



# **Chula Vista Bayfront Bond Financing Presentation**

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## **Disclosure Responsibilities Under the Federal Securities Laws**

**Presented by:**

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# Why Is Disclosure Necessary?

- The Chula Vista Bayfront Facilities Financing Authority plans to issue bonds (the “Bonds”) in the public capital markets
- The disclosure document for the Bonds will contain information regarding the finances and operations of the Authority, the City of Chula Vista, the San Diego Unified Port District, the Bayfront Project Special Tax Financing District and RIDA Chula Vista, LLC (“RIDA”)
- Investors in municipal securities have rights under federal securities laws
- All “material” information must be disclosed

# The Securities Act Of 1933

- 1933 Act has two substantive rules:
  - Registration requirement
  - Antifraud rule
- Municipal securities are exempt from the registration requirement, but are subject to the antifraud rule
- Section 17(a)(2) prohibits any person from, directly or indirectly, obtaining money or property by means of any untrue statement of a material fact or by a misleading omission.

# Securities Exchange Act Of 1934

## Rule 10b-5

- Also contains antifraud provisions
- 1975 amendments to 1934 Act made it clear that antifraud provisions apply to government issuers

# Rule 10b5

“It shall be unlawful for any person . . .

- a) To employ any device, scheme or artifice to defraud,
- b) 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 . . . .”

# The “Materiality” Standard

- “[w]hether or not there is a substantial likelihood that a reasonable investor or prospective investor would consider the information important in deciding whether or not to invest.”
- Materiality is determined in context of all the facts and circumstances, typically being judged in hindsight
- Guidance comes primarily from court decisions and SEC enforcement cases
- SEC has declined to provide advance guidance on materiality

# Levels Of Culpability

- Negligence – Failed to meet Prudent Person Test
- Recklessness – Ignored “red flags”
- Intent to defraud – Scierter

# When Do Disclosure Rules Apply?

- New primary offerings
- Continuing Disclosure Reporting--Annual Report and filings for listed event notices and voluntary filings
- Any other circumstance where an issuer is “speaking to the market.” (See next slide).
- At this time, securities law does not impose a requirement to update or correct any statement previously made, if there is no other reason to be making a statement to the market



# Recent SEC Staff Legal Bulletin

- All statements of a municipal issuer reasonably expected to reach investors are subject to antifraud provisions
- Fact that the information was not published for the purpose of informing the markets is not relevant
- Types of statements which are subject to anti-fraud rules:
  - Websites
  - Public Reports Delivered to Governmental and Institutional Bodies
  - Public statements made by municipal issuer officials
  - Social media

# Primary Offerings

- A sale of bonds to the public
- Official Statement is offering document to investors – equivalent to prospectus
- Must contain all material information for the particular bond sale
- Official Statement is the Authority's document
  - Port District and City are responsible for their information including Appendices
- Underwriters, municipal advisors and lawyers can help develop the Official Statement but the Authority, City, Port District and RIDA and are ultimately responsible for content

# Annual Reports

- The Authority, the City, the Port District and the Financing District will be required to provide Annual Reports as long as bonds are outstanding
- Includes Audited Financial Statements
- Includes Financial Information identified in the respective Continuing Disclosure Certificate (i.e. updates to specific information in the Official Statement)
- Consider Rule 10b5 implications – is there more you should be saying?
- When filing Annual Report ask if anything happened since the date of the audited financial reports that has materially impacted the Authority's, the City's, the Port District's or the Financing District's financial condition?

# Disclosure Process

- Important to review any disclosure procedures at outset
- Assign appropriate staff to oversee and coordinate process
- Seek input from all key officials with relevant information
- Disclosure Counsel helps pull information together and produces a draft Preliminary Official Statement (“POS”)
- Draft POS reviewed by working group and revised prior to submission to the Authority Board, Board of Port Commissioners and City Council
- Important to maintain attorney-client privilege for sensitive issues

