

Liability for Municipal Officials[1]

by Devala Janardan, Associate Counsel

2008 was a year of bad stories for the US and world economy. News headlines focused on the major stories — the collapse of Lehman Brothers, the government-backed bailout of the American Insurance Group (AIG), and the federal takeover of Fannie Mae and Freddie Mac. There was one story, however, that originated in 2008 that was not widely picked up by the media and will certainly have major implications for municipal lawyers and other public officials. In April 2008, the Securities and Exchange Commission (SEC) filed a complaint for violations of federal securities laws against five former officials of the City of San Diego. What made this complaint[2] unusual is that it was the *first* time that the SEC went after public officials in their *individual* capacity for civil penalties. On October 27, 2010, the SEC reached a settlement with four former public officials for the City.[3]

The problems for San Diego, like many other municipalities, started in the early part of the decade. The City faced increased difficulty in funding its pension and health care obligations. This was due to a number of factors, including: 1) the City's intentional under-funding of its pension plan; 2) the City's granting of additional retroactive pension benefits; 3) San Diego's use of pension fund assets to pay for additional pension and retiree health care benefits; and 4) the pension plan's less than anticipated earnings on investments.[4] Despite these problems, the City completed a series of bond offerings totaling over $260 million in 2002 and 2003. As part of these bond offerings, the City released disclosure documents to be used by rating agencies and investors. While the documents included some mention about increasing pension costs, it did not accurately detail the amount that these costs were to rise, such as the fact that the City's unfunded pension liability was expected to increase from $284 million in 2002 to $2 billion by 2009. The SEC went after the City for securities fraud and the parties reached a settlement in 2006.[5] While the settlement required San Diego to hire an independent monitor to improve its disclosure procedures, it *did* not impose any financial penalty upon the City. The SEC took the position that if a fine were imposed on the City, it would essentially be a burden on the taxpayers to pay the fine.[6]

The SEC filed its 2008 complaint against five former San Diego officials, including the City Manager, City Auditor/Comptroller, Deputy City Manager for Finance, Assistant City Auditor/Comptroller, and the City Treasurer.[7] The individuals were charged with violating Section 17(a) of the Securities Exchange Act of 1934. Section 17 states: (a) It shall be unlawful for any person in the offer or sale of any securities or any security-based swap agreement... by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly - (1) to employ any device, scheme, or artifice to defraud, or (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.[8]

Essentially, the SEC accused the former officials of having "substantial knowledge" of the City's difficult financial positions, and despite this, recklessly advised the City Council and/or certified false and misleading disclosure documents.

As mentioned above, *this is the first time* that the SEC pursued (and obtained) civil penalties against individual public officials in a municipal bond offering. On October 26, 2010, the SEC reached a settlement with four of the former officials: the City Manager, City Auditor/Comptroller, Deputy City Manager of Finance, and the Treasurer. The City Manager, Auditor, Deputy City Manager all agreed to pay $25,000 in civil penalties, while the City Treasurer agreed to pay $5000. The SEC's charges against the Assistant City Auditor/Comptroller are pending.

The Director of the SEC's Los Angeles Regional Office stated that "[m]unicipal officials have a personal obligation to ensure that investors are provided with complete and accurate information about the issuer's financial condition" and that "[t]hese former San Diego officials are paying a price for their actions that jeopardized the interests of investors and put the city's current future retirees at risk."[9] Municipal attorneys will certainly want to be on top of the issues with increased enforcement by the SEC. IMLA will be offering a series of teleconferences in 2011 on municipal finance issues.

Notes

1. This article continues the discussion from the Federal column in the previous issue of the *Municipal Lawyer*.
2. Complaint of Securities and Exchange Commission, *SEC v. Uberuaga, et al.*, (S.D.Cal. 2006).
3. Press Release No. 2010-204, Securities and Exchange Commission, Former San Diego Officials Agree to Pay Financial Penalties in Municipal Bond Fraud Case (Oct. 27, 2010) (on file with author).
4. Order Instituting Cease-and-Desist Proceedings, Making Findings, Imposing a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934. Administrative Proceeding File No. 3-12478 (Nov. 14, 2006).

