



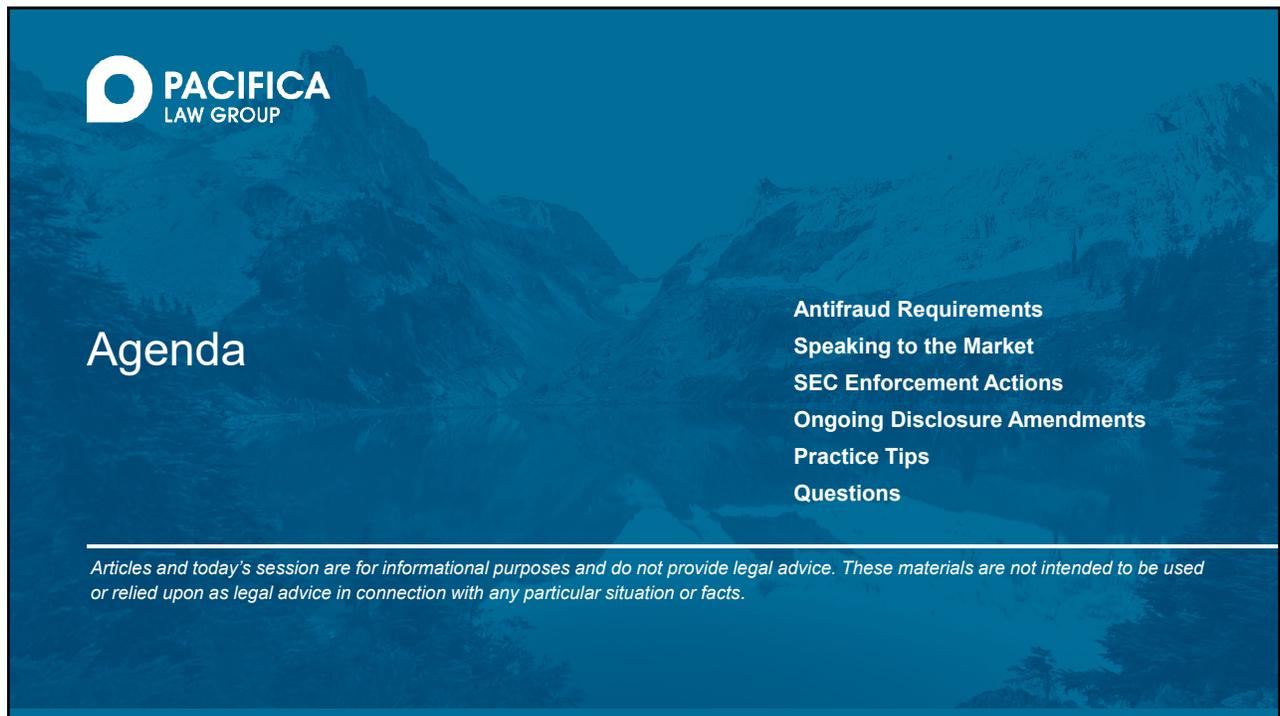
PACIFICA
LAW GROUP

Securities Law Training

City of Tacoma

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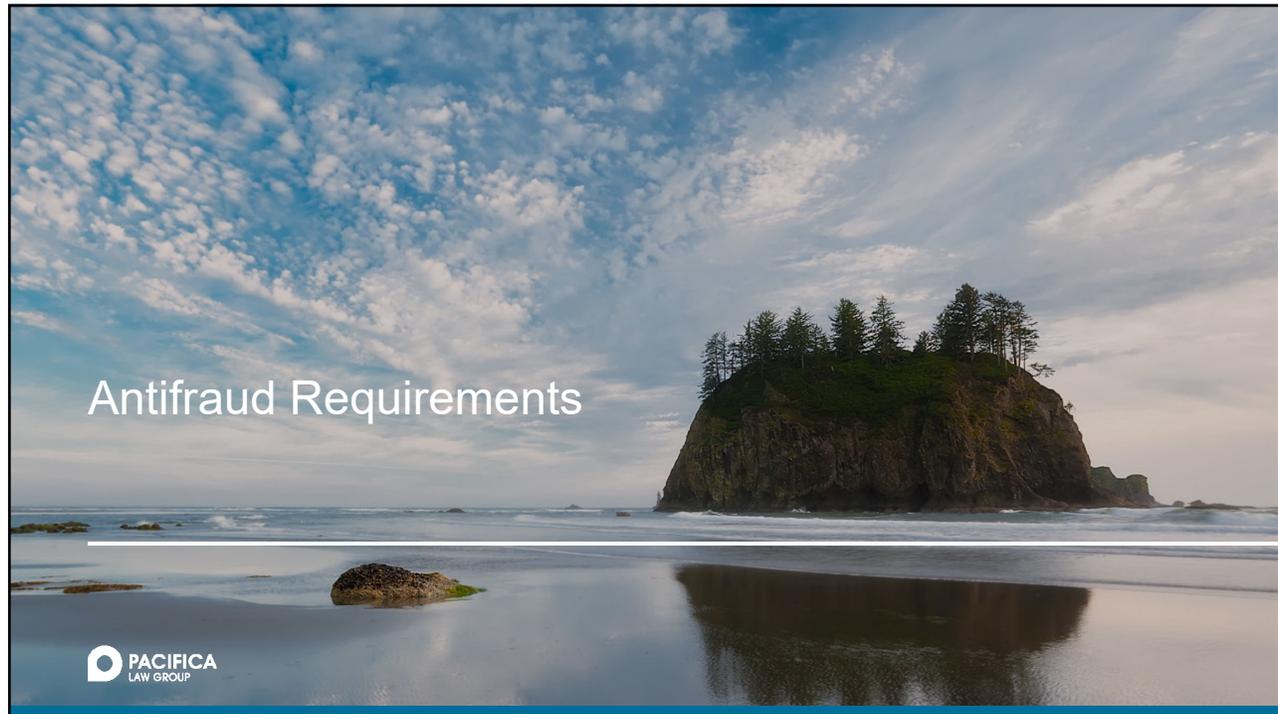


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Agenda

- Antifraud Requirements
- Speaking to the Market
- SEC Enforcement Actions
- Ongoing Disclosure Amendments
- Practice Tips
- Questions

Articles and today's session are for informational purposes and do not provide legal advice. These materials are not intended to be used or relied upon as legal advice in connection with any particular situation or facts.



Applicability of Federal Securities Laws to Tacoma's bonds

State and Municipal Disclosure is not Directly Regulated

- The Tower Amendment prohibits the SEC and MSRB from requiring state and municipal bond issuers to file a prospectus or other disclosure prior to the sale of bonds
- 1975 Senate Report rationale:
 - respect for the rights of state governments to access the capital markets
 - concerns about the costs of regulation for state and local government issuers
 - and the perceived lack of abuses in the municipal market

Municipal Bonds; Antifraud Laws

Municipal Bonds are Subject to the Antifraud Laws

- State and municipal bond issuers are subject to the laws prohibiting fraud in communications with investors, under Rule 10b-5 under the Securities Exchange Act and Section 17 of the Securities Act
