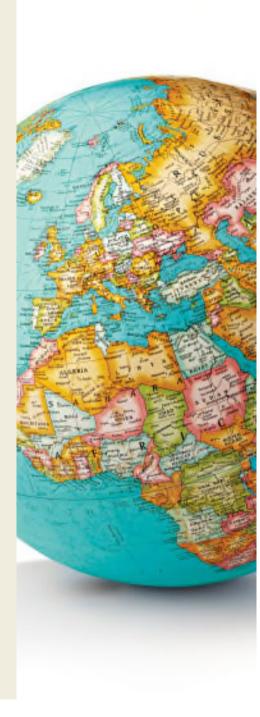
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Overview of Federal Laws and Securities and Exchange Commission Rules Governing Disclosure

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39 Offices in 19 Countries

SANDERS Background to Disclosure Laws

• Prior to the Great Depression

- > No federal regulation of securities.
- Only common law causes of action such as fraud and breach of fiduciary duty.
- Sale of fraudulent securities increasingly prevalent leading up to Great Depression (when half of all securities worthless).

Objectives of Congress to Remedy Abuse

- Federal framework requiring disclosure of material information to investors.
- Prohibit misrepresentations and other fraudulent conduct in purchase and sale of securities.
- > Policy: to create efficient capital markets.

SANDERS Federal Disclosure Laws

• Securities Act of 1933

Broad, accurate and complete disclosure in connection with <u>primary</u> offer and sale of securities

• Securities Act of 1934

- Requires provision of information to investors in <u>secondary</u> markets
- Sec. 10(b): unlawful to use manipulative or deceptive device or contrivance in connection with purchase or sale of securities

• Rule 10b-5

- Adopted in 1942 to implement Sec. 10(b)
- Prohibits the making of any untrue statement of material fact or omitting to state material fact in offer, purchase, or sale of securities

• Rule 15c2-15

- Adopted in 1990
- Regulates municipal securities brokers and dealers and requires continuing disclosure

Federal Statutes Governing Disclosure

- Securities Act of 1933 (primary offer and sale)
 - Section 5 Registration and registration statements.
 - > Exemptions from Registration:
 - Section 3(a)(2): security issued or guaranteed by (A) United States or any territory thereof; (B) any State or any political subdivision of a State or territory, or any public instrumentality of one or more States or territories.
 - Section 3(a)(4): security issued by a person organized and operated exclusively for religious, educational, benevolent, fraternal or charitable purposes and not for pecuniary profit.
 - Why Exempt? Absence of significant abuses, sophistication of investors, constitutional difficulties in applying federal securities law to municipal issuers; costs of regulation.

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Federal Statutes, continued

Section 17 prohibits making materially false or misleading statements of sellers (but not purchasers).

Securities Act of 1934 (secondary markets)

- Section 10(b): unlawful to use manipulative or deceptive devices in connection with the purchase or sale of securities.
- Section 17 (1933 Act), Section 10(b) (1934 Act), and Rule 10b-5
 - Prohibit the making of any untrue statement of material fact or omitting to state a material fact in the offer, purchase, or sale of securities.

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 "It shall be unlawful for any person . . . to make any untrue statement of a <u>material</u> fact or to omit to state a <u>material</u> fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading"

• Materiality

- Substantial likelihood that fact disclosed or omitted would be considered significant by a reasonable investor under the circumstances.
- Look at disclosure required in registered transactions, facts an issuer would not want to disclose, facts that would look bad in a complaint, etc.

SQUIRE SANDERS Rule 10b-5, continued

Additional Elements

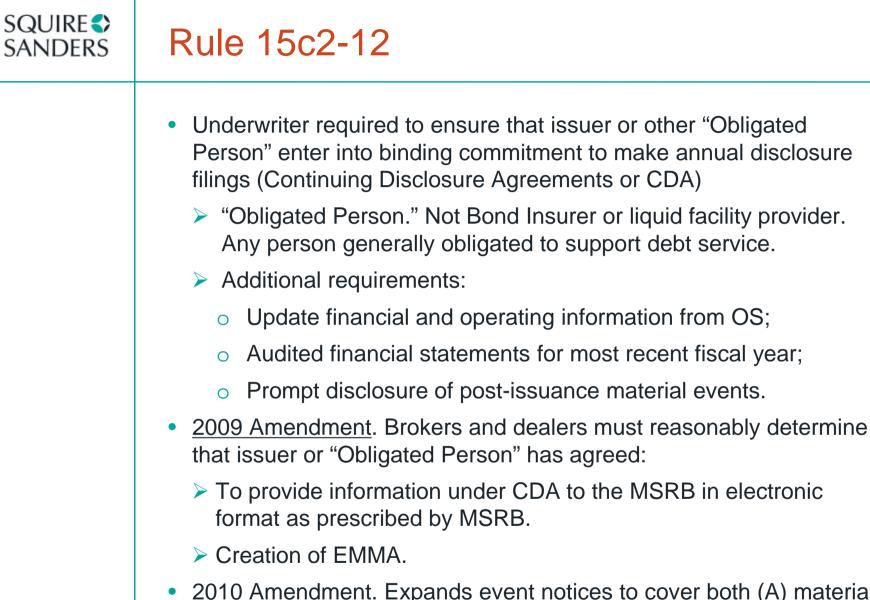
- <u>Omission</u>: where omission of the material fact would make the remaining statements misleading in light of the circumstances under which they were made .
- <u>Scienter</u>: intent to deceive, manipulate or defraud, although some courts (e.g. DC Circuit) recognize mere recklessness (extreme departure from ordinary care).
- <u>Reliance of plaintiff</u>: must be actual and reasonable.
 - Presumed under "fraud on the market" theory.
- <u>Damages</u>: out of pocket loss? Expected gain? Courts differ.
- <u>Standing</u>: actual purchase or sale; mere ownership is not enough.

