

Bond Case Briefs

Municipal Finance Law Since 1971

SEC Charges School District and the District's Former Chief Financial Officer with Violations of Securities Laws in a 2018 Bond Offering.

On September 16, 2021, the Securities and Exchange Commission ("SEC") entered an order against a school district (Sweetwater Union High School District (the "District") in San Diego County, California) and charged the school district's former chief financial officer ("CFO") with misleading investors who purchased \$28 million of the District's 2018 bonds (the "Bonds").

In its actions, the SEC noted that the District and its former CFO presented stale and misleading financial information in connection with the offering of the Bonds. Specifically, the District included misleading FY2018 budget projections in its offering document for the Bonds, which budget did not reflect salary increases approved prior to the start of FY2018. When the District's financial standing was being reviewed and then disclosed in the bond offering document, the District projected that its operations would result in a general fund balance of around \$19.5 million when in reality, its operations resulted in a negative \$7.2 million general fund balance; the District did not disclose that this projection was inconsistent with known actual expenses at that time. The former CFO's department generated reports that showed expenses trending higher than its budget projected, to which the SEC said the District "continued to ignore reports showing that its budget for the 2018 Fiscal Year was untenable." The District continued to use the stale budget projections in its reporting to the finance team¹, the rating agency and eventually bond purchasers. Further, the former CFO attested to the accuracy of the information in the offering document when she signed the offering document, the bond purchase agreement and a certification to the underwriter.

The charges were brought under the Securities Act of 1933 Section 17(a)(2) and (3) for the District and 17(a)(3) for the former CFO; violations of these provisions do not require intentional wrongdoing on the part of the actor and can be established on the basis of negligence. Section 17(a)(2) and (3) provide, in relevant part, as follows:

It shall be unlawful for any person in the offer of sale of any securities ... directly or indirectly - ...

(2) to obtain money or property by means of any untrue statement of a material fact or any omission 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; or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

"A statement or omission is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision."²

The SEC order against the District found that the District violated Section 17(a)(2) and (3) by “making misleading statements and omissions to investors, as well as to the bonds’ credit rating agency and other municipal industry professionals on the transaction.” The District was ordered to cease and desist violating Section 17(a)(2) and (3), implement various written policies and procedures, conduct staff training, retain an independent consultant to review the policies and procedures, implement recommendations of the independent consultant, disclose this settlement in future bond offerings, and provide certifications of compliance to the Staff of the SEC regarding these settlement conditions.

The SEC charged the former CFO with violating section 17(a)(3). The former CFO has agreed to settle with the SEC, including being enjoined from participating in any future municipal securities offerings and paying a \$28,000 penalty. The settlement is pending court approval.

1 The finance team consisted of the underwriter and its counsel, bond counsel, disclosure counsel and the District’s municipal advisor.

2 Securities Act of 1933 Release No. 10981, September 16, 2021, citing *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988).

Dorsey & Whitney LLP

by Jennifer Block, John Danos, David Grossklaus, Cristina Kuhn, James Smith

October 27, 2021