# Federal Securities Law: Staff Legal Bulletin No. 21 (OMS)

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On February 7, 2020, the Securities and Exchange Commission released *Application of Antifraud Provisions to Public Statements of Issuers and Obligated Persons of Municipal Securities in the Secondary Market: Staff Legal Bulletin No. 21 (OMS)*.[1] The Office of Municipal Securities prepared SLB 21 at the direction of Chairman Clayton, given July 29, 2019 during his remarks to the SEC Fixed Income Market Structure Advisory Committee.[2] This is the first Staff Legal Bulletin issued by OMS. Prior SLBs have been issued by the Division of Corporation Finance, Investment Management, or Market Regulation, and occasionally, jointly by two or more divisions.

## Background

Since SLB 21 is a first for OMS, some background may be useful.

The SEC's website states:

> Staff Legal Bulletins summarize the Commission staff's views regarding various aspects of the federal securities laws and SEC regulations. They represent interpretations and policies followed by the Divisions of Corporation Finance, Market Regulation, or Investment Management on any given matter. Because they represent the views of the staff, staff legal bulletins are not legally binding.[3]

SLB 21 is more direct, stating under the caption "Supplementary Information:"

> The statements in this legal bulletin represent the views of the Office. This legal bulletin is not a rule, regulation or statement of the Securities and Exchange Commission (the "Commission"). Further, the Commission has neither approved nor disapproved its content. This bulletin, like all staff guidance, has no legal force or effect: it does not alter or amend applicable law, and it creates no new or additional obligations for any person."[4]

In contrast to staff legal bulletins, which reflect "the views of the Office" or division, the SEC website describes a Commission "Interpretive Release" as follows:

> The Commission occasionally provides guidance on topics of general interest to the business and investment communities by issuing "interpretive" releases, in which we publish our views and interpret the federal securities laws and SEC regulations.[5]

Keep this in mind. Although SLB 21 does not itself speak for the Commission, it cites four Interpretive Releases, that is, statements by the Commission.[6]

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[1] Application of Antifraud Provisions to Public Statements of Issuers and Obligated Persons of Municipal Securities in the Secondary Market: Staff Legal Bulletin No. 21 (OMS), *available at*: https://www.sec.gov/municipal/application-antifraud-provisions-staff-legal-bulletin-21.

[2] Chairman Jay Clayton, Remarks to the SEC Fixed Income Market Structure Advisory Committee, July 29, 2019, available at: https://www.sec.gov/news/public-statement/clayton-remarks-fimsac-072919; see Federal Securities Law: Recent SEC Regulatory and Enforcement Matters, *The Bond Lawyer*, Vol. 43, No. 3, p. 10 (Summer 2019).

[3] https://www.sec.gov/interps/legal.shtml.

[4] See n. 1 *supra*.

[5] https://www.sec.gov/rules/interp.shtml

## Subjects Addressed

SLB 21 explains its purpose at the outset:

> Market participants have raised questions about the application of the antifraud provisions to statements of municipal issuers, including annual and continuing disclosures accessible on the Electronic Municipal Market Access ("EMMA") system of the Municipal Securities Rulemaking Board ("MSRB"), as well as other statements of municipal issuers.
>
> The Office is issuing this bulletin to outline previous Commission statements relevant to understanding the application of the antifraud provisions to any statement of a municipal issuer that is reasonably expected to reach investors and the trading markets and, thereby, promote more informed disclosure practices by municipal issuers in the secondary market; facilitate investor access to accurate, timely, and comprehensive information; and improve investor protection. Specifically, this bulletin presents the Office's views on:
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> - certain elements of Section 10(b) of the Exchange Act and Rule 10b-5;
> - the scope of coverage under the antifraud provisions with respect to statements made by municipal issuers in the secondary market; and
> - the role of policies and procedures in providing accurate, timely, and comprehensive information to investors and the trading markets.