# Disclosure Process (cont.)

- Board Members, City Council Members and Port Commissioners
  - SEC has stated that Board members and elected officials have a duty to review the POS prior to release
  - Review key sections of POS related to the Authority, the City, the Financing District, the Port District and the Project
  - Notify appropriate staff of any questions, concerns, or need for changes to make POS accurate prior to release
- “Due diligence” meeting/call with staff, underwriter, Disclosure Counsel and Municipal Advisors before release of POS
- Appropriate officials of the Authority, Port District, City and RIDA deem POS final as of its date before release to investors

# Timing Considerations For Bond Sale

- Progression of a bond offering
  - POS
  - Bond Sale
  - Final OS
  - Closing
- Be mindful of timing of public actions or releases
  - State and local budgets, audited financial statements
  - Assessed valuation and delinquency data
  - Events related to pending litigation
  - Events related to the Bayfront Project, RIDA, the Hotel Operator, etc.

# What Should Be Disclosed?

- Unlike corporate securities, there is no “line item” set of rules for what goes into an Official Statement
- Starting in 1975, leaders in municipal market created a set of Guidelines for Official Statement content
- Other groups have suggested disclosure for particular market segments
- Look at practices in the industry; recent SEC enforcement actions
- In the end, issuer must use its own good judgment

# Disclosure Considerations

- Disclosure must reflect specific circumstances of the financing
- Disclosure must use current information whenever possible
- Read the disclosure with “fresh eyes”
- If you think something may be a concern, raise the issue with colleagues and the working group
- There are no “stupid questions”
- Political sensitivity and business and confidentiality considerations are not exceptions to disclosure



# Disclosure Topics for the Bayfront Project

- Description of the Bayfront Project and Financing Plan
- Description of RIDA's debt and equity financing
- Construction risks related to the Bayfront Project
- Description of revenues committed to pay the bonds
- Consultants' revenue projections and assumptions
- Limited nature of revenues available to pay debt service
- Bonds may be unrated
- Possible impact of next economic downturn; impacts of COVID-19 Pandemic
- Risks related to Hospitality Industry
- Past continuing disclosure compliance of Port and City
- Litigation and investigations; challenges to the project
- 17 • Validation action

# Topics of Recent SEC Enforcement Actions

- Misleading or Incomplete Financial Disclosures
- Failed Economic Development Projects
- Inadequate Pension Disclosures
- Failure to disclose missed Continuing Disclosure Filings

# SEC Enforcement

- SEC enforcement actions are the primary vehicle to ensure compliance
- SEC has power to bring civil actions or refer to Justice Department for criminal action
- SEC has brought actions against municipal issuers, including individual officers, as well as other participants in the market, such as underwriters, lawyers, advisers, etc.
- SEC brings actions even when there was no default, no rating downgrade, or any evident market impact on the bonds

# Consequences of Bad Disclosure

- SEC Investigation – fees for lawyers and consultants
- Adverse publicity
- Potential for reduced market access
- May have to impose new procedures and oversight to settle SEC actions
- Monetary fines imposed on the issuer
- Individual fines imposed on public officials, including individuals who did not participate in the financing
- Criminal charges against issuer officials

# What Can Go Wrong?

- Orange County – (Board approved Official Statement without review.)

- Board that authorizes securities is responsible for disclosure
- Reliance on professionals must be reasonable

“A public official who approves the issuance of securities and related disclosure documents may not authorize disclosure that the public official knows to be materially false or misleading; nor may the public official authorize disclosure while recklessly disregarding facts that indicate that there is a risk that the disclosure may be misleading. When, for example, a public official has knowledge of facts bringing into question the issuer’s ability to repay the securities, it is reckless for that official to approve disclosure to investors without taking steps appropriate under the circumstances to prevent the dissemination of materially false or misleading information regarding those facts.”

# What Can Go Wrong? (cont)

- San Diego (Inaccurate disclosure on pension and retiree healthcare liability and errors in financial statements.)

- City commissions a review of its disclosure practices
- Conclusions from review:

“the City’s procedures, policies and practices for disclosure and financial reporting are inadequate in major respects. Undermining the reliability of its public disclosure have been, among other factors, the (1) the City’s excessive reliance on outside professionals to generate its disclosure documents, (2) its lack of procedures to verify the accuracy of those documents and (3) the absence of high-level oversight to judge the clarity and completeness of information provided to the investment markets.”

