

Chapman Client Alert

August 29, 2017

Current Issues Relevant to Our Clients

SEC Charges Issuer, Underwriter and Related Parties in First Post-MCDC Enforcement Actions

On August 23, 2017, the Securities and Exchange Commission (SEC) announced settlements in enforcement actions against the Beaumont Financing Authority (BFA); Alan Kapanicas (Kapanicas), the former executive director of BFA; O'Connor & Company Securities Inc. (O'Connor Securities), the underwriter of the BFA obligations; and Anthony Wetherbee (Wetherbee), the co-founder and former primary investment banker of O'Connor Securities. Copies of the SEC's Orders can be found [here](#) and [here](#).

BFA and Kapanicas each agreed to settle charges filed by the SEC alleging material misstatements and omissions in the sale of municipal securities violating Sections 17(a)(2) and (a)(3) of the Securities Act of 1933, by making false statements about prior compliance with BFA's continuing disclosure obligations in five bond offerings in 2012 and 2013. O'Connor Securities and Wetherbee also agreed to settle charges for failing to conduct reasonable due diligence with respect to the continuing disclosure representations of BFA.

These actions represent the first SEC enforcement actions against municipal issuers and underwriters that did not voluntarily self-report under the Municipalities Continuing Disclosure Cooperation initiative (MCDC). MCDC offered underwriters and issuers the opportunity to self-report potential violations during the period of 2009 to 2014 in exchange for more lenient settlements than would otherwise be available for violations which were not self-reported.¹ When the MCDC was announced in March of 2014, the then-director of the SEC's Enforcement Division cautioned issuers and underwriters that "Those who do not self-report and instead decide to take their chances can expect to face increased sanctions for violations." Enforcement actions such as those described in this Alert are considered to be necessary to establish the credibility of market sweep enforcement actions such as the MCDC.

In alleging that BFA and Kapanicas made material misstatements and omissions in the sale of municipal securities, violating Sections 17(a)(2) and (a)(3) of the Securities Act of 1933, the SEC noted that Kapanicas approved and signed all of the continuing disclosure undertakings entered into in connection with the issuance of BFA's municipal bonds, was responsible for drafting, approving and filing the annual reports and notices that were required by those undertakings, and signed the final official statements that contained the material misstatements and omissions:

[Kapanicas] repeatedly either failed to read and understand the [undertakings] or disregarded their

requirements. He also repeatedly failed to read and confirm that the statements in the BFA's 2012 and 2013 official statements concerning [compliance with the undertakings] were accurate and complete, or ignored the fact that the statements were false.

The Order also emphasizes that "[d]espite seeking and receiving hundreds of millions of dollars in financing from municipal securities investors," BFA did not have any formal, written policies regarding post-issuance continuing disclosure or for the preparation of disclosure documents, nor did they appoint a compliance officer or enter into agreements with any professional service providers to assist them. Furthermore, the Order notes that BFA failed to account properly for the expenditure of bond proceeds or maintain appropriate records pertaining to the bond issues.

Under the terms of the settlement with BFA, which generally mirrored the settlement terms imposed under the MCDC, BFA agreed to undertake, and to certify compliance with, (i) the establishment of written policies and procedures and periodic training regarding the preparation, review and approval of official statements and continuing disclosures and the designation of a compliance officer to ensure compliance with those policies and procedures, (ii) the establishment of written policies and procedures and periodic training regarding the accounting of bond proceeds and recordkeeping and the establishment of a compliance officer to ensure compliance with those policies and procedures, (iii) the updating of any past delinquent filings, (iii) the retention of an independent consultant (not unacceptable to the SEC) to conduct a review of BFA's policies and procedures and (v) to disclose, for the next five years, the terms of the settlement in its offering documents in a "clear and conspicuous fashion."

Kapanicas agreed to settle the charges against him without admitting or denying the allegations, and to pay a \$37,500 penalty, along with agreeing to be barred from participating in any future municipal bond offerings. O'Connor Securities and

Wetherbee also agreed to settle the charges against them without admitting or denying the allegations. O'Connor Securities agreed to pay a \$150,000 penalty (which is \$50,000 more than they would have had to pay had they self-reported under MCDC) and to retain an independent compliance consultant to review its policies and procedures. Wetherbee agreed to pay a \$15,000 penalty and to be suspended from the securities industry for six months.

These actions by the SEC makes clear that the SEC's review of continuing disclosure compliance did not end with MCDC and further indicates the importance of each issuer and obligated person having formal, written disclosure policies and

procedures and post-issuance compliance policies, as well as the essentiality of following the same with regard to every offering of municipal securities subject to such policies and procedures.

[For More Information](#)

If you would like further information concerning the matters discussed in this article, please contact a member of our Public Finance Group or visit us online at chapman.com.

- 1 Our Client Alert on the MCDC initiative can be found [here](#). Under MCDC, the SEC issued cease-and-desist orders to 72 underwriting firms and 71 municipal issuers and obligated persons in response to voluntary self-reporting of potential misrepresentations in municipal bond offering documents regarding compliance by issuers and obligated persons with prior disclosure obligations. Our Client Alerts on the MCDC settlements with underwriters (dated June 22, 2015; October 5, 2015; and February 3, 2016) can be found [here](#), [here](#), and [here](#) and our Client Alert on the MCDC settlements with municipal issuers and obligated persons dated August 26, 2016, can be found [here](#).

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