MEMORANDUM

To Herbert Elish
From Frederick R. Cummings
George S. Balis
Subject Municipal Assistance Corporation - Aid to Needy Holders of City Notes

You have asked us to outline our tentative conclusions with respect to the legal implications of a program by which MAC would make available some financial relief to needy holders of (1) publicly held short-term obligations of the City now subject to the Moratorium ("City Notes") and (2) MAC bonds issued in exchange for City Notes in one or both of the exchange offers.

Although there are various legal and practical problems inherent in the "Mercy MAC" program outlined in this memorandum, it is our tentative conclusion that MAC may legally carry out a program along the lines described below.

I. Proposed Program.

A Mercy MAC program might take one of many forms and many variables exist within any such program for determination, as a matter of policy, by the MAC Board. However, a program along the following lines, previously discussed with you and members of your staff, seems to raise the fewest legal and practical problems. The proposed program can be outlined as follows:

A. Summary.

MAC would offer to exchange its Bonds, which would have certain favorable terms, for City Notes or MAC Bonds held
by needy persons meeting certain predetermined criteria. The special "Mercy MAC Bonds" would be issued under the Second General Bond Resolution\(^1/\) and would be Serial Bonds in the aggregate principal amount of the City Notes or MAC Bonds accepted in exchange. The Serial Bonds would be in relatively small denominations scheduled to mature semi-annually. An overall limit of $25,000,000 or $50,000,000 would be placed on the entire program. In addition, a limit would be placed on the aggregate amount of City Notes or MAC Bonds that could be exchanged by any one person. Financial tests would be established to determine eligibility for the exchange program and a mechanism to police eligibility would be put in place.

**B. Source of Funding.**

1. A source of funds must be identified from which MAC may pay Mercy MAC Bonds as they mature. For example, if the program is limited to $25,000,000 of Serial Bonds maturing semi-annually in equal amounts over five years, then, in addition to interest, MAC will need $2.5 million every six months over the life of the program. (Interest requirements, at 8% would be

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\(^1/\) By issuing Mercy MAC Bonds under the Second General Bond Resolution, the Corporation would make such Bonds basically similar to those issued in the Exchange Offers. We see no legal impediment, however, to issuing such Bonds under the First General Bond Resolution.
$1,000,000 for the first semi-annual payment and would reduce thereafter as principal is paid.\textsuperscript{2} MAC may certify for these funds from its normal revenue stream, but this would reduce the amount of cash flowing to the City.

2. Two possible alternative sources of funds have been identified. First, proceeds of a "Mini-MAC" offering could be used, presumably with a back-up commitment from the Clearing House Banks to purchase the balance of the offering not purchased by the public. Second, proceeds of a sale of long-term MAC Bonds directly to the Clearing House Banks (and perhaps investment banks) could be used. Direct sales to the Banks would be committed to in advance, but would be coordinated with the maturity dates of the Mercy MAC Bonds. The Banks should have an interest in providing relief to unsophisticated, needy holders of City Notes, because in many cases they played an important role in marketing such City Notes at the time of their original issuance and, therefore, they should be willing to participate in the program.

3. On balance, we believe that direct Bank funding is preferable to Mini-MAC funding. Although MAC is committed to do Mini-MAC, MAC has suggested that this might not be an appropriate time for implementation of that program. Furthermore, it does not seem entirely appropriate to suggest that small investors fund what may be considered a "bail-out" of other small investors.

\textsuperscript{2} The City is now paying interest on City Notes at the rate of 6% a year. Therefore, the only additional interest cost is the cost to the City of a higher interest rate on Mercy MAC Bonds.
Finally, certain of the legal arguments in support of the program may be strengthened by the argument that the funds for Mercy MAC are not available for any other purpose, as would be the case, presumably, if such funds came from the Banks. The Banks have indicated that they would purchase no new MAC Bonds, but might be willing to purchase these special purpose Bonds to fund Mercy MAC.

C. Terms of the Bonds.

1. A basic theme of the proposed program is that no person should receive cash immediately for the entire amount of his holdings. Rather, cash should be made available in limited amounts over a period of years to provide required living expenses. Accordingly, Serial Bonds would have to be issued in relatively small denominations. Term Bonds would require by-lot sinking funds which would not insure that any individual would receive cash (other than interest) at any specific time prior to ultimate maturity and would insure that some individuals would be paid off completely prior to ultimate maturity. Each is equally antithetical to the purpose of the program. We propose, therefore, that Serial Bonds be exchanged for a like principal amount of City Notes or MAC Bonds and that the Bonds so exchanged mature (serially) in equal amounts over the course of five years. Accordingly, someone exchanging a $10,000 City Note would receive MAC Bonds maturing $2,000 a year in each of five years. As an additional aid to the needy, maturities should be set semi-annually so that, in the above example, the person would receive $1,000 every six months.
2. We propose that the interest rate on the Mercy MAC Bonds be fixed at 8%, which is greater than the 6% Moratorium rate but equal to the interest on Exchange Offer Bonds.

