EXPANDING MUNICIPAL SECURITIES ENFORCEMENT:

PROFOUND CHANGES FOR ISSUERS & OFFICIALS

By Robert Doty,
AGFS, Annapolis, MD

Monday, December 15, 1975 THE DAILY BOND BUYER 3

The Municipal Market

Disclosure Seen Blocking New Issues, Reducing Bidding Accounts

By WILLIAM J. RYAN

'The Daily Bond Buyer' Summary of Key Markets

New on Calendar

Ohio States

Daily Bond Buyer Headline Reflecting Market Disclosure Disruptions in 1975

Since early 2013, the Securities and Exchange Commission has made clear that things have changed in the municipal bond market:

- ✓ **An issuer is enjoined from issuing bonds in an offering in progress**
- ✓ **An issuer is prohibited from issuing bonds for three years unless it employs "independent disclosure counsel"**
- ✓ **A sitting Mayor is charged as a "control person," pays a $10,000 fine, and is prohibited from ever participating in another bond issue, although not charged with fraud or negligence**
- ✓ **An issuer pays a $125,000 fine**
- ✓ **An issuer's General Manager/General Counsel pays a $50,000 fine**
- ✓ **An issuer official, charged only with negligence for failure to read an official statement, pays a $10,000 fine and is barred from future bond issues**

These are a few of the recent SEC "firsts"

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Dr. John E. Petersen

What We Do Today Flows Directly from John's Vision and Leadership More Than 40 Years Ago

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THE AUTHORITY ON MUNICIPAL BONDS

NEW YORK, N. Y. TUESDAY, OCTOBER

N.Y.C. Crisis Termed Threat To Housing Agencies' Bonds

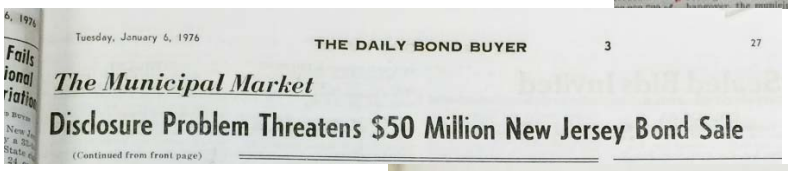
$4.5 Billion Nov. 4 Ballo

Feb. 13.

Disclosure, Taxable Bond, New Rules Seen as Major Industry Problems in '76

By John Connor

WASHINGTON, Dec. 31 — Still reeling from a New York City-induced



Tuesday, January 6, 1976 THE DAILY BOND BUYER 3

The Municipal Market

Disclosure Problem Threatens $50 Million New Jersey Bond Sale

(Continued from front page)

Monday, January 19, 1976 THE DAILY BOND BUYER

The Municipal Market

Ohio Postponement Heats Up Debate on Disclosure

By Alan Bautzer

When time and inventory hangs heavy on dealer's hands and important new issue like Ohio's $60 million are being postponed because of disclosure problems, it's a good bet that there's going to be a lot of discussion about disclosure, not to mention the

'The Daily Bond Buyer' Summary of Key Markets

FRIDAY, JAN. 16, 1976

Municipal New Issues: A Michigan Community College District issue sold late Thursday of $12.5 million. Balance: $5.975 million. Visible supply $1,400.4 million.

In 2016, Puerto Rico is defaulting on multiple bond issues despite what had appeared to be strong legal protections, even constitutional priority, for investors. In its bankruptcy, Detroit recently substantially demoted purported general obligation bond security—raising important questions for thousands of issuers regarding what had been believed to be "gold plated" GO bonds. That followed bankruptcies of Jefferson County, Stockton and San Bernardino in which investors suffered significantly. The State of Illinois, the City of Chicago and the Chicago Public Schools—all important issuers—are confronting serious financial issues.

Yet, the municipal securities market continues to function smoothly, with low yields.

That stability is an extremely valuable market asset that must be protected—for the benefit of issuers and investors alike.

The widespread implementation by municipal market participants of sound disclosure and due diligence practices deserves much of the credit. Those practices are the result of the significant, authoritative disclosure and due diligence guidance provided by market organizations representing the interests of investors, issuers and bond counsel and of guidance provided through active market oversight by the Securities and Exchange Commission.

Unlike 1975 after New York City's default, municipal bond investors in 2016 have confidence that they have access to sound information enabling them to distinguish among credits and bonds.

