Disclosure Obligations of Issuers of Municipal Securities

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CHAPTER 1

Introduction

Municipal bonds, notes, certificates of participation and other municipal securities, while generally exempt from the registration requirements of federal and state securities laws, are subject to securities law disclosure rules–generally referred to as "antifraud rules." Issuers must ensure that, in connection with the issuance and sale of municipal securities to the public, prospective purchasers are provided the information they need to make an informed investment decision. Increasingly, it is clear that the obligation may apply even after bonds have been issued and issuers (and even issuer officials) can face suit or even civil or criminal penalties if the disclosure provided has material misstatements or omissions.

In recent years, the United States Securities and Exchange Commission (the "SEC") has made numerous public pronouncements, created an enforcement group targeted specifically at municipal securities and launched a series of high-profile investigations and enforcement actions, all indicating its increasing interest in perceived shortcomings in municipal disclosure practices focused both on the primary market and on continuing disclosures. As a result, issuers, issuer officials and underwriters are all facing increased scrutiny, as well as serious and costly consequences for inadequate disclosure practices.

The benefit of good municipal disclosure has been further enhanced by the recent decline in the use of bond insurance and decreased confidence in bond ratings as a complete measure of credit quality. Investors now, to a greater extent than ever, need and desire to make their own credit evaluation, and an informed evaluation requires comprehensive and adequate disclosure. Issuers who tell their story in a clear and complete way and develop a reputation for good disclosure can derive a financial benefit in the price paid for their bonds.

The purpose of this pamphlet is:

- to provide an overview of issuers' disclosure requirements under federal securities laws and the manner in which issuers can satisfy these requirements;
- to help issuers capture the benefits of good disclosure through the preparation and delivery of Official Statements in connection with the initial offering of municipal securities and through ongoing disclosure to the market; and
- to show issuers and underwriters why and how to reduce their exposure to liability under the securities laws.

Orrick has been ranked first in the country as disclosure counsel and as bond counsel for most of the last two decades. Over the last ten years, Orrick has served as disclosure counsel on over 1,250 transactions totaling over $250 billion in principal amount, or more than 20% of all transactions nationally which reported using disclosure counsel.

CHAPTER 2

Federal Securities Law

Municipal securities are subject to the federal securities laws administered by the SEC. Unlike corporate securities, municipal securities generally are exempt from the registration requirements of the Securities Act of 1933. Although this exemption from registration creates a key distinction between corporate and municipal offerings, many principles of law and policy applicable to corporate offerings are relevant, directly or by analogy, to municipal securities.

ANTIFRAUD RULES

Statements by municipal issuers to investors, or potential investors, and even statements to the public generally, if likely to be heard and relied upon by the securities market, are subject to regulation by the SEC under two key antifraud provisions of federal law: Section 17(a) of the Securities Act of 1933 and Rule 10b-5 promulgated by the SEC pursuant to Section 10 of the Securities Exchange Act of 1934. These laws and regulations are designed to ensure that parties buying or selling securities have access to the information necessary to make an informed investment decision. In order to comply with these laws for a public offering of municipal securities, issuers generally prepare a document analogous to a corporate prospectus, called an "Official Statement," that includes all of the information an investor would need to decide whether to purchase the offered securities. Various state laws also impose liability for inadequate disclosure, and securities sales are also subject to general statutory and common law rules such as those prohibiting fraud. Underwriters of municipal securities typically require municipal issuers to provide certifications regarding their compliance with securities laws in connection with the purchase and sale by the underwriters of the securities.

KEY EXCERPTS FROM ANTIFRAUD RULES
(emphasis added)

Section 17(a)	Rule 10b-5
"It shall be unlawful for any person in the offer or sale of any securities . . . by the use of any means . . . of . . . communication in interstate commerce or by use of the mails, directly or indirectly to employ any device, scheme or artifice to defraud, or (1) to employ any device, scheme, or artifice to defraud, or (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."	"It shall be unlawful for any person, directly or indirectly, by the use of indirectly, by the use of any means . . . of interstate commerce, or of the mails . . . (a) to employ any device, scheme, or artifice to defraud, (b) to make any untrue statement of a *material* fact or to omit to state a *material* fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

MATERIALITY

Both Section 17(a)(2) and Rule 10b-5 prohibit misstatements or omissions of "material" facts only, but this concept is not specifically defined by any SEC Rule. Rather, the concept has been developed through court decisions and SEC enforcement actions. The most common statements of what "materiality" means have been given by the courts as follows:

"[A]n omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote." [1]

"There must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having altered the 'total mix' of information made available." [2]

"Materiality will depend at any given time upon a balancing of the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of [the affected entity's] activity." [3]

The SEC has consistently refused to provide any advance guidance on exactly what constitutes material misstatements or omissions. Therefore, materiality ends up being decided only in hindsight, which puts a great deal of pressure on parties to a transaction to make an appropriate decision when deciding on a disclosure issue. A rule of thumb is that if a working group is spending more than five or ten minutes discussing whether an item should be included in a disclosure document, it is best to include it.

It should also be noted that if an item of information is thought to be material to investors, the fact that it is confidential, or politically embarrassing, is not a defense to leaving it out of the document, nor is it possible to claim the information is subject to attorney-client privilege. If such circumstances exist, some alternative method needs to be found to market the bonds, such as in a private placement without a publicly distributed disclosure document, or else the offering should be delayed until the information can be released.

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1 *E.g.*, TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449-50 (1976).
2 *E.g.*, Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988).
3 *E.g.*, *id.* at 238.

LIABILITY FOR FRAUD

Inadequate disclosure practices can lead to such outcomes or consequences as:

- investigation by the SEC,
- investigation by a local district attorney or the U.S. Justice Department,
- investigation or hearings by state or local legislative bodies,
- imposition of fines or penalties,
- civil suits for damages,
- substantial out-of-pocket costs to defend against government or private investigations or suits,
- harm to an issuer's reputation and investor confidence, or to political careers,
- inability to obtain timely audit reports and lack of access to public securities markets,
- rating agency downgrades, and
- sanctions (including monetary) against individual officials, including board members, deemed culpable for the actions of the organization.

Liability for false, misleading or incomplete statements or omissions under the antifraud laws attaches not only to the entity making the statements but also potentially to its directors, governing board members, officers and staff. Individual officials or members of the staff found to have violated the law may be subjected to penalties, fines, injunctions or, in extreme cases, incarceration, and there is no official immunity from these consequences. In addition, underwriters can be held liable for failing to discover and correct such fraudulent statements or omissions.

As stated above, both Section 17(a)(2) and Rule 10b-5 prohibit misstatements or omissions of "material" facts leading to fraudulent statements. To prove a violation of Rule 10b-5, the SEC must prove, among other elements, that the issuer intended to commit manipulation or deception, or knew it was manipulating or deceiving, or recklessly disregarded a manipulation or deception, in connection with the purchase or sale of securities. However, mere negligence, such as a negligent failure to be informed about the issuer's financial condition, is sufficient to find a Section 17(a) violation. Either the SEC or private entities can file a claim of violation of Rule 10b-5, but private entities must show not only that an issuer made a material misstatement or omission but also that the private entity purchased or sold the securities in reliance on such statement or omission and suffered a loss, as well as damages, as a result of that reliance. For more information, see the Orrick publication *SEC Investigations and Enforcement Actions: A Practical Handbook for Municipal Securities Issuers*.

Issuers and their directors, governing board members, officers and staff may rely on the advice of professionals, including attorneys, financial advisors, engineers, feasibility consultants or accountants, in determining what information to disclose, but reliance on professionals must be reasonable, and issuers and their boards must exercise independent judgment in approving securities disclosure. Further, while reliance on advice of professionals can be helpful in defending against certain claims, it will not help deflect all potential claims. Issuers and their principals are ultimately responsible for the accuracy of statements of fact about the issuer.

In addition, underwriters are expected to conduct their own thorough diligence review and are not permitted to rely solely upon the statements made by the issuers. This will be discussed further in Chapter Four – Preparing an Official Statement.

> "... [T]he issuer has ultimate responsibility for ensuring that its official statements meet the disclosure standards of the securities laws and has primary liability for failure to meet them. In this regard, the Commission has pursued numerous antifraud enforcement actions against municipal issuers for materially misleading statements or omissions in offering materials." Securities and Exchange Commission, Report on the Municipal Securities Market, at 59 (July 31, 2012).

INDIRECT REGULATION OF ISSUERS

Although the SEC can bring actions against issuers under Rule 10b-5 or Section 17(a) for inadequate disclosures in transactions already offered to the public, the SEC cannot regulate what issuers put into disclosure documents.

The SEC does directly regulate other participants in municipal financings, including underwriters, broker-dealers, municipal advisers and rating agencies, and the regulatory regime imposed on these entities can have indirect impacts on issuers. The most significant example is SEC Rule 15c2-12, which by its terms is applicable to underwriters and requires them to cause issuers to prepare Official Statements and to undertake in writing to provide post-issuance disclosures to holders of securities under most circumstances. Thus, by conditioning issuers' access to public markets, it indirectly imposes an obligation on issuers. See Chapter Five – Post Issuance Disclosure below.

The Municipal Securities Rulemaking Board (the "MSRB") was created by federal statute in 1975 and empowered to create rules governing municipal securities dealers and, since 2015, municipal advisers. Certain MSRB rules also have indirect impacts on issuers. For example, MSRB Rule G-34(c) requires municipal securities dealers to file certain documents, including copies of liquidity and credit facilities for variable rate securities, with the MSRB Short-Term Obligation Rate Transparency System, an activity that involves issuer input to the extent redaction of certain information (like pricing) from the facilities is necessary or desirable.

THE SEC'S EVOLVING ROLE

In recent years, the SEC has become increasingly vocal about its desire to enhance municipal disclosure and bring it into closer alignment with the corporate securities law regime, possibly including obtaining some direct regulatory authority over municipal issuers, although probably not so far as to repeal municipal securities' exemption from registration requirements. The primary rationales historically used to justify the generally more relaxed regulation of municipal securities–namely, that municipal issuers rarely default and that there is little perceived abuse–are becoming less compelling as cities and counties across the nation face unprecedented challenges to their fiscal stability, and as multiple examples of abuse or faulty disclosure are being uncovered by the SEC. SEC Commissioners have also spoken publicly about the need to increase the timeliness of ongoing disclosure by municipal issuers and potentially to create national standards, both in terms of the applicable accounting standards and in terms of topics addressed for municipal disclosure documents.

> "Investors and other market participants have long criticized the quality, consistency, and timeliness of the disclosures provided by municipal issuers. With respect to the initial disclosures that are made when bonds are first issued, there are concerns over the absence of detailed information about issuers' outstanding debt, such as liens and collateral pledges. There is also widespread concern that issuers are not disclosing bank loans, which issuers have been pursuing in greater numbers in recent years. Municipal issuers also have a contractual obligation to provide continuing disclosure for the vast majority of the securities they issue. But here, too, there are pervasive problems. Industry participants have long complained that many issuers struggle to meet their obligation to provide complete and timely disclosures to the secondary market."
> SEC Commissioner Luis A. Aguilar, Statement on Making the Municipal Securities Market More Transparent, Liquid and Fair (Feb. 13, 2015).

