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SEC Won't Be Pinned Down on MCDC Continuing Disclosure Violations.

CHICAGO – Securities and Exchange Commission officials repeatedly rebuffed bond lawyers' attempts to pin them down on the specific parameters of continuing disclosure violations based on the commission's settlements in June with 36 underwriters under the Municipalities Continuing Disclosure Cooperation initiative.

The initiative allows underwriters and issuers to receive lenient settlement terms from the SEC if they voluntarily self-reported any instances during the past five years in which they falsely claimed in official statements to be in compliance with their self-imposed continuing disclosure agreements.

Panelists at the National Association of Bond Lawyers' Bond Attorneys' Workshop here persistently questioned commission officials about whether an issuer who said it had complied with its continuing disclosure obligations materially violated those obligations if it was 14 days late in filing its annual financial disclosures. They also asked about whether the lack of violations involving the failure to file material event notices means the SEC does not consider these to be material to investors.

But LeeAnn Gaunt, chief of the SEC enforcement division's municipal securities and public pensions unit, told conference attendees that the commission described examples of violations in its settlements with underwriters to provide market participants with broad guidance, especially after they complained the earlier Kings Canyon Unified School District case failed to do so.

"We were genuinely in good faith trying to make these orders something that would be useful to you," Gaunt said during one of the panels on hot topics in municipal securities law. "Hearing the concerns expressed about the opacity of the Kings Canyon order and understanding that people genuinely in good faith were wanting to have a bit more texture on the nature of the violations that were reported and that were independently determined," the muni enforcement unit worked to ensure the order provided some guidance, she said.

But she said the examples cited reflect a range of conduct that fit the submissions the SEC received and that nobody should be "trying to find a bright line" in the order.

"What we tried to do in part in the spirit of the MCDC initiative, which was voluntary and cooperative, was not to necessarily lay bare every failure everybody reported," Gaunt said. "We wanted this to be a set of orders that were helpful to the industry, helpful to the market but didn't unduly [and] unnecessarily belabor failures, some of which were very repetitive in nature."

Elaine Greenberg, a panelist, partner with Orrick, Herrington and Sutcliffe, and predecessor to Gaunt at the SEC, sat on one of three hot topics securities law panels and tried to get more clarification on the SEC considers to be material violations under the initiative. Alexandra MacLennan, a partner with Squire Patton Boggs, similarly sought clarification from Mark Zehner, deputy chief of the SEC's muni enforcement office, during a different hot topics panel, but neither Greenberg and MacLennan made much headway with the SEC officials.

In response to Greenberg's questions on materiality examples, Gaunt said each example bullet point in each order is considered material, but she cautioned that if multiple events are mentioned in one bullet point, only the cumulative actions mentioned in the one point should be considered material.

Gaunt also said the absence of any examples involving failures to file material event notices does not mean they will not show up in future settlements.

"Nobody should take from that fact that we have decided that the failure to file material event notices is absolutely never actionable," Gaunt said. "We're not setting a floor, we're not setting a ceiling."

The examples are "not the universe of everything that could be," Rebecca Olsen, deputy director of the SEC's Office of Municipal Securities, said during another panel.

Zehner echoed Gaunt during his panel: "Those are only examples. They are not floors, they are not ceilings," he said, adding, there is no "magic line drawing."

Both Zehner and Olsen separately stressed that market participants should not be looking at the SEC to determine whether disclosure failures are material. They said materiality is always a facts and circumstances determination of what a reasonable investor would want to know when buying or selling bonds. "The market should not be looking to the SEC … to say what is material," said Olsen.

Gaunt did not rule out the possibility that there could me more than one more set of underwriter settlements, saying "there will be at least one more group" of underwriter settlements but that she could not "say for sure if there will be another one after that."

Some sources have said issuer settlements will not be released until next year. Asked about that by a reporter, Gaunt said she could not say.

Both Olsen and Jessica Kane, director of the SEC's OMS, said that the MCDC initiative has served an important purpose in focusing market participants' attention on the commission's Rule 15c2-12, on disclosure. Kane said the initiative has provided "valuable insight into how 15c2-12 is working." Both she and Olsen suggested that the settlements will allow them to determine whether further changes to the rule or other actions are needed.

One bond lawyer in the audience noted that most continuing disclosure agreements provide remedies for bondholders if issuers fail to meet their obligations. Zehner replied the SEC's focus during the investigation was not on issuers' failure to file disclosures but rather on whether they made false or misleading statements when they said they were meeting their obligations. Zehner added, however, "I think one of the issues that the industry has to wrestle with is whether current remedies on disclosure failures are adequate." Continuing disclosure agreements are essentially contracts between the issuer and the bondholders subject to state contract law. In theory, if the bondholders are upset that an issuer has failed to meet its continuing disclosure obligations and want to force the issue to remedy the situation, they can sue the issuer under state law. But in reality, a bondholder typically does not know the identities of other holders of the bonds and small holders do not have the financial resources to file a lawsuit.

Zehner said after the panel that if bondholders had an adequate enforcement mechanism to force issuers to comply with their disclosure obligations, the SEC would not need to bring enforcement cases in this area.

"In a perfect world, we should never have to show up," he said.

The MCDC also may already be changing some market practices. Until the initiative, most offering documents contained language saying the issuer had complied in all material respects with its continuing disclosure undertakings. If this language was included in an official statement and the issuer did not meet its undertakings, then the SEC could easily show the issuer made a false representation. As a result, many of the lawyers on panels said issuers may no longer include these statements in their offering documents.

“MCDC made issuers aware that those statements have risk,” said Barron Wallace, a partner at Bracewell & Guiliani and a panelist on an underwriter’s counsel roundtable. Paul Maco, a former OMS director from the same firm who was also a panelist, pointed out that these statements are not required by Rule 15c2-12 but rather have been a “construct that was developed by the bar.”

Another member of the audience asked Zehner what trends or patterns he sees in the market that bond counsel and underwriter’s counsel should pay attention to. Zehner said there are so many areas that it is hard to think of a list, but responded to the question by warning that “if you are participating in a higher risk, higher yield transaction, you need to be more careful.”

After the panel he explained that issuers need to be sure they are disclosing all of the risks in these kinds of deals. The SEC for example brought enforcement action against Allen Park, Mich., its former mayor, and its former city administrator in connection with $31 million of munis sold in 2009 and 2010 to finance a movie studio project in the city. The SEC found that offering documents contained false and misleading statements about the scope and the viability of a questionable movie studio project as well as Allen Park’s overall financial condition and its ability to pay debt service.

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