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SEC ACTIONS BASED ON MUNICIPAL ISSUER DISCLOSURE VIOLATIONS

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1. Introduction

As a general proposition, while federal securities laws do not require municipal securities to be registered, these laws impose a duty on municipal issuers to refrain from making false or misleading statements in connection with the offering of its securities. This obligation is typically fulfilled through a very formal process of the issuance of an "official statement" or other offering document, which constitutes the issuer's statement of facts surrounding the issuance.

Heretofore, the Securities and Exchange Commission (the "SEC") has not vigorously enforced these legal standards. However, recent developments, such as the enhanced enforcement powers granted in the Dodd-Frank law, as well as the SEC's heightened concern about disclosure related to municipal securities, have resulted in increased activity in this area, of which municipal issuers should be aware.

2. Background

SEC Rule 10b-5 (17 C.F.R. 240.10b-5), promulgated under Section 10(b) of the Securities Exchange Act of 1934, provides: "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

SEC Rule 15c2-12 requires underwriters to obtain and review a "deemed final" official statement" and requires the underwriter to contract with the issuer to receive the official statement within seven business days after an agreement to purchase, off, or sell the securities. It also prohibits the purchase and sale of municipal securities by an underwriter in a public offering unless the issuer or an "obligated person" undertakes to provide continuing disclosure, including the disclosure of certain enumerated events. Effective July 1, 2009, all continuing disclosure must be provided to the MSRB, through its Electronic Municipal Market Access System, or "EMMA." The rule was amended, effective December 1, 2010, to require notices of material events to be provided within 10 business days after occurrence.

A municipal issuer has no affirmative duty to disclose information unless it is engaged in the offering, purchase or sale of securities, or disclosure is required under a continuing

disclosure undertaking (as described above). However, if an issuer chooses to disclose information, it is prohibited only from disclosing information that is materially untrue or misleading, or that contains a material omission, making it misleading in light of the circumstances in which the information is closed.

The Dodd-Frank Wall Street Reform and Consumer Protection Act provided a number of enforcement tools, including whistleblower provisions that provide a reporting incentive, and the ability to impose civil penalties of up to $150,000 on administrative proceedings. Previously the SEC could obtain civil penalties only by bringing an action in federal court.

3. Focus of SEC Enforcement

The SEC has developed a body of cases, litigation releases, orders and investigative reports that reflect areas in which the SEC has found disclosure to be deficient, including (i) failure to disclose material interests in the transaction, (ii) failure to disclose intended use of bond proceeds (including failure to disclose investment expectations), (iii) failure to disclose potential taxability of bonds, (iv) failure to disclose existence of adverse reports , (v) failure to disclose material terms, (vi) failure to disclose financial condition accurately, (vi) failure to disclose kickbacks, broker fees and markups.

In 2010, the Enforcement Division of the Securities and Exchange Commission announced the formation of a specialized municipal securities and public pensions enforcement unit. Since then, the SEC has filed an increasing number of municipal market enforcement actions. This unit announced five priority areas: (i) offering and disclosure fraud (misrepresentations and omissions in offering documents), (ii) tax or arbitrage-driven fraud, (iii) pay-to-play and public corruption violations (prohibiting a firm from underwriting bonds within two years after on if its municipal finance professionals contributes more than $250 to an elected official of the issuer), (iv) public pension accounting and disclosure violations (including a focus on inadequate disclosure of public pension-funded liabilities), and (v) valuation and pricing fraud.

4. Enforcement tools

The SEC has a broad range of civil remedies that it can invoke, including:

- initiation of an action to enjoin any person engaged in or about to engage in any act or practice that violates the 1934 Act. In some cases, defendants may consent to the entry of an injunction without admitting the alleged violations. A defendant may contest a preliminary of final injunction by arguing that they have not violated the Act or that any further violation is improbable.

- award of a monetary penalty against any person in violation of the federal securities laws or an SEC cease and desist order. This may cover not only the issuer, but individuals such as officials and staff of the issuer. The defendant must agree to seek no tax benefit or insurance benefit for a penalty payment.

The following standards are applied in determining whether a fine is in the public interest: (i) whether the act involves "fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement," (ii) resulting harm to other persons, (iii) extent of unjust enrichment, (iv) degree of recidivism, (v) the need to "deter such persons and other persons from committing such acts or omission," and (vi) other considerations as justice may require."

- requirement of an "undertaking," which is a prospective action to ensure that the issuer cannot and will not commit the same violation again.

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5. Recent Enforcement Activity

The following are examples of cases in which the SEC has targeted municipal issuers and/or their officers:

- In August, 2010, the SEC settled a claim against the State of New Jersey that it misled investors in $25 billion of municipal bonds by masking underfunding of two of its pension funds. The SEC had found that the bond offering documents failed to disclose the pension plans' asset and funded ratio information on a market-value basis. This resulted in concealing an unfunded liability.

- In October, 2010, the SEC announced that four former San Diego city officials agreed to pay financial penalties for roles in misleading investors in municipal bonds about the city's fiscal problems related to its pension and retiree health care obligations. It was the first time that the SEC had secured financial penalties against city officials in a municipal bond fraud case. Three were fined $25,000 each and one was fined $5,000. The SEC stated that, "municipal officials have a personal obligation to ensure that investors are provided with complete and accurate information about the issuer's financial condition."

- In March of 2013, the SEC accused the State of Illinois of misleading investors about the condition of its public pension program. The SEC maintained that the pension contribution schedule was not sufficient to cover both the cost of benefits and payments to amortize the unfunded actuarial liability, which was masked by the use of longer than customary amortization period. The result, according to the SEC, was that Illinois issued municipal bonds that were marketed under false pretenses, in that investors could not see the increasing risk of investing in the state's bonds while the unfunded pension liability grew and

placed financial pressure on the state's budget. The case was settled with a cease and desist order, without a monetary penalty.

- In July of 2013, the SEC filed an enforcement action in federal court against the city of Miami, Florida, and its former budget director alleging securities fraud in connection with the city's 2007 and 2008 annual financial statements and a subsequent 2009 bond issue. The SEC alleged that from 2007 to 2009, the city made transfers from capital project funds to a general use fund to mask deficits in the general fund. The SEC alleged that these improper transfers falsely inflated the general fund balance to meet a reserve level requirement for that fund, resulting in a higher rating for the bonds. The SEC is pleaded claims against both the city and its former budget director.

- In July of 2013, the SEC for the first time charged a municipal issuer, the West Clark Community Schools , an Indiana school district, with securities fraud for stating in an official statement that it was in full compliance with prior continuing disclosure undertakings when in fact is had failed to make numerous filings.

6. Conclusion

Since the recent financial crisis, there has been heightened scrutiny by the SEC over activities in the securities market that are manipulative or dishonest. The SEC has undertaken a heightened interest in enforcement of disclosure standards in the municipal market, as can be seen the examples cited above. Issuers and their officers can best protect themselves by taking the following actions:

- Engage competent disclosure counsel and follow industry standards for disclosure in connection with new issues.

- Enter into a well-crafted continuing disclosure agreement with respect to new issues.

- Designate an employee to take responsibility for continuing disclosure and assure that regular disclosure is done on schedule and that material events are disclosed promptly within the required time limits.

- Maintain books and records in accordance with appropriate accounting standards and engage an accounting firm familiar with the industry standards, particularly with respect to the reporting of pension liabilities and the allocation of bond proceeds.

- Maintain and enforce up-to-date policies and compliance with applicable laws, related to conflicts of interest and political contributions.