3. We question whether Mercy MAC Bonds should be made non-transferable. We are not in a position to predict how the market would react to Bonds with terms such as those outlined. If such Bonds were to trade at or above par or at any price higher than first and second Exchange Offer Bonds, Mercy MAC Bondholders might be thought to have gained even more of an advantage over holders of MAC Exchange Offer Bonds than MAC intended to give them. Non-transferability would eliminate any such unintended advantage, but would add a complication which the Board might consider unnecessary or undesirable as a matter of policy.

D. Limitation on Amount.

1. Outstanding City Notes are in either $10,000 minimum denominations or $25,000 minimum denominations. (We understand, but have not yet confirmed, that only the BANs scheduled to mature on March 12, 1976 were issued in $10,000 denominations.)

2. We suggest, therefore, that a maximum amount of City Notes or MAC Bonds exchangeable by any one person be set at $25,000. Accordingly, one City Note issued in a minimum denomination of $25,000, two City Notes issued in minimum denominations of $10,000, or five MAC Bonds issued in minimum denominations
of $5,000, could be exchanged by any one person pursuant to the program.

**E. Financial Tests.**

1. Although we believe that strict financial tests should be established for eligibility for participation in the Mercy MAC program, e.g., maximum net worth, maximum annual income, maximum aggregate assets, we are not in a position to suggest what limits should be set. Constitutional requirements of due process and equal protection will mandate, however, that whatever standards are chosen be based on reasonable distinctions and designed to fairly accomplish the legitimate goals of the Mercy MAC program.

2. In addition, it will have to be decided whether the financial tests must be applied without exception or whether some group should be constituted to grant exceptions. Furthermore, it is possible that general rather than specific tests could be adopted and a group appointed to apply those standards on a case-by-case basis. If such a group is to be constituted, there will be a serious problem as to the delegability of the power to make such distinctions. This question is discussed elsewhere in this memorandum.

**F. Acquisition Date Limitation.**

In order to exclude speculators, even if they are needy, and to prevent transfers designed to take improper advantage of the program, we suggest that no one be eligible to exchange
unless he acquired his City Notes prior to an arbitrary chosen date. June 10, 1975, the date of MAC's creation, might be a reasonable cut-off date.

G. Application of Criteria.

Even if flexible criteria are not developed and no exceptions from specific criteria are to be permitted, somebody will have to be designated to determine whether the specific criteria are met. In addition, affidavits will have to be developed pursuant to which eligibility will be determined and documentation, such as original confirmation slips, cancelled checks, or whatever, will have to be made available to support such affidavits.

II. Legal Considerations.

A. Equitable Considerations.

1. General equitable principles require that in situations in which there is a doubt as to whether a municipality will be able to repay all of its obligations when due, it must apply any limited resources available for such a repayment pro rata to all holders of such obligations and may not prefer one holder to another. Thus, in Bankers Life Co. v. City of Little Field, Tex. 93 F.2d 152, 153, (5th Cir. 1937), Justice Holmes, sitting as Circuit Judge stated:
"It has been an invariable rule based upon equitable principles, that all persons in the same status, entitled to share in the distribution of a fund, are on a parity, entitled to a pro rata share of such funds as their interests may appear and no more. . . . Equity knows no other basis."

Similarly, in Rising v. Hoffman, 116 Col. 63, 179 Pac. 2d 430 (1947), the court held, under equitable principles, that upon insolvency any funds available for the retirement of bonds must be held in trust for all bondholders:

". . . After the maturity date of the bond issue, all unpaid bonds are on a basis of equality, and, as to them, no priority or preference exists; but where the district is insolvent and thereby the funds on hand are insufficient to pay all of the outstanding matured bonds, then it becomes the duty of the town treasurer as a statutory trustee to pro rate the funds among all of the owners of the outstanding bonds." 179 Pac. 2d at 436.

