Bond Case Briefs

Municipal Finance Law Since 1971

Charter School Defrauds Bond Holders.

Municipal bonds are sold to fund a variety of local projects. One of the sales features is the local interest. Another can be the tax free income. Thee bonds can thus be a very attractive investment. Critical to the investment is the ability to repay. The necessary information is supposed to be provided to potential investors in the offering documents. If those documents do not have the proper information, as in the Commission's most recent municipal bond case, investors can suffer significant losses. *SEC v. Park View School, Inc.*, Civil Action No. 3:20-cv-08237 (D. Ariz. Filed September 14, 2020).

Park View School, defendant, is an Arizona nonprofit corporation based in Prescott Valley, Arizona. It operates two charter schools that receive funding from the state of Arizona. That funding is paid in monthly installments beginning in July, the start of the fiscal year. The payments are based on reported school enrollment. The schools submit a budget of anticipated expenses to the Arizona State Board for Charter Schools at the beginning of the year. The firm's operations and finances were managed by Debra K. Slagle, also a defendant.

This action is based on two offerings, the first in 2011 and the second in 2016. In 2011 Park View was a conduit borrower for a $6.625 million by Pima Industrial Development Authority. The bonds were issued subject to an indenture agreement that governed disbursement of the bond proceeds and repayment of the bond investors. The 2011 Indenture provided that the trustee deposit almost $250,000 of the bond proceeds into an Operating Reserve Fund to protect investors. The bonds were to build the school facilities.

Monthly deposits were required to be made to cover the operating expenses under the terms of the 2011 bond offering to an Operating Reserve Fund. Ms. Slagle, however, made 12 requested over a four-year period, beginning in May 2012, to withdraw funds. While she certified that each request was permissible, that claims were incorrect.

The school was unable to replenish the withdrawals despite efforts by Ms. Slagle to aid the project. By January 2016 Park View was essentially out of cash and owed $400,000. Ms. Slagle made four requests totaling $31,900 from the Operating Reserve Fund and a total of $46,000 from the Repair and Replacement Fund. Each request certified that it was for unbudgeted expenses or repair and replacement costs. In fact, most of the funds were used to cover payroll and to pay other operating expenses.

In 2916 Ms. Slagle decided to seek another bond offering to repay the 2011 bonds and other debt. The Official Statement for the offering was posted on the Municipal Securities Rulemaking Board's Electronic Municipal Market Access system in April 2016.

The statement was based on a feasibility study for the next two years that contained projects showing Park View as profitable. The projections contained material errors, understating, for example, the operating expenses for 2016 by 20%. Key to the projections was an expense reduction program. The statement and projections were created by Ms. Slagle.

The offering materials did not disclose the operating difficulties of Park View. While the projections were based on an expense reduction program, it had not in fact been adopted or implemented. Without that program Park View's on-going financial difficulties would preclude meeting the projections in the offering materials.

No debt reduction was ever adopted. By early the next year Park View defaulted. It was April 2017, one year after the offering. The complaint alleges violations of each subsection of Securities Act Section 17(a) and Exchange Act Section 10(b). The action is pending.

SEC Actions – T. Gorman

September 15 2020