This demonstrates emphatically why a vigilant market discipline is essential to promote strong issuer disclosure and underwriter due diligence practices.

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EXPANDING MUNICIPAL SECURITIES ENFORCEMENT: PROFOUND CHANGES FOR ISSUERS & OFFICIALS

By Robert Doty[1]

FOREWORD

Most municipal securities market practitioners are well aware that recently the Securities and Exchange Commission stepped up extensively its enforcement efforts in the municipal market. Some perhaps also are aware that, during this period, the Commission continued to expand the enforcement activities of its specialized Public Finance Abuse Unit, created in 2010.[2]

In the absence of affirmative authority to regulate municipal securities issuers directly[3]—through pre-offering review and pre-offering disclosure mandates or more than generalized

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[1] President/Proprietor, AGFS, a municipal securities litigation consulting firm in Annapolis, MD. Mr. Doty has worked in the municipal securities market for more than 40 years as a bond counsel, underwriter counsel, issuer counsel, investor counsel, trustee counsel, investment banker, financial advisor and special consultant to issuers and underwriters. He is a member of the bars of California, New York and District of Columbia and is an inactive member of the bars of Texas and Ohio. He graduated from Harvard Law School in 1967.

Mr. Doty's most recent books are **THE BLOOMBERG VISUAL GUIDE TO MUNICIPAL BONDS** (John Wiley & Sons 2011) and **MUNICIPAL SECURITIES LAW & PRACTICE: REGULATION, DISCLOSURE AND ENFORCEMENT**, 212 Securities Practice Series (Bloomberg BNA 2014, rev. 2015). He is the author of more than 80 articles on municipal securities law and the municipal bond market. Mr. Doty consults and serves as an expert witness in connection with certain actions summarized herein.

The discussion in this book contains quotations, and the footnotes cite dozens of articles, from The Bond Buyer because The Bond Buyer reports extensively on many of the SEC's enforcement actions affecting the market.

Mr. Doty solicits identification of errors. Mr. Doty may be contacted with questions or comments regarding the discussion herein at *Robert.Doty@AGFS.com*, Telephone: (916) 761-3432. His website is *www.AGFS.com*.

[2] The specialized Unit was previously known as the Municipal Securities and Public Pensions Unit, and changed its name to the Public Finance Abuse Unit in April 2016.

[3] Despite frequent assertions to the contrary by proponents of greater regulation of municipal issuers, the Tower Amendment, discussed at n. 100, is not the SEC's primary obstacle to regulating issuers. Literally, the Tower Amendment only prevents the SEC from requiring pre-sale filings with the Commission. If the Tower Amendment were repealed today, not much, if anything, would change in terms of the Commission's authority.

guidance—the Commission is now, both in effect and in reality, "regulating" by enforcement—post-offering review. This was the legislative bargain that municipal issuers struck in 1975.

The SEC is now leveraging that legislative bargain to its great advantage. For the past two years, the municipal market has been preoccupied with the SEC's Municipalities Continuing Disclosure Cooperation (MCDC) Initiative. While that occurred, however, significant other enforcement work transpired.

Many issuers, officials and their local counsel may be unaware of the sheer volume of non-MCDC enforcement activity or of the many "first" steps that the Commission achieved.

In this book, I bring together information regarding the SEC's enforcement actions since the beginning of 2013 to demonstrate what I believe is a substantially changed market environment for the future. For members of the International Municipal Lawyers Association, it is worth noting that, for the first time, local municipal lawyers are now the subject of SEC enforcement actions and, recently, even Justice Department criminal action.

Of more general interest, the Commission now is reaching in its enforcement work into new areas, such as identifying disclosure violations outside of traditional disclosure documents. The Commission also is becoming much bolder in seeking harsh remedies in more egregious fact settings, such as civil penalties—effectively fines—against issuers and officials, bars against issuers issuing bonds (requiring compliance with conditions precedent), and even barring municipal officials from ever participating again in bond issues (and in roles beyond serving as municipal officials). In the Ramapo, NY, enforcement action, as discussed beginning at page 177, the Commission now has made a criminal referral of a municipal disclosure matter and announced an intention to continue that practice. Furthermore, the Commission has made clear its intention to increase its coordination with the criminal authorities.[4]

For those unsophisticated issuers that may run afoul of the securities laws through negligence, rather than by intentional action, however, the Commission has been willing to assist by accepting commitments for the implementation of internal procedures to avoid future difficulties. This is evidenced in a number of actions, including the MCDC Initiative.