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") provides some evidence of a move at the federal level to strengthen SEC oversight over municipal securities along the lines requested by the SEC. The Dodd-Frank Act established a stand-alone municipal securities office at the SEC and gave the SEC the ability to levy civil fines in administrative proceedings (which are faster and more favorable to the SEC than complaints filed in federal district court) and created a regulatory regime for municipal advisers. The SEC is making active use of these new powers against issuers, issuer officials, underwriters and advisers, as spelled out in more detail in Chapter Seven of this booklet.

The dialogue among the SEC, issuers, investors, municipal advisers and broker-dealers regarding the future of municipal securities disclosure and its regulation by the SEC is expected to continue.

"...[M]unicipalities are populated by taxpayers who also are frequently investors in our national markets, perhaps even in the securities issued by those same municipalities. Indeed, the concerns of a citizen qua taxpayer and the same citizen qua investor have something very important in common. Just as an investor wants to understand the true financial health of an entity whose debt it purchases, a taxpayer has an interest in understanding the true fiscal health of the state or local municipality in which he or she lives. So the call for greater federal regulation of the municipal securities market could have benefits for both taxpayers and investors alike." SEC Commissioner Elisse B. Walter, Regulation of the Municipal Securities Market: Investors Are Not Second-Class Citizens, 10th Annual A. A. Sommer, Jr. Corporate, Securities and Financial Law Lecture (Oct. 28, 2009).

CHAPTER 3

The Official Statement

The offering document in a public offering of municipal securities is usually called the Official Statement. If the securities are being offered on a more limited basis, the offering document might be called an offering circular, an offering memorandum, a private placement memorandum or a limited offering memorandum. The Official Statement in a public offering of municipal securities is analogous to the prospectus in a registered public offering. While Official Statements used to take the form of a single soft cover "book" they now are most often distributed as an electronic file. The Official Statement contains the issuer's "official" statements; that is, the statements about itself upon which it intends others to rely, including statements about its financial condition, the securities, the project or program to be financed with the securities and the sources of repayment of the securities. Its purpose is to tell potential investors what they need to know in order to decide whether or not to buy the securities. The Official Statement can presuppose general knowledge, but, unlike a private placement memorandum or term sheet provided to a purchaser actively engaged in the transaction, it must be complete in the sense that the investor should not be expected to conduct any investigation beyond reading the document and any publicly available materials incorporated therein by reference.

PURPOSE OF THE OFFICIAL STATEMENT

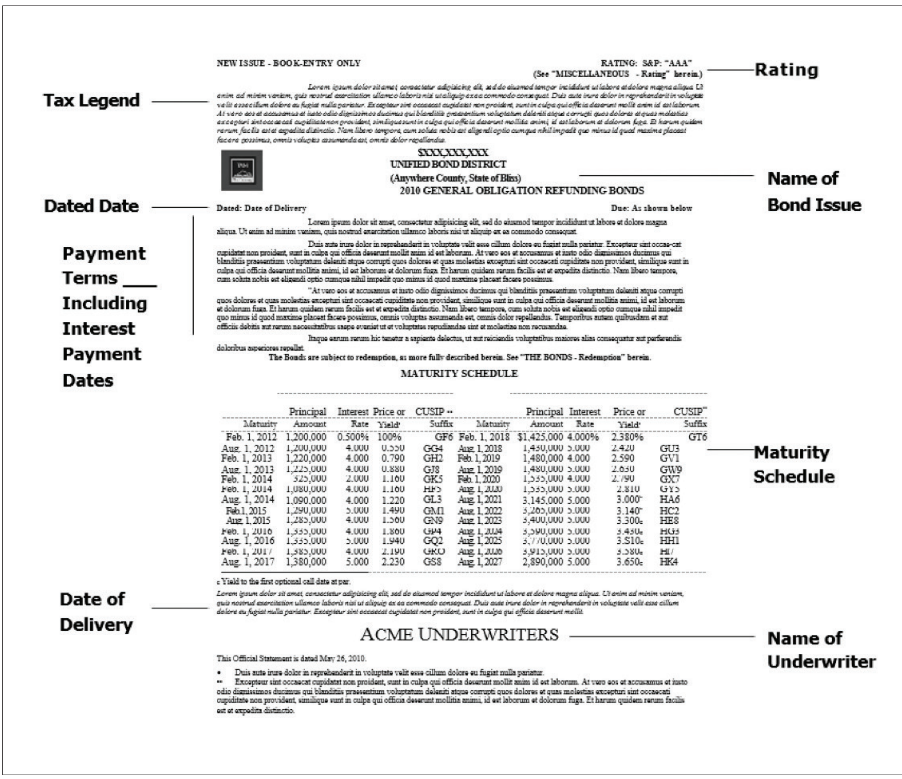
The Official Statement serves three basic functions: (1) it provides a description of the transaction – its purpose, use of the proceeds, and a description of the securities offered and their source of repayment, (2) it assists with marketing the securities and (3) it discloses material information associated with investment in the securities, which may include the risks related thereto. Marketing – an invitation to "invest" in the issuer through the purchase of the offered securities is viewed as "positive," and risk disclosure, including disclosure of "bad" facts, is often viewed as "negative"–a necessary evil to avoid the serious adverse consequences of failure to comply with securities laws. To be sure, a properly prepared Official Statement functions as the issuer's primary defense against claims that its securities were sold on the basis of incomplete or misleading information in violation of the antifraud provisions of federal or state securities laws. Risk disclosure can, however, also be viewed as a positive because it demonstrates that the issuer has a full understanding of its business and its financial condition and provides an opportunity to explain how risks are being addressed.

THE PRELIMINARY OFFICIAL STATEMENT

The Official Statement must be filed with the MSRB and must be provided to all purchasers. Because in many transactions the Official Statement cannot describe the securities completely until after they have been sold, a Preliminary Official Statement is made available and distributed in advance of the offering. SEC Rule 15c2-12 requires the Preliminary Official Statement to be "final" except for pricing and information dependent upon or determined as part of the pricing. The Preliminary Official Statement is used by the underwriters to solicit interest in the securities. Depending upon the complexity and novelty of the transaction, the Preliminary Official Statement is generally distributed, by electronic posting or by the mailing of printed copies, between a few days and a couple of weeks before the expected sale date. The issuer can also voluntarily file the Preliminary Official Statement on the MSRB's Electronic Municipal Market Access (EMMA) website, which helps to assure that investors in the primary market receive material information at the time an investment decision is made. If material developments occur or material information comes to light after the Preliminary Official Statement has been distributed, the Preliminary Official Statement must be supplemented prior to the sale date. It may not be enough to correct or update the information in the final Official Statement post-sale, as the SEC is increasingly focused on the state of disclosure at the time the purchaser's investment decision is made. As stated above, the Preliminary Official Statement is supposed to be "final" except for pricing information. With almost universal electronic distribution of Preliminary Official Statements now the norm, supplementing the document is simple and no longer carries a stigma associated in the past with "stickering" a disclosure document.

CONTENTS OF THE OFFICIAL STATEMENT

The specific content varies, of course, based on the type of securities offered, but Official Statements generally follow a simple basic format. The Official Statement cover identifies information such as the amount, maturities, interest rates and payment information for the securities being offered, a brief description of their source of repayment, their tax status, the expected delivery date and ratings.



Typical Official Statement Cover

The body of the Official Statement generally consists of a brief overview of the purpose of the financing, a more detailed description of the terms of the securities (especially any mandatory or optional tender or redemption provisions and, if the securities are variable rate securities, the manner in which interest rates are determined) and their security (pledges of revenues, tax receipts or assets, including limitations, reserve funds and any credit enhancements and their providers) and the sources and uses of funds for the financing. The body of the Official Statement also describes the issuer and its financial condition, especially the financial and operating data relevant to the payment of the securities and any parity, senior or subordinate obligations of the issuer. If the issuer's obligation is limited to a particular source, such as the revenues of a utility enterprise or the proceeds of a special tax, the discussion will focus on information related to that source. The body of the Official Statement will also provide information about the tax treatment of interest paid on the securities, the terms of the underwriting, published ratings of the securities, the presence or absence of litigation, a summary of the issuer's undertaking to provide continuing disclosure and various other matters.

The body of the Official Statement may also include a separate "risk factors" section. These are more common with enterprise or revenue obligations than tax-supported general obligations. This section can be used to highlight special risks unique to the securities or the industry, or to disclose risks a description of which cannot easily be worked into the general discussion. It is critical to be clear, however, that because a "risk factors" section cannot address all risks and even described risks cannot be fully comprehended apart from context, an investor must read the entire Official Statement for a full understanding of the risks associated with the offered security. A thorough discussion of risk factors is not only useful to potential investors, but can ward off claims by the SEC and private litigants in the event that disclosed risks materialize.

The Official Statement generally includes, as appendices, various items that, while part of the Official Statement, would interfere with the flow if included in the body of the Official Statement. Typical appendices include:

- the issuer's audited financial statements,
- expert consultant reports or feasibility studies, if any, in whole or in summary form,
- information of only indirect importance such as general demographic and economic information,
- summaries of legal documents (to the extent not described in the body of the Official Statement),
- a form of the continuing disclosure undertaking,
- a description of the Depository Trust Company's book-entry procedures and
- the form of the opinion to be delivered by bond counsel.

The information in an Official Statement should be primarily historical, verifiable information. Projections of future receipts, operating revenues, expenses or debt service are, however, often important and included particularly for revenue obligations. In such cases, it is essential to clearly identify the information as projected and state clearly the assumptions on which the projections are based, that forward–looking statements are about the future and are based on assumptions and qualified, and that the achievement of expected results is subject to uncertainties, including the occurrence (or nonoccurrence) of future events. Likewise, although it is preferable that the historical financial information included be audited data, unaudited or "stub period" financial data is often included, depending on timing of the publication of the Official Statement relative to timing of the release of the audited financial statements and the quarter-over-quarter or year-over-year volatility of the revenues or other financial results being described in the Official Statement. Some market sectors, such as healthcare, require quarterly financial data. In such cases, it is important to clearly distinguish between audited and unaudited data.

DISCLOSURE GUIDANCE

Guidance as to what ought to be contained in an Official Statement is available from a variety of sources. A review of the Official Statements prepared by the issuer for other offerings or Official Statements prepared by other issuers for the offering of similar securities can provide useful templates and can serve as checklists. Further, investor and analyst groups publish guidelines. The Government Finance Officers Association has produced comprehensive guidelines for disclosure in municipal offerings entitled *Disclosure Guidelines for State and Local Government Securities* (the "GFOA Guidelines"). The GFOA Guidelines are not legally binding, and even though they have not been updated since 1991, they still provide a useful standard for disclosure that can be referred to by issuers of municipal securities. The *Disclosure Handbook for Municipal Securities* published by the National Federation of Municipal Analysts contains specific disclosure recommendations for various types of debt financing techniques.

While helpful to provide readers with relevant and customary information in a format they are familiar with, templates, guidelines and checklists cannot substitute for judgment. Each municipal offering has its own story and a mere update to a model disclosure document without careful reflection about the current transaction does not suffice. (What is new? What is different? What could go wrong? What do purchasers of these particular securities need to know, and is that being told clearly?) The issuer and its financing professionals must carefully consider the issuer's current situation and the terms of the debt, and the security and source of funds for its repayment, and form an independent judgment as to what information must or should be included to assure that the Official Statement (i) contains the information needed for a potential investor to make an informed investment decision and (ii) does not contain material misstatements or omissions. A sense of balance and perspective is also essential. Important information should be presented clearly and prominently. Sometimes, it is even highlighted by putting it in a bold font or italics or even having it underlined.

