# Bond Case Briefs

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## SEC to Municipal Issuers and Obligated Persons: What You Say Can and Will Be Held Against You: Squire Patton Boggs

**SEC Staff Releases Staff Legal Bulletin No. 21 on Application of Antifraud Provisions to Public Statements in Secondary Municipal Market and Misses Opportunity to Develop a Real-World Approach**

In response to a July 2019 direction from Securities and Exchange Commission (SEC) Chairman Jay Clayton, the SEC Office of Municipal Securities (OMS) staff issued a Staff Legal Bulletin No. 21 (OMS) that discusses the application of antifraud provisions to public statements of municipal issuers and obligated persons in the municipal secondary market.1 The purpose of the OMS bulletin, according to the OMS staff, is to "outline previous Commission statements relevant to understanding the application of the antifraud provisions to any statement of a municipal issuer that is reasonably expected to reach investors and the trading markets, and, thereby, promote more informed disclosure practices by municipal issuers in the secondary market; facilitate investor access to accurate, timely and comprehensive information; and improve investor protection."2 Relying heavily on the 1994 Interpretive Release3 and the City of Harrisburg Section 21(a) Report4, the OMS staff puts forth the proposition that virtually every statement made by a municipal issuer, including staff and elected officials, in any medium (e.g., websites, social media, speeches, governmental meetings and reports to other governmental agencies), for any purpose, is reasonably expected to reach investors and the trading market, and is, therefore, subject to the federal securities antifraud provisions.

In order to appreciate the gravity of that proposition, a review of the elements of the antifraud provisions might be informative.

As referred to in the bulletin, SEC Rule 10b-5 essentially prohibits making an untrue statement of a material fact or omitting to state a material fact necessary in order to make the statements made in light of the circumstances under which they were made not misleading, all in connection with the purchase or sale of any security. The bulletin describes how the federal courts and the SEC interpret the phrase "material fact"5. However, the bulletin omits any discussion about when statements will be viewed as being made "in connection with" a purchase or sale of a security or how the phrase "in light of the circumstances under which they were made" might aid the legal analysis.

The discussion of what constitutes a "material fact" revolves around the concept that a fact is material, and its omission from a statement is material, if the inclusion or exclusion, as the case may be, of that fact would alter the total mix of information available. Usually, this analysis of materiality involves a disclosure document (e.g., an official statement). In the case of secondary market disclosure, however, it is not clear from the bulletin what the "total mix of information" would include. The OMS staff suggests that the relative importance of any particular fact (and its materiality) might be affected by whether investors otherwise have regular access to accurate, timely and comprehensive information as opposed to "uneven and inefficient" access to information about the issuer. The staff specifically identifies the MSRB's EMMA system "or some other investor relations-focused medium (e.g., investor website)" as potential means to provide regular access to

information, but does not delve into what should be considered “regular” or “comprehensive.”

While the bulletin did not discuss the phrase “in connection with the purchase or sale of a security” in the context of the antifraud rules, this concept bears touching on, particularly with respect to municipal issuers. There does not appear to be one uniform interpretation of the meaning of this phrase, although several judicial interpretations have been made with respect to the corporate market. One interpretation is that all publicly disseminated statements are deemed to be made in connection with a securities transaction if they are “reasonably calculated to influence the investing public.”6 Case law also refers to a “transactional nexus” requirement, meaning there must be a connection between the alleged fraud and the purchase or sale of securities.7 Courts have found sufficient “connection” in SEC filings, press releases, public statements, letters published in the financial press, news articles, investment research reports and product advertisements.8 Whether this same standard should be applied with respect to municipal issuers is a question that should be given serious consideration in light of the differences in the flow of information in the public and private sectors. Private entities (e.g., corporations, partnerships, etc.), to a large extent, are able to control the release and dissemination of their information and, thus, may keep private all information other than what they choose to divulge or what applicable law requires. State and local government entities, on the other hand, generally are subject to public records laws and are prohibited from keeping any information private unless a law specifically provides an exclusion. Additionally, many jurisdictions have transparency laws that make it compulsory for state and local governments to post specific documents on their websites (or otherwise provide for public access) for the benefit of the entities’ constituents. These public records and transparency laws were not developed for the benefit of potential debt investors and so the question is whether complying with these laws should automatically result in federal antifraud scrutiny. When a city clerk posts on the city’s website the agenda materials for the next city commission public meeting, should the assumption be that the posting was made to influence the investing public? Is it reasonable to assume an investor might rely on the meeting agenda materials in making an investment decision and, thus, those materials should be “vetted” for antifraud liability? What if the agenda package includes the audited financial statements for acceptance by the city commission? Contrast that to the city finance director posting the final accepted audited financial statements on a webpage designated as the city’s “investor relations page.” There is an obvious distinction to be made.