We have not found any New York cases discussing the principal of pro rata distribution of available funds by a municipality when there are insufficient funds to pay all outstanding obligations. Our research indicates, however, that there are no States which have decided this question otherwise. For a further example of cases in which this principle is stated, see 171 ALR 1033 (1947). See also, 15 McQuillin, Municipal Corporations, § 43.127 (1970, Supp. 1975). We have no reason to

3/ Although the City is not insolvent, its position may be deemed comparable, to the extent that outstanding short-term notes have passed their stated maturity date and holders of short-term notes are not currently receiving payment of their principal.
believe that New York would adopt a contrary rule in a similar case.

2. This is not, however, such a case and, accordingly, it is our tentative conclusion that the equitable principles discussed above should not be applicable to the Mercy MAC program outlined herein. The distinguishing features of the Mercy MAC program are as follows:

(i) MAC is not the City or a City agency; it is a State agency. It will be MAC and not the City which will make non-pro rata distributions to holders of City Notes and MAC Bonds. Although moneys flowing to MAC from tax and per capita aid sources ultimately flow to the City if not used by MAC, the taxes are now State taxes and the per capita aid has been dedicated to MAC by State legislation. Accordingly, even to the extent that MAC uses its revenue sources ultimately to pay debt service on the Mercy MAC Bonds (or on bonds issued to the Banks to fund Mercy MAC sinking fund payments), it will be using State and not City revenue sources.

(ii) Under the program outlined herein, MAC would not be making any cash immediately available. The form of the transaction will be a bond-for-note exchange rather than cash payment for outstanding notes. The exchanged City Notes will remain outstanding in the hands of MAC.
(iii) No cash is "available" for pro rata payment to holders of outstanding City Notes. It is assumed that the Banks will be willing to buy MAC Bonds only if and to the extent that the proceeds of such sales are used to fund sinking fund obligations on Mercy MAC Bonds pursuant to this program. Accordingly, the equitable principle that "available" funds must be distributed pro rata is simply not applicable.

(iv) There is a reasonable and rational basis for the distinction between needy holders and other holders. This is substantially different from an arbitrary distinction based on date of issuance or serial number of the notes, which were the kinds of distinctions made in the equity cases described above.

3. Equitable principles can be superseded by legislation. Accordingly, a specific statute authorizing and directing MAC, as a State agency, to implement the Mercy MAC program would erase any lingering doubt as to the applicability of the equitable principle of pro rata distribution. Although it is our tentative conclusion that such legislation is not, as a matter of law, necessary, it may be appropriate as a political matter to seek legislation. If such legislation were forthcoming, it would, of course, strengthen the defense against a legal attack on the Mercy MAC program.
B. Constitutional Considerations.

Because MAC is a State agency, its actions in adopting and implementing a Mercy MAC program will have to pass the Constitutional tests of equal protection and due process.

1. The traditional equal protection test is whether the proposed discrimination or distinction is rationally related to a legitimate state concern. See, e.g., Railway Express Agency v. New York, 336 U.S. 106 (1949), in which a law forbidding all advertising on motor vehicles, except advertising of the owner's products, was upheld against Constitutional attack.

In recent years, a "new" equal protection test has developed in two types of cases: (i) those in which the basis of the distinction drawn by the State is "inherently suspect" either because of its tendency to disadvantage persons of a discernible and stigmatized status (e.g., classifications based on race, religion, alienage, legitimacy) or persons who are exercising federally protected rights (e.g., interstate travel); and (ii) those in which the effect of the distinction is to impair a "fundamental right" (e.g., procreation, voting, personal liberty). A State classification which either rests upon grounds "inherently suspect" or impairs a "fundamental right" will be sustained only if demonstrably necessary to promote a compelling State interest. The State bears a heavy burden of justification in such cases.
2. Against this legal background, the Mercy MAC program should be judged by the traditional test. The program will not impair any recognized equal protection "fundamental right." Although it is true that the Mercy MAC proposal involves a poverty/wealth distinction, poverty and wealth have been held not to constitute a "suspect classification." James v. Valtierra, 402 U.S. 137 (1971).

No rigid formula has been developed under the traditional test to determine whether a distinction is rationally related to a legitimate State concern. Many laws and State actions are in some respect unequal in form or in application. It is only arbitrary or invidious discrimination that the traditional equal protection clause prohibits.

Here, it is beyond question that the Mercy MAC program is aimed directly at a legitimate State concern: providing a modicum of financial relief, by using State funds, to a financially troubled group. If any authority for this proposition is required, it is notable that protective legislation based wholly upon age, economic need and the prevention of severe economic hardship has been sustained in city rent increase exemption laws, public assistance, social security, real estate tax subsidies and federal and state income tax
exemptions. See, e.g., Parrino v. Lindsay, 323 N.Y.S.2d 689, 692 (1971).