SQUIRE SANDERS Rule 10b-5, continued

- <u>Private cause of action</u>: courts originally looked to common law fraud, but modified the common law elements.
 - > Primary liability: issuer, underwriters, etc.
 - > Secondary liability: bond counsel, underwriter counsel, etc.
- <u>Aiding and abetting liability</u>. Only SEC and federal prosecutors may bring action, not private plaintiffs.
 - Primary violation,
 - > Defendant provided substantial assistance,
 - Scienter or duty to inquire regarding primary violation.
- Aiding and abetting: Attorneys.
 - SEC v. Frank: attorney as mere scrivener.
 - > <u>Matter of Ira Weiss</u>: head in the sand approach.

SQUIRE SANDERS Rule 10b-5, continued

- Aiding and Abetting: Local Government Officials.
 - "We relied on the staff and the lawyers to put together the disclosure."
 - Orange County, CA Cases: "steps appropriate under the circumstances."
- <u>Limitations</u> under Sarbanes-Oxley (2002): claims may be brought <u>no later than</u>: (A) two years after discovery of facts constituting violation; or (B) five years after such violation.



 <u>2010 Amendment</u>. Expands event notices to cover both (A) material events and (B) events that must be reported regardless of materiality.

Compliance with the Law: Key Principles

• Importance

Recognize the importance of good disclosure.

• Perspective

> Make sure to review disclosure documents in their entirety.

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?).

• Group Review

Gather various contributors to Official Statement for a page by page collective review.

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Compliance with the Law, continued

Disclosure Documents

- Official Statement—"marketing document or "insurance policy"?
- Other Documentation.
- Disclosure over the Internet.
- Shifting the burden—private placements with investor's letters.

• Due Diligence Review

- Document Review Sessions.
- Due Diligence Meeting/Conference Call.
- > Due Diligence visit to borrower by counsel.

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New Developments

- ► EMMA
- Credit Rating Proposals

Continuing Disclosure

- Continuing Disclosure Agreement
- Annual Reports
- Material Events

Voluntary Disclosure

- > Information "reasonably expected to reach investors"
- Investor information web page

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SEC Actions

- May be brought against:
 - Governmental issuer
 - Individual members of issuer's legislative body
 - Governmental officials and employees
 - > Third parties (underwriters, financial advisors, bond counsel)
- Include:
 - Investigations
 - Formal and informal
 - Subpoena powers

SANDERS Enforcement, continued

- Injunctive actions in Federal Court
 - o Stop illegal activity
 - o Disgorge ill-gotten gains
 - Maintain integrity of the marketplace
- > Administrative proceedings
 - Monetary penalties (broker dealers)
 - Cease and desist orders: temporary and permanent
- Criminal referrals to Justice Department
 - Securities law violations, mail and wire fraud, money laundering, extortion and racketeering

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Private enforcement actions

- Securities class action litigation
- Private attorneys general
- Whistleblower actions

Internal Revenue Service Actions

Section 6700 penalties for abusive transactions

State Attorney General Actions

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Examples of Enforcement Actions

- Orange County Report (1996)
- Maricopa County (1996)
 - > Omissions basis of enforcement, even if not affect ability to pay
- City of Miami (2001)
 - Denied reliance on professionals defense
- Mass Turnpike Authority (2003)
 - While investigating cost increases and improving disclosure practices, still found to violate law
- City of San Diego (2006)
 - Failed to disclose material information regarding pension plan
 - Lost market access
 - Civil and criminal proceedings
 - Required remedial undertakings
- Other
 - State of New Jersey (2010)

SQUIRE SANDERS Recent Developments

Dodd-Frank Act of 2010

- Changes regarding "municipal advisors"
 - Must register with SEC and MSRB
 - Fiduciary duty to municipality

• SEC Enforcement Unit

> 2010 unit focuses on municipal securities and public pensions

• SEC Report of 2012 (issues for possible future regulation)

- Timeliness and comparability of financial information disclosed
- Absence or insufficiency of conduit borrower continuing disclosure
- Disclaimers of responsibility for disclosure information
- Undisclosed or inadequately disclosed conflicts of interest



Summary

• Three contexts of disclosure

- Primary offering official statements
- Secondary market continuing disclosure undertakings
- > Any information reasonably expected to reach investors

Standards

- Materiality
- Negligence, recklessness, intent

Causes of Action

- SEC administrative action
- SEC civil action in Federal District Court
- Criminal referral to Justice Department
- Private plaintiffs

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• Five key principles

- Make good disclosure
- Perspective big picture
- Accountability source documentation
- Investor's perspective
- ➢ Group review



Conclusion

Questions?



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