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Day Pitney: Mayor Settles SEC Enforcement Action for Municipal Bond Disclosure Violation.

The Securities and Exchange Commission ("SEC") is continuing its scrutiny of the municipal market and using provisions of the Securities Exchange Act of 1934 previously unused in the municipal market to bring enforcement actions against individual public officials. On November 6, 2014, the SEC announced that it had charged the City of Allen Park, Michigan ("City"), and two city officials with fraud with respect to the City's \$31 million general obligation limited tax bonds issued in 2009 and 2010 ("Bonds").

For the first time, the SEC has charged a municipal official as a "control person" under Section 20(a) of the Securities Exchange Act of 1934. This provision was enacted to prevent high-level officials from hiding behind lower-level officials. The SEC alleges that the former mayor of the City, Gary Burtka, directly or indirectly controlled both the City and the former city administrator, Eric Waidelich, when the City omitted material facts that rendered statements and disclosures in the City's offering materially misleading.

In 2008, the City entered into a public-private partnership to finance, in part, with the proceeds of the Bonds, a \$146 million movie studio project ("Project") to be run by a Hollywood producer ("Producer"). The Bonds were "double-barreled" bonds set to be serviced with revenues from the Project and the City's tax revenue. By the time the Bonds were issued the City was aware that it could not keep its commitment to donate land to the Project, and therefore the Producer chose to withdraw his financial support for the Project. As a result the City faced a \$2 million budget deficit for Fiscal Year 2010 and lost a major source of revenue for the Bonds. The City failed to disclose any of these facts in its offering documents and provided outdated budget information. The SEC found that the City's offering documents related to the Bonds contained false and misleading statements about (1) the scope and viability of the Project, (2) the financial condition of the City and (3) the City's ability to service the Bonds.

Burtka was charged despite not preparing or signing the offering documents, which were primarily prepared by Waidelich. In charging Burtka individually under Section 20(a), the SEC alleged that Burtka championed the Project, making numerous public pronouncements about it that were materially misleading, and was in a position to control the actions of the City and Waidelich. As mayor, Burtka attended meetings where the Project was discussed and never mentioned the various problems plaguing the Project.

Without admitting or denying the SEC's findings, the City, Burtka and Waidelich have agreed to settle the SEC's charges. Burtka has agreed to pay \$10,000 to settle. As part of its settlement, the City has agreed to a cease and desist order from the SEC. The terms of the City's settlement include the adoption of a written disclosure policy and the retention of disclosure counsel who will consult on future offering documents and provide training to all personnel involved in the City's bond offering and disclosure process.

In addition to increased scrutiny generally, the SEC's Division of Enforcement ("Division") has stated

publicly that it plans to look for opportunities to bring charges against individuals who participate in violating federal securities laws. The Division plans to increase its focus on pension fund abuses, pay-to-play violations and undisclosed conflicts of interest. The director of the Division recently stated that he believes “the most effective deterrent is individual liability.” The SEC hopes that its increased enforcement efforts will alter market behavior. Issuer officials who want to cast their municipality’s finances or economic development projects in an uncritical positive light should reassess that position in view of the SEC’s recent actions and pronouncements.

The attorneys in Day Pitney’s Municipal Finance group routinely counsel clients on proactively addressing compliance with their disclosure obligations. Please feel free to contact any of the attorneys on the right of this advisory if you would like to discuss this advisory or your disclosure obligations.

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The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

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