

# **Bond Case Briefs**

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## **Bond Advisors Behaving Badly re: Tax-exempt Bonds.**

We all know that the federal tax rules and regulations applicable to tax-exempt bonds are very complex. So are the federal and state securities laws. At times this is frustrating for bond advisors. However, we should remember that the federal and state securities laws are intended to protect investors/bondholders by requiring that all material facts be disclosed fully and accurately, thus allowing the investors/bondholders to make informed decisions regarding their investments.

All bond advisors likely make small mistakes at times over the course of their careers that violate the complex securities laws, or that cause their issuer clients to inadvertently violate the federal tax rules. We oftentimes refer to these small, inadvertent mistakes as “foot faults”. More aggressive bond advisors sometimes commit more serious violations that result in civil penalties. The bond advisors that commit fraud may end up under the supervision of the Federal Bureau of Prisons, rather than the Securities and Exchange Commission (“SEC”).

Assuming you are like me (an advisor that tries to comply with all of the rules and regulations) you may have the same morbid curiosity I do about what actions bond advisors take that result in civil or criminal penalties and/or even jail time. (I think it basically makes me feel good about myself and what a law-abiding bond advisor I am.) Below is a list of some actions that recently resulted in charges, fines, settlements and/or incarceration for bond advisors during the last several months. This list includes only a few of the more interesting cases. Unfortunately, there are many more.

(1) Christopher Brogdon has recently been charged by the SEC with fraud. Mr. Brogdon allegedly misrepresented in offering documents what types of projects the potential bondholders would be investing in. For example, many of the bond offering documents he gave potential investors discussed funding nursing homes, assisted living facilities and retirement communities. However, instead of using all of the bond proceeds for such stated purposes, Mr. Brogdon used some of the proceeds for other business ventures he was involved in, and to pay debt service on other bond issues that he had been involved with (a sort of Ponzi Scheme). Mr. Brogdon, being a devoted spouse, even transferred some of the bond proceeds to his wife’s personal bank accounts.

(2) Douglas MacFaddin and Charles LeCroy recently settled with the SEC. Both were investment bankers that the SEC had accused of improperly making payments to certain broker-dealers associated with one or more commissioners of Jefferson County, Alabama. According to the SEC, all parties involved knew that the broker-dealers would be doing little or no work to earn the money. In exchange for these generous payments, the two former investment bankers secured very large bond and swap deals for their employer. As part of the settlement reached with the SEC, each agreed to disgorge the profits he earned personally during the process. Given the relatively minor fine for MacFaddin’s and LeCroy’s alleged criminal actions, I am guessing that they provided evidence to be used against bigger fish up the food chain (who were criminally prosecuted for taking bribes).

(3) Investors in a failed sucralose plant recently agreed to settle their suit against the former Morgan Keegan for \$8.5 million. There are several other pending lawsuits related to the failed project. The bondholders, other investors and the Missouri Secretary of State all claim that Morgan Keegan committed securities fraud. First, the plaintiffs argued that Morgan Keegan did not do

adequate due diligence. If it had, the plaintiffs allege, it would have discovered that the company that was to operate the sucralose plant was not currently operating a similar facility in China. (In other words, the subject company did not have the experience that Morgan Keegan purported it had). Second, the plaintiffs claim that Morgan Keegan made false statements. For example, the plaintiffs allege that Morgan Keegan said that the bonds were secured by company patents, when in fact, the patents had been denied. Seems like a pretty material misstatement to me.

(4) As you probably remember, the SEC charged Edward Jones with pricing-related fraud a few months ago. Instead of selling municipal bonds to its customers at the initial offering price, Edward Jones bought the bonds for its own inventory at the initial offering price. Later, Edward Jones sold the municipal bonds to its clients at prices exceeding the initial offering price, thus making an unauthorized profit. The SEC imposed a significant fine on Edward Jones and is requiring Edward Jones to make restitution to its customers (or more likely former customers).

In closing, the four instances above should serve as a reminder as to why we need rules and regulations governing municipal bonds – because some bond advisors do behave very badly.

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