

INSIGHTS

Participation Not Required: SEC Charges Mayor as Control Person in Municipal Bond Offering

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In an unprecedented exercise of its authority to charge municipal officials with “control person” liability, the Securities and Exchange Commission (SEC) recently announced fraud charges against the City of Allen Park, Michigan, its former mayor and former city administrator for materially false and misleading statements made in offering documents for two municipal bond issuances in 2009 and 2010.¹ This case marks the first time a city official has been charged on the theory that he “controlled” the persons who committed the primary securities law violations, although he is not alleged to have participated in or even had knowledge of the conduct at issue.

The bond offering

In 2008, the City of Allen Park initiated plans for a \$146 million movie studio project. As originally planned, the project was to include eight sound stages and would be led by a Hollywood movie producer, with hopes that the project would facilitate economic development in Allen Park. Plans for the project were announced in a press release by the City in April 2009.²

To implement the project, the City entered a Public Private Partnership (PPP) with the producer and a private developer. Funding was to come in part from \$31 million in general obligation municipal bonds, the proceeds of which the City would use to buy land that would be subsequently donated to the developer for the project.

In early 2009, however, the City was advised by its bond counsel that it could not donate the land to the developer as originally planned. Additionally, the City learned that it was facing a \$2 million budget shortfall. These developments caused the PPP to disintegrate, leaving financing for the project uncertain.

Nonetheless, the City offered \$28.3 million in general obligation limited tax bonds on November 12, 2009, and another \$2.7 million on June 16, 2010.³ Neither the offering documents nor public announcements by city officials disclosed that the project had significantly deteriorated from its original plan.

Charges and penalties

On November 6, 2014, the SEC announced that it had filed fraud charges against the City of Allen Park, former Mayor Gary J. Burtka, and former City Administrator Eric C. Waidelich for their actions in connection with the bond offerings.

Charges were brought against the City and City Administrator Waidelich under Section 17(a)(2) of the Securities Act of 1933, and Section 10(b) and Rule 10(b)-5 of the Exchange Act of 1934, which prohibit the use of materially false or misleading information in the issuance of securities.

Significantly, Mayor Burtka was charged under Section 20(a) of the Exchange Act, which provides for joint and several control person liability against individuals with authority to oversee and direct individuals involved with securities offerings.⁴ As such, even though Mayor Burtka was not alleged to have participated in drafting the disclosure documents at issue, or even to have had any knowledge regarding the contents of the disclosure documents, the SEC found him liable “with and to the same extent as the City and the City Administrator.”⁵

All parties agreed to settle with the SEC and entered into voluntary cease-and-desist orders. As part of the settlement agreement, Mayor Burtka agreed to pay a \$10,000 penalty to the SEC. Administrator Waidelich, who settled charges that he reviewed and approved the offering documents at issue, was not fined. Both Waidelich and Burtka are barred from participating in any future municipal bond offerings. The City agreed to implement remedial measures including adoption of a compliance and training program for city officials involved with future bond offerings.

Implications for mayors, councilmembers, and other elected officials

Mayors, Councilmembers and other elected officials should be aware of this proceeding and its demonstration of their exposure to potential securities fraud liability even if they are not involved in the preparation of disclosure. This case illustrates once again the SEC’s stated intention to charge more public individuals – particularly control persons – with violations of securities laws. In the SEC’s press release, LeeAnn Ghazil Gaunt, Chief of the SEC Enforcement Division’s Municipal Securities and Public Pensions Unit, is quoted to state “[w]hen a municipal official like Burtka controls the activities of others who engage in fraud, we won’t hesitate to use every legal avenue available to us in order to hold those officials accountable.”⁶

Moving forward, those involved with municipal securities offerings may be well advised to update their training and compliance programs to account for the SEC’s shift toward pursuing control person liability.

¹ Press Release 2014-249, SEC Charges Allen Park, Mich. And Two Former City Leaders in Fraudulent Muni Bond Offering for Movie Studio Project, 1 (Nov. 6, 2014), available [here](#).

² Complaint at 5, SEC v. Eric C. Waidelich, 2:14-CV-14279 (Nov. 6, 2014), available [here](#).

³ SEC Order, In re City of Allen Park, Michigan, File No. 3-16259 (Nov. 6, 2014), available [here](#).

⁴ Complaint at 14, SEC v. Gary J. Burtka, 2:14-CV-14278 (Nov. 6, 2014), available [here](#).

⁵ *Id.* at 14.

⁶ Press Release at 1.