



## SEC Rule 15c2-12: Continuing Disclosure Requirements and Related 1934 Act Issues

### Key Laws — *Securities Exchange Act of 1934*

- ▶ Anti-Fraud provisions
  - ▶ Section 10(b): prohibits fraud in purchase or sale of securities
  - ▶ Rule 10b-5: communications to “marketplace” cannot contain **untrue statement of material fact** or **omission of material fact** “necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading”
  - ▶ “Material”: a fact is material if there is a substantial likelihood that the fact would affect a **reasonable investor’s** decision whether to buy or sell the security
  - ▶ Section 17(a): “unlawful for any person in the offer or sale of any securities ... by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly (1) to employ any device, scheme, or artifice to defraud, or (2) to obtain money or property by means of any untrue statement of a 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; or (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser”



## 1934 Act - Rule 15c2-12 (con't)

- ▶ Rule 15c2-12: New Issue Disclosure
  - ▶ Preliminary Official Statement (POS)
    - ▶ Must contain:
      - ▶ Information concerning the terms of the securities
      - ▶ Financial information or operating data material to an evaluation of the securities
    - ▶ Must be reviewed by underwriter before it bids for, offers/purchases/sells bonds
    - ▶ Must be "**deemed final**" by the issuer and obligor
  - ▶ Official Statement (OS)
    - ▶ Same as the POS except it includes pricing-related information
    - ▶ Delivered to underwriter within 7 business days after pricing and in time to accompany buyer confirmations

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## 1934 Act - Rule 15c2-12 (con't)

- ▶ Rule 15c2-12: Continuing Disclosure
  - ▶ Two types of reporting:
    - ▶ Annual report
      - ▶ Financial information or operating data of the type included in the OS
      - ▶ Audited financial statements, when and if available
  - ▶ Event disclosure
    - ▶ Failure to file annual report
    - ▶ 14 listed events (see following slide); no materiality determination for most events
  - ▶ Method of Filing: MSRB's EMMA System

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## 1934 Act - Rule 15c2-12 (con't)

- ▶ Rule 15c2-12: Continuing Disclosure
  - ▶ Notice of 14 listed events must be given "in a timely manner not in excess of ten business days after the occurrence of the event" of:
    - ▶ Principal and interest payment delinquencies
    - ▶ Non-payment related defaults, if material
    - ▶ Unscheduled draws on debt service reserves reflecting financial difficulties
    - ▶ Unscheduled draws on credit enhancements reflecting financial difficulties
    - ▶ Substitution of credit or liquidity providers, or their failure to perform
    - ▶ Adverse tax opinions or events affecting the tax-exemption
    - ▶ Modifications to rights of security holders, if material
    - ▶ Bond calls, if material, and tender offers
    - ▶ Defeasances
    - ▶ Release, substitution, or sale of property securing repayment of the securities, if material
    - ▶ Rating changes
    - ▶ Bankruptcy, insolvency, receivership or similar event
    - ▶ Consummation of a merger, consolidation or acquisition involving the Issuer, if material
    - ▶ Appointment of successor or additional trustee or the change of name of a trustee, if material

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## Rule 15c2-12 – Issues

- ▶ What does "timely manner not in excess of ten business days" mean?
  - ▶ Adverbs are not your friend!
  - ▶ Do words "timely manner not in excess of" mean anything? Do they create an additional standard in some contexts?
- ▶ What does "business day" mean?
  - ▶ Market open?
  - ▶ State Government open?
  - ▶ County Government open?
  - ▶ Federal Government open?
- ▶ No knowledge Carve Out:
  - ▶ Rule requires reporting within 10 business days of occurrence, not discovery, of event.

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## Rule 15c2-12 - Enforcement

- ▶ Rule 15c2-12 - Enforcement
  - ▶ Imposes liability for secondary market statements
    - ▶ Continuing disclosure reports
    - ▶ Statements “reasonably expected to reach investors and trading markets”
      - ▶ Press releases
      - ▶ Web site postings
  - ▶ In the absence of Continuing Disclosure filings, investors may look to other information, including the statements of public officials (see Release No. 69515 – [In the Matter of The City of Harrisburg, Pennsylvania](#) discussed below)

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## Rule 15c2-12 – Compliance History

- ▶ Disclosure about Disclosure
  - ▶ SEC staff have stated that they believe that the history of an issuer or obligated person’s compliance with previous continuing disclosure undertakings during the five-year period preceding the publication of a preliminary official statement in connection with a bond offering is material information for potential buyers of bonds.
  - ▶ Notwithstanding Tower Amendment prohibitions on the SEC’s power to dictate the content of official statements, the staff’s position essentially makes the inclusion of such disclosure mandatory.

