

INSIGHTS

SEC Fraud Charges Against School District Demonstrate Increased Focus on Disclosure Compliance by Municipal Issuers

July 31, 2013

By: [**Britt Cass Steckman**](#)

On July 29, 2013, the Securities and Exchange Commission announced that it had charged an Indiana school district and its underwriter with securities fraud for falsely stating in a 2007 offering document that the issuer was in compliance with its continuing disclosure obligations, when in fact it had not made any continuing disclosure filings in the years preceding the bond issue. The SEC charged the issuer with violation of Exchange Act Section 10(b) and rule 10b-5 thereunder, a scienter-based fraud charge, as well as violation of Securities Act Section 17(a)(2), a negligence-based charge. The use of the scienter based charge underscores the SEC's view of the serious nature of the violation. This represents the first time that the SEC has charged an issuer with securities fraud for falsely stating that it was in compliance with its continuing disclosure obligations, demonstrating the SEC's increased willingness to go after municipal securities issuers in addition to the investment banks that have traditionally been the targets of regulation and enforcement. Both the issuer and the underwriter settled with the SEC without admitting or denying the charges. As part of the settlement, the issuer agreed to remedial actions including the adoption of written policies for its continuing disclosure obligations and the designation of an individual responsible for ensuring compliance with those obligations, as well as implementation of annual training for personnel involved in the bond offering and disclosure process. This continues the pattern of enforcement actions against municipal issuers in which the SEC has emphasized the necessity for issuers to adopt and implement disclosure policies and procedures.

Securities Exchange Act Rule 15c2-12 prohibits an underwriter of municipal securities from underwriting municipal securities unless it determines that the issuer of the securities has agreed to provide continuing disclosure to the market. Issuers and obligated persons must agree to provide annual financial information and provide notice when specified material events occur.

According to the SEC cease-and-desist orders against West Clark Community Schools, an Indiana school district, and its underwriter, City Securities Corporation, West Clark issued \$52 million of municipal bonds in March 2005, underwritten by City Securities. As required by Rule 15c2-12, the 2005 offering document stated that the school district had agreed to provide annual financial information and timely notice of material events. However, the school district never submitted any annual reports or material event notices. In December 2007, the school district publicly offered \$31 million of municipal securities, again using City Securities as

underwriter. Despite the district's failure to provide any continuing disclosure, the December 2007 official statement stated that the school district had not failed to comply with any previous undertakings in the past five years. The SEC noted that City Securities "relied solely on the assertions of the issuer that it had complied with its prior continuing disclosure undertakings" and failed to independently confirm that the required disclosure had been made.

The SEC found that West Clark violated Section 17(a)(2) of the Securities Act and Section 10(b) and Rule 10b-5 of the Exchange Act by falsely stating that it was in compliance with previous undertakings when it knew or should have known that it had not provided continuing disclosure to the market as required by its 2005 continuing disclosure agreement. The SEC found that City Securities violated Section 17(a)(2), Rule 10b-5, and Rule 15c2-12 by failing to conduct reasonable due diligence to allow it to reasonably believe that the statements in the 2007 official statement were accurate in all material respects.¹

Andrew Ceresney, Co-Director of the SEC Division of Enforcement, stated: "This case demonstrates that we will be vigilant in making sure municipal issuers and underwriters comply with their obligations." Issuers and underwriters of municipal securities should take him at his word, as this and other recent SEC actions demonstrate that the Commission intends to charge municipal securities issuers for perceived violations of the federal securities laws, whether those violations are negligent, reckless, or knowing.

¹ The SEC further found that the head of the City Securities public finance department willfully aided and abetted its 15c2-12 violation.