SECURITIES WITH CREDIT OR LIQUIDITY SUPPORT

If credit for the securities is enhanced by a bond insurance policy, a letter of credit or another credit facility, or if a third party is providing liquidity support, the description of the terms of such credit or liquidity support and disclosure regarding the credit or liquidity provider must be included in the Official Statement. A form of any bond insurance policy or letter of credit securing the securities is generally included as an appendix to the Official Statement.

For fixed rate municipal securities secured by bond insurance or other credit support, the financial condition of the issuer is nonetheless material because, no matter the financial strength of the credit provider, an issuer financial failure could lead to an early par redemption when interest rates would otherwise result in the securities being valued at a premium. The financial condition of the issuer is also material for variable rate securities with liquidity but not credit support because the issuer's financial failure could excuse the liquidity provider from performance. In both of these cases, an Official Statement with full disclosure of the issuer's financial position (plus disclosure concerning the credit or liquidity provider) is necessary. There may be different considerations if there is a "full credit substitution" letter of credit, where investors are protected against financial consequences of a default by the issuer or obligor.

There is a range of market-accepted approaches to disclosure for variable rate debt including commercial paper, with both credit and liquidity support (e.g., variable rate demand bonds secured by a letter of credit or by a standby purchase commitment and bond insurance) because, so long as the credit and liquidity providers are financially sound, the securities, as variable rate obligations, will never be worth materially more or less than par and the holder can receive par, upon seven days' or similar notice, even if the issuer fails. On the one hand, sometimes full financial disclosure respecting the issuer or other obligor is included in the Official Statement for such securities, and it should be noted that representatives of the SEC have expressed a preference for full financial disclosure, regardless of the credit or liquidity support provided. On the other hand, sometimes in transactions using an irrevocable direct pay letter of credit which provides "full credit substitution," virtually no financial information about the issuer or underlying obligor is included, in which case the investor is explicitly instructed to make its investment decision on the basis of the letter of credit provider and not on the basis of the condition or circumstances of the issuer.

CONDUIT OBLIGATIONS

In most conduit offerings of municipal securities, debt service on the securities is payable solely from amounts received by the governmental conduit issuer from the conduit borrower. Therefore, in such transactions, information on the financial condition of the conduit issuer is not necessary (and could be misleading) and should not be included in the Official Statement. The Official Statement should, moreover, make clear that the conduit issuer is assuming responsibility only for the limited material included in the Official Statement that has been provided by it, which is generally only a brief description of the conduit issuer and a statement that there is no pending litigation against the conduit issuer challenging the financing or the issuance of the municipal securities. On the other hand, fulsome information on the conduit borrower/underlying obligor in a conduit transaction is vital to the offering and to the Official Statement. All of the typical disclosures that an issuer would have to make would now be done by the obligor. The liabilities and the responsibilities would now also attach to the obligor, including all continuing disclosure obligations.

APPLICATION OF DISCLOSURE OBLIGATIONS

The use of an Official Statement or other offering document which meets Rule 10b-5 standard applies not only to initial offerings of municipal securities, but to other transactions such as remarketings or tender offers, when the issuer is seeking action from investors. Rule 10b-5 standards also apply to dissemination of other documents, such as a Comprehensive Annual Financial Report ("CAFR"), or to other circumstances where the issuer is "speaking to the market" in a manner reasonably expected to be perceived by market participants as important to making a decision to buy, hold, tender or sell the issuer's securities.

CHAPTER 4

Preparing an Official Statement

Under federal and state securities laws, the issuer of municipal securities is responsible for the completeness and accuracy of the Official Statement used to offer its securities. Therefore, it is critical that the issuer prepare an Official Statement that tells prospective investors what a reasonable investor should know in order to make an informed investment decision, without material misstatements or omissions. Although underwriters and other parties may have securities law responsibilities of their own, the issuer may not transfer its primary responsibility (and potential liability) for disclosure to such parties. To protect its interests and ensure a quality product, the issuer must maintain ownership of the Official Statement, both of its content and of the process of its preparation, and the issuer should expect that a commitment of staff time and governing board oversight will be required.

From the standpoint of the issuer of municipal securities, the following are the steps to be taken in preparing an Official Statement:

DETERMINE THE TEAM AND DEFINE ROLES AND RESPONSIBILITIES

Early on, the issuer should determine which financing team member will coordinate the preparation of the Official Statement. Counsel generally takes on this role, although the document, or pieces of it, can be prepared by the issuer's financial advisor or issuer staff. Counsel preparing the Official Statement typically provides the underwriter with a statement that, based on limited procedures, and subject to a variety of qualifications and exclusions, nothing came to the attention of such counsel that caused it to believe that the Official Statement contained any untrue statement of a material fact or omitted any material fact necessary in order to make the statements in the Official Statement, in the light of the circumstances under which they were made, not misleading. Although this letter is often referred to as a "10b-5 opinion" it is not a legal opinion but rather a statement of what counsel did not find in the limited procedures it followed and excludes substantial portions of the Official Statement, like audited financial statements and other financial information. Rendering this "negative assurance" letter is not the primary value that such counsel brings. Rather, its value is the comfort that can be derived from knowing what counsel must do in order to render that opinion, provided it is a counsel with knowledge, skill and experience in securities disclosure. That process is called the due diligence review. As a separate matter, at the bond closing, an official of the issuer will sign a "10b-5 certificate" similarly stating that the Official Statement contains no material misstatements or omissions, but unlike the comfort letter of counsel, this certificate cannot exclude any parts of the Official Statement since the issuer is responsible for the entire document (although the issuer can rely on expert reports such as feasibility studies and audited financial statements).

In preparing an Official Statement, the issuer can, of course, benefit from the assistance of underwriters, financial advisors, feasibility consultants, accountants and attorneys so long as such professionals will be given access to the information necessary to properly discharge their responsibilities and the issuer has a reasonable basis to believe that they have experience and skill relevant to their role in securities disclosure.

However, involving qualified professionals does not relieve the issuer of its responsibilities with respect to the Official Statement, which is ultimately the issuer's disclosure document. Much of the information in the Official Statement is about, or obtained from, the issuer (except in the case of a conduit financing). The issuer is therefore in the best position to know if the disclosure contained in the Official Statement is inaccurate or misleading, and the professionals on which the issuer is relying are in turn relying on the accuracy and completeness of the information received from the issuer and the issuer's review of the information about it in the Official Statement. Therefore, while issuers may rely on the advice of such professionals to an important extent, issuers cannot ever completely rely on or delegate to professionals.

> "Because they are ultimately liable for the content of their disclosure, issuers should insist that any persons retained to assist in the preparation of their disclosure documents have professional understanding of the disclosure requirements under the federal securities laws." Exchange Act Release No. 26985 (June 28, 1989), 54 Fed. Reg. 28799, 28811 n.84 (July 10, 1989).

THE CASE FOR SEPARATE DISCLOSURE COUNSEL

Historically, in a negotiated sale of municipal securities, the firm serving as counsel to the underwriters prepared the Official Statement, while in a competitive sale it was bond counsel or the financial adviser who prepared the Official Statement. Increasingly, issuers, especially large and frequent ones, have preferred to engage their own counsel to be responsible for disclosure matters, including preparation of the issuer's Official Statements, so that such issuers can have an attorney-client relationship with such counsel. Such counsel is usually referred to as disclosure counsel. In some cases, disclosure counsel is the same firm as bond counsel. If a separate disclosure counsel or underwriters' counsel takes the lead on disclosure, bond counsel's role with respect to the Official Statement is typically limited to ensuring the accuracy of the descriptions of the securities and the documents relating to their issuance. In any event, the counsel preparing the Official Statement should have ample experience and reputation in disclosure matters for similar types of financings or credits. It is also helpful that such firm have experience with SEC investigations and securities enforcement actions (in case there are any) and adequate insurance coverage.

The value of using separate disclosure counsel by an issuer includes the following points:

- Disclosure counsel has an attorney-client relationship with the issuer, with duties of care, loyalty and confidentiality, and will protect the interest of the issuer, none of which applies to an underwriter's counsel.
- Having a regular disclosure counsel will assure consistency from one transaction to the next. "Rotating" disclosure counsel frequently is not recommended.
- Disclosure counsel can usefully help narrow the scope of continuing disclosure obligations to what is reasonably needed by investors.
- Disclosure Counsel can help the issuer develop good policies and procedures for primary market and continuing disclosure and provide training to the issuer's staff and board.

While using separate disclosure counsel could add another party to the financing team, this can be mitigated by using bond counsel as disclosure counsel. Furthermore the cost of disclosure counsel could be offset at least in part by reducing the scope of work by underwriter's counsel.

ESTABLISH A PROCESS FOR ENSURING THE ACCURACY AND COMPLETENESS OF THE OFFICIAL STATEMENT

The SEC has recommended that issuers establish formal, written procedures to be followed for the preparation of Official Statements. Such procedures might include establishment of a disclosure review committee, a detailed process for compiling information for inclusion in the Official Statement and for issuer staff review and formal sign-off on disclosure documents, and systematic training of staff and board members in the discharge of disclosure responsibilities. Formal procedures can be useful, but they must be followed, as an issuer may be exposed to greater liability if it has express procedures in place that it does not follow fully and consistently. Nonetheless, the benefits of setting up workable procedures and establishing a regular training program should outweigh the risks. Of equal importance is to establish, at the commencement of a financing, a plan for the preparation of the Official Statement and a schedule that allows sufficient time for the completion of all required work, including appropriate review and participation by members of the financing team and knowledgeable issuer staff. A particular officer of the issuer should be responsible for managing the Official Statement preparation process, and such officer should be empowered to obtain the assistance of other necessary or appropriate participants within the issuer's organization.

> "Issuers of municipal securities have an obligation to ensure that financial information contained in their disclosure documents is not materially misleading. Proper disclosure allows investors to understand and evaluate the financial health of the state or local municipality in which they invest. The State [of New Jersey] was aware of the under funding of [its pension systems] and the potential effects of the under funding. However, due to a lack of disclosure training and inadequate procedures relating to the drafting and review of bond disclosure documents, the State made material [mis]representations and failed to disclose material information regarding [its pension systems] in bond offering documents."
> *In the Matter of State of New Jersey, Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933*, Making Findings, and Imposing a Cease-and-Desist Order, Securities Act Release No. 9135 (Aug. 18, 2010).

PREPARE AND REVIEW THE OFFICIAL STATEMENT

Preparation of an Official Statement should begin with a thoughtful consideration of the big picture. For example,

- What are the important or unusual features of the issue's structure?
- What is the credit, the source of payment and the security for the securities?
    - The issuer's general fund?
    - Particular tax revenues?
    - Revenues of an enterprise?
    - Contractual payments to be received from other governmental entities or from private parties?
    - Assets (property? funds?) of the issuer?
- What are the limitations, practical as well as legal, on bondholder remedies?
- What is the plan for payment of the principal of and interest on the securities?
- What could happen that could fundamentally alter the situation?
- What could go wrong in the short, intermediate and long term?
- If the unexpected happens, where would that leave holders of the securities?

