be liable to residents harmed by the leak?

- A locality raises money to renovate its elementary school. During the two-year upgrade, the temporary facility selected by the school board becomes moldy as a result of adding insulation. Could the underwriters be liable for harm to students and teachers caused by mold?

The answer to each of these questions should be a resounding no. Indeed, in each example, as in the instant case, the underwriters—mere arm's-length participants in a financing transaction—had no right or ability to control policy and operational decisions made by government leaders, to control how the government entity spends its money, or to monitor and evaluate the wisdom of decisions by officials. *See C.H. ex rel. Z.H.* v. *Oliva*, 226 F.3d 198, 201 (3d Cir. 2000) ("It is, of course, well established that a defendant in a civil rights case cannot be held responsible for a constitutional violation which he or she neither participated in nor approved."). Were such theories of liability to gain traction, as explained further below, the result would be fewer (or significantly more expensive) power lines, highways, hospitals, and elementary schools—particularly for the most financially constrained municipalities. It strains credulity to believe that either Congress or state legislatures would have intended this result.

There is also a significant risk that parties would seek to weaponize liability here in the much larger market for corporate underwriting. Corporate underwriters, like municipal underwriters, participate in the distribution of securities by purchasing those securities from issuers and reselling them to investors. *Picard Chem. Inc. Profit Sharing Plan* v. *Perrigo Co.*, 940 F. Supp. 1101, 1112 n.8 (W.D. Mich. 1996). They also have disclosure obligations to investors and face potential liability for material misstatements and fraud under the securities laws, *see*, *e.g.*, *In*

re WorldCom, Inc. Sec. Litig., 346 F. Supp. 2d 628, 656 (S.D.N.Y. 2004), and likewise owe no fiduciary duties to issuers, nor have the ability to control corporate decisions, *Union Cty., IA* v. *Piper Jaffray & Co.*, 741 F. Supp. 2d 1064, 1102 (S.D. Iowa 2010). Indeed, in the corporate context, Courts have described the relationship between underwriters and issuers as "adverse." *See*, *e.g.*, *In re Equimed, Inc.*, 2006 WL 1865011, at *3 n.3 (E.D. Pa. June 30, 2006); *Feit* v. *Leasco Data Processing Equip. Corp.*, 332 F. Supp. 544, 581 (E.D.N.Y. 1971); *Escott* v. *Barchris Constr. Corp.*, 283 F. Supp. 643, 696 (S.D.N.Y. 1968). Yet were Plaintiffs' novel theory of liability to prevail, the reasoning could be expanded by analogy to hold corporate underwriters liable for a company's misconduct, magnifying the detrimental impact outlined in Section I.C, *infra*, increasing the cost of borrowing for a wider swath of persons, and creating broader disruption in the capital markets.

C. Plaintiffs' Novel Theory of Liability Would Have Catastrophic Consequences For Municipalities and the People They Serve.

As the risk associated with underwriting municipal bonds increases—as it inevitably will if Plaintiffs establish that underwriters can be liable under § 1983 and state common law for government decisions—underwriters will be forced to protect their already-thin margins by requiring higher spreads on bond sales or shifting the risk to municipalities in the first instance through indemnification, contribution, or insurance arrangements. *Cf. McNair* v. *Johnson & Johnson*, 818 S.E.2d 852, 866 (W.Va. 2018) (expansion of liability results in "significant litigation

costs" that are added to product prices "to the disadvantage of consumers"). The practical impact is that state and local governments will receive less in bond proceeds or otherwise face increased financial exposure in connection with bond issues, and will be unable to fund necessary capital projects absent increased taxpayer revenue. Thus, the very parties injured by government wrongdoing in cases like the present action—local residents—will pay more for projects needed to ensure their safety and well-being.