The most unfortunate and confusing part of the bulletin, however, is the OMS staff’s discussion of policies and procedures. Quoting the Harrisburg report, the staff cited the SEC’s recommendation that municipal issuers, among other things, evaluate public statements “prior to public dissemination” for accuracy and completeness.9 The staff suggests that the development and consistent application of policies and procedures such as described in the Harrisburg Report “can help a municipal issuer regularly provide more accurate, timely, and comprehensive information to investors, better manage communications with their investors; and comply with the antifraud provisions.”10 After five pages of analysis and the expansive conclusion that all public statements are subject to antifraud provisions, the staff encourages municipal issuers to “identify the place” where the issuer will make pertinent financial information regularly available, “which may include a central repository, such as the EMMA system, or an investor-relations website.”11 Yet the bulletin does not otherwise distinguish liability by whether information is posted to a central or investor-focused location. The only sense to be made of this statement in the context of the rest of the bulletin is that the staff is suggesting municipal issuers need to bulk up the information intentionally made available to investors and the trading market so that the public dissemination of other information is less likely to alter the total mix of information available. But, if all public statements (which, from a public records perspective, essentially include all public information) are subject to the antifraud rules regardless of the purpose of the disclosure, why would it matter whether information is posted on EMMA or on a non-investor-focused website? Can we conclude by this

recommendation that OMS staff believes that information disseminated to a designated investor location (e.g., EMMA or an investor relations page) would result in a greater weight being given to such information?

The OMS staff could have discussed, but did not, whether the phrases “in connection with” or “under the circumstances under which the statement is made” could be applied to distinguish information routinely posted on an issuer’s website for the information and convenience of its citizenry or statements made in a political setting from statements made during an annual investor call, posted to EMMA or to an “investor relations page.” OMS staff could have stated, but did not, that municipal issuers and obligated persons would benefit from the use of reasonable precautionary language that could, if properly used, successfully communicate to the reader of the public statements the nature and purpose of the statements, thereby promoting investor understanding and providing a small level of comfort to the municipal issuer or obligated person regarding potential securities liability for intentionally (but understandably so) incomplete information (e.g., unaudited financial statements with no financial notes) or un-vetted information dissemination (e.g., public records responses).

By omitting any discussion of these important elements of the legal analysis, the OMS staff has missed the opportunity to provide meaningful guidance to the municipal market that would have been far more likely to facilitate investors’ regular access to accurate, timely and comprehensive information than what is contained in the bulletin. In fact, the bulletin’s proposition that all public statements are subject to antifraud rules could lead municipal issuers to provide less information by means of informal media (such as a website). A similar result occurred in response to the MSRB’s market analysis that insider trading liability could result from one-on-one investor communications.12

Perhaps the best guidance to be gained from the staff bulletin might be derived from the omitted analysis. We have long provided clients with advice regarding the dissemination of information to the secondary market and specifically about the use of websites to communicate with bondholders. The National Association of Bond Lawyers (NABL) has also provided a very useful publication for its members setting out considerations in the drafting of disclosure policies and procedures similar to what is encouraged in the staff bulletin.13 The staff bulletin can be construed to support the approach set out by NABL, which is to establish (and follow) written procedures for a formal process of vetting information before it is posted to EMMA or to an investors relations webpage and to clearly delineate which information is (and is not) intended for investor consumption. Regardless of the legal arguments that can be made to limit the reach of federal antifraud provisions to public information of governmental entities clearly not intended for investors or the trading market, it behooves governmental entities and other obligated persons to review the type of information available on its websites and in other media, review (and strengthen, if necessary) the current procedures for posting new information and otherwise releasing public statements, and consider voluntary postings to EMMA (or an investor relations page) of relevant vetted financial information (with appropriate precautionary language) that is otherwise routinely prepared and reviewed internally.

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