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Expect a Lot of Enforcement in 2014, Experts Say.

WASHINGTON — The Securities and Exchange Commission's enforcement division is expected to focus next year on holding municipal bond issuer officials personally accountable and making sure both issuers and underwriters understand the importance of disclosure policies and procedures.

A series of 2013 cases, including actions against Harrisburg, Pa., South Miami, Fla., and the Greater Wenatchee Regional Events Center Public Facilities District in Washington State, offer a blueprint of what the commission may do in the coming year, SEC officials, private securities lawyers and other market participants said.

"You will see our increased focus on municipal issuers and issuer officials," said LeeAnn Gaunt, chief of the SEC enforcement division's municipal securities and public pensions unit. Gaunt took over the unit several weeks ago after working on the muni team since 2010 and spending 13 years in the SEC's Boston office.

The commission will make public a number of enforcement actions in the coming year. "We have a healthy pipeline," she said.

Gaunt said the SEC's 2012 comprehensive report on the municipal market remains "a useful guidepost" to where the commission's efforts will be focused. That report flagged concerns regulators continue to have about the muni market, including the lack of both pricing transparency and disclosure in the secondary market.

Disclosure

"The enforcement division will continue to focus in on disclosure," said Elaine Greenberg, a lawyer at Orrick, Herrington & Sutcliffe LLP's Washington D.C. office. Greenberg is the former chief of the SEC's municipal securities and public pensions enforcement unit.

She left the commission in July after presiding over several of the precedent-setting cases. She drew particular attention to the Wenatchee case, the first time the SEC ever collected a financial penalty from a municipal issuer.

The Wenatchee district agreed to pay \$20,000 to settle charges it misled investors by falsely claiming no independent revenue estimates for an arena had been conducted, when in fact they had. Greenberg said the case could be a "harbinger" of things to come.

"It's very instructive of where the SEC appears to be focused," she said.

The case could be a preview of 2014 actions in two ways, according to Greenberg. First, the action shows that the SEC is willing to extract financial penalties from municipal issuers if the money can be obtained without affecting taxpayers. In Wenatchee, the money came straight from arena operating funds.

Second, Greenberg said, the case is a good indication that the SEC will bring action against

underwriters who fail to do their due diligence and even a wider range of transaction participants. In the Wenatchee proceeding, the commission also went after underwriter Piper Jaffray & Co. as well as the developer, Global Entertainment. Individuals at Piper and Global were also charged and involved in settlements.

"The SEC is most likely going to continue to scrutinize their conduct," Greenberg said of deal participants who have not traditionally faced SEC penalties.

Greenberg said the SEC will probably continue to bang the drum on pension and other post-employment benefits, or OPEB, liabilities. The topic has become increasingly hot as more and more municipalities have been forced to face growing pension and OPEB liabilities. The bankruptcy judge's ruling on Detroit has raised the specter that pension benefits can be cut in bankruptcy proceedings.

Greenberg added that, in 2014, an issuer official might be charged with fraud in the secondary market, something that did not happen in 2013. The SEC's 21(a) report on Harrisburg warned that issuer officials could face charges if they spread false information to the market, as Harrisburg's mayor did in a "state of the city" address. The mayor was not charged. Harrisburg was, however, a unique case in that the city had not been filing proper disclosures for extended periods of time and forcing investors to rely on such informal information as a speech.

Individuals

The muni market should watch out for an increased focus on individuals, according to Paul Maco, a securities lawyer at Bracewell & Giuliani. "I think the signals have been pretty clear," Maco said. "That is one of the possibilities the Harrisburg 21(a) report warned about."

Maco noted several other indications in 2013 that individuals would come under fire in the coming year, including SEC commissioner Daniel Gallagher's statement to The Bond Buyer that "municipalities don't commit frauds, people do." Maco said the SEC charged some individuals in the secondary market years ago, and looks to be pivoting back that way as a refresher.

"It is, in a way, shifting back and reminding officials," Maco said. He added that there is no reason to think 2014 will not be as active in enforcement as 2013, given Gaunt's background knowledge and experience working in the unit.

"Their new director is someone very familiar with the area, and doesn't need any on-the-job learning," he said.

John McNally, a lawyer at Hawkins, Delafield & Wood LLP, said the SEC's recent muni actions clearly present a "theme" that market participants should expect to continue in 2014.

"The core message from the SEC's enforcement actions is the importance of written disclosure controls and disclosure training," McNally said, pointing out that SEC actions against New Jersey, Illinois, and Harrisburg all cited the importance of issuer disclosure training, while the more recent Wenatchee case made the same point for underwriters.

"The key is that written disclosure controls and training serve not only to enhance the quality of disclosure but also to establish a defense were misleading disclosures to occur," he said.

McNally said the National Association of Bond Lawyers has undertaken a project aimed at providing guidance to the market on that very issue, and that it is likely to be available in the first quarter.

Another issue the SEC might explore is issuers' failure to disclose deferred infrastructure maintenance, according to McNally. Governmental Accounting Standards Board accounting and reporting standards require municipal entities to report the true cost of unmade repairs, but governments are not actually bound to adhere to GASB standards unless they want a clean audit opinion. Issuers that say they are following the GASB standards, however, must do so or they could face fraud charges.

