

Chapman Client Alert

September 27, 2021

Current Issues Relevant to Our Clients

SEC Charges School District and Former CFO with Materially Misleading Investors

On September 16, 2021, the Securities and Exchange Commission (SEC) charged Sweetwater Union High School District, a San Diego County, California, school district serving approximately 47,000 students (the “*District*”), and its former Chief Financial Officer, Karen Michel, with making material misstatements and omissions in connection with the District’s April 2018 \$28 million bond issue (the “*Bonds*”). By making such material misstatements and omissions to investors, as well as to the Bonds’ credit rating agency and other municipal industry professionals involved with the Bond transaction, the SEC alleged that the District violated Sections 17(a)(2) and 17(a)(3) of the Securities Act of 1933 (the “*Act*”) and that Michel violated Section 17(a)(3) of the Act.¹

Summary of Allegations

The alleged material misstatements and omissions related to the District’s fiscal year 2018 budget projections. According to the SEC, the District’s fiscal year 2018 budget, which was included in materials provided to investors, the rating agency and others involved in the Bond transaction, failed to accurately account for an approved 3.75% salary increase for its employees and instead anticipated a less than 1% increase in salaries based on year-end estimates for the prior fiscal year. The adopted fiscal year 2018 budget further projected that the District would end the year with an operating surplus and a positive general fund balance of over \$22.2 million. The District actually ended fiscal year 2018 with a negative general fund balance of \$7.2 million based on total deficit spending of approximately \$28.7 million. The SEC further alleged that although mid-year budget monitoring reports showed that the District’s actual expenses were trending significantly higher than its budgeted projections, the District made no effort to bring its budget into line with actual expenses and continued to use misleading budget projections.

According to the SEC, Michel provided the misleading budget projections to the professionals facilitating the Bond offering, including the underwriter and its counsel, bond counsel, disclosure counsel and the District’s municipal advisor, and also attested to their accuracy notwithstanding the mid-year budget monitoring reports described above. The SEC further

alleged that the projected \$19.5 million year-end general fund balance for fiscal year 2018 disclosed in both the preliminary official statement and the final official statement for the Bonds was based on the misleading budget projections and omitted the fact that such projections varied significantly from known actual expenses and internal reports.

Settlement Terms

Without admitting or denying the allegations in the complaint, the District agreed to settle with the SEC and consented to the entry of an SEC order finding that it violated Sections 17(a)(2) and 17(a)(3) of the Act and agreed to engage an independent consultant to evaluate its policies and procedures related to its municipal securities disclosures.

Michel agreed to settle with the SEC, without admitting or denying the allegations in the complaint, and consented to the entry of an SEC order enjoining her from participating in any future municipal securities offerings. Michel also agreed to pay a \$28,000 penalty.

Conclusion

Issuers and their finance officials should understand that material misstatements or omissions within financial documents, including those containing future projections, carry

¹ Section 17(a)(2) of the Act makes it unlawful “in the offer or sale of any securities ... directly or indirectly ... to obtain money or property by means of any untrue statement of 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.” Section 17(a)(3) of the Act makes it unlawful “in the offer or sale of any securities ... directly or indirectly ... to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.” 15 U.S.C. §77q(a).

potential securities law antifraud liability when made available to the public, whether in connection with a primary offering of municipal securities or disclosures made pursuant to continuing disclosure agreements. In response to the recent activity of the SEC and the U.S. Department of Justice and related civil and criminal penalties imposed for securities law violations, issuers and their finance officials should evaluate their current policies and procedures for primary and secondary market disclosures related to municipal securities.

For More Information

If you would like further information concerning the matters discussed in this article, please contact a member of our Public Finance Group or visit us online at chapman.com.

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