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Can EMMA Be Used as a Defense by Banks in VRDO Lawsuit?

WASHINGTON – The disclosure of some variable-rate demand obligation information on EMMA shouldn't be used to dismiss a lawsuit alleging fraud in VRDO remarketing because the whistleblower involved is providing non-public information gleaned from an independent investigation, lawyers for the plaintiff told an Illinois court.

Attorney Michael Behn of the Chicago law firm of Behn and Wyetzner made that argument along with others late last week, in urging a Cook County, Ill., Circuit Court judge to allow the suit to go forward.

The defendants, banks who provided remarketing services for Illinois VRDOs, had previously argued that the law requires the suit be dismissed in part because it is based on information that is available to the public through the Municipal Securities Rulemaking Board's EMMA website.

The outcome of the suit has wide-ranging implications because a victory for the plaintiff (relator) could set the table for more actions in other states.

The suit, filed as a False Claims Act action, charges that the remarketing firms set VRDO rates artificially high in order to be paid for remarketing services without having to remarket the securities, in violation of remarketing circulars and agreements that generally commit remarketing agents to try their best to set the rates at the level necessary to market the bonds at par.

A major point of contention is whether the claims of the relator, Edelweiss Fund LLC, which filed the suit on behalf of Illinois, are subject to a "public disclosure bar" under the law. That bar is intended to prevent whistleblower lawsuits brought on the basis of information available to the wider public.

The banks vigorously denied the fraud and other charges. In July, lawyers for the banks told the court that the suit is based entirely on publicly available VRDO reset information, including information posted on the MSRB's EMMA website. EMMA and other publicly-available websites are effectively news media, the defendants argued.

But in a Sept. 14 filing in response to the defendants' request to dismiss the suit, Behn told the court that the information disclosed on EMMA and elsewhere does not meet the threshold for dismissal under the disclosure bar.

"The EMMA website, which is the primary outlet through which the banks say Edelweiss' allegations were disclosed, does not qualify as 'news media' or an 'administrative' report," Behn said. "Any claimed disclosures on the EMMA website are inapplicable to the public disclosure bar."

Even if EMMA and the other websites the banks cite qualify as "news media," they do not disclose the alleged fraud, Behn added. The interest rates and information laid out in official statements reveal nothing of the alleged robo-resetting scheme, or of the collusion, of which Edelweiss claims to have direct knowledge.

“If the EMMA data constitutes disclosure of the misrepresented state of facts, where was the true state of facts publicly disclosed?” asked Behn.

Edelweiss brought the suit on the basis of non-public knowledge and data gleaned from Edelweiss’ own investigation, Behn said, meaning that the banks’ efforts to dismiss the suit on the basis of the public disclosure bar must fail.

Edelweiss is a Delaware-registered limited liability company formed specifically to pursue the litigation but is not identified beyond that in the suit. An expert consulting witness for Edelweiss is Michael Lissack, the former Smith Barney banker who helped the government win hundreds of millions of dollars — and reaped tens of millions of dollars himself in the process — from filing whistleblower lawsuits against Wall Street and other firms in 1995 over charges they engaged in yield-burning.

Behn’s filing also attacked the several other points on which the banks sought to have the suit dismissed, including claims that Edelweiss has not properly alleged false claims or a conspiracy. The complaint lays out specific false statements, Behn wrote, namely the language in the remarketing agreements that pledges to remarket the bonds at the lowest rate permitting them to be sold at par.

The banks also attempted to have the court throw out the claims pertaining to conduit issuances, since Illinois is not on the hook for the conduit bonds and could not have paid the allegedly inflated remarketing fees. But the law does not require financial damage to Illinois for those claims to be upheld, Behn said, and courts have previously imposed False Claims Act liability when government interests were harmed regardless of direct financial loss to that government.

Scrutiny of the VRDO market appears to have grown in the months since the Edelweiss suit was unsealed in April. Sources told The Bond Buyer earlier this month that the Securities and Exchange Commission is conducting a sweep of the 12 top banks and broker-dealers that remarket VRDOs and has sent them letters seeking information and documents on their remarketing and rate resetting practices.

Other VRDO whistleblower and class action suits have been filed in courts in other states and the Justice Department’s antitrust division is conducting a criminal investigation of VRDO remarketing practices of a number of banks and broker-dealers, some of the sources said.

But even if the court sides with Edelweiss and allows the suit to continue, it may be many months before it is decided.

“Cook County courts like to try cases before juries and so do we,” Behn said. “We hope to get discovery done and this case to a jury within a year or two after we win this motion.”

By Kyle Glazier

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