The answers to all of these and similar questions will depend, of course, on the terms of the debt, the issuer's financial strength, and the security and source of payment for the debt.

The next step is to begin drafting the Official Statement, starting with the selection of a template or templates to use as a starting point. This will generally be a combination of a prior Official Statement of the issuer, if any, and Official Statements describing securities with comparable structures or credit concerns. Although merely updating or following an example, no matter how similar, will not suffice, a good template or collection of templates can serve as a checklist to help ensure that important items are not overlooked. Then follows a combination of information gathering, document drafting and diligence (to confirm that the information to be presented in the Official Statement is accurate and that additional disclosure is not required).

The drafting process generally involves several drafts that may be heavily revised (the number depending upon the complexity of the credit and the relevance of available templates), followed by revisions for smaller changes or to fill in blanks. Drafting follows receipt of information and the results of diligence, of course, but the drafting process in turn may suggest additional matters that bear consideration and research. The content of the Official Statement may also be shaped by the type of information that investors are presently focused on in their own internal review of issuer credits, such as unfunded liability in pension and other post-employment benefit systems, potential hedge termination payment liability, issuer investment policies, issuer liquidity and cash position, and bankruptcy risk.

DUE DILIGENCE

Under the Securities Act of 1933, underwriters of municipal securities have an affirmative responsibility to perform a "reasonable investigation" or take "reasonable care" that the Official Statement for such securities does not contain any material misstatements or omissions and may assert a "due diligence" defense to legal claims that they did not discharge this responsibility adequately. Thus, the term "due diligence" is used to describe both the reasonable investigation and care by the underwriters to avoid liability in connection with municipal disclosures. In addition, although a "due diligence" defense is not available to the issuer of securities, the issuer may have its own "due diligence" responsibility in the sense that it must ensure the accuracy and completeness of the information presented in the Official Statement, as described above.

The due diligence process varies from transaction to transaction depending on the security and source of payment of the securities, risk factors and the frequency with which the issuer offers securities in the market and works with a particular underwriting team or underwriters' counsel and its own disclosure counsel. The issuer's assembling information for inclusion in the Official Statement, as described above, and its participation in conference calls and meetings to review the contents of the Official Statement, as well as providing thorough responses to questions and requests for further information by members of the working group, are the key elements of the due diligence process and typically occur in the regular process of drafting the Official Statement and other financing documents. Due diligence activity may also involve consultation with, and the review of relevant portions of drafts by the issuer's internal staff, including representatives from finance, public works or engineering, and general counsel, extracting material from financial, feasibility and other reports, reviewing material contracts, litigation, permits or licenses, and reading governing board minutes. General topics of investigation include financial and industry trends and issuer-specific news and developments. Specific matters can include budget issues, financial results, regulatory compliance, analysis of pending or threatened litigation, legislation or other developments that could affect revenues, and approval or construction status or other concerns respecting the source of revenue or projects to be financed. Sometimes counsel preparing the Official Statement will conduct a site visit or prepare a formal, written list of questions for the issuer to answer and a written list of documents for the issuer to produce for review. Key issuer officials may also be interviewed, sometimes at a formal "due diligence" meeting. Such interviews are important less to uncover hidden details than to confirm that the financing team's understanding of the "big picture" is consistent with management's and to assure that the discussions of the issuer and its operations and financial condition, the challenges it faces and its expectations in the Official Statement are consistent with how the issuer is articulating such matters for other audiences in other contexts.

GOVERNING BOARD APPROVAL

As a general matter, issuers bring a full, near-final draft of the Official Statement (in reality it is usually the Preliminary Official Statement in a fixed rate transaction) to the governing board for approval prior to publication. The issuer's governing board has a legal responsibility to ensure that the issuer complies with all applicable securities laws, and governing board members may be subject to personal civil and criminal penalties for failure to discharge such responsibility. As described above, internal procedures, either formal or informal, can be developed and used by staff to provide board members with comfort that disclosure has been vetted by the individuals most knowledgeable about various matters. Governing board members should, in particular, ensure that the professionals (bond counsel, disclosure counsel or underwriters' counsel) responsible for disclosure matters are qualified, that staff has followed reasonable internal review procedures and that any material concerns they have about the issuer or the securities have been adequately covered in the Official Statement. Board members should also consider the "big picture" when reviewing disclosure documents: What are the basic economic drivers for the issuer or enterprise supporting debt repayment? What are its biggest challenges? What is it concerned about? What could go wrong or cause a default? To do this effectively, of course, governing board members must have an adequate understanding of the proposed transaction.

These considerations are largely inapplicable in conduit transactions, where the issuer expressly disclaims responsibility for the bulk of the Official Statement, whose content is the responsibility of the conduit borrower.

"A public official who approves the issuance of securities and related disclosure documents may not authorize disclosure that the public official knows to be materially false or misleading; nor may the public official authorize disclosure while recklessly disregarding facts that indicate that there is a risk that the disclosure may be misleading. When, for example, a public official has knowledge of facts bringing into question the issuer's ability to repay the securities, it is reckless for that official to approve disclosure to investors without taking steps appropriate under the circumstances to prevent the dissemination of materially false or misleading information regarding those facts." *Report of Investigation in the Matter of County of Orange, California as it Relates to the Conduct of the Members of the Board of Supervisors*, Exchange Act Release No. 36761 (Jan. 24, 1996).

PUBLICATION

Preliminary Official Statements and Official Statements are released to the public through website posting (or less frequently, delivery of printed "books") to prospective investors (in the case of the Preliminary Official Statement) or purchasers of the securities (in the case of the Official Statement). The Preliminary Official Statement and Official Statement should not be made available to investors until each member of the working group is satisfied that all significant issues have been vetted and is comfortable that the information it is responsible for is accurate and complete and that no information known to be untrue or misleading is included. In larger organizations, it may be desirable for the particular departments or officials with specific knowledge about sections of the Official Statement which they have provided to sign an internal 10b-5–type certificate to the official who will ultimately sign the Official Statement or the 10b-5 closing certificate on behalf of the issuer.

OTHER MARKETING ACTIVITIES AND OTHER PUBLIC STATEMENTS

In offering its securities, an issuer's discussion of matters relating to its credit are often not confined to the Official Statement. Issuers also make formal presentations to rating agencies or prospective credit enhancers (generally prior to publication of the Preliminary Official Statement), and often make presentations to groups of prospective major investors (bond funds or other institutional purchasers) during the period of time between the publication of the Preliminary Official Statement and the pricing of the securities, each of which must conform with the antifraud standards discussed in Chapter Two. There are often "internet road show" slides prepared by the underwriters to assist in marketing. These communications, while important to a successful issuance, pose risks because they can form the basis for securities claims, yet the speakers often approach them with less formality than statements that have been made in Official Statements. Issuers should ensure that communications with rating agencies, credit enhancers and potential investors are carefully prepared and reviewed in advance, and that any additional written materials available to investors, such as an internet road show, are entirely consistent with and only contain information which can be found in the Preliminary Official Statement.

Information provided to rating agencies and credit enhancers can go beyond that provided to investors by including greater detail, technical analysis and conjectural or other soft information not appropriate for a disclosure document. In providing such information, though, the issuer should consider whether such information is consistent with the Official Statement or should be included in the Official Statement to avoid misleading investors, and whether such information is accurate and not misleading for the particular purposes for which it is being presented.

Public information offered by the issuer, including a CAFR or statements by officials and information posted on the issuer's website that are intended or can be expected to reach and affect the market for municipal securities, can also be viewed as statements about the issuer's securities. Although the making of such statements cannot and should not be prevented (and are sometimes legally required, as for the CAFR), it is important that care be taken and that the accuracy and completeness of such statements be considered, in the light of the circumstances under which they are being made. For instance, although a CAFR speaks as of a prior date, the issuer must make sure there have not been actions since the end of the prior fiscal year which must be disclosed in order for the CAFR not to present a misleading picture of the entity's financial condition. The SEC has brought enforcement actions based on exactly this situation.

"A municipal issuer may not be subject to the mandated continuous reporting requirements of the Exchange Act, but when it releases information in the public that is reasonably expected to reach investors and the trading markets, those disclosures are subject to the antifraud provisions. The fact that they are not published for purposes of informing the securities markets does not alter the mandate that they not violate antifraud proscriptions." *Statement of the Commission Regarding Disclosure Obligations of Municipal Securities Issuers and Others*, Securities Act Release No. 7094 (Mar. 9, 1994).

"Public officials should be mindful that their public statements, whether written or oral, may affect the total mix of information available to investors, and should understand that these public statements, if they are materially misleading or omit material information, can lead to potential liability under the antifraud provisions of the federal securities laws. . . Given this potential for liability, public officials who make public statements concerning the municipal issuer should consider taking steps to reduce the risk of misleading investors. At a minimum, they should consider adopting policies and procedures that are reasonably designed to result in accurate, timely, and complete public disclosures; identifying those persons involved in the disclosure process; evaluating other public disclosures that the municipal securities issuer has made, including financial information and other statements, prior to public dissemination; and assuring that responsible individuals receive adequate training about their obligations under the federal securities laws." Report of Investigation in the Matter of the City of Harrisburg, Pennsylvania Concerning the Potential Liability of Public Officials with Regard to Disclosure Obligations in the Secondary Market, Exchange Act Release No. 69516 (May 6, 2013).

CHAPTER 5

Post-Issuance Disclosure

Issuers are not obligated to make any disclosures unless required to do so by law or agreement. Section 17(a) and Rule 10b-5 require full and complete disclosure in connection with the initial offering of the securities, and Section 14(e) of the Securities Exchange Act of 1934 requires disclosure in connection with a tender offer to purchase outstanding securities. Otherwise, there is generally no obligation to provide post-issuance disclosure except to the extent the issuer has agreed to do so. Of course, if an issuer is making statements it should expect to reach the securities market, it has an obligation to make sure those statements are not misleading to investors.

The legal basis for a formal ongoing disclosure obligation is SEC Rule 15c2-12 (the "Rule"), which requires the underwriter of an issue of municipal securities to obtain a commitment (also known as an "undertaking") from the issuer or other obligated person with respect to the securities to provide this ongoing disclosure. An "obligated person" is any entity or fund, public or private, which is liable by contract or other arrangement to support payment of part or all of the obligation. This undertaking generally takes the form of a Continuing Disclosure Certificate or Continuing Disclosure Agreement executed by the issuer of the securities, or other obligated person, at closing. In keeping with the Rule, the continuing disclosure undertaking typically requires issuers or obligated persons to provide two types of ongoing disclosure: (i) an annual report, which must be provided by a specific date set forth in the undertaking (not more than one year after the end of the fiscal year) and (ii) notices of certain events, if and when any occur during the year, within 10 business days of the occurrence.

Excerpt from SEC Rule 15c2-12:

"A Participating Underwriter shall not purchase or sell municipal securities in connection with an Offering unless the Participating Underwriter has reasonably determined that an issuer of municipal securities, or an obligated person for whom financial or operating data is presented in the final official statement has undertaken . . . in a written agreement or contract for the benefit of holders of such securities, to provide [annual reports and material event notices] . . . either directly or indirectly through an indenture trustee or a designated agent."

