



CDIAC

**CALIFORNIA
DEBT AND
INVESTMENT
ADVISORY
COMMISSION**

SESSION ONE: WHY IS DISCLOSURE IMPORTANT?

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Audience Polling

Detailed Directions in Program

Link: *b.Socrative.com/login/student*

Room Name: *CDIAC*

Questions

1. Has your agency participated in a financing either via public offering or direct placement?
2. If the answer to question one is yes, has your agency engaged a third party to assist in meeting its continuing disclosure obligations?
3. Does your agency produce your continuing disclosure agreement in house?
4. Does your agency have a continuing disclosure policy?
5. Does your agency have a plans for any future financing either via public offering or direct placement?



Municipal Disclosure: What Can Go Wrong?



Aggressive Enforcement Efforts by the SEC



Enforcement Division Unit created in 2010 to focus on Municipal Bonds and Pension Funds

Approx. 25 attorneys – Most are former prosecutors



Aggressive Enforcement Efforts by the SEC



Dodd-Frank Act gave SEC new power to obtain fines in administrative (“cease and desist”) actions - settlements & civil fines are becoming common.

Long-standing agenda to move municipal market closer to corporate market, particularly for ongoing disclosure.

Enforcement Actions

Failure of Officials to Read Offering Documents

Orange County (1996)

UNO Charter School (2016)

Inadequate Pension Disclosures

City of San Diego (2006)

State of New Jersey (2010)

State of Illinois (2013)

State of Kansas (2014)

Enforcement Actions

Failure of Officials to Read Offering Documents

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In these cases, SEC focused on failure to disclose funding shortages and the potential impact pension funding pressures would have on future budgetary flexibility, as well as misstatements on remedial plans.

Inadequate Pension Disclosures

City of San Diego (2006)

State of New Jersey (2010)

State of Illinois (2013)

State of Kansas (2014)

SEC also highlighted lack of training and internal procedures which resulted in disclosure lapses.

Misleading or Incomplete Financial Disclosures

City of
Miami, FL

Interfund
transfers to mask
budget gaps
allegedly not
disclosed

Victorville, CA

Alleged inflated
valuation of
property in taxing
district, other
conflicts of interest

City of
Allen Park, MI

Failure to
disclose
budget gap

Failure to Disclose Unusual Actions to Meet Rate Covenant

Westlands Water District

SEC alleged that District undertook extraordinary accounting transaction to meet debt service coverage. SEC also alleged that District did not disclose a prior period accounting adjustment which would have adversely affected debt service coverage.

No allegation that the accounting was improper. District, General Manager and Chief Financial Officer all entered into settlements in which they neither admitted nor denied allegations but paid fines of \$125,000, \$50,000 and \$20,000, respectively

Failed Economic Development Projects

Greater Wenatchee Regional Events Center, WA

Did not disclose prior, less favorable projections; project failed to generate expected revenues; settled (2013)

City of Allen Park, MI

Failure to disclose collapse of movie studio project which was expected to generate revenue to cover budget gaps; settled (2014)

City of Harvey, IL

Nondisclosure of failed hotel project; also fraud by City Controller; settled (2014)

Failed Economic Development Projects

Rhode Island Economic
Development Corp

Alleged failure to disclose
funding shortfall for
startup software
company; two officials
settled; issuer and
underwriter contesting
(2016)

Ramapo, NY

Baseball stadium

Failure to Disclose Risk

Port Authority of New York and New Jersey

SEC alleged that PA official statements failed to disclose the risk that certain proposed uses of bond proceeds to fund highway and bridge improvements in New Jersey were not authorized by its statutes and bond resolution. Issuer settled, conceding correctness of SEC's statements of fact (first case where issuer was not allowed to neither admit or deny the allegations), agreed to outside monitor of disclosure procedures, and paid \$400,000 fine. (2017)

Disseminating False Statements

On March 27, 2019, the Supreme Court issued its opinion in *Lorenzo v. SEC*

The Court held that "dissemination of false or misleading statements with intent to defraud can fall within the scope" of SEC Rule 10b-5(a) and (c) even if the disseminator did not "make" the statements. The "dissemination" consisted of someone (Lorenzo) sending two emails to investors containing false information, but which were composed by someone else. The Court emphasized that Lorenzo disseminated the emails knowing the information was false and with an intent to defraud. In holding Lorenzo primarily liable, the Court highlighted that (1) he communicated directly with investors; (2) he invited investors to ask him follow-up questions; and (3) he sent the emails "in his capacity as vice-president of an investment banking company".

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Increasingly Aggressive Actions by SEC in Recent Years

Filings against
States

New Jersey
Illinois
Kansas

Levying fines
against issuers

Wenatchee (WA)
Westlands (CA)

Levying fines
against individual
defendants

San Diego (CA)
Allen Park (MI)
Harvey (IL)
Westlands (CA)
RI Econ Dev Corp

Increasingly Aggressive Actions by SEC in Recent Years

Increasingly charging
issuer officials along
with the issuer

Miami (FL)
Allen Park (MI)
Harvey (IL)
Wenatchee (WA)
Victorville (CA)
Westlands (CA)
RI Econ Dev Corp
Ramapo (NY)

Officials barred from
future involvement in
municipal finance

Allen Park (MI)
Harvey (IL)
Sought in Ramapo (NY)

Benefits of sound continuing disclosure practices



Credit Rating



Transparency



Market Efficiency

Credit Rating

Issuer Management

- 20% of the credit rating from Standard & Poor's
- Compliance with existing laws and legal agreements is crucial
- Policies and formalized procedures help your cause
- Timely submission of required financial information is considered

Credit Rating, *continued*

Spreads Between Ratings

- AA- to A+ = 5 basis points
- A- to BBB+ = 7 to 8 basis points

Transparency

- Generates political capital
- Reduces issuer liability and headline risk
- Establishes practical database
- Develops institutional knowledge
- Ensures future continuity

Market Efficiency

- Informs investors
- Elevates municipal bonds
- Creates demand
- Secures access to capital markets

