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# Initial and Continuing Disclosure

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# Introduction

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- disclosure contexts
- disclosure standards
- SEC and private litigation



# Introduction

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- overview of principal SEC enforcement actions against municipal issuers
- steps to assure accuracy of disclosure



# SEC Jurisdiction in Municipal Securities Arena

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- no securities registration
- antifraud provisions apply
- regulate municipal securities brokers and dealers (Rule 15c2-12)

# Disclosure Contexts

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- primary
  - preliminary and final official statements
- secondary
  - Rule 15c2-12 continuing disclosure
  - voluntary filings
- “reasonably expected to reach investors”
  - investor information webpage

# Antifraud Disclosure Standard

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- Rule 10b-5

- “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 . . . .”

# Antifraud Disclosure Standard

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- material

- “substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable [investor].”

# Litigation

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- SEC enforcement actions
  - administrative
  - civil
  - criminal (referral to Department of Justice)
- private plaintiff





# Rule 10b-5 SEC Action

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- a materially misleading misstatement or omission
- made or omitted with scienter (fraudulent intent or recklessness)
- in connection with the purchase or sale of a security

# Rule 10b-5 Private Action

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- 3 SEC elements  
plus
- damages
- reliance on misleading disclosure

# Rights of Action

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- Rule 10b-5 of 34 Act – scienter
- Section 17 of 33 Act (SEC only)
  - (a)(1) – scienter
  - (a)(2); (a)(3) – negligence

# 17(a)(2) – 17(a)(3) Elements

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- materially misleading misstatements or omissions
- misstatements or omissions were made in offer or sale of securities; and
- misstatements and omissions were made with negligence



# SEC Enforcement Actions

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- the governmental issuer
- individual members of issuer's legislative body
- governmental officials and employees
- third parties (e.g., underwriters, financial advisors, bond counsel)



# Orange County Report Principles

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- “a public official may not authorize disclosure that the official knows to be false”
- “nor may a public official authorize disclosure while recklessly disregarding facts that indicate that there is a risk that the disclosure may be misleading”

# Orange County Report

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*what is acting recklessly?*

- public official has knowledge of facts bringing into question the issuer's ability to repay the securities
- fails to take steps appropriate under the circumstances to prevent the dissemination of materially false or misleading information regarding those facts

# Orange County Report

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*what are appropriate steps?*

- “such steps could have included becoming familiar with the disclosure documents and questioning the issuer’s officials, employees or other agents about the disclosure of those facts”





# Reliance on Professional Defense

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- make complete disclosure to the appropriate professional of the potentially material mistake or omission at issue,
- request the professional's advice as to what disclosure is proper,
- receive advice regarding the appropriate disclosure, and
- rely in good faith on that advice.

# Maricopa County (1996)

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- omissions concerning an issuer's financial condition can be the basis for an enforcement action, regardless of whether such condition would affect negatively the ability of an issuer to pay principal and interest in a timely fashion

# City of Miami (2001)

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- misstatements in the Comprehensive Annual Financial Report (CAFR) that was voluntarily filed
- misstatements in CAFR transmittal letter
- material to current bondholders
- denied reliance on professionals defense

# Massachusetts Turnpike Authority (2003)

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- delay in disclosing cost increases, on argument that increases were speculative and not quantified
- 17(a)(2) and (3) violations for other issuer's offerings that included Authority-provided misleading information (negligence)

# San Diego Key Points

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- nature of misleading disclosure
  - “failed to disclose material information regarding substantial and growing liabilities for its pension plan and retiree health care and its ability to pay those obligations in the future”
- where misleading disclosure occurred:
  - in the disclosure documents for its 2002 and 2003 offerings,
  - in continuing disclosures filed in 2003,
  - in presentations to the rating agencies.



# San Diego Key Points

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- impact of disclosure deficiencies:
  - dozens of people either fired or resigned
  - delayed audited financials
  - suspended access to the public markets for bond offerings
  - forced to borrow at higher costs
  - numerous investigations
  - [pending] criminal proceedings



# Key Principles

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- **IMPORTANCE:**
  - recognize the importance of good disclosure
- **PERSPECTIVE:**
  - make sure to review disclosure documents in their entirety

# Key Principles

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- ACCOUNTABILITY:

- maintain a record of the sources of the material being included in the Official Statement

- INVESTOR'S PERSPECTIVE:

- read and draft from the perspective of an investor (i.e., what would you like to receive if you were the prospective investor?)





# Key Principles

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- **GROUP REVIEW:**
  - gather various contributors to Official Statement for a page by page collective review



# Voluntary Disclosure

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- disclosures reasonably expected to reach investors and the trading markets
  - responses to public inquiries
  - issuer websites



# Issuer Websites

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- hyperlinks
- presumption that posted information is current

# Issuer Websites

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- hyperlinks
  - disclaimers may be insufficient if issuer knows, or is reckless in not knowing, that the information is materially false or misleading

# Issuer Websites

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- presumption that information is current
  - separately identify historical information
  - segregate historical information in separate section
  - date information and note no updates
  - use disclaimers



# Public Inquiries

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- selective disclosure – no prohibition
- insider trading
  - employee receiving financial or other benefits



# Public Inquiries

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- clarifying information – no prohibition, but ...
  - consider updating documents if conversation reveals ambiguity
  - timing may matter - consider fairness



# Benefits of Voluntary Disclosure

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- larger investor group/lower interest rates
- increase investor cooperation re: waivers and consents
- facilitate communication re: tender offers





# Voluntary Disclosure - Tips

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- appoint investor relations person
- maintain record of investor contacts
- do not undertake more than resources permit



# Voluntary Disclosure - Tips

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- establish process for preparing/releasing information
- ensure information is widely and evenly disseminated
- Follow SEC guidance provided by Securities Offering Reform
  - SEC Release Numbers 33-8591 and 34-52056 (July 19, 2005), available at [www.sec.gov/rules/final/33-8591.pdf](http://www.sec.gov/rules/final/33-8591.pdf)



# Voluntary Disclosure - Tips

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- ensure all sources of information are consistent
- seek advice of competent consultants
- use disclaimers
  - risk of liability for knowing, or recklessly not knowing, that information is false or misleading

# Summary

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- three contexts of disclosure
  - primary offering – official statements
  - secondary market - continuing disclosure undertakings
  - any information reasonably expected to reach investors

# Summary

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- standards
  - materiality
  - negligence, recklessness, intent

# Summary

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- causes of action
  - SEC administrative action
  - SEC civil action in Federal District Court
  - criminal referral to Justice Department
  - private plaintiffs

# Summary

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- five key principles:
  - make good disclosure
  - perspective – big picture
  - accountability – source documentation
  - investor's perspective
  - group review

# Summary

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- voluntary disclosure:
  - compliance with antifraud provisions
  - fairness
  - good investor relations
  - implementation of process and procedures to ensure the above



# The End

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