CONTENTS OF THE ANNUAL REPORT

The annual report is required to contain annual financial information and operating data for the issuer of the type contained in the final Official Statement, as specified in the continuing disclosure undertaking. The annual report is also required to contain the issuer's most recent audited financial statements. Most issuers agree to provide the annual report for a given fiscal year within six to nine months of the fiscal year close, taking care to allow sufficient time for preparation and receipt by the governing board of the audited financial statements.

The issuer should carefully review the section of the Continuing Disclosure Agreement describing the contents of the annual report. The description of non-audit information to be provided should be specific (as opposed to a general statement requiring the issuer to provide information "of the type included in the Official Statement"), and the issuer may want to limit the requirement to information that the issuer already updates each year and plans to continue to update. It is also important to be consistent so that the annual reporting requirements do not vary from one issue of securities to the next.

Because the audited financial statements are always a component of the annual report, many issuers find it to be a helpful practice to work with their auditors to include in the audited financials any updates to tables or other financial and operating data required to be included in the annual report. This has the dual benefit of obtaining auditor review of the updated disclosure and simplifying the process of preparing and submitting the annual report. Issuers should carefully review the continuing disclosure undertaking's description of the annual report to be sure that all required updates are included in each annual report.

There may be instances when the audited financial statements are not completed by the time the annual report is due. In this case, the SEC has provided guidance which says that the issuer should file unaudited financial statements with its annual report, and then file the audited statements as soon as they are available. This is treated as compliance with the Continuing Disclosure Agreement. However, the decision to file unaudited financial statements should not be made as a matter of course. As stated below, this could lead to 10b-5 exposure if such unaudited financial statements do not provide an accurate picture of the issuer. Unfortunately, under current SEC guidance, once a date for filing the annual report is set in the Continuing Disclosure Agreement, it is very difficult to change it if the issuer finds that its audits are regularly taking longer than the time set in the Agreement.

The Rule also requires the issuer to promise, in the Continuing Disclosure Agreement, that if it fails to provide the annual report, or any part of it, on time, it must make a public notice (see below on the methods of reporting) of its failure to file the annual report. Unless the issuer does this, a late filing actually involves two separate violations of the Agreement.

Since the annual report is a document intended to be read by existing or future bondholders, it is subject to Rule 10b-5 standards. Unless the issuer has other recent Official Statements which have kept investors apprised of current financial and other developments, an issuer must be mindful to report any material developments since the date of the last financial statements. In this regard, an issuer must also carefully consider whether, if the audited financial statements are late, it wants to file unaudited financial statements with an annual report, as this could lead to 10b-5 exposure if the final audited financial statements are materially different than the unaudited versions which are filed.

MATERIAL EVENT NOTICES

The continuing disclosure undertaking also requires the issuer to provide notice "in a timely manner not in excess of ten business days after the occurrence of" certain types of events relating of the securities to which the Continuing Disclosure Agreement has been signed that are likely to be material to bondholders or potential investors. The Rule was amended, effective December 1, 2010, to expand this list of events, and again August 20, 2018 (with compliance beginning February 27, 2019 (the "2018 Amendments")).

MATERIAL EVENTS (As of September 2018)

Events that Always Require Notification

- Principal and interest payment delinquencies;
- Unscheduled draws on debt service reserves reflecting financial difficulties;
- Unscheduled draws on credit enhancements reflecting financial difficulties;
- Substitution of credit or liquidity providers, or their failure to perform;
- Issuance by the Internal Revenue Service of proposed or final determination of taxability or of a Notice of Proposed Issue (IRS Form 5701 TEB);
- Tender offers;
- Defeasances;
- Rating changes, or
- Bankruptcy, insolvency, receivership or similar event of the obligated person.
- Default, event of acceleration, termination event, modification of terms or other similar events under a "financial obligation" (defined in footnote 2) of an obligated person, if any such event reflects financial difficulties.[1 2 3]

(footnotes on next page)

Events that Require Notification if Material

- Unless described in the fifth bullet of the list above, adverse tax opinions or other material notices or determinations by the Internal Revenue Service with respect to the tax status of the securities or other material events affecting the tax status of the securities;
- Modifications to rights of holders of the securities;
- Optional, unscheduled or contingent Bond calls;
- Release, substitution or sale of property securing repayment of the securities;
- Non-payment related defaults;
- The consummation of a merger, consolidation or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms; or
- Appointment of a successor or additional trustee or the change of name of a trustee.
- Incurrence of a "financial obligation" of the obligated person, or agreement to covenants, events of default, remedies, priority rights or other similar terms of a financial obligation, any of which affect security holders.[1 2 4]

The 2018 Amendments added two new "events" which are listed on the chart on the previous page. Although the 2018 Amendments are not required to be included in Continuing Disclosure Agreements prior to February 27, 2019, issuers would be well advised to start analyzing how the new reporting requirements will impact them, to update disclosure practices and policies and establish internal monitoring mechanisms to detect covered events. Underwriters will need to update their diligence procedures prior to the compliance date. Since interpretation of the 2018 amendments is evolving, all market participants should consult with their counsel to think about how to measure materiality or the corresponding test of reflecting financial difficulty. In addition, Orrick lawyers are also available to answer any questions about any developments in materiality or interpretation in connection with the 2018 Amendments.

There are regular discussions and proposals for the SEC to modify this list, so issuers and obligors which have to prepare continuing disclosure undertakings need to make sure to look at the latest version of the Rule.

FILING POST-ISSUANCE DISCLOSURE

Both the annual report and any event notices are required to be filed in searchable PDF format with the MSRB's EMMA website. Many issuers' filings are handled by finance or other staff, while others engage the trustee, financial advisor or other outside consultant as a dissemination agent, to remind the issuer of the required filings and assist with their preparation and submission to EMMA. *Orrick's subsidiary, BLX Group LLC ("BLX"), can assist issuers with preparation and/or filing of their annual reports and material event disclosures on EMMA.*

EXCEPTIONS TO POST-ISSUANCE DISCLOSURE RULES

There are some exceptions to the Rule or to the general principles outlined above. Securities maturing in 270 days or less (typically, commercial paper notes)

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[1] The Rule was amended on August 20, 2018 to add these two new "events" for which issuers would be contractually obligated through new Continuing Disclosure Agreements signed on or after the compliance date of February 27, 2019.

[2] The term "financial obligation" means a (i) debt obligation; (ii) derivative instrument entered into in connection with, or pledged as security or a source of payment for, an existing or planned debt obligation; or (iii) guarantee of (i) or (ii). The term "financial obligation" shall not include municipal securities as to which a final official statement has been provided to the Municipal Securities Rulemaking Board, consistent with the Rule.

[3] This item would apply to a default, etc., for any financial obligation of the obligated person whenever such obligation was entered into, if it occurs after the signing of a Continuing Disclosure Agreement which includes this event.

[4] This item would apply to financial obligations entered into, or covenants etc. made, only after the issuance date of a new bond issue to which a new Continuing Disclosure Agreement is signed.

are exempt from the ongoing disclosure requirements of the Rule, as are privately placed securities. Although the Rule was amended effective December 1, 2010 to include new issues of variable rate demand bonds, such bonds that were outstanding as of November 30, 2010, can be remarketed or reoffered without a continuing disclosure undertaking so long as the bonds continuously maintain a $100,000 minimum denomination and tender rights of nine months or less. Certain short-term securities (with maturities of 18 months or less) are subject to lesser ongoing disclosure requirements. Finally, if the issuer of the securities is a conduit issuer or otherwise is not the true party responsible for repaying the securities, the ultimate obligor or obligors are required to execute the undertaking and provide the ongoing disclosure, rather than the issuer.

There may be instances, particularly with private placements or limited offerings to institutional investors which could be exempt from the Rule, where the investors require certain periodic financial or operating information from the issuer or obligor. It may be better in such a case to include those provisions in bond documents rather than a voluntary Continuing Disclosure Agreement, as the bond documents can be modified more easily, if desired, after issuance, and noncompliance does not require five years of disclosure in official statements.

INCENTIVES FOR COMPLIANCE

As further incentive to issuers, the Rule requires any instances of material noncompliance with continuing disclosure undertakings to be disclosed in each of the issuer's Official Statements for a period of five years following the noncompliance, even if the noncompliance has been "remedied." Underwriters (both in negotiated and competitive offerings) are required under the Rule to make diligent inquiry to ensure that the issuer has properly disclosed any material noncompliance within the prior five years in the Preliminary Official Statement. However, the SEC has said that it is not enough for underwriters to ask the issuers if they are in compliance with their continuing disclosure undertakings and rely on such issuers' representations regarding past compliance. Rather, underwriters must obtain evidence reasonably sufficient to determine whether the issuer has complied with its obligations under each of its continuing disclosure undertakings. This has led underwriters to conduct five-year look-back reviews regarding issuers' compliance when they are involved in a new bond financing.

In 2014-2016, the SEC brought a series of enforcement actions (numbering over 140) against both issuers and underwriters based on the finding that issuers had either falsely stated in an Official Statement that they were in material compliance for the prior five years or had failed to disclose noncompliance with their continuing disclosure undertakings. Correspondingly, underwriters had failed to cause the issuers to correct these misstatements or omissions. In the settled consent decrees, the SEC found these actions to be violations of Section 17(a)(2) constituting negligent behavior. This program, called "MCDC," is discussed further in Chapter Seven. Virtually all of these cases involved late or nonexistent annual report filings, but the SEC declined to define how late a filing must be to constitute "material" noncompliance with the Continuing Disclosure Agreement. As a result, the practice has now developed that issuers are listing in their Official Statements any noncompliance with an Agreement, no matter how technical or minor.

Beyond mere legal compliance, careful and diligent attention to each continuing disclosure undertaking can improve an issuer's relations with investors for future financings. Providing updated and accurate information on a timely basis is of value to investors and confirms that the issuer is managing its affairs well. In addition, there has generally been increased attention to continuing disclosure compliance by investors and a call by investors and the SEC to increase the frequency, timeliness and scope of municipal continuing disclosure undertakings.

Sometimes, issuers have enlisted assistance from a third party in preparing their annual reports, event notices, voluntary filings, as well as the formulation of their internal policies and procedures relating to continuing disclosure compliance. One such party is BLX, a subsidiary of Orrick. BLX is an SEC Registered Investment Advisory Firm and a MSRB registered "municipal advisor" that provides continuing disclosure services to issuers, borrowers and underwriters. BLX has extensive experience in both content and dissemination of annual reports and event notices and prepares over 100 annual reports per year for over 200 bond issues. Contact information for BLX can be found in the "Contacts" section at the end of this book.

INFORMAL STATEMENTS BY ISSUERS

Any informal statements by issuers, even those not taking place during the course of a bond financing, can also be considered disclosure to the market. Public statements, press releases, website postings and statements to the press and governing board proceedings are all widely and publicly available and are often monitored by rating agencies, investor analysts and other market participants. Many issuers deliberately make such informal statements by publishing press releases or voluntary disclosure statements to EMMA or the issuer's own investor relations website. Even in connection with such informal statements, the issuer should always consider whether other material information also must be disclosed to avoid being misleading.

Care should be taken by officials and officers of issuers not to make unconsidered public statements that may provide only a partial story or distort investors' perception of the issuer's financial strength.