As an "outline" of previous Commission statements, SLB 21 presents no surprises. SLB 21 cites the 1994 Interpretive Release[7] throughout. The 1994 Interpretive Release and its pronouncement regarding public statements of issuers are central to any discussion of antifraud liability in municipal bond secondary market disclosure. The 1994 Interpretive Release states that:

> A municipal issuer may not be subject to the mandated continuous reporting requirements of the Exchange Act, but when it releases Information to the public that is reasonably expected to reach investors and the trading markets, those disclosures are subject to the antifraud provisions. The fact that they are not published for purposes of informing the securities markets does not alter the mandate that they not violate antifraud proscriptions.[8]

Chronology provides context. The 1994 Interpretive Release followed the 1988 proposing and 1989 adopting releases implementing Exchange Act Rule 15c2-12[9] and the accompanying interpretation of municipal underwriter responsibilities, and it preceded subsequent SEC rulemaking relating to municipal disclosures. In

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[6] Exchange Act Release No. 20560 (Jan. 13, 1984), 49 FR 2468, 2469 (Jan. 20, 1984), Public Statements by Corporate Representatives (the "1984 Release"); Exchange Act Release No. 33741 (Mar. 9, 1994), 59 FR 12748 (Mar. 17, 1994), Statement of the Commission Regarding Disclosure Obligations of Municipal Securities Issuers and Others (the "1994 Interpretive Release") *available at* https://www.sec.gov/rules/interp/1994/33-7049.pdf; Exchange Act Release No. 42728 (April 28, 2000) 65 FR 25843, Use of Electronic Media (May 4, 2000), *available at* https://www.sec.gov/rules/interp/interparchive/interparch2000.shtml; and Exchange Act Release No. 58288 (Aug. 1, 2008), 73 FR 45862 (Aug. 7, 2008), Commission Guidance on the Use of Company Web Sites, *available at* https://www.sec.gov/rules/interp/2007/34-58288fr.pdf.

[7] 1994 Interpretive Release *supra* n. 6.

[8] Id. at 12756 citing the 1984 Release and *In re Ames Dept. Stores Inc. Stock Litigation*, 991 F.2d 953, 965-967 (2d Cir. (1993) (with respect to corporate information).

[9] Exchange Act Release No. 26100, 53 FR 37778, Municipal Securities Disclosure (Sept. 22, 1988) ("Proposing Release"); Exchange Act Release No. 26985 (June 28, 1989), 54 FR 28799, Municipal Securities Disclosure (July 10, 1989) ("Adopting Release").

March 1994, the Commission proposed a continuing disclosure regime under Exchange Act Rule 15c2-12 that was in form quite different from its final form effective July 5, 1995. Paper-based NRMSIRs[10] created under Rule 15c2-12 were not replaced by EMMA until July 1, 2009. When the 1994 Interpretive Release was issued, the internet, essential to EMMA, had yet to attain commercial use; issuer websites did not exist; and the Office of Municipal Securities would not be created until the following year, 1995.

Much has happened since, both in Commission guidance and the environment that SLB 21 addresses. In discussing the elements of Exchange Act Section 10(b) and Rule 10b-5 and giving examples of statements covered by the statute and rule, SLB 21 reflects Commission guidance in two interpretive releases--Use of Electronic Media[11] and Commission Guidance on the Use of Company Web Sites[12]--as well as the Commission's statements regarding "the obligations of public officials relating to their secondary market disclosures for municipal securities" in a report under Exchange Act section 21(a) regarding the City of Harrisburg, Pennsylvania.[13]

SLB 21 closes with the staff's view that policies and procedures can be effective tools to manage potential liability under the broad reach of the antifraud provisions, as can use of website management tools to identify locations providing disclosure documents to investors.[14]

As a summary of outstanding Commission interpretations, SLB 21 provides little that is new. However, two statements deserve attention. The first, and the more benign, is the staff's description of the 1994 Interpretive Release as "*principles-based* guidance to assist municipal issuers, and others, in meeting their obligations under the federal securities laws, including under the antifraud provisions (*emphasis added*)." The second is the staff's view provided under "Examples of Statements Covered by the Antifraud Provisions – C. Public Reports Delivered to other Governmental or Institutional Bodies."