- The SEC has authority to bring civil antifraud enforcement proceedings against state and municipal issuers (and refer criminal antifraud cases to the DOJ)
- Since 2012, the SEC has increased its focus on the municipal market
- SEC will initiate an investigation when it has reason to suspect that the federal securities laws have been violated
 - Looking for disclosure-based violations
 - Investigation typically involves scrutiny of all persons involved in the conduct in question
 - issuer, its officers and key employees (whether or not still employed), the underwriters, the municipal advisor, legal counsel

Municipal Bonds; Antifraud Laws

Rule 10b-5

- Rule 10b-5 makes it unlawful for any person 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,
 - in connection with the purchase or sale of any **security [including bonds]**
- Requires intent, but recklessness is sufficient
 - highly unreasonable conduct that is an extreme departure from the standards of ordinary care

Municipal Bonds; Antifraud Laws

Section 17(a)

- Comparable requirements to Rule 10b-5
- It shall be unlawful for any person in the offer or sale of any securities ... 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

Key distinction between 10b-5 and 17(a) is *intent*

- Based on SEC settlements: negligence is sufficient to establish a violation of Section 17(a)
 - “knew or should have known” standard for establishing negligence
 - Failure by an actor to conform conduct to the standard of a reasonable person under like circumstances
 - Did you exercise reasonable care?