3. The guidelines for eligibility to participate in the Mercy MAC program must, however, reflect a rational attempt to draw a distinction between needy holders and other holders. Of course there will be some difficult line drawing, but so long as the criteria perform the function of identifying the needy bondholders, the Mercy MAC program will not be violative of equal protection principles.

4. The considerations that establish that the Mercy MAC proposal will not violate equal protection principles are equally applicable to the question whether the Mercy MAC proposal violates due process.

C. Delegation

1. A question may be raised as to whether MAC, without specific authorization by the State Legislature, has the power as a matter of Constitutional and administrative law to distinguish between "needy" and other holders of City Notes and MAC Bonds for the purpose of making available favorable Mercy MAC treatment. New York courts have traditionally sanctioned legislative programs which have entrusted significant responsibility to State boards, commissions and authorities. Indeed, it has been stated that constitutionally to confer discretion does not mean that:
"a precise or specific formula must be furnished in a field where flexibility and the adaptation of the legislative policy to infinitely variable conditions constitute the essence of the program..." Martin v. State Liquor Authority, 43 Misc.2d 682, 686 (Sup. Ct. 1964), aff'd. 15 N.Y.2d 707 (1965); See Gaynor v. Marohn, 268 N.Y. 417, 424 (1935).

Although fundamental questions of policy are not subject to delegation, broad agency discretion has been upheld where guided by relatively general legislative standards. As one court has stated:

"It is enough if the Legislature lays down 'an intelligible principle'..." Utica v. Water Pollution Control Board, 5 N.Y.2d 164, 169 (1959).

2. Under these tests, MAC should have the authority to implement the Mercy MAC proposal without further State legislation. By legislative mandate, MAC is specifically empowered to assist the City to "[meet] its obligation to the holders of its outstanding securities." Section 3010 of the New York State Municipal Assistance Corporation Act (the "Act"). One specific means available to MAC is to exchange MAC bonds for City Notes, so long as the Board determines that the rights of the other note holders are not prejudiced by such exchange. (See Section 3035 of the Act.) This is a determination which, as discussed elsewhere herein, appears reasonable.

3. It would appear that the MAC Board has a significant degree of flexibility in determining how to administer the Mercy MAC program. In order to accomplish its legislative mandate of "assisting the municipality... [to meet] its obligations to the
holders of its outstanding securities." MAC is specifically authorized

"to do any act and all things necessary or convenient to carry out its purposes and exercise the powers expressly given and granted in this article or in the special act creating such municipal assistance corporation." Section 3010 of the Act.

4. The above analysis indicates that the MAC Board may itself, with whatever advice it chooses to acquire, develop and adopt specific eligibility guidelines for the program and may instruct its staff or others to perform the ministerial acts of implementation. If the MAC Board were to wish to delegate to another body the task of adopting guidelines or the power to grant significant exceptions to such guidelines, separate legislation to so empower such a body would probably be required.

D. **Statutory Considerations.**

1. A question might be raised regarding the power of MAC to use the proceeds of a sale of Bonds to Banks to pay principal and interest when due on Mercy MAC Bonds. Section 3012(1)(a) of the Act specifically empowers all municipal assistance corporations to issue bonds to provide sufficient funds for achieving
their corporate purposes. The exchange of Mercy MAC Bonds for City Notes pursuant to the Mercy MAC program is clearly within MAC's corporate purposes. This program can be instituted, however, only if funds are made available to finance the Mercy MAC debt service. The proceeds of the sale of Bonds to the Banks will provide that funding and, accordingly, will serve to insure the effectiveness of the Mercy MAC program. It is true that Section 3012(1)(a) states that "corporate purposes" includes making payments of interest on its notes and bonds, and that it does not list the making of payments on principal. But it is obvious from the language, however, that the list of certain purposes is by no means an exclusive one.

The First and Second General Bond Resolutions provide that the Corporation shall apply the proceeds derived from the sale of each series of Bonds as shall be specified in the Series Resolution authorizing such series. Assuming the Series Resolution authorizing the issuance of Bonds to the Banks will authorize that the proceeds of such sale be applied to the Mercy MAC debt service, there would be no legal obstacle to such application of the proceeds.

2. Section 3035(3)(b) of the Act requires that the Board of Directors of MAC shall determine that the terms of any proposed exchange of MAC Bonds for outstanding City Notes
"will not prejudice the rights of holders of other bonds and notes of the [C]ity."

