

## INSIGHTS

## First Issuer MCDC SEC Settlement Announced

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On July 8, 2014, the U.S. Securities and Exchange Commission announced that it has entered into a settlement order with Kings Canyon Joint Unified School District (Kings Canyon)—the first settlement with an issuer under the Commission’s Municipalities Continuing Disclosure Cooperation (MCDC) initiative which began in March 2014.<sup>1</sup> The Kings Canyon settlement order is also noteworthy for what it does not do – provide useful SEC guidance on the scope of potential disclosure violations to be reported under the MCDC. *See our prior Update, [\*\*SEC Municipalities Continuing Disclosure Cooperation Initiative Targets Issuers and Underwriters with a “Prisoner’s Dilemma.”\*\*](#)*

Under the MCDC, the Commission’s Enforcement Division “will recommend favorable settlement terms to issuers and obligated persons involved in the offer or sale of municipal securities (collectively, “issuers”) as well as underwriters of such offerings if they self-report to the Division possible violations involving materially inaccurate statements relating to prior compliance with the continuing disclosure obligations specified in Rule 15c2-12” of the Securities Exchange Act of 1934 (Rule 15c2-12).<sup>2</sup> The “favorable settlement terms” under the MCDC will only be available until September 9, 2014. The Commission charged Kings Canyon with misleading bond investors about its compliance with its prior Rule 15c2-12 continuing disclosure agreements and issued an order that instituted cease-and-desist proceedings against Kings Canyon and imposed remedial sanctions against it in line with the terms of the MCDC. In its order, the Commission found that Kings Canyon publicly offered municipal bonds on four occasions—in December 2006, November 2007, December 2007, and November 2010. As part of the three offerings in 2006 and 2007, Kings Canyon contractually undertook to make the kind of disclosures required by Rule 15c2-12. The Commission found that Kings Canyon had affirmatively stated in the Official Statement for its November 2010 municipal bond offering that “[t]he District has had no instance in the previous five years in which it failed to comply in all material respects with any previous continuing disclosure obligation under [Rule 15c2-12],” when in fact “[b]etween at least 2008 and 2010, the Issuer failed to submit some of the disclosures required under the contractual terms of its Continuing Disclosure Certificates.” The Commission concluded that the issuer’s statement regarding compliance with prior continuing disclosure undertakings is “an untrue statement of material fact” that violates Section 17(a)(2) of the Securities Exchange Act of 1934.<sup>3</sup>

Without admitting or denying the Commission’s findings, Kings Canyon consented to the cease-and-desist order, and agreed to complete the following undertakings (all “standardized settlement terms” under the MCDC): (1) to establish written policies for its continuing disclosure obligations; (2) to comply with existing continuing disclosure undertakings (including

updating any past delinquent filings) within 180 days; (3) to cooperate with any subsequent investigation regarding the false statement(s), including the roles of individuals and/or other parties involved; (4) to disclose the terms of this settlement in clear and conspicuous language in any future bond offering materials for the next 5 years; and (5) to certify to the Commission staff that it has complied with these undertakings.

In addition to being the first case against an issuer resolved under the MCDC, the Kings Canyon settlement order is significant for what it does not do: provide specific guidance on the scope of potential violations the SEC expects to be reported under the MCDC. In July 2013 (prior to the commencement of the MCDC initiative), the Commission announced that it had settled charges against an issuer and its underwriter for violations regarding statements about compliance with continuing disclosure obligations that the Commission found to be materially inaccurate because the issuer had *never* filed its required disclosure reports.<sup>4</sup> The Kings Canyon proceeding contrasts with this earlier proceeding because in Kings Canyon the untrue statements of material fact stem from the school district's failure to submit not "*any*" or "*all*" but merely "*some*" of its required disclosures. In choosing to find that Kings Canyon's failure to submit "*some*" required disclosures amounts to a failure to "*comply in all material respects* with any previous continuing disclosure obligation under [Rule 15c2-12]" the Commission does indicate it expects reports of instances in which less than total non-compliance is misstated in an Official Statement as compliant, but provides no indication of how much less, either by type or frequency. By its choice of words, the Commission leaves the scope of expected potential violations broad and vague, apparently by intent.

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<sup>1</sup>*In the Matter of Kings Canyon Joint Unified School District*, Securities Act Release No. 9610 (July 8, 2014).

<sup>2</sup>In general, Rule 15c2-12 prohibits an underwriter from purchasing or selling municipal securities unless the underwriter has reasonably determined that the issuer, or an obligor in the case of conduit and similar financings, has undertaken in a written contract to disclose annual financial information and notices of certain significant events.

<sup>3</sup>Section 17(a)(2) of the Securities Exchange Act of 1934 prohibits the offering or sale of any securities in exchange for money or property "by means of any untrue statement of material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading."

<sup>4</sup>*In the Matter of West Clark Community Schools*, Securities Act Release No. 9436, Exchange Act Release No. 70057 (July 29, 2013); *In the Matter of City Securities Corporation and Randy G. Ruhl*, Securities Release Act No. 9434, Exchange Act Release No. 70056 (July 29, 2013).