

Bond Case Briefs

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Miami Case Shows SEC Increasingly Targeting Individuals; Willing to Fine Cities.

The Securities and Exchange Commission's recent enforcement action against Miami, Fla. signals the commission's seriousness about both upholding prior cease and desist orders and holding public officials accountable, market participants said.

The lawsuit, filed July 19 in a federal court in Florida, charges both the city and former budget director Michael Boudreaux with securities fraud. It also nails the city for violating an existing cease and desist order issued in 2003, the first time the SEC has charged a city for violating such prior orders.

"This shows that the cease and desist orders have teeth," said John McNally, a bond lawyer at Hawkins, Delafield & Wood LLP. Cease and desist orders bar a government, individual or organization from causing further violations like the ones in a settlement and have been seen by some market participants as slaps on the wrist.

While the SEC lawsuit does not specify an amount, it asks the court to impose a financial penalty on the city for allegedly failing to abide by the terms of its 2003 agreement and sliding back into the same type of conduct that led to the earlier enforcement action. This is the second time the SEC has tried to impose a civil financial penalty on a city, with Victorville being the first.

"If you violate the cease and desist, they can ratchet up the penalties," McNally said. "Normally, people are not returning to the same kind of conduct."

Robert Dean Pope, an attorney at Hunton & Williams LLP, said the actions show that issuers need to take a close look at interfund transfers, since the SEC's case against the city rests heavily on what the commission says were impermissible transfers to the general fund designed to mask a growing deficit and secure better bond ratings. Pope said the action goes against the SEC's longtime policy of not imposing civil penalties on municipal issuers, which ultimately burden the taxpayers, though Miami is a special case because of its apparent pattern of misconduct. "Does this represent a change in that policy? I don't think so," Pope said.

Observers agreed that the latest action represents the next step in a pattern of recent enforcement actions against municipal issuers, several of which have seemed to set new precedents for what issuers can expect the SEC to do. Illinois settled with the commission on March 11 after being charged with fraud for misleading pension disclosures in bond documents between 2005 and 2009. The next month, the commission tagged Victorville, Calif., as well as officials and an underwriter for defrauding investors by inflating valuations of property in connection with a 2008 bond offering. The SEC charged Harrisburg, Pa. in May with misleading investors through public statements and other non-bond documents, and that same month filed a complaint against South Miami, Fla. for making false statements in documents certifying that bond proceeds were being properly used.

While the Harrisburg action tread new ground in establishing that speeches by public officials and documents not traditionally part of bond disclosure could cause securities law violations, many

market participants wondered why no individuals were held accountable in that case. The South Miami case also was a first in terms of focusing on bond documents not expected to reach investors.

In a speech on May 10 at the 45th Annual Rocky Mountain Securities Conference in Denver, SEC commissioner Daniel Gallagher said the commission would be taking the kid gloves off when dealing with issuer officials in the future.

“Although cities and municipal issuers are distinct legal entities, in fact they act through individuals,” Gallagher said. “And they meet their primary and continuing disclosure obligations under state and federal law through the conduct of public officials. So when we find material misstatements or omissions by public officials in connection with municipal securities, we can, should, and will take action to hold the appropriate public officials accountable.”

Paul Maco, a partner at Bracewell & Giuliani LLP, said the recent enforcement actions and Gallagher’s comments combine to offer a picture of SEC intent going forward.

“The tough stance taken by the SEC in Miami is less of a surprise in light of the build-up in enforcement actions against municipal issuers this spring alone, the Harrisburg 21(a) report and commissioner Gallagher’s May 10 speech on holding public officials accountable,” Maco said. “They appear to signaling greater use of a ‘name and shame’ approach to enforcement actions against municipal issuers and officials.”

Muni consultant and advisor Robert Doty said the action against Miami should be noted by all muni professionals but added that the full implications will not be known until the case plays out in court. Doty is president of the municipal finance consulting firm AGFS and senior advisor and counsel to the executive team at the financial advisory firm, Government Financial Strategies, Inc., both located in Sacramento, Calif. Miami has denied wrongdoing. Still, Doty agreed, the case is a sign that the expected crackdowns on issuers are coming to pass.

“It shows seriousness, and it will have an influence,” he said.

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