QUESTIONS FROM INVESTORS

Investors may contact issuers directly from time to time with questions regarding their finances or operations. Fielding questions from investors is not prohibited, but it is a best practice for issuers to identify a single point person for responding to such inquiries to maintain consistency, and to respond to inquiries with information that is already available to the general public to the extent possible. Circumstances may arise in which issuers may want to provide an investor with helpful information that is not yet publicly available; in that case, although there is no legal requirement to do so as there is in the corporate market, the issuer may want to consider making that information more broadly available to the public or to the market. In certain cases, it may make sense for an issuer to make a voluntary disclosure filing on EMMA.

CHAPTER 6

Disclosure in the Information Age

A unique challenge for today's issuer of municipal securities is taking advantage of the efficiency, convenience and flexibility of digital media while limiting exposure to the concomitant risks. Disclosure regarding new offerings and continuing disclosure are now required to be made in electronic format. Generally, Official Statements for securities are made available in electronic form via link to a PDF file. Final Official Statements for municipal securities are also required to be posted on EMMA. Continuing disclosure has also been required to be made via EMMA since July 1, 2009, and issuers' annual reports and material event notices remain available there for viewing by the general public, with the ultimate goal of increased market transparency. Digital marketing strategies include "net road shows" in which issuers pre-record a presentation about an offering of municipal securities that is made available to investors via link along with a link to the Preliminary Official Statement.

RISKS OF ELECTRONIC DISCLOSURE

While the use of electronic media for disclosure is inevitable, issuers should take care to reduce associated risk of three types. First, there is the ongoing and continuous availability of stale or outdated information about the issuer-between the continuous availability of formal postings via EMMA and caching of websites by search engines, even information that is no longer "online" may be accessible. Second, there is the potential for the simultaneous availability of inconsistent information. Third is routine "publication" of vast amounts of information that is available to the investing public and that has not been reviewed from the perspective of the issuer's compliance with securities laws.

Because investors are evaluating municipal securities from their computers, it becomes much easier for them to take the logical step of visiting an issuer's website or other websites referenced in the Official Statement. Therefore, it is important to use links very carefully in Official Statements.

Although citing the issuer's public website or links to information about large capital projects being funded by the securities offered may be helpful for investors who want to learn more, it is generally not advisable to incorporate those websites by reference into the Official Statement. The risk is threefold. First, the website may change or evolve after the date of the Official Statement, and there is no way to clearly define the website that is incorporated by reference as of the date of the Official Statement. Second, the website incorporated may link to other websites, and the issuer should take care not to inadvertently incorporate extraneous or incorrect information by such a reference. Third, the information available at a particular link is generally not reviewed with an eye toward compliance with Rule 10b-5 in the same way an issuer's Official Statement should be. If it is absolutely necessary to affirmatively incorporate a link by reference, risk can be reduced by the issuer's creation of a dedicated webpage without extraneous links, preceded by an acknowledgment and disclaimer by the viewer that must be accepted before the website can be viewed.

CONTROLLING INVESTOR ACCESS TO ELECTRONIC DISCLOSURE

One helpful strategy for taking control of investors' access to digital information about an issuer is to use EMMA to post voluntary disclosure to the market that does not fit in one of the "traditional" required disclosure categories of Official Statement, annual report or material event notice. Issuers have used this option to disclose the approval of potential refunding transactions, anticipated tender offers or updates on significant developments that do not fit one of the listed events from Rule 15c2-12. Another is to create and maintain an "investor relations" website, a central repository for the issuer's statements to the market and other information investors or potential investors frequently seek out. The site would be available to members of the general public who read and accept an appropriate disclosure and disclaimer before accessing the site, including a statement that no content contained in or accessible by link from the issuer's website is intended to be relied upon in connection with the purchase or sale of the issuer's securities. The use of such a web portal can be a convenience for investors that also helps the issuer control and designate its statements to the market, but the issuer must carefully control, maintain and update the content of the website. Disclosures to the market should be dated, clearly state that the disclosure speaks only as of its date, and state that the issuer has not undertaken to update or correct the information based on events occurring after that date.

Ultimately, each issuer will need to balance the benefits with the costs of these options and determine what is workable given its information technology and investor relations management resources.

CHAPTER 7

Enforcement of Securities Laws by the Securities and Exchange Commission Against Issuers, Officials, Board Members and Staff

GENERAL

As explained earlier in this booklet (see Chapter Two), issuers of municipal securities are subject to certain laws concerning disclosure of material information to potential investors. Holding municipal issuers accountable under these laws is an important means to ensure their effectiveness. Unlike the corporate securities market, where "private actions" are frequently brought in court by shareholders, such private actions by bondholders are very rare in the municipal securities market. Most actions claiming that the antifraud provisions (Sections 17(a)(2) and (3) of the Securities Act of 1933 and Section 10(b) and Rule 10b-5 under the Securities Exchange Act of 1934) have been violated are the result of action by the Enforcement Division of the SEC.

While enforcement activity by the SEC has occurred for many years, there has been a marked increase in the SEC's focus on the municipal market since 2010. In that year, the Enforcement Division reorganized into certain subject matter Units, one of which was formed to focus on Municipal Securities and Public Pensions. The new Unit has about 25 professionals located in SEC Regional Offices around the country, including attorneys, accountants and investigators, many of whom are former prosecutors. They have taken their role seriously and all participants in the municipal market-issuers, underwriters, municipal advisers, attorneys, consultants, and more-have been the targets of enforcement actions. As a symbol of what the Unit is doing, its Chief recently renamed this as the "Public Finance Abuse Unit." Another factor in increased enforcement activity is that the SEC was given significant new powers under the Dodd-Frank Act, in the aftermath of the financial crisis of 2008-09, which included the ability to levy monetary fines against municipal issuers and officials.

The balance of this chapter together with Appendix A will summarize the kinds of enforcement actions which have been brought in recent years, with a main focus on actions against issuers, particularly governmental agencies, but as noted above, many other municipal market actors have also been sanctioned or charged. Appendix A which follows will provide detailed summaries of many enforcement actions brought by the Public Finance Abuse Unit since 2010 (and a few earlier ones). The subjects of these enforcement actions run the gamut, including:

- Inadequate disclosure about pension funding shortfalls,
- Misleading or incomplete disclosures about an issuer's financial condition,
- Failure to disclose the use of unusual accounting actions,
- Failure to disclose shortcomings in risky economic development projects,
- Failure to disclose other financial or legal risks, and
- Failure to comply with continuing disclosure obligations.

Consider the results of these enforcement actions:

- Five governmental agencies were levied civil fines in amounts of \$20,000, \$50,000, \$125,000, \$400,000 and \$1,000,000 (the last after a city refused to settle with the SEC and lost a jury trial).
- A number of agencies were required at their own cost to engage outside consultants and/or legal counsel to review and oversee their disclosure practices.
- A number of individual employees working for agencies targeted by the SEC were also named and had to settle SEC charges. They each had to pay a civil fine (for which they could not be reimbursed by their agency or from insurance) ranging from \$10,000 to \$50,000, and some were barred from taking part in municipal securities offerings for a period of time. *It is clear now that if the SEC decides to bring an enforcement action against a government agency, it will also charge those officials who it feels were culpable for the alleged disclosure failure.*
- In one instance the SEC referred a case to the U.S. Department of

Justice, which indicted two town officials in New York State. One pled guilty and paid a $20,000 fine; one went to trial and was convicted and sentenced to 2-1/2 years in jail and fined $75,000. As the criminal trial concluded, the SEC has renewed a civil action against this official for securities fraud, seeking a large, additional civil fine.

- In a sweeping program to address widespread failures by issuers to comply fully with continuing disclosure obligations (the "MCDC initiative" discussed in the Appendix), over 70 issuers/obligated persons signed consent decrees and were required to engage outside consultants to oversee their continuing disclosure practices. These issuers/obligated persons have to disclose their SEC settlements in all of their official statements for five years.
- The SEC has used certain new theories and techniques, such as asserting indirect liability for "aiding and abetting" securities violations, or liability of an individual as a "control person" over other public officials who actually took part in the securities offering with the violation of law. In one case, the SEC successfully obtained an injunction against a new bond offering by an issuer which it was in the process of investigating for fraud in a prior bond offering. In another case, the SEC based its claim on statements made by an issuer and its officials in statements and documents other than an Official Statement.
- In addition to the monetary penalties imposed by a settled SEC case, an issuer and potentially some of its officials face costs in the hundreds of thousands or even millions of dollars to defend the case, even if they are successful in avoiding an SEC filing or settling on favorable terms. Moreover, SEC investigations and charges result in bad publicity, political damage, and possible reductions in ratings or other financial market consequences.
- The SEC (as distinct from private plaintiffs) does not have to prove that an alleged disclosure violation resulted in any bond default, loss of value or financial harm to any investors. This was the case for many of the actions set forth in the Appendix and referred to above.

CONCLUSION

Securities law compliance, including creation of policies and procedures and regular training from competent counsel, should now more than ever be at the forefront for every issuer and obligated person. The Public Finance Abuse Unit at the SEC is active and looking to make examples out of issuers, obligors, underwriters and officials. The examples discussed above and spelled out in detail in Appendix A make it clear that the Unit is ratcheting up its activity and the level of penalties which it seeks to impose on entities and individuals who violate securities laws. Orrick has extensive experience in advising issuers and officials, including defending against SEC inquiries or enforcement actions.

This is a serious matter for all market participants. The consequences of an SEC investigation are very expensive and can be politically and reputationally harmful, even if no charges are ever brought. Costs are much more expensive and harmful if an SEC action is filed.

We hope this booklet was informative and provides you with some guidance on how and why it is important to comply with federal securities laws.

APPENDIX A

SUMMARY OF CASES

This Appendix A will provide summaries of the enforcement cases referenced in the preceding chapter of this booklet. In each case, the footnote provides the reader with the citation and with a link to the underlying case as found at the end of this Appendix A. This is only a sampling, and doesn't include every action brought by the SEC in recent years. In any case which is identified as being "settled," the respondent entity or person agreed to the entry by an Administrative Law Judge (or in a few cases, a federal District Court Judge) of a consent decree stating the respondent would not violate the antifraud laws in the future, while neither admitting nor denying that it had violated the law (unless noted otherwise). Other sanctions are often included, including actions and monetary fines against individual public officials.

1. Inadequate Pension Disclosures

The SEC brought actions against the City of San Diego (2006),[1] the State of New Jersey (2010),[2] the State of Illinois (2013)[3] and the State of Kansas (2014),[4] all of which were settled. In the case of the City of San Diego, however, the SEC also levied fines on certain individual officials in a separate action. These actions generally focused on failure to adequately disclose funding shortfalls in pension systems, and the potential for future budget difficulties as pension contributions would have to be increased. In one case there was also misleading information about plans to remedy the shortfall. A common theme of all these actions was inadequacy of internal procedures and training to ensure accurate disclosure in securities Official Statements.