## Principles-Based Guidance

SLB 21, as noted above, describes the 1994 Interpretive Release as "*principles-based* guidance":

> Specifically, the Commission stated that when a municipal issuer releases information to the public that is reasonably expected to reach investors and the trading markets, those disclosures are subject to the antifraud provisions because such statements are a principal source of significant, current information about the municipal issuer. [cit. om.] The Commission's *principles-based* approach to the application of the antifraud provisions applies to all statements of municipal issuers that are reasonably expected to reach investors and the trading markets notwithstanding changes in municipal issuer disclosure practices, technology, investor expectations, and regulatory framework (*emphasis added*).

We are now to understand, at least in the view of OMS staff, that the Commission takes a "*principles-based* approach to the application of the antifraud provisions to … all statements of municipal issuers that are reasonably expected to reach investors and the trading markets…" *This is new*.

What does "principles-based" mean? SLB 21 does not tell us. Is the Commission's approach towards municipal issuers different than its approach toward corporate issuers and registrants when it judges their public

[10] Nationally Recognized Municipal Securities Information Repositories.
[11] Use of Electronic Media, n. 6 *supra*.
[12] Company Web Sites, n. 6 *supra*.
[13] Exchange Act Release No. 69516 (May 6, 2013), *Report of Investigation in the Matter of the City of Harrisburg, Pennsylvania Concerning the Potential Liability of Public Officials with Regard to Disclosure Obligations in the Secondary Market.*
[14] For discussion of the evolution of disclosure policies and procedures and application to municipal issuers, see Maco, Federal Securities Law: What Does the SEC Have in Mind? Putting Disclosure Policies and Procedures in Context, *The Bond Lawyer*, Vol. 43, No. 1, p. 8 (Winter 2019).

statements under the antifraud provisions? If so, in what way? Is the Division of Enforcement instructed to apply the antifraud provisions in a principles-based approach to municipal issuers when it prepares action memoranda to the Commission recommending enforcement? Is this approach different than the approach taken by the courts in applying the antifraud provisions to municipal issuers? Or is it, pardon the phrase, nothing more than regulatory cool kids speak and, if so, why is it there and what is it attempting to say?

The phrase "principles-based" is nowhere to be found in the 1994 Interpretive Release. A search for the phrase in the Exchange Act yields no result. Nor to my knowledge does it have meaning under the Administrative Procedure Act. The phrase is used once in the Commission's 2012 *Report on the Municipal Securities Market,* on page 135, in describing the Commission's proposed legislative approach to "provide the Commission authority to establish improved disclosures and practices in the municipal securities market"[15]: "The legislative proposal does not envision detailed line item disclosure requirements such as those applicable to corporate issuers under Regulation S-K. Rather it is intended as a more principles-based approach."[16] However, the *Report* provides no explanation.

The phrase "principles-based" is often contrasted with "rules-based" in academic contexts and international financial regulatory groups such as IOSCO,[17] with U.S. securities regulation serving as the paradigm for "rules based," U.K. financial markets regulation as the paradigm for "principles based," and the respective New York and London markets regulated under each providing contrasting approaches to other nations as they choose a model for regulating their own markets.