These consequences are unlikely to be felt equally by all populations. As Plaintiffs explain in their opposition, "a distressed municipality has little choice among bond sales alternatives" and, as a result of its "poor credit and limited (if any) financial solvency," may be forced to sell its bonds at a "substantial discount." (PageID.893.) Economically distressed municipalities, therefore, which already pay a premium to borrow funds, would be disproportionately affected by the inflated borrowing costs that would result from Plaintiffs' theory. Indeed, by analogy to the tort of negligent entrustment, Plaintiffs contend that Defendants had a duty not to entrust the City of Flint with funds that it was likely to use in an unreasonable and risky manner. (PageID.919-20.) Under this paternalistic principle, economically depressed governments are more likely than wealthy ones to cut corners or forego expensive protective measures, and underwriters should not assist them in obtaining the funding they desperately need. Not only is this wrong legally, but it reflects a

lack of confidence in a municipality's elected leaders—and as a matter of social policy is completely backwards.

Underwriters seeking to mitigate legal exposure might even choose to exit the business, a similarly devastating result for local governments and their taxpayers. That Plaintiffs' theory would have such far-reaching consequences cautions against affording that theory credence. *See*, *e.g.*, *Tapucu* v. *Gonzales*, 399 F.3d 736, 743 (6th Cir. 2005) (considering "far-reaching consequences" in rejecting statutory interpretation); *United States* v. *King*, 840 F.2d 1276, 1282-83 (6th Cir. 1988) (considering "adverse social consequences" in rejecting defense).

D. As Persuasively Argued By Defendants, Plaintiffs' Legal Theories for Underwriter Liability Founder.

Defendants' motion to dismiss explains why Plaintiffs' theories of underwriter liability under § 1983 and state common law fail as a matter of law, in part because liability would undermine the regulatory scheme put in place by Congress. (*See* PageID.852, 857-58.) *Amicus* elaborates upon two of those arguments here, namely that (i) Plaintiffs' § 1983 conspiracy claim fails because an underwriter does not conspire to violate the Constitution by engaging in ordinary arm's-length underwriter activities; and (ii) Plaintiffs' negligence claim is preempted by the federal securities laws.

1. *An underwriter cannot conspire to violate the Constitution by underwriting and purchasing municipal bonds.*

In the Sixth Circuit, a plaintiff alleging a § 1983 claim based on conspiracy liability against a private actor "must prove that a single plan existed, that each alleged coconspirator shared in the general conspiratorial objective, and that an overt act was committed in furtherance of the conspiracy." *Rudd* v. *City of Norton Shores, Michigan*, 977 F.3d 503, 517 (6th Cir. 2020) (internal quotation marks omitted). Plaintiffs accuse the underwriters of conspiring with Flint to deprive Plaintiffs of their right to bodily integrity by "providing funding for the transition to the KWA" even though they should have known that the City would use "raw and untreated Flint River water as an interim water source." (PageID.99, ¶¶ 230-32.) If Plaintiffs are to be believed, Defendants were obligated to go beyond their underwriting duties to ensure that the residents of Flint had safe drinking water prior to funding the KWA pipeline, and through the mere act of *purchasing the bonds* without ensuring an adequate interim water source, acted with a "conspiratorial objective" in furtherance of a "shared plan" to deprive Flint's residents of their constitutional rights.

But an underwriter cannot reasonably be considered to have conspired to violate the Constitution by performing the normal underwriter function of purchasing bonds. *Cf. United States* v. *Hamm*, 952 F.3d 728, 736 (6th Cir. 2020) (reasoning in criminal context that "a buyer-seller relationship alone is insufficient"

for conspiracy liability). A party with no ability or right to control or monitor municipal decisions cannot be charged with the effects of those decisions merely by virtue of a commercial transaction that, by MSRB rule, must be at arm's length.

A "classic judicial task [is] reconciling many laws enacted over time, and getting them to 'make sense' in combination." *United States* v. *Fausto*, 484 U.S. 439, 453 (1988). To do this, courts recognize that "the meaning of one statute may be affected by other Acts, particularly where Congress has spoken subsequently and more specifically to the topic at hand." *Food & Drug Admin.* v. *Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 133 (2000). In resolving these sorts of conflicts, "it is familiar law that a specific statute controls over a general one without regard to priority of enactment." *Brott* v. *United States*, 858 F.3d 425, 430 (6th Cir. 2017) (internal quotation marks omitted). The securities laws post-date § 1983 by more than half a century, and the statute delegating authority to regulate municipal bond underwriters came another half century later.[10] By rejecting Plaintiffs' attempt to extend § 1983 conspiracy liability to this novel context, this court would avoid