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Judicial Takings

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Notes

1. Stop the Beach Renourishment, Inc. v. Fla. Dep't of Envt'l Protection, 130 S. Ct. 2592 (2010).
2. *Brief of Amicus Curiae*, The Florida Shore and Beach Preservation Association, The Florida Association of Counties, and The Florida League of Cities In Support of Respondents, 2009 WL 3236333 at *17 (U.S. Oct. 5, 2009), citing the Fla. Dep't of Env. Protection, Bureau of Beaches and Coastal Systems, *Strategic Beach Management Plan* (May 2008) at 2.
3. *Id.* at *20 n.3.
4. *See generally*, Fla. Dept. of Env. Protection, *Critically Eroded Beaches in Florida* (June 2009) at 1-3, available at http://www.dep.state.fl.us/beaches/publications/pdf/CritEroRpt09.pdf.
5. The Florida Beach Erosion Control Program was established in 1964.
6. The Florida Beach and Shore Preservation Act, *Fla. Stat.* ch. 161, part I (2009). The specific sections of the Act in issue were sections 161.191 and 161.201.
7. Walton County v. Stop Beach Renourishment, Inc., 998 So.2d 1102 (Fla. 2008).
8. All of the decisions and many of the briefs are collected at www.inversecondemnation.com. Type in "beach takings case" in the search window or go directly to http://www.inversecondemnation.com/inversecondemnation/beachfront-takings-case-resources.html. The Supreme Court decision is at http://www.supremecourt.gov/opinions/09pdf/08-1151.pdf.
9. Tony Mauro, *Was Stevens' Condo the Reason for Justice's Recusal in Fla. Property Rights Case?*, The National Law Journal, Dec. 07, 2009.
10. Bormann v. Bd. of Sup'rs in and for Kossuth County, 584 N.W.2d 309 (Iowa 1998), *petition for cert. denied*, Girres v. Bormann, 525 U.S. 1172 (1999) (U.S. Feb. 22, 1999) (No. 98-1003).
11. Oral Argument Transcript, 2009 WL 4323938 at *8 (Dec. 02, 2009).
12. *Id.* at *20.
13. Stevens v. City of Cannon Beach, 510 U.S. 1207 (1994).
14. *Id.* at 1334-35 (citations omitted).
15. Jeffrey Toobin, *Activism v. Restraint*, The New Yorker, May 24, 2010, cited in Blumm and Dawson, *The Florida Beach Case and the Road to Judicial Takings*, (2010) available at http://ssrn.com/abstract=1669707. Blumm and Dawson cover the decision and its background in detail.
16. Lucas v. South Carolina Coastal Council, 505 U.S. 1003 (1992).
17. Penn Central Transp. Co. v. New York City, 438 U.S. 104 (1978).
18. 389 U.S. 290 (1967).
19. *Id.* at 443.
20. Kelo v. City of New London, 545 U.S. 469 (2005).
21. Lingle v. Chevron U.S.A. Inc., 544 U.S. 528 (2005).
22. San Remo Hotel, L.P. v. City and County of San Francisco, 545 U.S. 323 (2005).
23. *Common Sense and Private Property*, New York Times, June 17, 2010 at http://www.nytimes.com/201%6/18/opinion/18fri1.html?_r=1&ref=editorials.
24. PFZ Properties, Inc. v. Rodriguez, 928 F. 2d 28 (1st Cir. 1991), *cert. dismissed as improvidently granted*, 503 U.S. 257 (1992).
25. Stop the Beach Renourishment, Inc. v. Fla. Dep't of Envt'l Protection, 130 S. Ct. 2592, 2596.
26. *Id.* at 2618.
27. *Id.* at 2603.
28. Maunalua Bay Beach Ohana 28 v. State of Hawaii, 122 Haw. 34, 222 P.3d 441 (Haw. Ct. App. 2009).
29. 2010 U.S. LEXIS 8503 (Nov. 01, 2010).
30. PPL Montana, LLC v. State of Montana, 229 P.3d 421 (Mont. 2010).
31. First English Evangelical Lutheran Church of Glendale v. County of Los Angeles, 482 U.S. 304 (1987).
32. For a good sense of opinions from both sides, see John D. Echeverria, *Stop the Beach Renourishment: Why the Judiciary is Different*, Vermont Law School Legal Studies Research Paper Series Research Paper No. 10-45, Vermont Law School (Aug. 02, 2010) at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1652351, and Thomas, Murakami, and Eyerly, *Of Woodchucks and Prune Yards: A View of Judicial Takings from the Trenches*, Aug. 09, 2010, at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1655658. Seems like everyone is duking it out on SSRN these days. **ML**

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5. *id.*
6. Mary William Walsh, *San Diego Agrees to Settle SEC Pension Fraud Case*, N.Y. Times, Nov 15, 2006, athttp://www.nytimes.com/2006/11/15/business /15pension.html?ref=business.
7. These individuals worked for the City of San Diego during the time of the 2002 /2003 bond offerings, but not at the time the complaint was filed.
8. Securities Exchange Act of 1934, 15 U.S.C. §77(a)(q) (2006).
9. Press Release No. 2010-204 (Oct. 27, 2010). **ML**

Supreme Court

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practice" rule of causation. The sole rationale for discarding the requirement was that claims for declaratory and other prospective relief allegedly did not result in the sort of financial burdens imposed by damages awards, which the Ninth Circuit perceived as the basis for *Monell*'s rejection of respondeat superior liability against governments. The County, however, maintains that "[u]nless a plaintiff establishes constitutional liability under that standard, no remedy, whether it be damages, injunctive or declaratory relief, is appropriate." For their part, the respondents argue that when a plaintiff seeks prospective relief, a separate showing of municipal responsibility is not required because the other standards applicable to such claims (e.g., Article III standing constraints) ensure the requisite connection exists between the local government and the challenged conduct. Accordingly, the question before the Supreme Court is whether the "custom, policy, or practice" requirement extends to prospective equitable relief sought against a local entity.

A decision is forthcoming. **ML**