Lessons to Learn from the Harrisburg SEC Fraud Charges

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Recently, the Securities and Exchange Commission (the “SEC”) broke new ground when it charged Harrisburg, Pennsylvania (the “City”) with securities fraud in connection with material misstatements and omissions regarding the City’s financial condition. This represents the first time that statements outside of securities disclosures were the basis of SEC charges against a municipality.

A troubled incinerator project has been the source of deep financial struggles for Harrisburg, pushing it to the brink of bankruptcy. Pennsylvania’s Governor declared a state of fiscal emergency, and a state court appointed a receiver to oversee its finances. Like many distressed issuers, the City had problems keeping up-to-date disclosures, failing to comply with its continuing disclosure requirements from 2009 to 2011.

The SEC grabbed the attention of many, however, by citing Harrisburg for the accuracy of speeches and presentations of government officials. For example, in the 2009 State of the City Address, the Mayor described the incinerator as an “additional challenge” and an “issue that can be resolved.” Left omitted was the fact that the City would likely bear responsibility for the incinerator’s debt and had already made guaranty payments. The SEC also cited mid-year fiscal reports posted on the City’s website, and the City budget which misstated a credit rating.

In short, the City’s failure to supply its required disclosures ratcheted up reliance on other statements. “In an information vacuum caused by Harrisburg’s failure to provide accurate information about its deteriorating financial condition, municipal investors had to rely on other public statements misrepresenting city finances,” stated the SEC’s release. “Statements that are reasonably expected to reach the securities markets, even if not prepared for that purpose, cannot be materially misleading.”

In recent years, the SEC has been scouring financial disclosures by cities, states and other municipal borrowers, and stepping up its policing in the municipal debt market. Market studies have shown that as many as 20% of the nearly 50,000 issuers of municipal debt don’t supply timely disclosures after their bonds have been issued. Harrisburg should be viewed as a lesson to all issuers – especially those struggling to remain solvent – on the need to meet continuing disclosure obligations and to provide accurate and complete information when discussing finances.

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