The rights of the other noteholders should not be deemed to be affected, because the exchange will have no impact on the payment of principal of and interest on their notes. No funds otherwise available for payments to other noteholders are to be used in the Mercy MAC program described herein. The rights of the City bondholders would not be prejudiced, because the City is current in the payment of the principal of and interest on its outstanding bonds.
III. Applicability to Needy Holders of MAC Exchange Bonds.

A. Legal Analysis.

1. The power of MAC to exchange Mercy MAC Bonds for currently outstanding MAC Bonds held by Bondholders who are otherwise eligible for Mercy MAC participation is contained in Section 3012 of the Act. This section provides that MAC has the power "to refund any bonds by the issuance of new bonds whether or not the bonds to be refunded have or have not matured." Under the proposal, this refunding would be accomplished by the issuance to the eligible MAC Bondholders of new Mercy MAC Bonds, pursuant to a new Series Resolution adopted pursuant to the Second General Bond Resolution.

2. Each of the Series 1 through 6 Resolutions provides that a fixed dollar amount must be applied to the retirement of outstanding Bonds (if not previously repurchased) in order to fulfill the sinking fund requirement in each year in which a sinking fund installment must be paid. The Bonds received by MAC in exchange from eligible Bondholders will not be deemed "outstanding" for purposes of the sinking fund call. Accordingly, the pool of Bonds against which such fixed dollar amounts may be

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4/ The Second General Bond Resolution also contains provisions for the "refunding" of bonds by the issuance of new bonds. The type of "refunding" contemplated by the Resolution, however, would be either difficult or impossible to effectuate in the context of the Mercy MAC proposal.
applied will be reduced and the chance that a Bond held by a non-eligible Bondholder will be selected in the sinking fund lottery will be increased.

B. Conclusion.

1. Although we continue to consult with Bond Counsel to MAC on this point, we find no legal impediment to making the Mercy MAC program equally applicable to holders of MAC Bonds received in the first or second exchange offers if such holders otherwise meet the Mercy MAC eligibility standards.

2. In the second exchange offer Official Statement, which was issued after the Mercy MAC concept was first discussed by the press, after describing the concept in general terms, MAC stated:

"The Corporation has determined, however, that if it implements any such proposal, such proposal will be equally applicable to persons who have theretofore exchanged City Notes for bonds of the Corporation pursuant to this Exchange Offer, so that no person will be denied such an opportunity to be paid in cash by reason of such person's tender of City Notes pursuant to this Exchange Offer."

At the time, we thought that it would be legally impossible to make a Mercy MAC program available to holders of first Exchange Offer Bonds. Subsequent analysis and refinement of the proposed terms of the program have led us to the contrary conclusion.

*   *   *
We will inform you promptly if our continuing research or consultations with Bond Counsel alters any of the conclusions expressed in this memorandum.

Please call us if you have any further questions or would like to discuss this memorandum with us.

ALT
FRC
GSB
Letter to: Anderson
Blumenthal
Ohrenstein
Steingut with cc Bd/Est

Gentlemen:

Last September, the Board of Directors of this Corporation, at your request, committed to offer to sell certain small denomination bonds to the public. Following discussions with the City's Board of Estimate, the terms of this offering were worked out by the Corporation's staff and approved by the Board of Directors, with the offering tentatively scheduled for July, 1976. The Board is prepared to go forward but believes that you should first be apprised of certain facts which raise questions as to the wisdom of such an offering.

-- Volatility. The market for all of the Corporation's publicly-traded bonds is extremely volatile. For example, the Corporation's bonds dropped about 10% in market value following the downgrading of our Series A and B bonds by Moody's Investor Services, Inc. on May 23, 1976.

-- Illiquidity. Due to the small denominations and the fact that brokers' and transfer agents' costs and charges are to a large extent determined by the number of pieces of paper handled rather than their value, there is likely not to be any meaningful secondary market for the securities. Those who buy them would in effect be locked into the investment until its maturity.

-- Interest rate. We find ourselves in a real dilemma when attempting to establish an appropriate interest rate for the bonds. At the present time, our bonds supported by the State sales and stock transfer tax revenues are selling in the market
place at yields to maturity of 10% or more. Our bonds supported by State per capita aid are selling at substantially higher yields. Therefore, in order to offer a bond which would be valued at its full face amount would presently require an interest rate of at least 10%. However, we have offered in exchange for City notes bonds bearing an interest rate of 8%. These bonds are currently selling for 73 to 82 percent of their face value. We are concerned that offering a higher rate of interest than that 8% offered to City note holders — many of whom were also relatively small investors — would inevitably lead to widespread criticism; but to offer 8% would mean substantial losses for any purchaser who was forced to liquidate.

