







# Federal Securities Law

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May 18, 2023

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# Federal Securities Laws

## Overview

Although municipal bond issuers are exempt from the SEC's registration and filing requirements that apply to corporate issuers, all issuers (including municipalities) are subject to the antifraud requirements that apply when issuers speak to the market.

- Disclosure Framework
  - Antifraud Rules
  - Rule 15c2-12, Continuing Disclosure
  - Voluntary Disclosure
- Recent SEC Enforcement Cases

# Disclosure Framework; Antifraud Laws

## Antifraud Requirements Apply Whenever an Issuer Speaks to the Market

The antifraud provisions apply any time an issuer speaks to the market. Rule 10b-5, promulgated under Section 10(b) of the Securities Exchange Act of 1934, prohibits fraud in connection with the purchase and sale of securities. Among other provisions, it makes unlawful:

- any untrue statement of a material fact or
- omitting 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.

Similar language under Section 17(a) of the Securities Act.

- SEC settlements under Section 17(a) have been based on a negligence standard
  - “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

# Materially Accurate and Complete

## Materiality

Whether a statement or omission can give rise to a securities law violation depends on whether the statement or omission is material.

The definition of “material” has been established by case law:

- 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 Staff Legal Bulletin (Feb. 7, 2020)

## A caution regarding the scope of the antifraud requirements

The SEC Office of Municipal Security (OMS) released a Staff Legal Bulletin summarizing existing law regarding the application of the antifraud requirements to public statements by issuers and borrowers.

- Rule 10b-5 under Section 10(b) of the Securities Exchange Act
  - Applies to secondary market disclosures as well as primary disclosures
  - Prohibits making any untrue statement of material fact or omitting 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

*Any public statement (at least by officials who may be viewed as having knowledge regarding the financial condition and operation of an issuer) may be reasonably expected to reach investors and therefore be subject to the antifraud requirements.*

# Secondary Market Disclosure

## Antifraud Requirements Apply Whenever an Issuer Speaks to the Market

The antifraud provisions apply any time an issuer speaks to the market. Secondary market disclosure includes required EMMA filings and voluntary disclosure.

- SEC Rule 15(c)(2)-12
  - Underwriter must confirm the issuer has entered into a written undertaking to provide annual information and notice of listed events
- Contractual obligation of the issuer and/or obligated party to provide:
  - Annual financial statements
  - Annual operating or other information as stated in the undertaking
  - Notice of certain events within 10 business days of the notice of the occurrence of the event

# Required Filings on EMMA

## Certain events require notice

An undertaking to provide continuing disclosure is required, under Rule 15(c)(2)-12 to include a commitment to provide notice within 10 business days of the occurrence of certain events.

- Certain events must be noticed in all cases, such as:
  - Rating changes
  - Unscheduled draws on debt service reserves or credit enhancement reflecting financial difficulties
  - Defeasances and redemptions
- Other events must be noticed *if material*, such as:
  - Non-payment related defaults, if material



# Additional Event Notices – Listed Events 15 and 16

## Notice event 15

- Incurrence of a financial obligation of the obligated person
  - if material, or
- Agreement to covenants, events of default, remedies, priority rights, or other similar terms of a financial obligation of the obligated person, 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 obligated person
  - any of which reflect financial difficulties

# Definition of Financial Obligation

## Two notice events were added effective 2019

Issuers now must include two new notice events relating to bank loans and other “financial obligations.”

### Definition

- 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, swaps related to debt and guarantees of both are included
- SEC Adopting Release notes that “the term ‘debt obligation’ generally should be considered to include lease arrangements entered into by issuers and obligated persons that operate as vehicles to borrow money”

# What financial obligations must be disclosed?

## Materiality and financial difficulty standards

The amendment requires notice of incurrence of a financial obligation, if material, and notice of certain events involving financial obligations that reflect financial difficulties.