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## Rule 15c2-12 – MCDC Initiative

- ▶ SEC’s MCDC Program
  - ▶ History
  - ▶ Current Status
  - ▶ Possible Future Developments
  - ▶ Future guidance on materiality in 15c2-12 context likely to come from cumulative enforcement actions rather than from comprehensive guidance from staff or rulemaking by the Commission

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## 15c2-12 Enforcement: West Clark Community S.D.

Release No. 33-9435 (July 29, 2013)

- ▶ School District issued bonds in 2005, entering into a standard continuing disclosure undertaking
- ▶ School District issued bonds again in 2007 noting in the Official Statement that the School District had not failed to comply with a 15c2-12 undertaking for the prior five years and certified to the same statement at closing
- ▶ In fact, School District had failed to file any information between 2005 and 2010 [thus in order—but post 2007 failure not relevant to misstatement in 2007 official statement, except perhaps as evidence of intent to violate undertaking]
- ▶ SEC charged School District with securities fraud under 17(a) and underwriter for lack of due diligence
- ▶ School District settled with the SEC and agreed to, with the assistance of counsel, ensure all disclosures were current and accurate and to implement policies and procedures to prevent future noncompliance

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## 15c2-12 Enforcement: City of Harrisburg

Release No. 34-69515 (May 6, 2013)

- ▶ Harrisburg Authority, a municipal authority of the City of Harrisburg, issued bonds to construct a waste-to-energy facility
- ▶ The City of Harrisburg agreed to guarantee the bonds issued to construct the facility
  - ▶ As a result, the City was considered a "materially obligated person" for purposes of Rule 15c2-12 and entered into a continuing disclosure undertaking for purposes of the Rule
  - ▶ The City failed to comply with the continuing disclosure undertaking for over two years
- ▶ In the absence of current information disseminated pursuant to the undertaking, investors sought out material elsewhere, including the CAFRs, the City Budgets and Mid-Year Fiscal Reports
  - ▶ Most of these documents included misrepresentations, including failure to disclose payments made under the guarantee, ratings downgrades and rating misrepresentations, including a note that the City's credit rating from Moody's was "Aaa"
- ▶ In the SEC's order, it noted that, in the absence of 15c2-12 filings, investors may have to rely on statements made by public officials
  - ▶ SEC issued a cease and desist order and required a written disclosure policy

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## 15c2-12- Policy and Procedures

- ▶ Policy on Continuing Disclosure
- ▶ Do you need one? The SEC seems to think so!
  - ▶ Part of each settlement of almost all SEC enforcement actions relating to failure to abide by the terms of a continuing disclosure undertaking or disclosures that a materially inaccurate (whether by reason of commission or omission) included the creation of a disclosure policy
  - ▶ Key components:
    - ▶ Maintain central file of continuing disclosure agreements (CDAs) for all debt—whether as an issuer or an obligated person.
    - ▶ Be Master Account Coordinator for all EMMA filings and ensure that multiple personnel have access to EMMA and are trained.
    - ▶ Review each CDA to identify reporting requirements [coordinate with counsel and financial advisor].
    - ▶ At least annually summarize and log in a Disclosure Compliance Report all annual reporting requirements in CDAs. Coordinate with other parties to keep log current.
    - ▶ File annual required documentation no later than applicable deadlines
    - ▶ File confirmation of each EMMA filing and share with staff, counsel and financial advisor.
    - ▶ Material Events
    - ▶ Training
    - ▶ File Retention

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## 1934 Act Enforcement: City of Miami

March 21, 2003

- ▶ In fiscal year 1995, Miami was facing a severe cash shortage and issued bonds to finance current operating cash needs
- ▶ Miami's Comprehensive Annual Financial Report and Official Statements during this time did not accurately note the scope of the liquidity difficulties
- ▶ Miami Cease and Desist Order: "The City Manager actually admitted he wasn't familiar with disclosure requirements ... and dismissed importance of bond offering documents" (citing reliance on ratings)

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## 1934 Act Enforcement: City of South Miami

Release No. 33-9404 (May 22, 2013)

