May 8, 2014

New initiative from the SEC encourages municipal issuers and underwriters to self-report material misrepresentations regarding continuing disclosure failings or risk harsher penalties

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What is the MCDC Initiative?

On March 10, 2014, the SEC introduced the Municipalities Continuing Disclosure Cooperative Initiative (the "MCDC Initiative") to encourage issuers and underwriters of municipal securities to self-report material misstatements in final official statements relating to prior compliance by issuers with their continuing disclosure obligations. The MCDC Initiative provides an opportunity for issuers and underwriters to negotiate settlement terms that may be more favorable than those that will be available to issuers and underwriters if a violation is found by the SEC after the expiration of the MCDC Initiative on September 10, 2014. You can read the SEC's press release for the MCDC Initiative here:
http://www.sec.gov/divisions/enforce/municipalities-continuing-disclosure-cooperation-initiative.shtml.

Here are the highlights of the MCDC Initiative:

- The MCDC Initiative addresses instances in which issuers made materially inaccurate statements in final official statements for bond sales completed in the last five years regarding their having substantially complied with prior continuing disclosure obligations. In order to determine if they have been in compliance with their continuing disclosure obligations, issuers should review the continuing disclosure agreement that was signed at the closing of each bond transaction. Under the SEC's rules:
  - The MCDC Initiative does not address failures to comply with continuing disclosure undertakings and only applies when issuers misstated their compliance in offering documents when they sold new bonds.
  - Underwriters for these bond offerings may also have violated the antifraud provisions of the securities laws to the extent they failed to exercise adequate due diligence in determining whether issuers have complied with such obligations and, as a result, failed to form a reasonable basis for believing the truthfulness of a key representation in the issuer's official statement.
- For eligible issuers and underwriters, the SEC's Enforcement Division will recommend that the Commission accept a settlement pursuant to which the issuer or underwriter consents to the

institution of a cease and desist proceeding for a negligent violation of the federal antifraud laws. The SEC Enforcement Division will also recommend a settlement in which the issuer or underwriter neither admits nor denies the findings of the SEC.

- For eligible issuers, the settlement to be recommended by the SEC's Enforcement Division must contain certain undertakings by the issuers, including establishing appropriate policies, procedures and training regarding continuing disclosure obligations and cooperating with any subsequent SEC investigation. For eligible issuers, the SEC's Enforcement Division will recommend that there is no monetary fine for the issuer.

- For eligible underwriters, the settlement to be recommended by the SEC's Enforcement Division must contain certain undertakings by the underwriters, including retaining an independent consultant to conduct a review of the underwriter's due diligence process and procedures and cooperating with any subsequent investigation by the SEC. For eligible underwriters, the Division will recommend a civil penalty ranging from $20,000 to $60,000 per offering, depending on the size of the offering, with a cumulative cap of $500,000.

- Importantly, issuers and underwriters run the risk of incurring substantially larger fines, penalties and litigation if they do not self-report under the MCDC Initiative.

- An individual can be just as liable as the issuer or underwriter who employs such individual if their actions violate the federal securities laws. While the MCDC Initiative will protect the entities who self-report, it does not protect individuals associated with issuers and underwriters.

- The MCDC Initiative expires midnight (Eastern Time) on September 10, 2014. Issuers and underwriters who do not participate in the MCDC Initiative will risk the imposition of harsher penalties if any violations are found by the SEC.

What have we learned about the MCDC Initiative?

It has been close to two months since the SEC announced the MCDC Initiative, and attorneys from the SEC's Enforcement Division have provided the following informal clarifications:

- *Substantial Increased Enforcement.* The SEC staff have made clear in every discussion of the MCDC Initiative that, at the close of the MCDC Initiative, the SEC will, as one SEC attorney stated, come down like a "ton of bricks" on issuers and underwriters who failed to self-report violations of the federal antifraud laws. That includes the imposition of civil penalties in actions against issuers if the facts warrant such penalties.

- *Statute of Limitations.* The SEC's Enforcement Division has stated that the statute of limitations for these violations is generally five years and that issuers and underwriters should be reviewing statements concerning continuing disclosure compliance for offerings completed in the last five years. As the obligation to disclose continuing disclosure failings in a final official statement extends back five years, this means issuers and underwriters may need to research continuing disclosure compliance back ten years.

- *Materiality.* The SEC will not provide any additional guidance regarding the types of failures to comply with a continuing disclosure undertaking that constitute material noncompliance or when such past failures to comply with a continuing disclosure undertaking render materially untrue a statement in an offering document to the effect that an issuer or obligated person has materially complied with its past continuing disclosure undertakings. Issuers and underwriters will need to consult with counsel and make their own determinations concerning what constitutes materiality in this context.

- *Individual liability.* The SEC has clarified that their intent behind carving individuals out of the MCDC Initiative is to reserve the ability to charge individuals who have acted intentionally or deliberately in any violations of the federal antifraud laws.

What steps should an issuer take with respect to the MCDC Initiative?

- Issuers who have done a bond offering in the last five years and during the five years prior to the offering that was subject to a continuing disclosure undertaking, should analyze the following questions:
    - In the five years before the offering, were there any failures to comply with any continuing disclosure undertaking?
    - If so, what was disclosed, if anything, about these failures in the offering documents during the next succeeeding five years?

- For issuers that are uncertain regarding whether there may have been undisclosed failures to comply with a continuing disclosure undertaking, contact your general counsel, city attorney or county counsel for your issuing entity or any other counsel experienced in securities law. A decision to self-report or not self-report under the MCDC Initiative is an important decision and carries with it potentially significant legal consquences. You should make any such decision with the advice of appropriate and experienced counsel.

- Issuers should communicate with any underwriter of bonds issued in the last five years. If an underwriter is going to self-report for one or more of your offerings, the issuer will need to know, as that may factor into the decision whether to self-report. If an issuer is going to self-report, the underwriter will need to know, too.

- Issuers and underwriters, along with their counsel, should carefully consider how to complete the self-reporting forms. There may be areas on the form that require general answers rather than reference to specific events.

If you have any questions about the MCDC Initiative or this alert, please contact your Nixon Peabody attorney or:

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