-- Maturity. In order to accommodate the relatively high debt service expense of the City over the current 14-year period, the Corporation offered to holders of City notes in our most recent exchange offer bonds with a 15-year maturity and no amortization of principal in the initial five years. For the same reason, we are currently seeking a second restructuring of our bonds held by City banks, pension and sinking funds, also to defer payment of principal for five years. Therefore we do not feel that it would be equitable to offer the small-denomination bonds with less than a five-year maturity.

-- Cost. Substantial costs are involved in any new bond offering which would offset to a great degree any possible benefit to the City. Based on the costs incurred in our first and second exchange offers the staff estimates that a successful
$25 million offering would cost the Corporation between $700,000 and $1,000,000.

Comparison to other investment and savings media. I believe we are all agreed that the benefits of an issue of small-denomination bonds are to give New Yorkers of moderate means an opportunity to invest in the future of their City, and to offer this small investor the benefits of tax-free securities. The principal alternative savings medium for this investor is a savings account. The range of interest we would offer is higher than that offered by savings accounts and is tax-free. However, savings accounts are not volatile, are liquid, mature as the investor elects, and are also insured by the federal government. In addition, we would no doubt be relying upon the commercial and savings banks for the bulk of our sales effort, and would be in direct competition with these same institutions for the savings dollar.

Disclosure. The Corporation is extremely proud of the standards we have set for full disclosure in our Official Statements. Our latest statement is an extremely complex 90-page document. While we can have counsel prepare a simplified version, we definitely would not want to be in the position of disclosing less to the small investor than to the larger, more sophisticated investor. As an illustration of the magnitude involved, the City's Official Statement, 110 pages, is for sale at the City Record for $17 per copy.

Likely nature of investors. Implicit in this discussion is the assumption that buyers of small-denomination
bonds are likely to be very unsophisticated investors. Even if we disclose and underline the points made above, it is probable that their meaning and significance may be missed or misinterpreted by this class of investors. In addition certain unique features of our bonds such as the requirement for annual appropriation of taxes by the Legislature and the fact that our backing is from State and not City tax and aid revenues, may be missed or misinterpreted.

Conclusion. In summary, it is our judgment that on the one hand the likely buyers of the small-denomination bonds are likely to be among the least sophisticated of investors; and that on the other hand the bonds are likely to be illiquid, volatile in price, either relatively high in interest rate or worth less than their issue price, have five-year or longer maturities, and be relatively complex and expensive to issue.

If, in light of these factors, you continue to wish us to issue such bonds, we will of course honor our earlier commitment.

Sincerely,

FGR
Chairman
Mr. Felix G. Rohatyn  
Lazard Freres & Co.  
One Rockefeller Plaza  
New York, New York

Municipal Assistance Corporation

Dear Felix:

In view of the Clines piece in last Thursday's New York Times, I think that we must discuss the possibility of a "Mercy-MAC" program in our Second Exchange Offer Official Statement. (Although, because this idea had been discussed previously, I am not sure that we could have or should have avoided mention of it in the Official Statement regardless of the Clines piece.)

We are, however, caught in a dilemma that results from the fact that we will not be able, I do not believe, to resolve the underlying legal and policy issues - can it be done, should it be done - prior to the scheduled issuance of the Second Exchange Offer Official Statement. Accordingly, the Official Statement would disclose the possibility of a limited cash payment at the same time it invites tenders. The dilemma is obvious.

I have been able to identify only one way out around this problem, other than simply shooting down the proposal at this time on a policy basis, which I do not think that we should do. That "solution" would be to make the policy determination now that we will not do a Mercy-MAC program unless it can be made equally available to those persons who have already tendered City Notes pursuant to either the First or the Second Exchange Offer. (Obviously, the basic dilemma is also solved simply by making Mercy-MAC available to persons tendering in the second exchange offer, but as a matter of policy that might not be wise.)

May 17, 1976

RECEIVED
MAY 17, 1976
Attached is a proposed form of rider for the Second Exchange Offer Official Statement that would disclose the Mercy-MAC proposal and announce the policy decision that Mercy-MAC would be implemented only if it could be implemented without regard to a prior exchange.