Former Chair Harvey Pitt used the phrase in testimony before the House Committee on Financial Services in March 2002 regarding H.R. 3763, the Corporate and Auditing Accountability, Responsibility, and Transparency Act of 2002,[18] the House version of what ultimately became the Sarbanes-Oxley Act:[19]

> Present-day accounting standards are cumbersome and offer far too detailed prescriptive requirements for companies and their accountants to follow. That approach encourages accountants to "check the boxes" -- to ascertain whether there is technical compliance with applicable accounting principles. *We seek to move toward a principles-based set of accounting standards, where mere compliance with technical prescriptions is neither sufficient nor the objective (emphasis added).*[20]

Five years later, former Commissioner Roel Campos shared these thoughts on the principles vs. rules debate:

> First, I think it's pretty clear that the dichotomy between the supposed U.S. rules-based approach and the U.K. principles-based approach is overblown. Certainly, I do not think it is a matter of choosing one over the other. I challenge anyone to name a market that can solely be run by principles, and similarly, to find a market that does not enact its rules based on broad overarching principles.

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[15] *Report on the Municipal Securities Market* (July 31, 2012), p. 134, *available at*: https://www.sec.gov/news/studies/2012/munireport073112.pdf.
[16] Id. p. 135.
[17] See https://www.iosco.org/. A keyword search on the site using "rules based" or "principles based" will provide numerous illustrations of such usage.
[18] Harvey L. Pitt, Chairman, Testimony Concerning The Corporate and Auditing Accountability, Responsibility, and Transparency Act, Before the Committee on Financial Services United States House of Representatives (March 20, 2002), *available at* https://www.sec.gov/news/testimony/032002tshlp.htm.
[19] Pub. L. 107-204 July 30, 2002.
[20] Harvey L. Pitt Testimony Concerning The Corporate and Auditing Accountability, Responsibility, and Transparency Act, Committee on Financial Services, House of Representatives (March 20, 2002), available at: https://www.sec.gov/news/testimony/032002tshlp.htm.

*The United States.* I would also like to dispel the notion that the United States and the SEC are strangers to a principles-based regulatory approach. In fact, the concept of principles-based regulation is not at all new. Broad principles have been set forth in the 1933, 1934 and 1940 Acts as well as in numerous rulemakings. Where possible, we in the U.S. use principles to guide our actions. Then, our system of enforcement and the court system develop these principles into enforceable rules and standards over time.

For example, take our famous anti-fraud provisions: Exchange Act Section 10(b) and Rule 10b-5. I suppose in one sense these are rules -- after all, we do call it Rule 10b-5 -- but in another sense they're principles-based statements. Section 10(b) generally prohibits the use or employ a "manipulative or deceptive device . . . in contravention of" the SEC's rules. And Rule 10b-5 basically says: (1) you can't employ any device, scheme or artifice to defraud; (2) you can't make any untrue statement of a material fact or to omit to state a material fact; and (3) you can't engage in any act or practice that operates as a fraud or deceit upon any person. Together, these two sections are 227 words long. Now, I don't have exact statistics for you, but I would guess that a majority of the SEC's enforcement cases are based primarily on these 227 words. Not bad for an allegedly rules-based regime.

*United Kingdom.* Meanwhile, the FSA has been cited by many as the paradigm of the modern regulator, with its principles-based structure. The FSA pursues four over-arching objectives and has adopted eleven principles for firms doing financial business. Streamlined as this may appear, the reality is somewhat different. In addition to the eleven principles, enforced by FSA via disciplinary actions and fines, the FSA also has an entire book of rules that … is over 8500 pages long. By contrast, I'm pretty sure that the SEC's rules and regulations are nowhere near 8500 pages long. Admittedly, the SEC deals only with securities laws, but still, our rulebook is relatively modest in comparison, especially in relation to those civil code jurisdictions.[21]

…

Having argued that the principles vs. rules dichotomy is somewhat overblown, there are profound differences between the UK and other European markets and the U.S. market. In my opinion, these differences drive the dichotomy between the principles-based and rules-based systems.

*Retail vs. Institutional.* For example, the U.S. has the largest and deepest retail markets in the world, while the U.K. is more dominated by institutional and controlling shareholders. Given this, it seems obvious that there should be different approaches to regulation. In the U.S., we need more specific rules and regulations that apply with clarity so that the less sophisticated individual investors can understand them. By contrast, in the U.K., the large institutions are better able to cope with more general principles.

