

## Municipalities in the SEC's Crosshairs: Disclosure Responsibilities and Best Practices in an Era of Heightened Scrutiny



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### Public Statements by City Officials

- Generally, no requirement to speak.
- When a municipality elects to “speak to the market,” it must be accurate and complete.
- Examples of public statements:
  - Preliminary official statements and official statements;
  - Continuing disclosure filings;
  - CAFRs;
  - Press releases and public statements by officials, such as State of the City addresses.

## Indirect Regulation by the SEC

- Municipal issuers are subject to the SEC's antifraud rules even though they do not have to register securities and are exempt from the SEC's periodic reporting requirements.
- "When a municipal issuer releases information to the public that is reasonably expected to reach investors and the trading markets, such disclosure is subject to the antifraud provisions." (SEC 2012 Report on Municipal Issuers)
- "The fact that [statements] are not published for purposes of informing the securities markets does not alter the mandate that they not violate antifraud proscriptions." (March 1994 Statement of the Commission Regarding Disclosure Obligations of Municipal Securities and Others)

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## Securities Violations Under Rule 10b-5

- **Rule 10b-5:** It shall be unlawful for any person . . . 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, in connection with the purchase or sale of any security.
- Intentional or reckless act is required.
- Under **Section 17(a)** of the Securities Act, the SEC can charge securities fraud under a negligence standard ("knew or should have known").

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## The Question of Materiality

- The materiality standard remains opaque, but it is clear that the SEC staff's bar for materiality is very low.
- Materiality is defined as:
  - a substantial likelihood that a reasonable bond investor would consider it important in making an investment decision; or
  - viewed by a reasonable investor as having significantly altered the "total mix" of available information.
- In practice, SEC staff takes a subjective, hindsight view of materiality.



## Reliance on Professional Services

- Issuers and principals are ultimately accountable for the accuracy of statements of fact about the issuer and cannot delegate this responsibility.
- In the event of a misstatement, reliance on advice of professionals will only serve as a defense under limited circumstances.
- *Presence of counsel* does not equate to *advice of counsel* (a defense requiring a privilege waiver): SEC generally requires a direct request for advice on a particular disclosure topic.

## SEC Enforcement Actions

- Municipalities Securities and Public Pensions Unit
- SEC expects nearly strict liability for compliance. Recent cases have sought:
  - Financial penalties;
  - Individual accountability (control person liability);
  - Parallel criminal charges;
  - Admission of wrongdoing;
  - Public statements outside of offering materials or continuing disclosures.

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## SEC Investigations – An Inside Look

- An investigation is NOT a litigation;
- Broad document subpoenas;
- Team of lawyers and accountants with no automatic protections offered by a court;
- No designated timeline or budget;
- Personal subpoenas issued to officials and staff;
- Cooperation and credibility are paramount.

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## SEC Settlements and the Wells Process

- Terms of settlement may take numerous forms:
  - Generally “neither admit nor deny” but may require an admission;
  - Cease and Desist Order;
  - Financial penalty and/or disgorgement;
  - Industry bar for individuals;
  - Compliance undertakings (including consultants and monitors);
  - Cooperation against others under investigation;
  - Future disclosure obligations.

