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SEC's Harvey Action Illustrates MCDC Vulnerability for Issuers.

WASHINGTON — The Securities and Exchange Commission's enforcement action against Harvey, Ill., and its comptroller may give issuers pause about participating in the SEC's self-reporting program, a top municipal bond lawyer said.

John Grugan, a partner in Ballard Spahr's Philadelphia office, said the SEC's most recent muni enforcement action is a perfect illustration of why it's unrealistic to expect all issuers to participate in the commission's Municipalities Continuing Disclosure Cooperation initiative. In a civil suit filed earlier this week in the U.S. District Court for the Northern District of Illinois,, the SEC accused the city and comptroller Joseph Letke of misusing bond proceeds and misrepresenting investment risks and Letke's own financial interests in connection with bond offerings in 2008, 2009, and 2010. A federal judge blocked an imminent sale of the Chicago suburbs bonds at the request of SEC lawyers, an almost unheard-of step in the municipal market.

Grugan, who is co-leader of Ballard's municipal securities regulation and enforcement group, said that the case is a straightforward misuse of bond funds action on its face, not much different from many others the SEC has charged over the years. But this case came to light during the MCDC period, and was brought by the Chicago office where MCDC architect Peter Chan works, Grugan pointed out. The MCDC allows issuers, other borrowers and underwriters to get lenient settlement terms if they voluntarily self-report certain disclosure failures to the SEC by Sept. 10, but the commission has been clear that the settlement will not apply to individuals and will not cover violations other than offering documents that paint a false picture of the issuer's continuing disclosure record.

"This case illustrates how the SEC, once it begins its investigation, can go in different directions," Grugan said. "It can mushroom into something that's not controllable by the issuer."

There is no indication that Harvey attempted to participate in the MCDC, Grugan said, adding that the kind of activity alleged in the case could be easily discoverable by SEC investigators and would not fall under the MCDC's lenient terms, which include immunity from civil penalty for muni issuers. Some securities lawyers have said publicly that participation in the initiative is a slam dunk for all underwriters and most issuers.

Robert Feyer, senior counsel at Orrick, Herrington & Sutcliffe in San Francisco, said the case represents another exclamation point on the SEC's increasingly vocal vows to be tough on muni securities lawbreakers.

"It's certainly a significant action," Feyer said.

Lawyers said it was unclear if the SEC could pursue action against Letke under the municipal advisor regime. According to court documents, Letke ran two companies which both were registered municipal advisors and provided financial advisor services regarding the issuance of municipal bonds to Harvey and other municipalities. Most of the MA regulatory regime remains in effect and

most of the conduct mentioned in the complaint pre-dates the 2010 Dodd-Frank Act, after which all MAs have been subject to fair dealing rules.

The case does have some parallels with a 2001 enforcement action against Pacific Genesis Group, Inc., a municipal securities underwriting firm based in Alameda, Calif., and its former lead underwriter, David Fitzgerald. In that case, filed in late 2000, a judge ordered all proceeds of a recent bond offering be returned to investors when the SEC accused the firm of raising money for residential developments via misleading offering documents. Fitzgerald went on to lose his broker's license.

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