Let me explore this in a little more detail. In the U.S., the form of regulation that Congress designed is based upon keeping retail investors in the game. Retail investors are generally concerned that they are "dumb money" and worry that investing is a game for the technically competent and those in the know. And so, when large scale fraud occurs -- for example, Enron, WorldCom or Adelphia -- there is a danger that the retail sector will flee and invest elsewhere. This could distort the health of the markets.

Accordingly, the U.S. system depends an intensive and comprehensive enforcement regime, which includes remedies such as civil penalties and disgorgement of ill-gotten gains. In this way our retail markets are reassured that there is a high price to pay for those who commit fraud. Consequently, our

[21] A new regulatory framework for the United Kingdom under the Financial Services Act 2012 came into effect in 2013, abolished the FSA, and put in place a new regulatory structure under the Bank of England, the Prudential Regulatory Authority, and the Financial Conduct Authority.

retail investors generally are confident that they will not be cheated by those who have inside information or those who manipulate markets. However, this regime requires rules to provide notice of what conduct is and is not appropriate. If the U.S. didn't have a large retail sector, then we might be in the position to provide basic principles and do less enforcement. That, however, is not the world we live in.

*Private Litigation.* In addition, the level of private litigation in the U.S. far outstrips that of the U.K. Given this, it's not surprising that there are specific rules and regulations in the U.S. Individuals, companies and regulated entities want to know what's permissible and what's not so they can tailor their conduct accordingly. The rules, in many instances, provide a safe harbor from litigation. In this regard, I should note that market participants often want these rules, to protect them from litigation. The SEC and the FASB don't generally sit around trying to figure out how to impose more rules on the market; rather, we're most often responding to what the market wants.

In any event, these differences are why it's an academic exercise to argue about whether principles-based or rules-based regulations are better. The underlying market realities drive the differences.[22]

Commissioner Campos's comments illuminate the background and policy implications for both rules-based and principles-based regulation, as does his exposition of Rule 10b-5 as a rule that is "principles-based." His statements explaining why retail markets require a combination of a rules-based approach and enforcement would seem to suggest that, in his view, a rules-based approach would be appropriate for the largely retail municipal bond market.

While all this provides insight into the differences between rules-based and principles-based guidance, without more than what SLB 21 provides, it remains unclear as to what it intends to signal by characterizing the 1994 Interpretive Release as "principles-based" guidance. Greater explanation would be helpful, particularly for municipal officials and their lawyers. As courts have reminded the SEC, "word choices have consequences…"[23]

## Public Reports Delivered to other Governmental or Institutional Bodies

While much of SLB 21 summarizes previous Commission statements, under "IV. Examples of Statements Covered by the Antifraud Provisions," the staff presents its own views, applying Commission guidance to examples of public statements made by municipal issuers. Worth noting among these examples is "C. Public Reports Delivered to other Governmental or Institutional Bodies". The text, presented below, has two parts.

The first part of the text summarizes prior Commission statements:

In many cases, municipal issuers prepare and disseminate reports or other documents containing financial information and/or operating data to various governmental or institutional bodies, or to the public. The Commission previously has cited certain of these reports, including Comprehensive Annual Financial Reports, budgets, and mid-year financial reports, as information reasonably expected to reach investors and the trading markets, and therefore subject to the antifraud provisions, even if not filed with EMMA.

[22] Roel C. Campos, Commissioner, Principles v. Rules, Luxembourg Fund Industry Association and the American Chamber of Commerce Luxembourg (June 14, 2007), *available at*: https://www.sec.gov/news/speech/2007/spch061407rcc.htm.

[23] *SEC v. Tambone*, 597 F.3d 436, 443 (1st Cir. 2010), discussing the SEC's choice of the word "make" in drafting Rule 10b-5. "Word choices have consequences, and this word choice virtually leaps off the page. There is no principled way we can treat it as meaningless."