I am having research done here, and Don Robinson is similarly having research done in his office, on the substantive legal issues to attempt to reach a consensus as to whether any such program (coupled with Mini-MAC or separate from Mini-MAC) can be done legally. The nay-sayers abound, but I am not convinced as yet that they are correct. I am convinced that Mercy-MAC is an intriguing and worthwhile idea and, accordingly, I continue to press for a way to do it legally.

After you have had a chance to look at the rider and consider the problem, please call me.

Best personal regards.

Sincerely,

Allen L. Thomas

ALT:brt
Encls.

BY HAND

cc: Mr. Heineman
    Mr. Blish
    Mr. Keegan
    Mr. Robinson
February 25, 1976

Mr. Leonard Joseph
Room 4600
140 Broadway
New York, New York 10005

Dear Mr. Joseph:

We are in receipt of your letter dated February 24 and regret to advise that there is no possibility of late tendering in connection with the MAC exchange offer. The tender offer expired December 29, 1975.

Sincerely yours,

[Signature]
Judith Chazen
Executive Secretary
February 24, 1976

Municipal Assistance Corporation
for the City of New York,
Two World Trade Center,
New York, New York 10047.

Dear Sirs:

I am a holder of $20,000 of New York City Notes which matured on December 11, 1975. At the time you offered to exchange MAC Notes for these New York City Notes I was ill and was unable to effectuate the exchange. I would now like to do so and would appreciate learning whether such an exchange can now be effectuated. I would obviously waive any requirement to receive an up-to-date MAC prospectus.

Very truly yours,

[Signature]

Leonard Joseph
Mr. Felix Rohatyn
Municipal Assistance Corporation
2 World Trade Center
New York, New York

Dear Felix:

At the time the moratorium was adopted some discussion was had on the potential of offering shorter redemptions, particularly for senior citizens who have little or no other source of income.

I have received several inquiries from individuals who describe themselves in this category and wanted to know whether or not either M.A.C. or the Control Board had under consideration any special measures to relieve individual hardship in instances like this.

Sincerely,

Albert H. Blumenthal

AHB:a
REPORT OF THE COMMITTEE ON

SMALL Denomination Bonds

The Committee met on September 25, 1975 and made the following recommendations as to the characteristics of small denomination bonds to be authorized by MAC.

Denomination. Offerings could be in denominations of $50, $100, $250 or $500, with the purchaser free to select any of these authorized denominations. (The trustee estimates that the average will be $100).

Transferability. The recommendation was for registered form both as to principal and interest. Transferability would be through the trustee and only for legally required reasons such as death of the registered holder. There was a strong minority viewpoint that the bonds should be in bearer form.

Redemption. It was recognized that redemption before maturity is not feasible.

Term. A term of at least five years and not more than eight years was recommended. Need decision.

Interest Rate. It was recommended that the rate should be approximately midway between the market rate for a corresponding maturity on large denomination bonds and such lower rate as would recover all of the additional unit costs of small denominations. (As shown below, this would mean, on the Committee's assumptions, approximately 1 percent under a corresponding large denomination rate).

Interest Payment. The majority view was that interest should be paid only at maturity and that it should accrue annually and compound annually with a schedule printed on the back showing the amount accrued each year. There was a strong minority viewpoint that it would be unwise to defer the payment of interest through the entire term of the bond. In this minority viewpoint, interest should be paid annually either by check if the bonds are registered as to interest as well as principal, or by the payment of bearer coupons if they are not registered as to interest.

Security. Recommendation is for issuance under the General Bond Resolution so that the security would be the same as the publicly held series B bonds.
"Flowering". It was recommended that the bonds be given the maximum legally possible applicability to city taxes. This is permitted by Sec. 3073(4) of our statute, which required ERCB approval and application only at maturity. It also requires that bonds so received by the city be presented to MAC "for payment to the city."

Format. Among the formats considered were: a small certificate with engraved border, wafer and corporate name; a standard size engraved certificate; and a "pass book". While there was no decision on this point, the consensus seemed to favor a certificate. After receiving cost estimates, the undersigned favors standard size certificates: their formality is impressive and should reduce the risk of lost certificates and the expense of replacement.

Method of Sale. Subscription rather than underwriting was recommended. The expectation is that banks and savings and loan institutions throughout the state will agree to act as sales agents under written agreements with MAC. Under Arthur Quinn's leadership the New York and Bronx County savings banks have agreed to do this without compensation, and he hopes to extend such agreement to the rest of the state and to other banks and S & L's.