The bottom line is that the noose is tightening for those issuers and officials who do not pay careful attention to the important role in municipal finance of sound disclosure to investors. This development warrants care at the time issuers employ their legal counsel—bond counsel, issuer disclosure counsel[5] and local issuer counsel—and their financial professionals.

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[4] Although the Commission can seek to obtain civil penalties, disgorgement of ill-gotten gains, injunctions, bars and other remedial relief, only the criminal authorities can seek to impose sanctions such as criminal fines and incarceration.

[5] Issuer disclosure counsel is distinct from underwriter's counsel. Underwriters are arm's-length (even if friendly) parties that work with issuers as principals. See, *e.*g., Municipal Securities Rulemaking Board, Notice 2012-38, "*Guidance on Implementation of Interpretive Notice Concerning the Application of MSRB Rule G-17 to Underwriters of Municipal Securities*" (July 18, 2012) ("The underwriter's primary

More than 25 years ago, the SEC expressed its fundamental premise that "issuers are primarily responsible for the content of their disclosure documents and may be held liable under the federal securities laws for misleading disclosure."[6]

It is becoming ever more apparent that issuers and officials should pay that warning heed .

Even if the best qualified and careful advisors cost more, it can be money well spent. It may be much wiser to spend a few thousand dollars to be careful, to spend a bit more time to double check the accuracy of information, and to delay closings when significant issues emerge, than to become embroiled in litigation either with the SEC or private claimants. It is virtually impossible to present a sound defense without incurring costs well into seven figures.

I hope that I am able to communicate the swiftness and scope of recent change in SEC enforcement. My goal is to enable issuers and officials—many of whom are not in touch with this subject matter on a daily basis—to consider how best to proceed prudently when they need to raise money for vital public purposes.

I am especially grateful to Elaine Greenberg, John McNally and Joseph (Jodie) Smith for review, encouragement and insightful comments. I cannot express how much I appreciate it. In addition, Jodie Smith and Gilbert Southwell provided helpful comments on "Hypothetical: Test Yourself." I alone, however, am responsible for the opinions expressed in this book, and take sole responsibility for those opinions.

In addition, I express my special thanks to The Bond Buyer for allowing me to cite and quote extensively from dozens of informative articles over the past several years that add a significant dimension to the legal analysis. The Bond Buyer accommodated my invasion of its executive editorial

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role is to purchase securities with a view to distribution in an arm's-length commercial transaction with the issuer and it has financial and other interests that differ from those of the issuer; … Unlike a municipal advisor, the underwriter does not have a fiduciary duty to the issuer under the federal securities laws and is, therefore, not required by federal law to act in the best interests of the issuer without regard to its own financial or other interests").

Counsel to underwriters do not have contractual relationships with issuers. Issuers are considered to be primarily responsible for their disclosure documents. Issuers need advice in their own interests. In that light, issuers may wish to consider whether they want to rely upon underwriter's counsel to write the issuers' disclosure documents. Issuer disclosure counsel can do the job for similar cost, and should be expected to advise issuers in the issuers' best interests pursuant to contractual relationships. In addition, disclosure counsel can maintain an ongoing relationship with an issuer that continues beyond a particular transaction. For the same reason, issuers need to employ careful and skillful municipal advisors who will place issuers' interests first.

Many of the best legal counsel and municipal advisors—those who emphasize the quality of their advice over counting their "deals"—will offer non-contingent fee structures that do not require them to achieve bond closings, even in doubtful circumstances, in order to be paid after months of hard work.

[6] SEC Rel. No. 34-26985 n. 84, 54 F.R. 28799, 28811 n. 84 (July 10, 1989). This statement is quoted at greater length at n. 66.

offices rummaging through 40-year old issues to extract copies of stories to inform my readers. Those old Daily Bond Buyers tell a tale about which many, if not most, municipal securities market participants today know little or nothing regarding the impacts of the New York City financial crisis on the market and how municipal securities law began. It is crucial for market participants to understand how the market derived its present regulatory configuration.

My wonderful wife, Deborah, deserves extraordinary thanks for her constant encouragement and patience as I littered our home with tall stacks of papers and spent long hours in a silent cocoon for months focusing on my research, computer and writing.

Robert Doty