- ▶ Conduit Issuer/Lender sold tax-exempt bond for benefit of several conduit borrowers, including the City of South Miami in 2002 and 2006
  - ▶ City of South Miami to use proceeds for construction of parking garage to serve retail facility to be constructed by developer
  - ▶ South Miami made material misrepresentations concerning the use of proceeds
    - ▶ City represented that none of the proceeds would be used for private use in tax certifications relied upon by Bond Counsel
    - ▶ City loaned a portion of the proceeds to the developer in violation of the certification
    - ▶ City altered the terms of a ground lease relied upon by Bond Counsel, including provision of parking spaces in the facility to the developer
  - ▶ Effects
    - ▶ Upon bond counsel's discovery of the misrepresentations:
      - ▶ IRS: South Miami and Conduit Lender apply for settlement under IRS Voluntary Closing Agreement Program (VCAP) to preserve tax-exemption and enter into closing agreements with payment of penalty to IRS and redemption of certain affected bonds
      - ▶ SEC: South Miami's actions jeopardized the tax-exemption on both issues of bonds, a fact investors would have considered material; SEC issues a cease and desist order and to comply with remedial undertakings, including the recommendations of an independent consultant

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## 1934 Act Enforcement: Pension Cases – New Jersey and Illinois

Release No. 33-9135 (August 18, 2010) and Release No. 33-9389 (March 11, 2013)

- ▶ SEC, in separate actions, entered cease and desist orders against New Jersey and Illinois relating to disclosures relating to their respective pension obligations
- ▶ Illinois misled investors about changes to its statutory funding plan, including pension holidays.
  - ▶ While Illinois disclosed the amendments to its statutory plan and the pension holidays, it did not disclose the effect of those changes on the contribution schedule and its ability to meet its pension obligations
- ▶ New Jersey made material misrepresentations and omissions about the underfunding of two major pension plans in offering documents
  - ▶ In particular, New Jersey disclosures suggested that such plans were adequately funded when they were not, masking the potential effect of fully-funding New Jersey's obligations under such plans on other state operations
- ▶ SEC issued cease and desist orders against both states and required that each implement remedial action plans

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## 1934 Act Enforcement: Kansas

Release No. 33-9629 (August 11, 2014)

- ▶ The SEC followed up the enforcement actions against New Jersey and Illinois with a substantially similar enforcement action against the State of Kansas
  - ▶ Purportedly based upon the advice of its auditor, the State of Kansas did not include the underfunded status of Kansas Public Employees Retirement System (KPERs) in the State's Comprehensive Annual Financial Report (CAFR)
    - ▶ During the period cited by the Commission in its enforcement action, KPERs had, by some measures, the second-worst funded ratio of any state pension fund
  - ▶ Not only was the underfunded status not covered in the CAFR, but the State also failed to include any supplemental disclosure regarding the underfunded status in various official statements relating to credits that were primarily based on state appropriations
    - ▶ The Commission determined that the failure to disclose the underfunded status, which it viewed as material information, "resulted from insufficient procedures and poor communications between Kansas Development Finance Authority [the State's primary issuer] and the Kansas Department of Administration [which is charged with the State's finances, including debt issuance]"
  - ▶ The SEC imposed penalties similar to those imposed on New Jersey and Illinois

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Release No. 33-7260 (January 24, 1996)

- ▶ **SEC Report:** issued “to emphasize the responsibilities under the federal securities laws of local governmental officials...”
  - ▶ Supervisors were aware of County financial condition and budgetary reliance on investment returns generated by County Pools
  - ▶ Supervisors knew that the investment strategy was tied to debt issuance
  - ▶ Supervisors failed to take “steps appropriate under the circumstances” to assure that the County’s financial situation was being adequately disclosed to potential investors
    - ▶ “Public official who approves issuance of securities and related disclosure documents may not authorize disclosure that the public official knows to be materially false or misleading”
    - ▶ “Public official may not authorize disclosure while recklessly disregarding facts that indicate that there is a risk that the disclosure may be misleading”

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## 1934 Act Enforcement: Personal Liability of Legislators and Staff

- ▶ **Orange County**
  - ▶ Treasurer: SEC cease and desist order; 6 years in jail, \$100K fine
  - ▶ Asst Treasurer: SEC cease and desist order; 3 years in jail; \$10K fine
- ▶ **Wenatchee:**
  - ▶ Contract Manager: Cease and desist order
  - ▶ Private Operator: Cease and desist order; \$10k fine
- ▶ **Victorville (SCLAA):**
  - ▶ SEC seeking cease and desist order against former City and authority officials and monetary penalties (details below)

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## 1934 Act Enforcement: SEC Action - San Diego (2008 Complaint)