[10] *See* An Act to Enforce the Provisions of the Fourteenth Amendment to the Constitution of the United States, Pub. L. 42-22, § 1, 17 Stat. 13, 13 (1871) (codified at 42 U.S.C. § 1983); Securities Exchange Act of 1934, Pub. L. No. 73-291, § 10(b), 48 Stat. 881, 891 (1934) (codified at 15 U.S.C. § 78j); An Act to Amend the Securities Exchange Act of 1934, Pub. L. No. 94-29, 89 Stat. 97 (1975).

creating conflict between § 1983 and the statutory scheme Congress subsequently erected to regulate the municipal bond market.

2. *Federal securities law preempts Plaintiffs' negligence claim.*

As Defendants explain, Plaintiffs' negligence claim is preempted by the federal securities laws. (PageID.857-59.) Federal law displaces state law when state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Hughes* v. *Talen Energy Mktg., LLC*, 136 S. Ct. 1288, 1297 (2016).[11] The Supreme Court has further elaborated that state law may be displaced where a "federal statutory scheme amply empowers [an agency] to punish and deter" and "this authority is used by the [agency] to achieve a somewhat delicate balance of statutory objectives." *Buckman Co.* v. *Plaintiffs' Legal Comm.*, 531 U.S. 341, 348 (2001) (reasoning that "[t]he balance sought by the [FDA]" could be "skewed" by allowing state tort law claim). State laws are particularly likely to be preempted "in fields of regulation that have been substantially occupied by federal authority for an extended period of time." *Wachovia Bank, N.A.* v. *Burke*, 414 F.3d 305, 314 (2d Cir. 2005) ("Regulation of federally chartered banks is one such area.").

Here, all of the ingredients for preemption are present:

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[11] "Federal regulations have no less pre-emptive effect than federal statutes." *Fid. Fed. Sav. & Loan Ass'n* v. *de la Cuesta*, 458 U.S. 141, 153 (1982).

First, the relevant federal regulatory scheme—which ensures that bond issuers (and state and local governments in particular) will have reliable, affordable access to a market through which to raise funds—is longstanding. This regulatory scheme has existed since at least 1975, when Congress amended the Securities Exchange Act of 1934 "to provide for the regulation of brokers, dealers and banks trading in municipal securities." Pub. L. No. 94-29, 89 Stat. 97 (1975). Other regulations, such as the ones prohibiting misleading statements in documents marketing bond investments, are even older. *See* Securities Exchange Act of 1934, Pub. L. No. 73-291, § 10(b), 48 Stat. 881, 891 (1934) (codified at 15 U.S.C. § 78j); Sec. & Exch. Comm'n Release Notice, Release No. 34-3230, 1942 WL 34443 (May 21, 1942) (announcing Rule 10b-5).

Second, federal agencies including the SEC are empowered to enforce the federal rules and regulations that govern municipal underwriters and to punish violators, and they use that authority to achieve a delicate regulatory balance of duties that underwriters owe to investors and issuers. *See* pp. 7-11, *supra*.

Third, the federal regulatory scheme and state negligence law (as interpreted by Plaintiffs) impose conflicting obligations. Plaintiffs seek to use state negligence law to require underwriters to closely examine and oversee the actions of bond issuers. But federal regulations prohibit this sort of activity by underwriters, instead requiring them to deal with municipal issuers at arm's length.

For all these reasons, Plaintiffs' negligence claim stands as a clear obstacle to Congress' objectives and is preempted. *Cf. Mut. Pharm. Co.* v. *Bartlett*, 570 U.S. 472, 486 (2013) ("When federal law forbids an action that state law requires, the state law is without effect." (internal quotation marks omitted)).

CONCLUSION

For the foregoing reasons, Plaintiffs' claims are untenable in light of the function, duties and obligations of an underwriter of a municipal bond offering and should be dismissed.

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Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on March 10, 2021, I electronically filed the foregoing with the Clerk of the Court using the Court's CM/ECF filing system, which will effectuate service upon all counsel of record.

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