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Highlights of 2013 SEC Enforcement in the Municipal Market

In 2013, the Securities and Exchange Commission (the "SEC") brought a number of enforcement actions in the municipal market that not only reinforced the agency's commitment to regulating the municipal market, but also brought about a number of firsts for the SEC's municipal securities enforcement program. The enforcement actions described below demonstrate that the sufficiency and accuracy of disclosure in the municipal market is more important than ever and provide many important lessons for all issuers and obligated persons in municipal bond transactions.

First Penalty Assessed Against a Municipal Issuer: The Greater Wenatchee Public Facilities District

In November 2013, the SEC, for the first time, assessed a financial penalty against a municipal securities issuer. The SEC charged the Greater Wenatchee Regional Events Center Public Facilities District, a staff member of the District, a private developer and the president of the developer with misleading investors in connection with a 2008 bond offering that financed the construction of a regional events center and ice hockey arena (the *"Facility"*).

The charges were based upon the content of the official statement produced in connection with the offering of the bonds. According to the SEC, the official statement contained materially false and misleading language to the effect that the projected financial performance of the Facility had not been reviewed by any financial advisor or accounting firm in order to verify the reasonableness of the assumptions, the appropriateness of the preparation or the presentation of the projected financial performance. Additionally, the official statement failed to disclose that the City of Wenatchee's agreement to provide financial assistance to pay the bonds if the Facility's revenue was insufficient was limited by the City's remaining debt capacity.

The District agreed to settle the charges by paying a $20,000 penalty and undertaking remedial actions including the establishment of disclosure policies and ongoing training programs for District employees involved in municipal securities offerings or continuing disclosure. Although the SEC had previously declined to impose financial penalties against municipal issuers, the SEC did so in this case and noted that financial penalties against municipal issuers are appropriate for deterring misconduct.

First Charge of Issuer Violation of Prior Cease-and-Desist Order: City of Miami

In July 2013, the SEC took action against a municipality already under an existing SEC cease-and-desist order for the first time. In this action, the SEC charged the City of Miami and its former Budget Director with violations of the anti-fraud provisions of the federal securities laws,[1] alleging that the during the years 2007 through 2009, the City transferred balances from its Capital Projects Fund to its General Fund in order to mask deficits in the General Fund and maintain the City's bond ratings. By violating the anti-fraud provisions during these years, the SEC claimed the City also violated a 2003 cease-and-desist order issued by the SEC against the City for violations of the anti-fraud provisions of the federal securities laws in connection with a 1995 bond issuance.

First Charge of Falsely Claiming Compliance with Continuing Disclosure Requirements: West Clark Schools

In this July 2013 enforcement action, the SEC charged West Clark Community Schools, an Indiana school district, with falsely stating in a 2007 official statement that the school district was fully compliant with its duty to provide annual financial reporting and material event notices as required by a continuing disclosure undertaking entered into in connection with a 2005 bond offering, when in fact the district had failed to submit any of the required annual financials or event notices. City Securities Corporation, the school district's underwriter for both the 2005 and 2007 bond offerings, was also charged with failing to conduct sufficient due diligence to determine if the school district's representations in the 2007 official statement were true.

As part of its settlement with the SEC, the school district agreed to take remedial actions, including the adoption of written disclosure policies as well as implementing training for personnel involved in bond offerings and the disclosure process. In order to settle the charges against it, City Securities Corporation agreed to pay approximately $580,000 in fines and disgorgement, and also agreed to enhance its disclosure policies.

1. Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5.

First Charge Against an Issuer for Materially Misleading Statements Outside of Disclosure Documents: City of Harrisburg

On May 6, 2013, the SEC imposed a cease-and-desist order against the City of Harrisburg, Pennsylvania, for violations of the anti-fraud provisions of the federal securities laws in connection with bonds issued to finance upgrades and repairs to a solid waste resource facility. The SEC's complaint alleged that public statements by City officials contained material misstatements and omissions regarding the City's financial position during a multi-year period in which the City also failed to comply with its continuing disclosure undertakings. This action marks the first time the SEC took action against a municipality based on statements made publicly, as opposed to those made in the required disclosure documents. Additionally, this is the first SEC enforcement action to cite the failure of a municipal securities issuer to post continuing disclosure information on the Electronic Municipal Market Access (*"EMMA"*) website as contributing to the SEC's finding of fraud.

Increased Emphasis on Issuer Controls and Procedures: State of Illinois

In March 2013, the SEC issued a cease-and-desist order against the State of Illinois for alleged violations of the anti-fraud provisions of the federal securities laws in connection with bond offerings during the years 2005-2009. According to the SEC, although the State disclosed that its pension obligations were funded via a statutory plan and provided details of the plan, it failed to inform investors about the systematic underfunding of its pension plan and the impact such underfunding could have on the State's overall financial condition.

The SEC's order found that the State's misleading disclosures resulted from various institutional failures such as a failure to adopt policies and procedures to ensure that material information about the State's pension plan was communicated to individuals responsible for bond disclosures and a failure to train personnel involved in the disclosure process, and was actionable as negligence. The SEC order also noted favorably that prior to the enforcement action the State had taken remedial actions, such as retaining disclosure counsel, issuing significantly improved disclosures in the pension section of its bond offering documents and instituting written disclosure policies and procedures. The SEC did not seek monetary fines or penalties from the State or any individuals in this case.

Takeaways

Together, these enforcement actions demonstrate that the SEC is placing an ever-increasing emphasis on disclosure in municipal securities offerings. In particular, the 2013 enforcement actions make clear that the SEC will:

- hold accountable individuals involved in municipal bond transactions for deficient disclosures, including officers and employees of municipal issuers;
- view the facts associated with the development of a difficult or defaulted transaction in a manner that is not especially favorable for the transaction participants;
- insist that issuers and underwriters alike adopt comprehensive disclosure and due diligence policies and procedures as well as provide regular training to their officers and employees regarding their obligations under the federal securities laws; and
- insist that an underwriter develop a reasonable basis for belief in the accuracy and completeness of the official statement by conducting its own adequate due diligence.

Issuers and obligated persons in municipal bond transactions should expect that disclosures in the market will receive scrutiny from the SEC. As such, it is more important than ever that issuers ensure full and timely compliance with continuing disclosure undertakings. Additionally, because the SEC views financial and operating information and material event notices that are posted on EMMA as "speaking to the market" (i.e., information reasonably expected to reach investors in the bond market), issuers and obligated persons should ensure that the contents of these continuing disclosure filings are accurate and do not contain any material misrepresentations or omissions. It is also clear that the SEC will look favorably on a governmental unit's adoption of formal written policies and procedures regarding securities disclosure. As such, we continue to recommend that issuers and obligated persons consider the adoption of comprehensive disclosure policies that are appropriate for their circumstances in order to promote timely filing of complete and accurate disclosure information.

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