UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

-vs-

GARY J. BURTKA,

Defendant.

Case No. 14-14278
HON. AVERN COHN

-and-

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

-vs-

ERIC C. WAIDELICH,

Defendant.
_______________________________________/

Case No. 14-14279
HON. AVERN COHN

# COMMENTS OF THE COURT ON APPROVING CONSENT JUDGMENTS

## I. Introduction

Before the Court are motions for entry of consent judgments by the United States Securities and Exchange Commission ("SEC") in two separate and parallel civil actions relating to the sale of two sets of municipal general obligation limited tax bonds issued in October, 2009, and June, 2010, by the City of Allen Park ("City"), Michigan.

Defendants in the civil actions are the former Mayor of the City, Gary J. Burtka

("Burtka"), a control person, and Eric C. Waidelich ("Waidelich"), the former City Administrator, each of whom the SEC says engaged in actions which constituted violations of the securities statutes.

These actions were filed following an SEC administrative proceeding entitled In The Matter of the City of Allen Park, Michigan, Administrative Proceeding File No. 3-16259. In the course of the proceedings, the SEC found that the offering documents relating to the sale of the bonds referenced above contained false and misleading statements about the scope and viability of what was called the Studio Project, as well as the City's overall financial condition and ability to service the debt represented by the bonds. The SEC's press release 2014-249, attached as Exhibit A, describes the SEC's findings and actions.

The SEC in particular found that the two Official Statements describing the bonds contained false information. The first Official Statement, for a $28.275 Million Dollar bond issue, is dated October 27, 2009. The second Official Statement, for a $2.725 Million Dollar bond issue, is dated June 16, 2010. The Official Statements read essentially the same.

The consent judgments permanently bar each defendant from participation in an offering of municipal securities. In addition, Burtka is required to pay a $10,000.00 penalty. Each defendant's consent to the entry of a judgment is without admission or denial of the allegations contained in the respective complaint, except as to jurisdiction.

The Court deferred approval of the consent judgments because it lacked full knowledge of all the relevant facts, and wanted to assure itself that the consent judgments were fair and reasonable, and that the public interest was not disserved by their entry, as is the Court's obligation. See United States Securities and Exchange Commission v. Citigroup Global Mkts. Inc., 752 F.3d 285 (2d Cir. 2014).

Initially, the Court was puzzled because of the intense interest of the SEC in disclosure problems in municipal bond offerings. It wanted to know why in $30 Million Dollar fraudulent bond offering, only two unsophisticated municipal officers were charged with wrongdoing, and why sophisticated third-party participants had, in the SEC's view, not called to account.

In light of the Court's concerns and the standards for its approval, it asked the SEC to file a supplemental brief detailing the background of the administrative proceedings. The Court also asked the SEC to explain why individual responsibility was limited to the two defendants, and further what occurred between the end of October of 2009 and June of 2010, the relevant time frame for the Official Statements.

The purpose of these comments is to give context to what has culminated in the entry of the consent judgments as well as set forth some additional observations.

## II. Background

### A.

By way of general history, the public record reflects a longtime interest of the SEC in the problems of disclosure in the municipal bond market. In November, 1977, an SEC commissioner spoke to the Municipal Finance Officers Association Disclosure and Current Reporting Colleagues about municipal securities disclosure policies and the need for disclosure guidelines. In September, 2000, a senior staff member of the SEC spoke to the Municipal Finance Officers Association about the problems of disclosure. In 2012, the SEC published a Report on the Municipal Securities Market, an extensive study of all aspects of municipal bond offerings.

B.

As to these cases, planning for the Studio Project by the City began as early as August, 2008. It is fair to say that it was a fragile initiative. Significantly, in contrast to the optimistic tone of the Official Statements, Wayne County in a letter dated September 25, 2009, noted the downsizing of the Studio Project from what was described to it earlier in a request for participation in financing. As to general knowledge of the Studio Project, the letter said, "[Wayne County officials] continue to be disappointed in the manner in which we are informed of changes in the status of the project – namely through the local news media."