- The final Rule does not define or provide any new guidance on materiality, deferring instead to existing case law:
  - Materiality determinations should be based on whether the information would be important to the total mix of information made available to the reasonable investor.
  - A dollar threshold can be a useful starting point
    - Immaterial obligations may in the aggregate reach a materiality threshold
    - Take into consideration any qualitative factors
- “Reflecting financial difficulties” is to be applied per current Rule



# Statement on Municipal COVID-19 Disclosure

## Encourages Voluntary Disclosure

The recent statement of SEC Chair Jay Clayton and Rebecca Olsen, Director of the SEC Office of Municipal Securities, encourages voluntary disclosure of COVID-19 impacts and seeks to provide some assurances to issuers and borrowers in making a voluntary disclosure during this time of uncertainty

- “Today, in light of the potentially significant effects of COVID-19 on the finances and operations of many municipal issuers, we increase this focus and request that municipal issuers provide investors with as much information about their current financial and operating condition as is reasonably practicable. . . . We observe that, in today’s markets, the typical practice of providing historic financial information in the form of an annual information filing or similar disclosure may not enable investors to make informed assessments of the municipal issuer’s current and expected future financial condition.”
- “We also encourage municipal issuers to provide investors with forward-looking information regarding the potential future impact of COVID-19 on their financial and operating conditions.”

# SEC Statement on Municipal COVID-19 Disclosure

## Seeks to Provide Assurance

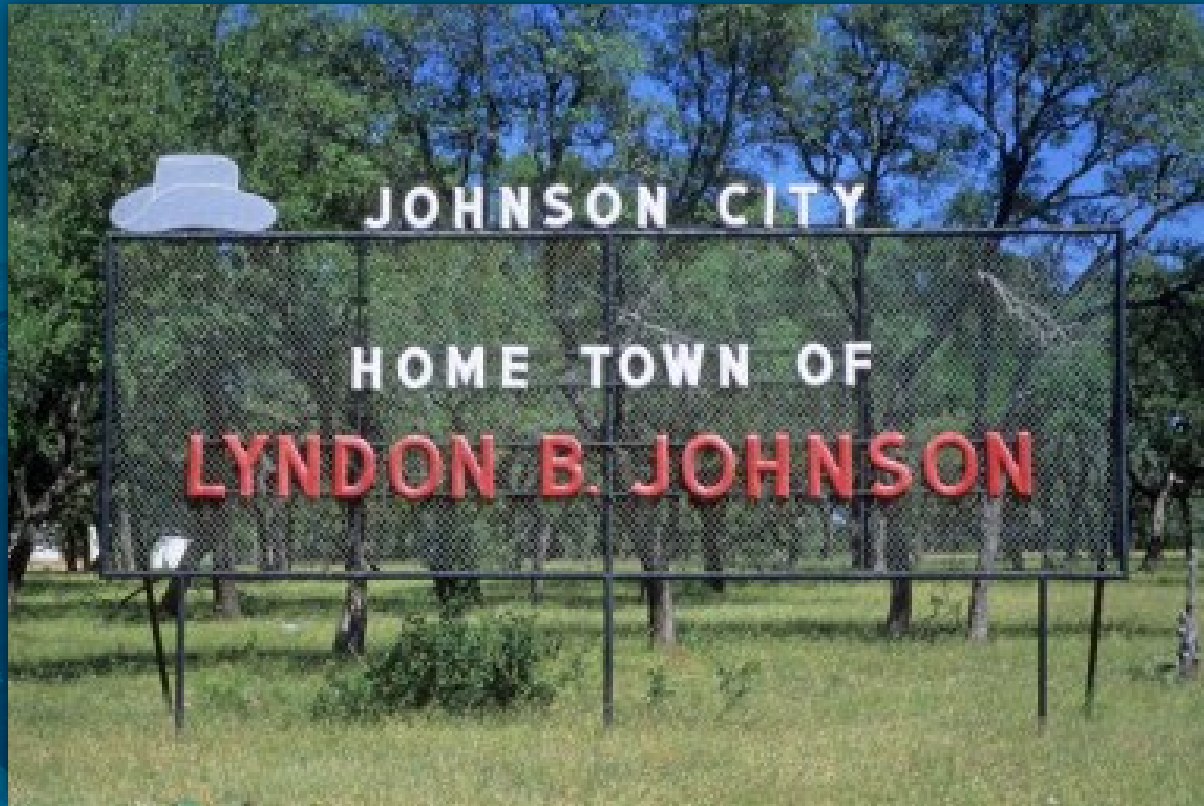
While encouraging disclosure of current and forward-looking information regarding COVID-19 impacts, the statement sought to provide some assurances to issuers and borrowers in making disclosures.