John Grugan, an attorney with Ballard Spahr LLC, said 2014 could be notable for an increased enforcement scrutiny on underwriters for shoddy due diligence, as well as additional investigations of "gatekeepers" such as lawyers and accountants.

"The SEC already has provided some indications about the areas it will focus on in 2014," Grugan said. "The SEC, for some time now, has highlighted its enforcement actions against gatekeepers, such as lawyers, audit committee members, and accountants, but recently the SEC increased its scrutiny of underwriters and named underwriters as defendants in several cases in which [it] claims greater due diligence should have been undertaken. Additional enforcement actions charging gatekeepers can be expected as the SEC continues to dedicate additional resources to its municipal securities investigations."

"Similarly, as the city of Harrisburg matter illustrates, the SEC now is examining secondary market disclosures, and it seems certain that the SEC will dedicate similar energy to its review of continuing disclosures," he said. "Further, the SEC announced a renewed focus on accounting fraud this fall, and this focus complements the SEC's already-established enforcement efforts with respect to pension plan accounting and pension funding and related disclosures. Additional investigations in these areas seem likely, as well."

Municipal Advisors

While it seems clear the SEC is prepared to take a hard line on issuer and underwriter disclosures, as well as unfair pricing and pay-to-play violations as they occur, what is less certain is how the enforcement division will interact with the municipal advisor community.

MAs must register or re-register with the SEC beginning in July under the commission's registration rule, which was approved in September. The rule itself becomes effective Jan. 13, but MAs have had to be registered under a temporary rule and have owed a federal fiduciary duty to their clients since the passage of Dodd-Frank in 2010.

Gaunt said the SEC could bring charges against MAs who break the fiduciary duty, and forthcoming rules from the Municipal Securities Rulemaking board will add specificity to the law. The MSRB has said one of its first priorities in 2014 will be a MA-specific fiduciary duty law.

Robert Doty, president and proprietor at municipal bond consulting firm AGFS, said he expects the SEC to flex its muscles in the MA space, but possibly not based on the basis of fiduciary duty.

"I would expect there to be enforcement actions against municipal advisors," Doty said.

Dodd-Frank contains a broad antifraud provision that applies to muni advisors, Doty said, which could allow the SEC to take action. But other experts viewed the probability of enforcement cases against MAs as less likely.

"This is a whole new registrant population," Greenberg said. "I think this may present opportunities for enforcement actions down the road."

The coming year might be too soon for the SEC to take such action in the absence of MSRB rules, she added.

"It's something that people should be on the lookout for down the road," Greenberg said.

Maco agreed that the time for tough action against MAs is probably further away than the coming year, "The greater activity should be on guidance," he said. "This is just the beginning. There is a lot more to come."

Once the MSRB has written rules for the fiduciary duty, supervision, and gifts and gratuities, then the SEC might be more inclined to step in, according to Maco.

"It will probably be a few years," he predicted.

Greenberg also said market participants should keep an eye on the possibility of enforcement actions against public-private partnerships after the South Miami enforcement case. In that case, the SEC took the city to task for not disclosing that the tax-exempt status of the bonds it used to fund a parking facility might be compromised.

P3s are growing in popularity in the U.S. particularly in Texas, Florida, and Virginia. The line between public and private use can get blurry, and that could be dangerous for municipalities, developers, officials, and other transaction participants who fail to be very straightforward about any tax issues they might have.

"As more of these deals get done, it presents a risk," Greenberg said.

The coming year may also be a deciding one for a number of convicted bid-riggers, following the successful appeal and overturned convictions of a trio of General Electric bankers in November.

Dominick Carollo, Steven Goldberg, and Peter Grimm escaped prison on the grounds that the federal prosecutors did not move quickly enough to indict them for alleged fraud committed near the turn of the millennium, two of three judges of the U.S. Court of Appeals for the Second Circuit ruled.

Former UBS AG bankers Peter Ghavami, Gary Heinz, and Michael Welty were convicted in August 2012 as part of the same government investigation, and their lawyers are currently reviewing the appeals court's decision to see how it might be applicable to their case. A key party, CDR Financial Products founder David Rubin, was also convicted and is scheduled for sentencing next month.

Anthony Sabino, a Mineola, N.Y., white-collar defense attorney and St. John's University law professor, said the overturned verdicts could open up a host of possibilities for the other convicted men.

"Frankly, I'm worried that this ruling will weaken future white collar crime cases because it draws a premature line as to when a conspiracy stops," Sabino said. "Sure, most bad guys go for the fast buck, but this holding almost encourages crooks to be patient. Only time will tell."

The ruling "opens up the door to a number of procedures to toss out their convictions, purely on the legal grounds at the heart of this case," he added.

Sabino noted that even previously convicted men who took plea bargains have been freed in similar circumstances, such as when some Wall Street floor traders were set free following the Second Circuit's decision in *U.S. v. Finnerty* in 2007.

U.S. Department of Justice attorneys have been silent on its plans for the muni bid-riggers, declining multiple requests for comment.

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