- ▶ Issued \$260 million in 5 issues in 2002 and 2003
- ▶ City staff and legislative body knew the City had huge unfunded liabilities for pensions, retiree health care
- ▶ Violation of anti-fraud rules: City did not adequately disclose the issue in disclosure documents, rating agency presentations, continuing disclosure reports

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## 1934 Act: Personal Liability of Legislators and Staff

- ▶ **San Diego (April 7, 2008):**  
SEC filed securities law charges against San Diego officials (City Manager, Auditor & Comptroller, Deputy City Manager for Finance, Assistant Auditor & Comptroller, City Treasurer) under Section 17(a) of 1933 Act, Section 10(b) of 1934 Act and Rule 10b-5
  - ▶ Seeking permanent injunction and civil penalties
  - ▶ Challenged actions: OS failed to disclose looming financial crisis and the officials, with knowledge of material facts -
    - ▶ Signed closing certificate as to accuracy of OS
    - ▶ Participated in rating agency presentations
    - ▶ Reviewed misleading financial statements and allowed their publication
  - ▶ In 2010, the charges against four of the five San Diego Officials (City Manager, Auditor & Comptroller, Deputy City Manager for Finance, City Treasurer) were settled. In addition to a cease and desist order, each of the four officials were obligated to pay financial penalties (\$25,000 for each of the City Manager, Auditor and Comptroller and Deputy City Manager for Finance and \$5,000 for the City Treasurer).

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## 1934 Act Enforcement: Personal Liability of Legislators and Staff

Filed July 19, 2013 (Miami); April 29, 2013 (Victorville)

### ► Recent Actions

- **SEC v. City of Miami and Michael Boudreaux (S.D. Fla.)**
  - SEC investigation found that the City of Miami and Michael Boudreaux, the City's finance director, made material misrepresentations regarding interfund transfers between the City's Operating and Capital accounts in both Official Statements and several of the City's Comprehensive Annual Financial Reports
  - To compound the SEC's allegations, the City was already operating under a cease and desist order
  - SEC is seeking a cease and desist order and civil financial penalties against the City and against the former finance director individually
  - Boudreaux appealing failed motion to dismissed based on qualified immunity to Supreme Court
  
- **SEC v. City of Victorville, et al. (C.D. Ca.)**
  - SEC Investigation found that the City of Victorville, which controlled and acted through the Southern California Logistics Airport Authority, inflated property values in official statements for tax increment financings and that an Assistant City Manager and the former Director of Economic Development, as well as the underwriter of the bonds, aided and abetted the fraud
  - SEC is also alleging that the developer misappropriated bond proceeds
  - SEC is seeking cease and desist orders against various individuals, including the Assistant City manager and the former Director of Economic Development, and financial penalties (including return of the misappropriated bond proceeds and prejudgment interest)

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## Select Other Recent Actions

- **SEC v. City of Harvey, Illinois and Joseph T. Letke (2014)**
  - This action was notable because the SEC actually intervened prior to the issuance of Bonds by the City, seeking and receiving an emergency court order to prevent the issuance
  - The City of Harvey and Letke, the City's Comptroller (and Financial Advisor), were accused of misappropriating the proceeds of prior bond issues, ostensibly issued to finance a hotel redevelopment project, to balance the City's operational accounts and to make payments to Letke
  - The City subsequently settled the case and the SEC secured a default settlement against Letke (financial penalty/barred from participation in municipal offerings)

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## Select Other Recent Actions

- ▶ In re. City of Allen Park, Michigan, SEC Release 33-9677 (November 6, 2014), SEC v. Burtka and SEC v. Eric Waidelich
  - ▶ The City intended to finance the development of a movie studio, primarily with bond proceeds
  - ▶ The City, which had anticipated a \$2 million operating deficit, secured a gift in the same amount from its partner in the development, a film producer
  - ▶ The City knew, however, at the time of the bond offering that it would not receive the \$2 million donation because it could not fulfill its conditions to the partnership agreement with the film producer
  - ▶ The City obscured the imbalanced budget in official statements for two separate bond issues and also failed to disclose other negative events relating to the proposed film studio development
  - ▶ The SEC ordered the City to establish disclosure procedures, to be drafted by disclosure counsel, and to conduct training for City personnel
  - ▶ The SEC also brought separate actions against Burtha, the former Mayor of Allen Park, and Waidelich, the former City Administrator
    - ▶ The action against Waidelich was premised on the fact that he provided the bulk of the inaccurate financial information in the Official Statements
    - ▶ The action against Burtha was premised solely on the fact that he was a “control person” for purposes of both the City’s and Waidelich’s violations