In a footnote to this statement, SLB 21 directs the reader to the *Harrisburg Report*.[24] In the *Harrisburg Report*, the Commission addressed "the obligations of public officials relating to their secondary market disclosures for municipal securities," and, referring to the 1994 Interpretive Release, stated that "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." [25]

What follows in the second part is worth careful review. It is not a summary or restatement of the Commission's prior statements, but rather the staff's view:

> Though the Commission has not specifically identified other types of reports which, once public, would be subject to the antifraud provisions, the staff believes that additional types of reports could be covered by the antifraud provisions depending on the facts and circumstances. [cite to 1994 Interpretive Release] In the staff's view, additional types of reports that could, depending on the facts and circumstances, be included in this category may include (but may not be limited to) reports submitted by a municipality to a state agency, reports made by a state or local official to a legislative body (such as a state legislature or city council), and other reports made part of a public record and available to the public. In the staff's view, depending on the facts and circumstances, such reports could be a source of significant, current information about the municipal issuer and thus could reasonably be expected to reach investors and the trading markets.

In other words, reports to a superior government body, the form and content of which may be dictated by state or local statute or ordinance, may be subject to the antifraud provisions. Yet, the staff's view raises questions. What prompted the staff to make the statement in SLB 21 about "reports submitted by a municipality to a state agency, reports made by a state or local official to a legislative body … and other reports made part of a public record …?" Has a particular problem or practice involving such reports come to the staff's attention and caused concern? SLB 21 does not tell us. In light of this statement, such documents and the other examples included in "IV. Examples of Statements Covered by the Antifraud Provisions" may, in the staff's view, be appropriate candidates for review under issuer disclosure policies and procedures, discussed in the final section of SLB 21.

In considering policies and procedures for reviewing reports submitted to state agencies or state or local legislative bodies, issuers and their advisors might take into account the context behind the 1994 Interpretive Release and the *Harrisburg Report.* In support of its statement regarding application of the antifraud provisions to disclosures "reasonably expected to reach investors and the trading markets" even when "they are not published for the purposes of informing the securities markets," the 1994 Interpretive Release cites *In re Ames Dept. Stores Inc. Stock Litigation,*[26] a decision by the Second Circuit handed down 11 months earlier. In *Ames,* the court reversed the district court's dismissal of a complaint by class action plaintiffs under F.R.C.P. 12(b)(6) for failure to state a claim. In addition to the portions of *Ames* cited by the Commission, the court stated (*emphasis added*):

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[24] *See* n. 13, *supra.* The *Harrisburg Report* is a report issued pursuant to investigative and enforcement powers under Section 21(a) of the Exchange Act.

[25] Id. In the settled administrative proceeding issued simultaneously with the *Harrisburg Report*, the City of Harrisburg, without admitting or denying the findings therein, consented to entry of an Order finding "Harrisburg made material misrepresentations and omissions in its 2007 and 2008 CAFRs, 2009 Budget and Transmittal Letter, 2009 State of the City Address and its Mid-Year Fiscal Report for 2009, regarding Harrisburg's credit ratings and the potential impact of the [Resource Recovery Facility] debt on the City's financial health. As a result of this reckless conduct, Harrisburg violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder." Exchange Act Release No. 69515 (May 6, 2013), *available at*: https://www.sec.gov/litigation/admin/2013/34-69515.pdf.

[26] N. 8, *supra*.