# What Can Go Wrong? (cont)

- State of New Jersey (State fails to disclose material information on two pension plans and specifically underfunding.)
  - Failure left investors unable to evaluate State's financial condition
  - State Treasurer did not read Official Statement
  - State Treasurer had no written policies or procedures relating to review or update
  - State Treasurer did not provide training concerning disclosure obligations

# What Can Go Wrong? (cont)

- State of New Jersey(cont.)

“Treasury had **no written policies or procedures** relating to the review or update of the bond offering documents. In addition, Treasury **did not provide training** to its employees concerning the State’s disclosure obligations under the accounting standards or the federal securities laws. Accordingly, the State’s procedures were inadequate for ensuring that material information concerning [the pension plans] or the State’s financing of [the pension plans] was disclosed and accurate in bond offering documents.”



# What Can Go Wrong? (cont)

- West Clark Community Schools District (Indiana) – (fraudulent misstatement in a 2007 Official Statement that it was in compliance with its disclosure obligations related to prior bond offerings.)
- The district had not submitted any of the required annual reports or notices for a previous 2005 bond offering, and the underwriter did not conduct adequate due diligence with respect to continuing disclosure compliance.

# What Can Go Wrong? (cont)

- Port Authority of New York and New Jersey – SEC alleged that Port Authority official statements failed to disclose the risk that certain proposed uses of bond proceeds to fund highway and bridge improvements in New Jersey were not authorized by its statutes and bond resolution. Issuer settled, conceding correctness of SEC's statements of fact (first case where issuer was not allowed to neither admit or deny the allegations), agreed to outside monitor of disclosure procedures, and paid \$400,000 fine.

# What Can Go Wrong? (cont)

- State of Illinois – (**Omission of** material information relating to the **unfunded liabilities of its pension system.**)
- City of South Miami (Florida) – (**Material misstatements related to the City's compliance with various tax requirements** for the bonds.)

# What Can Go Wrong? (cont)

- City of Allen Park (Michigan) – The SEC found that City bond offering documents related to an economic development project **used outdated information with respect to the project** and **used outdated City budget information**
- Allen Park - Settlement with the City:
  - The City agreed to cease and desist from future securities law violations and the City agreed **to adopt written policies and procedures**, to disclose the cease and desist order in any offering in the next two years and to **undertake disclosure training**.

# What Can Go Wrong? (cont)

Allen Park - Settlement with the City Administrator and Mayor:

- The City Administrator entered into settlement agreement, which included an order not to violate the federal securities laws in the future and **not to participate in an offering of municipal securities in the future**, but no payment of a fine.
- The Mayor entered into a settlement agreement, which included an order not to violate the federal securities laws in the future, not to participate in an offering of municipal securities and **payment of a \$10,000 fine.**

# What Can Go Wrong? (cont)

- Westlands Water District – The SEC found that the Water District bond official statement contained **misleading debt service coverage ratio** information due to **failure to disclose (1) extraordinary accounting transactions and (2) a later adjustment to prior year expenses.**
- Westlands Water District – Settlement:
  - SEC's cease and desist order found violation of Section 17(a)(2) of the Securities Act.
  - District ordered to **pay \$125,000.**
  - General Manager ordered to **pay \$50,000 from personal funds.**
  - Assistant General Manager ordered to **pay \$20,000 from personal funds.**

# What Can Go Wrong? (cont)

- Sweetwater Union High School District – SEC alleged that misleading budget information was included in an Official Statement contradicted by known actual amounts.
- Sweetwater Union High School District – Settlement:
  - Chief Financial Officer agreed to pay \$28,000 penalty and to be enjoined from participating in future municipal securities offerings.
  - District consented to an SEC order finding violations of the 17(a)(2) and 17(a)(3) of the Securities Act and to engage an independent consultant to evaluate disclosure policies and procedures.

# Summary of Recommended Actions

- Schedule periodic disclosure training
- Review policies and procedures from time to time
- Make sure that responsible officials are familiar with disclosure
- Review the entire POS prior to release
- Seek information and ask questions of the officials, employees and professionals who supplied information to be included in the POS
- Ask follow up questions to determine the reasonableness of any assumptions or estimates that were used in the POS