- “We would not expect good faith attempts to provide appropriately framed current and/or forward-looking information to be second guessed by the SEC.”
- Suggests use of “meaningful cautionary language.”
  - Description of relevant facts or assumptions affecting the reasonableness of reliance on and the materiality of the information provided,
  - Description of how certain important information may be incomplete or unknown, and
  - Process or methodology (audited vs. unaudited) used by the municipal issuer to produce the information
  - Notes “bespeaks caution” caselaw doctrine that provides some leeway with respect to forward-looking statements

# Recent Enforcement Actions



# SEC v. Anthony Holland



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REPORT OF EXAMINATION

## CITY OF JOHNSON CITY

*Johnson City, Texas*

For the Year Ended  
September 30, ~~2015~~

2016

# ***SEC v. Anthony Holland***

## **SEC enforcement action (W.D. Tex.)**

- Secondary market violation of Rule 10(b)(5)
  - 2016 financial statement/audit report provided to investors (per City's undertakings)
  - Materially false and misleading statements and omissions
    - Inaccurate financial data
    - Ongoing embezzlement
    - "Compliance with GAAP"

## **Outcome**

- Enjoined from municipal securities issuances
- Disgorgement, prejudgment interest, and other monetary penalties
- Federal criminal conviction for theft from state/local government (DOJ)

# SEC v. City of Rochester, et al.



## BOND ANTICIPATION NOTES REVENUE ANTICIPATION NOTES

RATING: See "Ratings" herein

*In the opinion of Woods Oviatt Gilman LLP, Bond Counsel to the City, under existing statutes and court decisions and assuming continuing compliance with certain tax certifications described herein, (i) interest on the Notes is excluded from gross income for Federal income tax purposes pursuant to Section 193 of the Internal Revenue Code of 1986, as amended (the "Code"), and (ii) interest on the Notes is not treated as a preference item in calculating the alternative minimum tax imposed on individuals. In addition, in the opinion of Bond Counsel to the City, under existing statutes, interest on the Notes is exempt from personal income taxes of New York State and its political subdivisions, including The City of New York. See "Tax Exemption" herein.*

*The Notes will not be designated by the City as "qualified tax-exempt obligations" pursuant to section 265(b)(3) of the Code.*

### CITY OF ROCHESTER NEW YORK

\$68,905,000

#### 3.00% BOND ANTICIPATION NOTES, 2019 SERIES II

(the "Series II Notes")

CUSIP # 771694 PH3

[Reoffered @ 1.10%]

Date of Issue: August 7, 2019

Maturity Date: August 6, 2020

\$50,000,000

#### 3.00% REVENUE ANTICIPATION NOTES, 2019 SERIES III (SCHOOL PURPOSE)

(the "Series III Notes" and together with the Series II Notes, the "Notes")

CUSIP # 771694 PJ9

[Reoffered @ 1.10%]

Date of Issue: August 7, 2019

Maturity Date: May 29, 2020

The Notes are general obligations of the City of Rochester, New York (the "City" and "State", respectively), for the payment of which the City has pledged its faith and credit. For the payment of such principal and interest, the City has the power and statutory authorization to levy ad valorem taxes on all taxable real property in the City subject only to the limitations imposed by Chapter 97 of the Laws of 2011 of the State of New York (the "Tax Levy Limit Law"). See "Legal Matters and the Tax Levy Limit Law" and "Tax Levy Limit Law," herein.

The Series II Notes are dated August 7, 2019 and will bear interest from that date until maturity at the annual rate or rates as specified by the purchaser of the Series II Notes, payable on maturity. The Series II Notes will mature on August 6, 2020. The Series III Notes are dated August 7, 2019 and will bear interest from that date until maturity at the annual rate or rates as specified by the purchaser of the Series III Notes, payable on maturity. The Series III Notes will mature on May 29, 2020. The Notes will not be subject to optional redemption prior to maturity. Interest on the Notes will be calculated on a 30-day month and 360-day year basis, payable at maturity.

The Notes will be issued as registered Notes, and will be registered in the name of Cede & Co., as nominee for The Depository Trust Company ("DTC"), as book-entry notes.

The Notes are issued in book-entry form. The Notes will be registered to Cede & Co., a single note certificate will be issued for each note bearing the same rate of interest and CUSIP number. Individual purchases will be made in book-entry form only, in the principal amount of \$5,000 or integral multiples thereof. Purchasers will not receive certificates representing their ownership interest in the Notes. Principal of and interest on the Notes will be paid in Federal Funds by the City to Cede & Co., as nominee for DTC.

The City will act as Paying Agent for such Notes.

