Chapman and Cutler LLP

Chapman Client Alert

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Current Issues Relevant to Our Clients

Fraud Charges against College Official Include Materially Misleading Continuing Disclosure Filing

On March 28, 2019, the Securities and Exchange Commission (SEC) charged Keith Borge, the former controller of the College of New Rochelle, a New York-based not-for-profit college (the "College"), with violating, and aiding and abetting violations of, the antifraud provisions of the federal securities laws. On the same day, in a parallel action, the United States Attorney's Office for the Southern District of New York announced criminal charges against Borge. Borge agreed to a partial settlement with the SEC and pleaded guilty to one count of failing to pay over federal payroll taxes and one count of securities fraud, with potential monetary sanctions and prison sentence to be determined at a later date. The maximum prison sentences for failing to pay over federal payroll taxes and securities fraud are 5 and 20 years, respectively. Geoffrey S. Berman, the United States Attorney for the Southern District of New York, stated that Borge "committed federal crimes for which he will now pay the price."

Summary of Allegations

In 1999, the City of New Rochelle Industrial Development Agency issued $24 million in revenue bonds for the purpose of financing renovations at the College (the "1999 Bonds"). The College was legally committed to support repayment of the 1999 Bonds and entered into a continuing disclosure agreement for the benefit of the bondholders. The continuing disclosure undertaking required the College to annually provide certain information, including audited financial statements, to the Electronic Municipal Market Access (EMMA) online system operated by the Municipal Securities Rulemaking Board.

The securities law charges against Borge relate to alleged false entries in the College's audited financial statements for fiscal year 2015. According to the SEC, by 2013, the College was under considerable financial stress as student enrollment declined and tuition revenues decreased. To address the College's operational cash flow needs, the SEC alleges Borge withdrew funds from the College's endowment fund without the requisite approval of the College's Board of Trustees. The SEC further alleges that Borge took numerous steps to conceal the misappropriation of such funds and to obfuscate the true financial condition of the College, resulting in the recording of approximately $25 million in net assets in the College's audited financial statements for fiscal year 2015 as opposed to the actual figure of negative $8 million. Finally, the SEC alleges that Borge intentionally withheld required payroll tax payments during fiscal year 2015 and omitted such payroll tax liability from the audited financial statements for that fiscal year, resulting in an overstatement of net assets in the amount of approximately $11.7 million.

Borge filed the audited financial statements for fiscal year 2015 on EMMA, as required by the College's continuing disclosure agreement for the 1999 Bonds, making the misrepresentations and omissions included in such audited financial statements available to investors. As a result, according to the SEC, secondary market purchases and sales of the 1999 Bonds were made based on false and misleading financial information. Following the initial disclosure of the College's financial challenges in December 2016, the SEC reported that the market value of the 1999 Bonds significantly decreased and yields for the 1999 Bonds doubled from 5% to 10%. The SEC concluded that the failure to accurately present the College's financial condition was material to the investment decision of holders, purchasers and sellers of the 1999 Bonds in the secondary market.

Conclusion

In response to the recent activity of the SEC and the Department of Justice and related penalties imposed for securities law violations, issuers and their finance officials should evaluate their current policies and procedures for primary and secondary market disclosures related to municipal securities. In addition, issuers and their finance officials should understand that material misstatements within financial documents carry potential securities law antifraud liability when made available to the public, whether in connection with primary or secondary offerings of municipal securities.

For More Information

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