Bond Case Briefs

Municipal Finance Law Since 1971

NYT: S.E.C. Stops City in Illinois from Selling Municipal Bonds.

Federal regulators went to court on Wednesday to keep a city in Illinois from bringing its bonds to market, an unprecedented step they called necessary to halt a widening securities fraud.

The Securities and Exchange Commission, in a complaint filed in United States District Court for the Northern District of Illinois, said that Harvey, an impoverished city of 25,000 south of Chicago, had sold $14 million in municipal bonds under false pretenses since 2008 and was planning to bring more of them to market this week.

Harvey issued bonds three times from 2008 to 2010, telling investors it was using the proceeds to rebuild a large Holiday Inn near a busy stretch of Interstate highway, something that was supposed to create jobs and bolster the city's fortunes. It used a legal provision that allows cities to share the value of their bonds' tax exemption with commercial companies for such projects.

Harvey said it would repay the debt from a dedicated stream of taxes it was counting on, including taxes collected from the travelers who would stay at the hotel. But the prospectus also called the securities "general obligation bonds."

Instead of renovating the hotel, the S.E.C. said, Harvey was using some of the money to meet its payroll and for other general operations. The developer who received most of the bond money moved to India, leaving a half-gutted hotel building standing empty "with dangling wires and exposed studs," the S.E.C. said. Work on the derelict site is at a standstill, and no one can stay at the hotel, much less pay the occupancy taxes pledged to bondholders.

Despite these many setbacks, the S.E.C. said, Harvey planned to bring a new batch of tax-exempt bonds to market as soon as this week — this time to build a supermarket — and its draft prospectus failed to tell prospective buyers about its previous bond disaster, which is still unresolved.

In addition to the city, the S.E.C.'s complaint named Harvey's comptroller, Joseph T. Letke. It said that Mr. Letke, an accountant, had worked at the same time for the city and for the developer who was given the bond proceeds to rebuild the hotel. He received $269,000 of the proceeds without disclosing the payments, as required, it said.

Mr. Letke's lawyer, Dean Polales, declined to comment.

In its complaint, the S.E.C. asked the court to prohibit Harvey and its officials from offering any municipal bonds for five years unless it retained a court-appointed independent consultant to make the offering legal. It also asked the court to make Mr. Letke forfeit ill-gotten gains and pay unspecified civil penalties.

The action against Harvey was the first time the S.E.C. sought an emergency court order to keep a municipality's bonds off the market, according to a person briefed on the case, who spoke on the condition of anonymity because the investigation was continuing.

“We moved quickly to stop this city and its comptroller from issuing more bonds under false pretenses,” Andrew J. Ceresney, director of the S.E.C.’s enforcement division, said in a statement. “We will continue to aggressively pursue municipalities and public officials who raise money through fraudulent bond transactions that harm both investors and residents.”

Throughout its existence, the S.E.C. has had only limited authority to police the municipal bond market. The law assumes that cities are under the control of the states, which are sovereigns. But in recent years, as municipal bankruptcies and bond defaults have become more common, the commission has been finding ways to step up its activities in the $3.7 trillion municipal bond market.

It has censured two states, New Jersey and Illinois, for misleading investors about their pension systems, for example, saying they papered over the risk that investors might find themselves competing with pensioners for the same limited pool of dollars — something that has happened in the bankruptcy of Detroit.

Bondholders have expressed surprise and anger at the way Detroit proposes to settle its debts, prompting market participants to look more carefully at city finances in general and the quality of the resources pledged to secure bonded debt.

By MARY WILLIAMS WALSH JUNE 25, 2014