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Antifraud Rules Apply When Speaking to the Market

Initial Disclosure

- Preliminary Official Statement
- Final Official Statement
 - Offering documents used in connection with the issuance and sale of municipal bonds

Other types of disclosure

- Ongoing disclosure undertaking
 - Contractual obligation to provide annual financial and operating information and notice of certain events
- Voluntary disclosure (“speaking to the market”)
 - Investor relations website
 - Social media



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Materially Accurate and Complete

Case law defines materiality:

- there is a substantial likelihood
- that a reasonable bond investor
- would consider it important in making an investment decision

There must be a substantial likelihood that a fact *"would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."*

SEC Focus on the Municipal Market

SEC strategy has focused on “first of their kind” enforcements, “broken windows”

- Enforcement strategy to change market behavior
- Since its 2012 report regarding the municipal market, the SEC has markedly increased its enforcement activity against state and municipal issuers
- Goal is to improve the quality of disclosure

SEC Enforcement: Common Remedies used by the SEC

Stopping bond issues from proceeding

- *Harvey, Illinois* – SEC obtained an emergency court order to stop bond issue from proceeding where it asserted the city and its staff had been involved in a scheme to divert bond proceeds to improper uses

Barring individuals and issuers from participating in future bond issuances

- *UNO Charter Schools* – former president of UNO Charter School Network paid a fine and prohibited from participating in any future bond issuing for failing to disclose conflicts of interest among the parties and other risks to bond owners

Jury trials

- *City of Miami* – First jury trial to decide federal securities case against municipality or its officers. Unanimous jury verdict found city and former budget director had violated anti-fraud laws

Criminal fraud charges

- *Ramapo, New York* – First criminal securities fraud case brought against city officials for accounting fraud in connection with the sale of municipal bonds
 - Town Supervisor pled guilty to one count of securities fraud and one count of conspiracy
 - Sentenced to 2-1/2 years in prison



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SEC Enforcement: Common Remedies used by the SEC

Seeking financial penalties

- *Against issuers, officials (personal liability), underwriters, developers and others*
 - *Wenatchee PFD*
 - *Failure to disclose feasibility report*
 - *City of Miami*
 - *City fined \$1M*
 - *Budget Director fined \$15k (reduced from \$450k)*
 - *Westlands Water District*
 - *Failure to disclose what bond coverage would have been absent extraordinary accounting procedure*
 - *A "little Enron accounting"*
 - *District fined \$125k*
 - *General Manager and former Assistant General Manager paid \$50k and \$20k, respectively, out of pocket*



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SEC Enforcement: Common Remedies used by the SEC

Finding individuals liable under a “Control Person” theory of liability

- *Allen Park, Michigan - The first time the SEC has charged a municipal official under a federal statute that provides for “control person” liability*
- *Mayor was an active champion of the project; in a position to control the actions of the City and the City Administrator with respect to the fraudulent bond issuances*
- *Mayor held liable as a “control person” for the City’s and City Administrator’s violations of the anti-fraud laws – joint and severally liable with and to the same extent as the City and the City Administrator*

Other common administrative remedial action

- *May not admit nor deny violations as part of settlement with the SEC*
- *Hire independent consultant and implement recommendations*
- *Cease and desist from committing future violations of the antifraud requirements*
- *Adopt written policies and procedures and periodic trainings relating to bond offering disclosures*



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Reliance on Advice of Professionals Defense

