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California City Prevails Against Investor Lawsuit.

LOS ANGELES — A federal appeals court ruling in a case brought by investors should set a favorable precedent for municipal bond issuers, said an attorney who handled the case for the city of Alameda, Calif.

In September, the U.S. Court of Appeals for the Ninth Circuit found in favor of Alameda in a lawsuit brought by Nuveen Investments alleging the firm was misled into purchasing notes issued for the Northern California city's cable television venture.

A three-judge panel found that securities that trade in inefficient, illiquid markets are subject to the same stringent loss causation rules as exchange-traded securities that trade in liquid, efficient markets such as the national stock exchanges.

Judge M. Margaret McKeown wrote the opinion, issued Sept. 19, affirming the summary judgment ruling against Nuveen by U.S. District Court Judge Susan Illston.

The lawsuit could have wider implications in cases alleging fraud by municipalities, because defaults on municipal bonds have been rare, and therefore little case law exists, said Richard Elder, a partner in Oakland, Calif. law firm Wulfsberg, Reese & Colvig, which represented the city.

It's significant that the Ninth Circuit issued a written decision, because Nuveen claimed that a special test should apply to securities issued in an inefficient market, Elder said.

"It is hard to prove misrepresentation when the trade was made in an inefficient market," Elder said.

In her May 2011 ruling, Illston found in the case of Nuveen Municipal v. Alameda that, according to California securities law, the city is not liable for negligent or intentional misrepresentation by an employee.

California public entities are immune from civil liability under state securities fraud laws, Elder said.

Other states have similar immunity provisions, said Gregory Aker, another Wulfsberg, Reese & Colvig partner who represented Alameda.

On the federal claims, which don't provide immunity to municipalities, the Ninth Circuit court found in its ruling that Nuveen failed to show a link between "the claimed misrepresentations and the economic loss the purchasers suffered when the city sold the cable and Internet system."

Kristyna Munoz, a Nuveen spokeswoman, said her firm doesn't comment on litigation issues such as this.

Aker summarized Nuveen's argument as trying to draw a distinction between "efficient" and "inefficient" markets.

Securities that trade on a national stock exchange daily are seen as trading in a more "efficient

market," because it's easier to determine the value of those securities that are traded more frequently, according to Aker.

Under that theory, municipal bond markets would be considered "inefficient," because the securities trade less frequently, he said.

Taking that a step further, Nuveen argued it is easier to show loss causation for securities that trade more frequently, because it is easier to ascribe a market value. In the case of the Alameda bonds, there were maybe a couple of dozen trades in the course of four years, Aker said.

"The importance is that the Ninth Circuit judges said that no matter how efficiently or inefficiently the securities traded, Nuveen still had to prove the fraud it was claiming caused its loss," Aker said.

The case stemmed from Alameda's failed foray into operating a telecommunications company, funded partly by municipal bonds. The utility laid fiber optic lines for cable TV and high-speed internet service.

The city of 75,000 residents in the San Francisco Bay area threw in the towel on its telecom operation in 2008, selling it to Comcast for a price less than what was owed on the bonds that financed it.

Alameda paid the bondholders of the unrated 2004 bond anticipation notes, which financed completion of the system and refinanced outstanding debt, $15 million for the outstanding principal of $33 million.

The city claimed that high construction and labor costs and stiff competition from Comcast caused it to sell.

The city launched the cable system in 1998. The project faced financial problems soon after it was completed in 2005 and the city hired a consultant to find ways to cut costs. The cuts resulted in a small operating surplus in 2007, but weren't enough to provide the revenue needed to refinance the BANs when they came due in 2009.

The sale to Comcast, which closed in November 2008, received consent from 95% of noteholders, including Nuveen, with the stipulation that it retained the right to sue the city to recover their losses. The holders of the other 5% were paid in full.

Nuveen held $20.5 million in face value of the notes, and had received $6.5 million in interest payments over the life of the notes, according to facts stated in the appeals court opinion.

Nuveen sued Alameda and underwriter Stone & Youngberg in U.S. District Court in October 2008 for $11 million alleging the city and the underwriter committed securities fraud by concealing information about the true risks associated with the city's cable business. Nuveen held the bonds in two high-yield tax-exempt funds.

The firm also alleged the city issued 2004 notes, which were tied only to the cable revenue, because it feared the terms of the $16 million in certificates of participation issued in 2000 for the system would allow the lender, Citibank, to seize assets from the city's electric utility to satisfy the debt. Those COPs were paid with the proceeds of the 2004 BANs.

Nuveen's suit also alleged that Stone & Youngberg was aware of Alameda's alleged fraud and provided substantial assistance to advance the fraud.

The underwriter, which had been slated to go to trial in October 2011, five months after Illston ruled in the city's favor, settled with Nuveen in September 2011 for an undisclosed sum.

Nuveen has until Thursday Oct. 3 to ask for a rehearing, either before the three-judge panel that issued the decision or before an 11-judge panel in Ninth District Court. Nuveen could also petition for review by the U.S. Supreme Court.

"We don't think either of those steps have likelihood of success; but they could try those remedies to further appeal the decision," Aker said.

The appeals court did affirm the lower court's denial of Alameda's request that Nuveen pay its defense costs.

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