The sales agent-bank would perform only the ministerial function of receiving a written application with the applicant's check or money, giving a receipt therefor and forwarding it to the Trustee. There would be no recommendations and no answering of questions or making of representations.

At each sales agent's officer there would be a current Official Statement and Bond Counsel's opinion and the application for purchase would advise the applicant of their availability for inspection.

The Trustee, on receipt of an application, would wait for check clearance and thereafter enter the bond information in its computer and, after authentication, mail the bond to the purchaser or, if directed, to the sales-agent bank for pick-up by the purchaser.

Other techniques may be evolved.

Size of Issue. A pilot first issue of $25,000,000 was recommended, subject to possible contrary advice from "promotional" sources. A preference was expressed for an over-subscribed first issue which suggests a small amount. Subsequent issues could easily be authorized. One possibility is for an open-ended series with the Finance Committee authorized to sell successive installments (the computer can be programmed to stop the processing of applications when any set limit is reached.)
Management. Discussion was bad, without final recommendation, of the possibility of a "project director" solely for the small denomination bond issue.

Promotion. There was no formal discussion of promotion techniques.

Maintaining Market. If it was desired that the bonds should be freely transferable and that a market be maintained to facilitate their transfer these are additional considerations, aside from costs. Mr. Gould has undertaken to make a separate report on this aspect.

Costs. The Committee did not discuss the costs of various alternatives. However, Mr. Goldberg has had discussions of costs with the Trustee and his conclusions are transmitted herewith.

Arthur Quinn, Chairman
Donna Shalala
Zane Klein
Herbert Elish
Daniel B. Goldberg

Committee on Small Denomination Bonds

October 10, 1975
October 10, 1975

TO: Committee on Small Denomination Bonds

FROM: Daniel B. Goldberg

SUBJECT: Costs of Issuance

This memorandum may be used to supplement your report of October 9th on the characteristics which the Board will have to choose for the issuance of small denomination bonds.

Costs. Some of the costs are approximately equal for conventional underwritten public sales and for the proposed new program: Bond Counsel fees should not be markedly different; and, surprisingly, bond printing costs will be very little more for the program because most of the cost is in the initial engraving rather than the printing and delivery. Similarly, printing official statements will probably not be much different.

Subscription, with the free service of the sales agent-banks, will, of course save the conventional underwriting fee. I will hazard the guess that this saving will be of the same order of magnitude as the additional average costs for about one year, as described below.

The additional costs will mostly be as a result of the Trustee's additional fees and disbursements in handling so many individual pieces of paper. For example, in a conventional $25,000,000 issue there would be approximately 5,000 certificates. For an equivalent small denomination issue the estimate is for 250,000 certificates; in a fully registered issue with annual interest payments there would be some 25,000 annual mailings, etc.

The Trustee has made price estimates of various alternatives, but has cautioned that these are only estimates. For comparison purposes I will first assume an 8-year maturity. The average annual costs given include proration of the fairly large start-up costs, with no weighting for their larger present value.
For an issue of bearer bonds with annual bearer-coupons the average annual Trustee's cost is estimated at about .40% on the assumptions stated. To this must be added a substantial initial cost for insurance of the mail delivery of the bond—$1.85 per bond at Post Office rates, but possibly less if privately insured. The insurance cost could be saved if methods could be devised for the agent-banks to issue the bonds directly.

For an issue of fully registered bonds (with only limited transferability) and all interest payable only at maturity, the corresponding estimated average cost is about 1.4% (including insurance).

If a fully registered issue has annual interest payments, the corresponding annual average would increase by about .25% to a total of about 1.65%.

An issue of bonds registered as to principal but with bearer coupons has not yet been priced. If the insurance cost is not substantial because of the bearer coupons, this cost should be close to the 1.4% estimated average for wholly registered bonds.

If the maturity is five years, the average annual costs would increase because of the fewer years over which to spread the fixed start-up costs. I hazard an estimate of .5% more than for an 8-year term.

If the registered bonds are made freely transferable through the Trustee, these costs would be substantially increased, but there is no estimate of the increase. Possibly such transfer costs could be recovered in whole or in part by charges against the registered holder.

Copies of the Trustee's letter on the price components of its estimates are attached.

Conclusion as to Costs. We may expect that the average annual incremental cost of the small denomination issue over a conventional issue may be about 2% of principal, plus or minus. If the issue bore a coupon rate under the conventional equivalent, the Corporation would absorb the balance of the increment, against which it could apply the savings in underwriting costs.

Daniel B. Goldberg