The Role of Professional Advisor

- Advice, assist in implementing policies and procedures

Affirmative defense (reliance on counsel or other professional advisors)

- The burden to demonstrate good faith reliance-on-professional-advice lies with the defendant
- All four tests must be answered in the affirmative (preponderance of the evidence)

Did the issuer completely disclose the facts about the conduct at issue to its advisor?	Yes	No
Did the issuer seek advice from its advisor as to whether the specific course of conduct was appropriate?	Yes	No
Did the issuer receive advice from the advisor that the specific course of conduct was appropriate?	Yes	No
Did the issuer rely on that advice and follow it in good faith?	Yes	No

SEC trial v. City of Miami/Boudreaux

- Comparable analysis re reliance on accountants



Recent Enforcement Actions

Enforcement strategy

Recent settlements focus on more classic bad actors

Focus on pay-to-play, bribery and kickbacks, public corruption

- Payments for business
- Invoices for unearned amounts
- Unregistered municipal advisors



Ongoing Disclosure and Recent Amendments

Ongoing Disclosure – SEC Rule 15c2-12

Applies to certain publicly sold municipal bonds

Prior to purchasing such municipal bonds, the Rule requires the **underwriter** to be certain that the **issuer** (the City) has entered into a written undertaking to provide certain annual information and notice of certain events to investors

- Annual information generally consists of audited financial statements and certain specified operating data
- Notice of the following 14 events must be provided within *10 business days of the occurrence* of the event
- Filed online at emma.msrb.org

- Principal and interest payment delinquencies;
- Non-payment related defaults, if material;
- Unscheduled draws on debt service reserves reflecting financial difficulties;
- Unscheduled draws on credit enhancements reflecting financial difficulties;
- Substitution of credit or liquidity providers, or their failure to perform;
- Adverse tax opinions, the issuance by the IRS of proposed or final determinations of taxability, material notices or determinations with respect to the tax status of the Bonds, or other material events affecting the tax status of the Bonds;
- Modifications to the rights of Bondholders, if material;
- Optional, contingent or unscheduled Bond calls other than scheduled sinking fund redemptions, if material, and tender offers;
- Defeasances;
- Release, substitution, or sale of property securing repayment of the Bonds, if material;
- Rating changes;
- Bankruptcy, insolvency, receivership or similar event of the obligated party;
- The consummation of a merger, consolidation, or acquisition involving the obligated party or the sale of all or substantially all of the assets of the obligated party, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material; and
- Appointment of a successor or additional trustee or the change of name of a trustee, if material



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Amendment to Address Bank Loan “Gap”

Rule amended

Effective February 27, 2019, new continuing disclosure undertakings must include two new notice events related to providing investors information regarding certain “financial obligations”

- The term financial obligation means:
 - (i) debt obligation;
 - (ii) derivative instrument entered into in connection with, or pledged as security or a source of payment for, an existing or planned debt obligation; or
 - (iii) guarantee of (i) or (ii)
- So debt (bank loans, lines of credit, commercial paper), swaps related to debt and guarantees of both are included



