

# Client Alert

Current Issues Relevant to Our Clients

July 30, 2013

## SEC Charges School District and its Underwriter for Continuing Disclosure and Due Diligence Failures

On July 29, 2013, in the first case of its kind, the Securities and Exchange Commission (SEC) charged West Clark Community Schools, an Indiana school district, with falsely stating in an official statement that the school district was fully compliant with its duty to provide annual financial reporting and material event notices as required by prior continuing disclosure undertakings. The SEC further charged City Securities Corporation, the school district's underwriter, with failing to conduct sufficient due diligence to determine if the school district's representations were true.

In an official statement prepared in connection with a 2007 bond offering by the school district that was underwritten by the underwriter, the school district stated that it was in full compliance with all of its prior continuing disclosure obligations. An SEC investigation revealed, however, that the school district had not submitted any of the required annual financial reports or material event notices for a 2005 bond offering. Bringing charges under numerous federal securities laws,<sup>1</sup> the SEC charged the school district with falsely claiming in the 2007 official statement that it was fully compliant with its continuing disclosure obligations and the underwriter with disseminating a materially false official statement and failing to conduct sufficient due diligence. In the SEC's view, the school district's non-compliance with its continuing disclosure obligations constituted "a fact [the underwriter] could have easily verified through a review of public repositories."

Additionally, and apparently unrelated to the school district's misrepresentations, the SEC investigation revealed that the underwriter and its executive vice president had provided improper gifts and gratuities to representatives of several municipal bond issuers—including travel expenses, donations to certain charities, out-of-state golf outings, and tickets to sporting events—in violation of certain rules of the MSRB.<sup>2</sup> Without the issuers' knowledge, the underwriter and its executive vice president billed these expenses back to these issuers as "miscellaneous" items relating to "printing, preparation and distribution of official statements."

Without admitting or denying the allegations, the school district, the underwriter, and the executive vice president entered into settlement agreements with the SEC, which settlements include payment by the underwriter of nearly \$580,000 in fines and disgorgement, a one year collateral bar and permanent supervisory bar of the executive vice president, and remedial actions by the school district.

For additional information, see the SEC Orders [here](#) and [here](#).

### Items to Note

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- The SEC reiterated in its Orders that an underwriter must develop a reasonable basis for belief in the accuracy and completeness of the official statement by conducting its own adequate due diligence, and that "sole reliance on the representations of the issuer will not suffice."
- The SEC further noted that while the underwriter had written procedures for expense reimbursement, the investigation revealed "a long standing and pervasive culture of lax supervision and loose internal controls as it relates to expense reimbursement."
- The SEC emphasized in a related press release that "[t]his case demonstrates that we will be vigilant in making sure municipal issuers and underwriters comply with their obligations."
- This action is the sixth municipal enforcement action by the SEC during 2013.

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<sup>1</sup> Sections 17(a)(2) of the Securities Act, Sections 10(b), 15(c)(2) and 15B(c)(1) of the Exchange Act and Rules 10b-5(b) and 15c12-2 thereunder.

<sup>2</sup> Municipal Securities Rulemaking Board (MSRB) Rules G-17 and G-20.