

SEC Finds Fraud In Information Posted to City's Website

Last week, the Securities and Exchange Commission (SEC) issued a [cease and desist order](#) against the City of Harrisburg, Pennsylvania, charging the City with fraud on the basis of misrepresentations and/or omissions in public statements and financial information available on the City's website during a long period of failure by the City to fully comply with its continuing disclosure obligations. This order marks the first time the SEC has instituted enforcement proceedings against a municipality other than in connection with alleged fraud and negligence in official statements or related disclosure documents prepared for a bond issue. Although the Harrisburg facts are somewhat unique, the SEC's legal analysis contained in both the order and [the report of the investigation](#) that accompanied the order underscore the SEC's decades long admonitions to municipal issuers and municipal officials to provide ongoing timely and accurate information to the secondary market.

The SEC's position, as stated in the order, is that by virtue of the City's prolonged failure to fully comply with its continuing disclosure undertakings by failing to file annual financial information and material event notices on the MSRB's EMMA system, secondary market investors had to seek out other publicly available information about the City at a time of increased interest in the City's financial condition. According to the SEC, from January 2009 to March 2011, the public information available about the City was posted on the City's website and included prior year's Comprehensive Annual Financial Reports (CAFR), the 2009 fiscal year budget, the Harrisburg Mayor's 2009 State of the City address and the 2009 Mid-Year Fiscal Report, all of which the SEC found to contain material misrepresentations or omissions regarding the City's then mounting fiscal difficulties.

While there are limited circumstances in which municipal issuers are required to speak to the market other than in connection with the issuance of its securities, if a municipal issuer chooses to make statements that are "reasonably expected to reach the market" those statements are subject to the antifraud provisions of federal securities laws. The SEC's legal conclusion in the Harrisburg case was that the City's statements and information available on its website could be "reasonably expected to reach the market," regardless of the City's intentions, in large part because the City failed to comply with its continuing disclosure undertakings.

Although the SEC did not proceed against any individuals, the accompanying report specifically addresses public officials' obligations with respect to secondary market disclosures. As stated in the report, "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." The report goes on to strongly suggest that public officials should, at a minimum, consider "adopting policies and procedures that are reasonably designed to result in accurate, timely, and complete public disclosures." For purposes of the report, the SEC defines "public officials" to include elected and appointed officials, as well as employees of state and local government entities and instrumentalities.

The SEC did not impose any monetary penalty against the City or any City official and the City, which consented to the entry of the order, neither admitted nor denied the SEC's findings.

What Can Municipal Issuers Do to Avoid Making the Same Mistakes?

One of the remedial measures instituted by Harrisburg and noted favorably by the SEC, was the development and adoption of formal written policies and procedures by the City with respect to both public statements about the City's financial condition and its future compliance with continuing disclosure undertakings. The disclosure policy instituted by the City is relatively simple and straightforward. Perhaps the two most important features of the policy are the designation of an individual within the City as having primary responsibility for complying with the policy and the requirement for annual training of City employees regarding the policy (although elected officials are not required to receive training). There is no "one size fits all" disclosure policy; however, some important goals in developing a policy may include the following.

1. *Comply with continuing disclosure undertakings.* This might seem obvious but personnel changes or changes in required filing information in more recent continuing disclosure undertakings may have occurred that could result in incomplete filings.
2. *Provide the means to assure that information publicly available to investors is accurate.* Some measures that can be taken in this regard include (a) careful review of any narrative discussion in any annual information filing made on EMMA or in the CAFR for consistency with financial statements, (b) checking of all bond ratings before each EMMA filing and (c) legal review of long-term debt notes in financial statements.
3. *Provide a means to assure consistency in public statements about financial condition.* Consideration should be given to the procedure for developing public statements about the financial condition, which procedure might need to be agreed to by senior executive officers (and elected officials) within the organization.
4. *Provide for monitoring of website content with the SEC order and report in mind.* Among the policy decisions to be considered in this regard may be whether to use the website for investor relations or limit investor information to that posted on EMMA. In either case, appropriate "directions" on the website should be considered to educate the viewer in terms of where information intended for investors can be found.
5. *Provide training for employees AND issuer officials about federal securities responsibilities.* For elected officials, compliance with federal securities laws should be considered as important as compliance with local public meetings and records laws.

If you have any questions regarding your organization's policies and procedures for compliance with federal securities laws relating to disclosure, please contact a member of the Squire Sanders Public Finance Practice Group or the Squire Sanders lawyer with whom you work.