> We have already indicated that, in ruling against the common stockholders, the district court misread the facts as well as the law. *The stockholders' complaint is not based solely upon misrepresentations in and omissions from the reset note and debenture prospectuses, but alleges a common course of false and misleading statements, including press releases, news articles, and quarterly and annual public filings, in connection with which the common stockholders made their purchases. In addition to the debt prospectuses, the defendants are alleged to have issued twenty-five such documents containing materially false and misleading statements, many of which go to the heart of the case, and a number of which are enumerated above.* Through them, it is alleged that defendants created a false impression in the investing public, throughout 1989 and early 1990, that Ames was financially secure, that it would be profitable at year end, and that the integration of Zayre into Ames was proceeding successfully. Allegedly, these releases and documents contributed to the "'total mix' of information made available" to the investing public and contributed to the artificial inflation or maintenance of the market price of Ames's common stock. *See generally Basic Inc. v. Levinson,* 485 U.S. at 232, 108 S.Ct. at 983, *quoting TSC Indus., Inc. v. Northway, Inc.,* 426 U.S. 438, 449, 96 S.Ct. 2126, 2132, 48 L.Ed.2d 757 (1976) (discussing the impact of publicly released information on prices of stocks trading in efficient markets and adopting the materiality standard of *TSC Indus.* for 10b–5 claims—that an omission is material if, in the view of a reasonable investor, it affects the total mix of information available). Thus, even if the district court were correct on the law, which, as we have indicated above, it was not, it also made erroneous factual assumptions which led it to dismiss the plaintiffs' claim improperly.[27]

In the *Harrisburg Report*, the Commission stated (*emphasis added*):

> *The misstatements and omissions in this case were not the result of an isolated incident but were recurrent and stretched from one fiscal year into the next.* From January 2009 through March 2011, at a time of increased public interest in Harrisburg's financial condition, and despite having entered into multiple written undertakings, Harrisburg failed to submit annual financial information, audited financial statements, notices of failure to provide required annual financial information and material event notices. Investors may be more likely to rely upon statements from public officials where written undertakings made pursuant to Rule 15c2-12 have not been fulfilled and required continuing disclosures are not available through the Municipal Securities Rulemaking Board's Electronic Municipal Market Access ("EMMA") system.
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> *The statements by the Harrisburg public officials were part of, and could have altered, the total mix of information available to the market. There is a substantial likelihood that a reasonable investor would consider the financial condition of the City important in making an investment decision, and there were no other disclosures made by the City as part of the total mix of information available to enable investors to consider other information.* These public officials' statements were the principal source of significant, current information about the issuer of the security and thus could reasonably be expected to influence investors and the secondary market. Because statements are evaluated for antifraud purposes in light of the circumstances in which they are made, the lack of other disclosures by the municipal entity may increase the risk that municipal officials' public statements may be misleading or may omit material information.[28]

Coincidentally, 25 days after publication of SLB 21, the SEC charged SCANA Corp., two of its former top executives, and South Carolina Electric & Gas Co. (SCE&G), now known as Dominion Energy South Carolina Inc., with defrauding investors by making false and misleading statements about a nuclear power plant expansion that

[27] 991 F.2d at 968.
[28] N. 13, *supra*.

was ultimately abandoned.[29] Paragraph 3 of the Commission's Complaint[30] alleges a course of false and misleading statements over a period of time:

> From 2015 through 2017, construction of the new nuclear units at V.C. Summer was a tale of two projects. Publicly, SCANA touted progress being made on the project in its periodic filings with the SEC, on earnings calls with financial analysts, in press releases and video presentations, and in filings and testimony before the South Carolina Public Service Commission ("PSC"). These false statements enabled SCANA to bolster its stock price, sell $1 billion in corporate bonds at favorable rates, and obtain regulatory approval to charge its customers more than $1 billion in increased rates to help finance the project. Internally, however, SCANA knew that – contrary to its public statements – the project was significantly delayed, the construction schedule was unreliable and unachievable, and the company was unlikely to qualify for $1.4 billion in federal production tax credits because the new units would not be completed by the January 1, 2021 deadline for receiving the tax credits. SCANA and its senior management knew that the expansion project was not viable without those tax credits.