2. Misleading or Incomplete Financial Disclosures and Unusual Accounting Actions

The SEC has brought a number of actions alleging failure to accurately describe the financial condition of the issuer.

a. City of Miami, FL (2013)[5] — The SEC alleged that the City had hidden shortfalls in its General Fund by temporarily transferring moneys from other funds into the General Fund just prior to fiscal year end, and then retransferring the funds out again. Although the City stated that its accountants had approved these actions, the SEC charged that failure to disclose the full amount or effect of the transfers, or that the funds transferred to the General Fund were originally allocated to capital projects that still needed the funds, materially misled investors as to the City's financial condition. In addition, the City, through its Budget Director, made misrepresentations to rating agencies concerning the transfers. The SEC also sued the Budget Director, who failed to get the charges dismissed on the grounds of governmental immunity. The City and the Budget Director refused to settle and took the case to trial, where a jury found in favor of the SEC. The City then settled the case and agreed to pay a fine of $1,000,000. The trial court judge imposed a fine of $15,000 on the Budget Director. The high level of the fines, and the City's decision to fight the charges, likely stem from the fact that the City was already subject to a cease and desist order arising from a prior SEC action for antifraud violations.

b. City of Allen Park, MI (2014)[6] — The City issued bonds to support a movie studio development. In the official statement the City failed to reveal a budget gap, which was supposed to be closed by private investment from the movie studio development. The movie studio plan fell apart but the City did not reveal the deterioration in the project or the impact of that event on the budget gap. The City and two of its officials settled charges; the two officials were barred from taking part in future municipal securities offerings and one official paid a penalty of $10,000.

c. Westlands Water District, CA (2016)[7] — In 2010, during a drought which reduced water usage (and hence revenue), the District took an unusual accounting action to transfer money from certain reserves into an operating account to add to its "revenues" in order to maintain a minimum debt service coverage ratio required under its bond indentures. In a later bond offering which showed prior years' coverage, the District failed to disclose that it only met the coverage in 2010 by use of the one-time accounting transfer. Even though the transfer was approved by the District's accountants, the SEC charged a securities law violation. The District settled and paid a fine of $125,000. The District's General Manager and Assistant General Manager were also charged and paid fines of $50,000 and $20,000, respectively.

d. Town of Ramapo, NY (2016)[8] — The Town, its local development corporation and various officials were charged with deliberately keeping misleading books which hid financial deficits and budget strains. According to the SEC, the problems arose from declining tax revenues and the failure of a minor league baseball park project. In addition to the SEC charges, the Department of Justice brought criminal charges for securities fraud against the assistant town attorney and the town supervisor. With respect to the criminal charges, the town supervisor was found guilty by a jury and was sentenced to two and one-half years in prison and a $75,000 fine. The assistant town attorney pled guilty and was sentenced to 18 months of supervised release and a $20,000 fine. With respect to the SEC changes, the assistant town attorney, the town attorney and the deputy finance director received lifetime bars from participating in future municipal securities offerings. In addition, the town attorney was fined $25,000 and the deputy finance dorector was fined $10,000. As of June 2018, SEC litigation against the town supervisor was ongoing.

e. City of Harvey, IL (2014)[9] — The SEC filed charges in federal court alleging that the City and its comptroller had been engaging in a scheme to divert bond proceeds for improper, undisclosed purposes, and that as part of the scheme, the City made misrepresentations and omissions to investors about how bond proceeds would be used. The official statements for the bond offerings represented that the bond proceeds would be used to develop and construct a hotel; however, City officials improperly diverted bond proceeds from the offerings into the City's general operations accounts and also used bond proceeds to make undisclosed payments to the City comptroller. After filing charges, the SEC learned that the City was about to issue additional bonds which did not disclose the shortfalls, and the SEC obtained an injunction blocking the new bond sale. The City later settled the SEC charges, which included a requirement to hire outside securities counsel and consultants. The SEC obtained a default judgment against the comptroller which required the comptroller to pay a penalty of $30,000 and pay disgorgement of approximately $187,000.

3. Failed Economic Development Projects

In a number of cases, bond proceeds were used to fund an ambitious economic development project which then failed. The SEC charged various parties for failing to adequately disclose the risks of the project or the impact that the project's failure would have on a municipality's financial condition.

a. The Greater Wenatchee Regional Events Center Public Facilities District, WA and Piper Jaffray & Co. (2013)[10] – A Washington municipal corporation issued short term construction notes to finance a regional event center. The developer of the events center had prepared a series of financial projections for operation of the center. The official statement for the notes contained the most recent version of the projections, and did not disclose that the projections had been reviewed by an independent consultant, which had raised questions about the center's economic viability, or that the projections had been revised upward after pressure from public officials asserting the projections were not sufficiently optimistic. This case also involved the last-minute replacement of an underwriter, who did not have adequate time to diligence the project. The issuer settled and paid a fine of $20,000. Piper Jaffray & Co., the underwriter of the notes, was also sanctioned by the SEC and agreed to retain a consultant to review its underwriting due diligence policies and procedures.

b. Rhode Island Commerce Corporation (f/k/a Rhode Island Economic Development Corporation), RI and Wells Fargo Securities, LLC (2016)[11] – A Rhode Island authority issued bonds, supported by a "moral obligation" pledge of the State of Rhode Island, to subsidize the move of a start-up software firm (which was planning on producing a certain game) from Massachusetts to Rhode Island. The official statement indicated that the bonds would only cover part of the startup costs needed to produce the planned software game, but failed to disclose that the remaining funding had not been obtained. The company could never finish developing the game and went bankrupt. Charges were brought against the Rhode Island Commerce Corporation, two Corporation executives, Wells Fargo Securities, LLC, the underwriter of the bonds, and the lead banker at Wells Fargo. The two Corporation executives settled and each paid a penalty of $25,000. The Corporation settled and paid a penalty of $50,000. As of April 2018, litigation against Wells Fargo and the lead banker was still ongoing.

City of Allen Park, Town of Ramapo and City of Harvey also fall into this category.

4. Failure to Disclose Risks

Certain cases have focused on failures to disclose known risks which the SEC asserted would have been material to investors.

a. City of South Miami, FL (2013)[12] — The City borrowed money in two pooled, conduit bond offerings by the Florida Municipal Loan Council and used the funds to build a parking garage. After the first issuance, contrary to its tax agreement, the City leased portions of the garage to a private developer and restructured the parking garage lease agreement, likely making the bonds taxable. In connection with the second issuance, the City failed to disclose these actions in documents prepared in connection with the issuance. The City settled this case and agreed to retain an independent consultant to review the City's policies, procedures and internal controls regarding municipal securities offering disclosures.

b. UNO Charter School Network, Inc., IL (2014)[13] — A nonprofit charter school operator failed to disclose in an official statement that family members of senior management had engaged in certain transactions with the school, which violated prohibitions against conflicts of interest in grant agreements with the State of Illinois. These conflicts could have led to withdrawal of the grants, which were critical to the school's finances and ability to repay the bonds. Charges were also brought against the President and CEO of the charter school operator. The operator and its President and CEO settled with the SEC. The operator agreed to improve its internal procedures and training, including appointment of an independent monitor. The President and CEO agreed to pay a $10,000 penalty and was barred from participating in any future municipal bond offerings.

c. Port Authority of New York and New Jersey (2017)[14] — The Port Authority is a bi-state agency, and its Commissioners are appointed by the Governors of New York and New Jersey. The Governor of New Jersey put pressure on the Port Authority to issue bonds to finance certain road improvements on the New Jersey side of the Hudson River, but internal counsel at the Port Authority raised significant questions as to whether this use of proceeds was permitted by the Port Authority's statute and existing bond resolutions. Counsel ultimately agreed to a theory which allowed this use and the Port Authority went ahead with a series of financings without disclosing the legal risk associated with such use of proceeds. Upon the commencement of an SEC investigation into the bond issues, the Port Authority revised its plans and used other funds for the road improvements, rather than bond proceeds. Nonetheless the SEC alleged the failure to disclose the legal risk was a violation of the antifraud rules. The Port Authority settled and agreed to admit wrongdoing, pay a fine of $400,000, establish written policies and procedures and conduct periodic trainings related to bond offering disclosures, improve internal procedures for Board of Directors approvals of bond sales, and hire an independent consultant to conduct a review of the Port Authority's disclosure policies and procedures.

d. Town of Oyster Bay, NY (2017)[15] — In 2017, the SEC filed charges against the Town of Oyster Bay and former town supervisor alleging that the town and the supervisor defrauded investors by hiding the existence and potential financial impact of the town's guarantees of private loans to a long-standing town concessionaire. The SEC complaint alleges that the town failed to disclose the guarantees in any of the town's bond offering documents between 2010 and 2015, and the disclosure related to the guarantees in connection with later bond offerings were materially misleading. The guarantees were material to investors because of the potential impact on the town's finances. The SEC complaint requests several types of relief, including permanently enjoining the former supervisor from participating in municipal securities offerings, barring the town from offering municipal securities unless it implements recommendations of an independent consultant on financial reporting and disclosure policies and procedures, and fines against both the town and the former supervisor. As of April 2018, the town and former supervisor are contesting the charges. Related criminal charges have also been brought against the former town supervisor.

5. Failures of Continuing Disclosure

As described earlier in this booklet, SEC Rule 15c2-12 requires, as a condition of having a dealer underwrite most issues of municipal bonds, that the issuer enter into a Continuing Disclosure Agreement calling for annual financial reports and certain other notices on a timely basis ("CDA"). The Rule also requires an issuer to disclose in any official statement if it has failed to comply in all material respects with its prior CDAs in the prior five years. There was widespread noncompliance with many CDAs over the years. Although the SEC could not directly enforce CDAs, it could bring antifraud actions if an issuer falsely stated in an official statement that it had complied with its CDAs in the prior five years.

a. City of Harrisburg, PA (2013)[16] — The City was under severe financial strain and therefore did not produce and file annual audits and financial reports as required by its CDAs. Nonetheless, the City and its officials made public statements concerning its financial condition, including budget reports. The SEC sued on the grounds that these public statements and budget reports omitted material information about the City's dire financial condition, asserting that in the absence of the required CDA reports, investors had no choice but to rely on the other statements for current information on which to make investment decisions.

b. West Clark Community Schools, IN and City Securities Corporation (2013)[17] — This school district affirmatively stated in an official statement that it had not failed to comply in all material respects with any prior disclosure undertakings when it had, in fact, never filed any annual financial reports as required by its existing CDA. The school district settled the case. City Securities Corporation, the underwriter of the bonds, was also sanctioned for failing to adequately conduct due diligence of the school district's statement on CDA compliance and paid a substantial fine.

6. Municipalities Continuing Disclosure Cooperation Initiative

Following up on the West Clark Community Schools action, the SEC in early 2014 created a program allowing both issuers and underwriters to voluntarily report by the end of the year any instances in the prior five years where they had issued or underwritten issues with incorrect statements regarding past CDA compliance. This was called the "MCDC" program. In return for the voluntary report, the SEC promised in advance relatively lenient settlement terms, which for issuers included agreeing to a cease and desist order, without admitting violation, and implementing remedial steps; issuers would not pay any fine. Underwriters were offered similar terms, but were subject to limited fines capped at $500,000 for any and all cases reported.

Ultimately virtually all underwriters in the municipal market made voluntary reports, in some cases listing hundreds of transactions. The SEC over the course of 2016 announced settlements with 72 broker/dealer firms, representing over 95% of the market. After finishing the underwriter settlements, the SEC announced a group of settlements with a sampling of 71 issuers from 45 states, ranging from states to counties, towns, utility authorities, nonprofit entities and others. An unknown remaining group of issuers were not charged, but the SEC did not treat this as an admission that these other issuers were not also culpable.