III. The SEC's Supplemental Filings

In response to the Court's concerns set forth above, the SEC filed a Supplemental Brief (Docs. 8 and 12), accompanied by the declaration of Mark Zehner, Deputy Chief of the Municipal Securities and Public Pensions Unit of the Division of Enforcement of the SEC (Docs. 8-1 and 12-1), describing in detail the investigation conducted by the SEC, the relevant facts relating to the Studio Project from its conception to its demise, and particularly the role played in that sequence of events by each of the individual defendants. The SEC also lodged with the Court the documents referenced in the administrative decision relating to the City.

The SEC also responded to the Court's query as to why it limited individual responsibility to Burtka and Waidelich instead of, for instance, including the underwriters of the bond issues, the City's bond counsel and the City's financial advisors in the charges of wrongdoing. The SEC explained in summary that the underwriters had no responsibility for the misstatements in the Official Statements because the bonds were sold by competitive bid, and that in such circumstances the underwriters neither write the offering documents nor formulate the terms of the offering. As to bond counsel, the SEC said they were retained for a limited purpose, that is the tax treatment of the bonds.

As to the financial advisors, the SEC said that while they wrote the Official Statements, and as to the parts which were false and misleading, particularly the nature and development of the Studio Project, the financial advisors relied on what Waidelich or City employees told it. In the SEC's words, "The information that defendant Waidelich supplied the financial advisors was incomplete, false and misleading," and went on to say:

> The Dodd-Frank Wall Street Reform and Consumer Protection Act established that financial advisors owe fiduciary duties to their municipal entity clients when they provide advice on an issuance of municipal securities. But, the conduct in this case occurred before the enactment of the Dodd-Frank Act and, at such time, under federal law financial advisors did not owe fiduciary duties to issuers of municipal securities. In addition, there was no contract in place between the Financial Advisor and the City stating what services the Financial Advisor agreed to provide to the City.

The SEC appears to be saying that the financial advisors had no obligation in formulating an official statement; it was no more than an amanuenses.

The SEC also describes in some detail the deterioration of the Studio Project between the date of the first Official Statement and the second Official Statement. Again, the SEC effectively says that the financial advisors continued in their role of scrivener.

Finally, the record is silent on the involvement of the City Council in the issuance of the bonds. The record is also silent as to the interactions between defendants and the City Council or defendants and the financial advisors as to the language of the Official Statements.

IV. Additional Observations

A.

On March 28, 2013, an emergency manager was appointed by the Governor of Michigan to deal with the City's fiscal issues, primarily the absence of resources to meet the debt obligations represented by the $30 Million Dollars of debt in the form of the bonds. Using a multitude of initiatives, the emergency manager resolved the fiscal issues which caused her appointment. The emergency manager, on September 25, 2014, reported to the Governor that the financial emergency had been rectified. A variety of initiatives put in place reflected an increase in taxes and reduction in services, and brought the City's finances into balance. This is good news for the residents of the City.

While the City is now on a more solid fiscal path, the fact that $30 Million Dollars in municipal bonds were issued based on misleading and fraudulent statements as to the Studio Project should not be forgotten. The citizens of the City have seen their taxes increased and municipal services reduced as a consequence. Only the SEC, whose responsibility runs to bond investors, has seen fit to investigate the debacle. The record is silent as to any pending investigation of the Studio Project by any state or federal agency responsible for investigating municipal misbehavior.

B.

Historically, there was in place a mechanism in the form of the Municipal Finance Commission, which had the responsibility of supervising borrowing by local governments, including review before bonds could be issued. A description of the Commission's work is described in a paper by Alvin D. Sokolow entitled State Review of Local Borrowing: The Michigan Municipal Finance Commission, Technical Bulletin B-3T, published by the Institute for Community Development and Services, Michigan State University, January 1963. However, the Commission has been abolished. Generally, its duties have been taken over by the Department of the Treasury Local Audit and Finance Division. However, these duties do not appear to encompass prior approval of the issuance of municipal bonds. However, they do require certain documents be filed with the department within fifteen (15) days after a bond issuance. See M.C.L. § 141.2319. Thus, it would appear that today the State of Michigan lacks a mechanism to review the legitimacy of municipal borrowings before debt instruments are issued. It is therefore fair to say that the State steps in only and after the barn door is closed and the horse escapes.

In other words, it is only after fraud is uncovered and a municipality loses its financial footings does the State take action.

Quis custodiet ipsos custodes? Who will guard the guards themselves?