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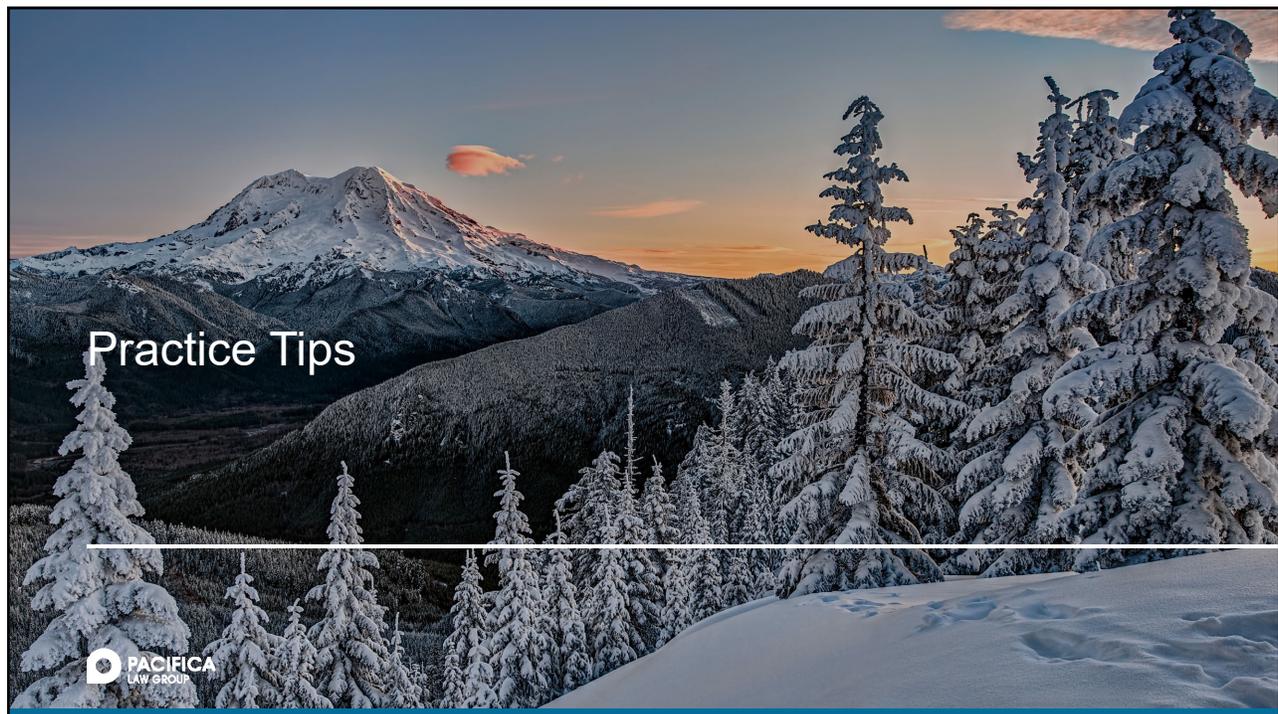
Amendments add Two New Notice Events

Notice event 15

- Incurrence of a financial obligation of the [City]
 - if material, or
- Agreement to covenants, events of default, remedies, priority rights, or other similar terms of a financial obligation of the [City], any of which affect security holders
 - if material

Notice event 16

- Default, event of acceleration, termination event, modification of terms, or other similar events under the terms of a financial obligation of the [City]
 - any of which reflect financial difficulties



Common Themes; Best Practices

Common themes

- SEC focus on content of disclosure from the perspective of reasonable investor
 - Did the issuer/other parties intend to commit fraud or were they negligent?
 - Did they follow industry standards and/or adopted procedures?

Not necessary to have a bond default or other financial harm

Many enforcement actions resulted from *omitted* information

- Post-issuance, rear view mirror review
- Hindsight is always 20/20

Best practices

- Adopt and follow disclosure procedures
 - To demonstrate reasonable care
 - To manage control person risk
- Review and update existing procedures to be ready to incorporate new listed events



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Key components of written procedures

SEC Settlements

In settlements, the SEC has required written continuing disclosure procedures and annual certifications and trainings

Key Components

- Identify responsible individuals:
 - for preparing, reviewing and approving
 - initial disclosure (POS, OS) and
 - continuing disclosure
 - Include individuals who provide input on:
 - the “big picture” and
 - new developments

Key Components

- Outline the steps involved:
 - In drafting, reviewing and approving disclosure documents:
 - Review by the finance team
 - Review by internal subject experts
 - Reconcile to source documents
 - Cover to cover review and
 - Auditor or other outside expert involvement, if applicable
- Provide for periodic training
 - to create and reinforce broad organizational awareness:
 - Of responsibilities under securities law and
 - Of procedures to demonstrate reasonable care



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Wrap Up

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- ▶ Comments?
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