As described in the Complaint, the entities were reporting companies with securities registered under the Exchange Act, and SCANA Corporation was a regulated monopoly in South Carolina. The Complaint alleges, among other matters, that the defendants made false or misleading statements on earnings calls, in press releases and video presentations, and in testimony and filings before the South Carolina Public Service Commission, as well as in filings with the SEC. The Complaint makes broad fraud allegations of violations under Section 17(a)(1), (2), and (3) of the Securities Act, Section 10(b) of the Exchange Act and Rules 10b-5(a), (b), and (c), broad allegations of aiding and abetting such violations, broad allegations of reporting provision violations under Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11 and 13a-13, as well aiding and abetting such violations, and allegations of false certifications under Exchange Act Rule 13a-14.

The litigation in SCANA is in its early stages. Should it proceed, the proceedings may shed light on the use, if any, to be made by the Division of Enforcement of the testimony and filings made with state agencies, as alleged in the Complaint, and in turn demonstrate how the Division might make use of filings made by municipal issuers with legislative bodies, as described in SLB 21.

Both *Ames* and *Harrisburg* involved allegations of false and misleading statements made over an extended period of time that contributed to the total mix of information made available to (and created a false impression among) the investing public. This background, together with whatever insight may be offered by the proceedings in SCANA, provides perspective to disclosure committee reviews, but no easy answers. In both *Ames* and *Harrisburg*, the view of the facts was retrospective.

Disclosure committees may find it wise to consider the total mix of information available to potential investors in the issuer's securities. Could public statements made to or filed with legislative or governing bodies by an issuer "be a source of significant, current information about the municipal issuer and thus could reasonably be expected to reach investors and the trading markets?" If so, the workload of an issuer's disclosure committee, in light of the staff's views expressed in part IV.B of SLB 21, may be greater than previously understood.

## Final Thoughts

[29] Litigation Release No. 24751 / February 27, 2020, Securities and Exchange Commission v. SCANA Corporation, et al., No. 3:20-CV-00882-MGL (D.S.C., Filed February 27, 2020). available at https://www.sec.gov/litigation/litreleases/2020/lr24751.htm.
[30] https://www.sec.gov/litigation/complaints/2020/comp24751.pdf.

At the July 29, 2019 SEC Fixed Income Market Structure Advisory Committee, Chairman Clayton explained what prompted him to direct OMS to prepare SLB 21:

> I have been informed recently that some issuers are receiving advice that, in connection with the distribution of information that is material to an investment decision, disclosing that information to investors on the MSRB's EMMA system triggers a more rigorous liability standard for that information than disclosing the same information to investors through other means. While I intend to explore the matter further and have not reached any definitive conclusions, in various scenarios I can imagine, I have significant questions about this advice and whether this is correct as a matter of law or policy.[31]

Does SLB 21 address whether the advice prompting his direction is correct? The advice that triggered the Chairman's perceived need for SLB 21 is not identified, nor to my knowledge, publicly known. SLB 21 does provide an overview of how, in the staff's view, Exchange Act Section 10(b) and Rule 10b-5 apply to statements made by an issuer in the secondary market. No distinction is made in either statute or rule with respect to a standard of liability. That standard varied in the courts from federal circuit to federal circuit until settled by the Supreme Court in 1976 in *Ernst & Ernst v. Hochfelder.*[32] Circuit courts have varied in minor ways in what constitutes "recklessness" under the *scienter* showing required by *Hochfelder* to establish liability, but that variation is among the courts, not among the forums in which disclosures are made. Without knowing more about the advice to which Chairman Clayton referred, and engaging in dialogue with its provider, it is difficult to understand what set this all in motion.[33]

[31] N. 2. *supra.*

[32] 425 U.S. 185 (1976).

[33] See Weber, Notes from the Editor (on "Connection" and "Circumstances"), *The Bond Lawyer*, Vol. 43, No. 4 (Fall 2019), inferring that the advice to which Chairman Clayton reacted was that municipal issuers may be exposed to greater liability when they post statements on EMMA that are otherwise available to investors, not because the applicable legal standard for liability differs, but because the place of posting statements may affect the "circumstances under which they are made" in judging whether omissions are misleading.