7. Post-MCDC Enforcement

The SEC is now looking into issuers and underwriters who had violations of CDA compliance, but who did not voluntarily report under MCDC. Specifically, individuals are also being held accountable. As of April 2018, there have been two SEC enforcement actions related to false disclosure of CDA compliance:

a. City of Beaumont, CA and O'Connor & Company Securities, Inc. (2017)[18] — The Beaumont Finance Authority ("BFA"), a joint powers authority created by the City, issued bonds on behalf of a Community Facilities District ("CFD") for housing developments. The CFD signed numerous CDAs in connection with BFA's bonds. Between 2012 and 2013, official statements for five BFA bond offerings, each underwritten by O'Connor & Company Securities, Inc. ("O'Connor"), disclosed one late CDA filing but failed to disclose many late CDA filings and the fact that every annual report was missing one or more elements of information required by the CDA. Besides BFA, the SEC also charged the city's former city manager and executive director of BFA. BFA, the former city manager, O'Connor and O'Connor's lead underwriter all settled. BFA is required to establish policies and procedures and training for securities law and CDA compliance, and for accounting and record-keeping for bond proceeds and bring all existing CDA filings up to date if not in compliance. The former city manager agreed to a permanent injunction against participating in any municipal securities offering and to pay a fine of $37,500. The SEC went beyond the MCDC settlements by including individual issuer officers and by imposing a requirement that BFA engage an independent consultant to provide a review and recommendations to BFA on the matters subject to new policies and procedures and comply with such independent consultant's recommendations, subject to appeal to the SEC.

b. Lawson Financial Corporation, Robert Lawson and Richard Brogdon (2017)[19] — The SEC charged an underwriter for failure to serve as gatekeeper to conduct reasonable due diligence when underwriting bond offerings. Lawson Financial Corporation ("Lawson Financial") was the underwriter for multiple bond issuances for entities controlled by Richard Brogdon ("Brogdon"), the proceeds of which were to be used for construction, acquisition and renovation of nursing homes, assisted living facilities and retirement housing. The bond offering documents represented that the Brogdon-controlled borrowers had not failed to comply with any prior continuing disclosure undertakings, when in fact other Brogdon-controlled borrowers had consistently failed to provide financial information required by existing disclosure undertakings. Lawson Financial conducted inadequate due diligence of Brogdon's continuing disclosure compliance for these offerings. Lawson Financial and Robert Lawson paid disgorgement of approximately $198,000, Lawson Financial paid a penalty of approximately $198,000, and Robert Lawson paid a penalty of $80,000 and was barred from the securities industry for three years. The SEC separately charged Brogdon with fraud, claiming that, among other things, Brogdon diverted bond proceeds to pay for his and his wife's personal expenses and to prop up other business enterprises and misappropriated revenues from the financed facilities and is seeking an order to repay $85 million to investors.

LIST OF CITATIONS

[1] *In the Matter of City of San Diego, California, Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934,* Securities Act Release No. 8751, Exchange Act Release No. 54745 (Nov. 14, 2006), available at **https://www.sec.gov/litigation/admin/2006/33-8751.pdf**.

[2] *In the Matter of State of New Jersey, Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Making Findings, and Imposing a Cease-and-Desist Order,* Securities Act Release No. 9135 (Aug. 18, 2010), available at **https://www.sec.gov/litigation/admin/2010/33-9135.pdf**.

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[6] *In the Matter of City of Allen Park, Michigan, Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order,* Securities Act Release No. 9677, Exchange Act Release No. 73539 (Nov. 6, 2014), available at https://www.sec.gov/litigation/admin/2014/33-9677.pdf; Press Release, Securities and Exchange Commission, SEC Charges Allen Park, Mich. and Two Former City Leaders in Fraudulent Muni Bond Offering for Movie Studio Project (Nov. 6, 2014), available at **https://www.sec.gov/news/press-release/2014-249**.

[7] *In the Matter of Westlands Water District, Thomas W. Birmingham, and Louie David Ciapponi, Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Making Findings, and Imposing a Cease-and-Desist Order,* Securities Act Release No. 10053, Accounting and Auditing Enforcement Release No. 3752 (Mar. 9, 2016), available at **https://www.sec.gov/litigation/admin/2016/33-10053.pdf**.

[8] United States v. St. Lawrence, No. 16-CR-259 (May 24, 2017) (guilty verdict for town supervisor); United States v. St. Lawrence, No. 16-CR-259 (Mar. 8, 2017), Court Docket (guilty plea of town attorney); Complaint, S.E.C. v. Town of Ramapo, No. 16-CV-2779, 2016 WL 1533360 (S.D.N.Y. Apr. 14, 2016), available at **https://www.sec.gov/litigation/complaints/2016/comp-pr2016-68.pdf**; Press Release, Securities and Exchange Commission, SEC: Town Officials in New York Hid Financial Troubles From Bond Investors (Apr. 14, 2016), available at **https://www.sec.gov/news/pressrelease/2016-68.html** (noting U.S. Attorney filing of criminal charges against town supervisor and attorney); Town Officials in New York Who Hid Financial Troubles from Bond Investors Agree to Lifetime Municipal Security Bars, Ligitation Release No. 24161 (June 8, 2018), available at **https://www.sec.gov/litigation/litreleases/2018/lr24161.htm**.

[9] S.E.C. v. City of Harvey, No. 14-CV-4744 (N.D. Ill. June 24, 2014), available at **https://www.sec.gov/litigation/complaints/2014/comp-pr2014-122.pdf**; Court Enters Default Judgment Against SEC Defendant Joseph T. Letke, Bars Him from Participating in Municipal Securities Offerings, and Orders Him to Pay Over $200,000, Litigation Release No. 23149, 2015 WL 349825 (Jan. 27, 2015), available at **https://www.sec.gov/litigation/litreleases/2015/lr23180.htm** (S.E.C. announcement of default judgment against comptroller); City of Harvey Agrees to Settle Charges Stemming from Fraudulent Bond Offering Scheme, Litigation Release No. 23149, 2014 WL 6850798 (N.D. Ill. Dec. 5, 2014), available at **https://www.sec.gov/litigation/litreleases/2014/lr23149.htm** (S.E.C. announcement of City settlement).

[10] *In the Matter of The Greater Wenatchee Regional Events Center Public Facilities District, Allison Williams, Global Entertainment Corporation, and Richard Kozuback, Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order*, Securities Act Release No. 9471 (Nov. 5, 2013), available at **https://www.sec.gov/litigation/admin/2013/33-9471.pdf;** *In the Matter of Piper Jaffray & Co. and Jane Towery, Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Sections 15(b) and 15(B)(c) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order*, Securities Act Release No. 9472, Exchange Act Release No. 70804 (Nov. 5, 2013), available at **https://www.sec.gov/litigation/admin/2013/33-9472.pdf**.

[11] S.E.C. v. Rhode Island Commerce Corp., No. 16-CV-107, 2017 WL 2264428 (May 24, 2017) (entry of judgment against Rhode Island Commerce Corp.); SEC Obtains Final Judgment Against Rhode Island-Based Issuer of 38 Studios Bonds, Litigation Release No. 23796, 2017 WL 2402703 (Apr. 3, 2017), available at **https://www.sec.gov/litigation/litreleases/2017/lr23796.htm**; SEC Charges Rhode Island Agency and Wells Fargo with Fraud in 38 Studios Bond Offering, Litigation Release No. 23480, 2016 WL 860670 (Mar. 7, 2016), available at **https://www.sec.gov/litigation/litreleases/2016/lr23480.htm** (noting two Corporation executives' settlement); Complaint, S.E.C. v. Rhode Island Commerce Corp., No. 16-CV-107 (D.R.I. Mar. 7, 2016), available at **https://www.sec.gov/litigation/complaints/2016/comp-pr2016-37.pdf.**

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[13] S.E.C. v. United Neighborhood Org. of Chi., No. 14-4044, 2014 WL 2980362 (N.D. Ill June 2, 2014), available at **https://www.sec.gov/litigation/complaints/2014/comp-pr2014-110.pdf**; Former CEO of Chicago Charter School Operator Settles Muni Bond Fraud Charges, Litigation Release No. 23578, 2016 WL 9086338 (June 21, 2016), available at **https://www.sec.gov/litigation/litreleases/2016 /lr23578.htm**; S.E.C. v. United Neighborhood Organization of Chicago, No. 14-CV-4044 (N.D. Ill June 2, 2014) (agreed final judgment from settlement with UNO and UNO Charter School Network, Inc.); Press Release, Securities and Exchange Commission, SEC Charges Charter School Operator in Chicago with Defrauding Bond Investors (June 2, 2014), available at **https://www.sec.gov/news/press-release/2014-110** (noting charter school operator's settlement).

[14] *In the Matter of The Port Authority of New York and New Jersey, Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Making Findings, and Imposing a Cease-and-Desist Order*, Securities Act Release No. 10278 (Jan. 10, 2017), available at **https://www.sec.gov/litigation/admin/2017/33-10278.pdf**.

[15] S.E.C. v. Town of Oyster Bay, New York, No. 1:17-cv-06809 (E.D.N.Y. Nov. 21, 2017), available at **https://www.sec.gov/litigation/complaints/2017/comp-pr2017-213.pdf**; Press Release, Securities and Exchange Commission, Long Island Town and Former Top Official Charged With Defrauding Municipal Investors (Nov. 21, 2017), available at **https://www.sec.gov/news/press-release/2017-213**.

[16] *In the Matter of the City of Harrisburg, Pennsylvania, Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order,* Exchange Act Release No. 69515 (May 6, 2013), **https://www.sec.gov/litigation/admin/2013/34-69515.pdf**; Report of Investigation in the Matter of the City of Harrisburg, Pennsylvania Concerning the Potential Liability of Public Officials with Regard to Disclosure Obligations in the Secondary Market, Release No. 69516 (May 6, 2013), available at **https://www.sec.gov/litigation/investreport/34-69516.htm**.

[17] *In the Matter of West Clark Community Schools, Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order*, Securities Act Release No. 9435, Exchange Act Release No. 70057 (July 29, 2013), available at **https://www.sec.gov/litigation/admin/2013/33-9435.pdf**; *In the Matter of City Securities Corporation and Randy G. Ruhl, Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Section 8A of the Securities Act of 1933, Sections 15(b), 15B(c) and 21C of the Securities Exchange Act of 1934, and Section 9(b) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order*, Securities Act Release No. 9434, Exchange Act Release No. 70056, Investment Company Act Release No. 30632 (July 29, 2013), available at **https://www.sec.gov/litigation/admin/2013/33-9434.pdf**.

[18] *In the Matter of Beaumont Financing Authority, Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order*, Securities Act Release No. 10406 (Aug. 23, 2017), available at **https://www.sec.gov/litigation/admin/2017/33-10406.pdf**.

[19] *In the Matter of Lawson Financial Corporation and Robert Lawson, Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Section 8A of the Securities Act of 1933, Sections 15(b), 15B(c) and 21C of the Securities Exchange Act of 1934, and Section 9(b) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order*, Securities Act Release No. 10334, Exchange Act Release No. 80376, Investment Company Act Release No. 32591 (Apr. 5, 2017), available at **https://www.sec.gov/litigation/admin/2017/33-10334.pdf**.

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