The Notes are offered when, as, and if issued by the City, and subject to the receipt of the final approving legal opinions of Woods Oviatt Gilman LLP, Rochester, New York, and certain other conditions. It is expected that the Notes will be available for delivery on or about August 7, 2019.

THIS REVISED COVER DATED JULY 25, 2019 SUPPLEMENTS THE OFFICIAL STATEMENT DATED JULY 17, 2019 RELATING TO THE OBLIGATIONS DESCRIBED THEREIN BY INCLUDING CERTAIN INFORMATION OMITTED FROM SUCH OFFICIAL STATEMENT IN ACCORDANCE WITH SECURITIES AND EXCHANGE COMMISSION RULE 15c2-12 (THE "RULE"). OTHER THAN AS SET FORTH ON THIS REVISED COVER PAGE THERE HAVE BEEN NO REVISIONS TO SUCH OFFICIAL STATEMENT. THE CITY WILL COVENANT TO PROVIDE NOTICE OF CERTAIN EVENTS AS DEFINED IN THE RULE. SEE "DISCLOSURE UNDERTAKING" HEREIN.

Dated: July 25, 2019



# ***SEC v. City of Rochester, et al.***

## **SEC enforcement action (W.D.N.Y.)**

- District CFO, City, Finance Director, Muni Advisor charged under Rule 10(b)(5) & Sec. 17(a)
- All Defendants: Material misrepresentations/omissions to rating agency:
  - Projected 2019 budget shortfall
  - Cause of \$63M cash flow decline
  - Purpose of issuance
- City Defendants: Material misrepresentations/omissions in POS/OS
  - Projected 2019 budget shortfall
  - Cause of \$63M cash flow decline
  - Purpose of issuance
  - 2018 data provided “inaccurate and outdated” presentation

## **Outcome**

- District CFO: \$25K penalty; enjoined from future municipal offerings
- City Defendants: Litigation

# *SEC v. Town of Sterlington, et al.*



# ***SEC v. Town of Sterlington, et al.***

## **State investigations → SEC enforcement action (W.D. La.)**

- Mayor, Town: Material omissions under Rule 10(b)(5) & Sec. 17(a)
  - SBC approval based on fictitious revenue projections
  - Misuse of proceeds from prior bond issuances
    - System revenues pledged as security
    - Misuse of proceeds presented risk to repayment
- Muni Advisor: Material omission under Rule 10(b)(5) & Sec. 17(a)
  - SBC approval based on fictitious revenue projections
  - Failure to register as a municipal advisor with the SEC

## **Outcome**

- Town: Cease-and-desist order
- Muni Advisor: Civil judgment in amounts TBD
- Mayor: Litigation



# *SEC v. Crosby Independent School District, et al.*





# ***SEC v. Crosby Independent School District, et al.***

## **SEC enforcement action (S.D. Tex.)**

- District/CFO: Material misrepresentations under Rule 10(b)(5) & Sec. 17(a)
  - FY17 financials appended to bond offering documents
    - Understated payroll and construction liabilities
    - Overstated District's General Fund reserves by \$11.7M
- External auditor: Improper professional conduct
  - Construction liability discrepancy
  - Change in fiscal year/payroll liability

## **Outcome**

- District: Order and finding of antifraud violations
- CFO: \$30,000 penalty; enjoined from future municipal offerings
- Auditor: Suspension from practice before the SEC

# SEC Enforcement Proceedings—Themes

## Active enforcement of “bread and butter” cases

- Fraud in presentation of financial information and projections
  - Inaccurate/fraudulent financial statements
  - Stale/outdated information
- Charges against municipal entities and individuals
  - Issuer leadership (mayors, finance officials)
  - External advisors (municipal advisors, auditor)
- Traditional, public sale context
  - Primary market disclosures (offering documents)
  - Secondary market disclosures (undertaking)
- *But also* private placements

## Misrepresentations to credit evaluators

- Credit rating agency
- State bond commission

# SEC Enforcement Proceedings—Takeaways

- 1. Develop internal controls and procedures.**
  - Secondary review and approval
  - Primary *and* secondary market disclosures
  - Periodic training
- 2. Carefully scrutinize financial projections.**
  - Assess underlying assumptions and base year
  - Note discrepancies from current year budget or prior statements
- 3. Ensure information provided to intermediaries is materially complete and accurate.**
- 4. Be wary of outdated information no longer reflecting current conditions; supplement and explain.**

# Wrap Up

Questions?

Comments?

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