Avern Cohn

AVERN COHN
UNITED STATES DISTRICT JUDGE

Dated: 1/28/15
Detroit, Michigan

EXHIBIT A

# SEC Charges Allen Park, Mich. and Two Former City Leaders in Fraudulent Muni Bond Offering for Movie Studio Project

**FOR IMMEDIATE RELEASE**
**2014-249**

*Washington D.C., Nov. 6, 2014* — The Securities and Exchange Commission today announced fraud charges against the City of Allen Park, Mich., and two former city leaders in connection with a municipal bond offering to support a movie studio project within the city.

An SEC investigation found that offering documents provided to investors during the Detroit suburb's sale of $31 million in general obligation bonds contained false and misleading statements about the scope and viability of the movie studio project as well as Allen Park's overall financial condition and its ability to service the bond debt.

The city and the two officials – former mayor Gary Burtka and former city administrator Eric Waidelich – have agreed to settle the SEC's charges.

"Municipal bond disclosures must provide investors with an accurate portrayal of a project's prospects and the municipality's ability to repay those who invest," said Andrew J. Ceresney, Director of the SEC Enforcement Division. "Allen Park solicited investors with an unrealistic and untruthful pitch, and used outdated budget information in offering documents to avoid revealing its budget deficit."

The SEC alleges that Burtka was an active champion of the project and in a position to control the actions of the city and Waidelich with respect to the fraudulent bond issuances. Based on this control, the SEC charged Burtka with liability for violations committed by the city and Waidelich. This is the first time the SEC has charged a municipal official under a federal statute that provides for "control person" liability. Burtka has agreed to pay a $10,000 penalty.

"When a municipal official like Burtka controls the activities of others who engage in fraud, we won't hesitate to use every legal avenue available to us in order to hold those officials accountable," said LeeAnn Ghazil Gaunt, Chief of the SEC Enforcement Division's Municipal Securities and Public Pensions Unit.

According to the SEC's administrative order against Allen Park and its complaints against Burtka and Waidelich filed in federal court in Detroit, the city began planning the studio project in late 2008 with the belief it would bring much-needed economic development. The state of Michigan had just enacted legislation that provided significant tax credits to film studios conducting business in Michigan. The original plan detailed a $146 million facility with eight sound stages led by a Hollywood executive director, and the city initially planned to repay investors with $1.6 million in revenue from leases at the site. Allen Park issued bonds on Nov. 12, 2009, and June 16, 2010, to raise funds to help develop the site.

The SEC's order finds, however, that by the time the bonds were issued, Allen Park's plans to implement and pay for the studio project had deteriorated into merely building and operating a vocational school on the site. Yet none of these plan changes were reflected in the bond offering documents or other public statements, which continued to repeat the original plans for the movie studio project. Investors were left uninformed not only about the deterioration of the project itself, but also the substantial impact it would have on the city's ability to service the bond debt. Without the planned revenues from the studio project, the expected annual debt payments on the bonds represented approximately 10 percent of the city's total budget. Furthermore, Allen Park used outdated budget information in the bond offering documents that did not reflect the city's budget deficit of at least $2 million for fiscal year 2010. The studio project completely collapsed within months after the second set of bonds were issued, and Michigan appointed an emergency manager for Allen Park in October 2010 while citing the failed project as a primary factor in the city's deteriorating economic condition.

The SEC's complaints allege that Waidelich as city administrator reviewed and approved the offering documents for the bonds. Waidelich's actions violated Section 17(a)(2) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5(b). Without admitting or denying the allegations, Waidelich has consented to a final judgment barring him from participating in any municipal bond offerings and enjoining him from future violations. The SEC alleges that Burtka is liable as a control person under Section 20(a) of the Exchange Act, based on his control of Waidelich and the city. Without admitting or denying the allegations, Burtka consented to a final judgment requiring him to pay the $10,000 penalty, barring him from participating in any municipal bond offerings, and enjoining him from future violations.

The SEC's order against Allen Park finds it violated Section 17(a)(2) of the Securities Act and Section 10 (b) of the Securities Exchange Act and Rule 10b-5(b). The city agreed to cease and desist from future violations of those provisions. The SEC considered certain remedial measures taken by the city, which settled the enforcement action without admitting or denying the findings.

The SEC's investigation was conducted by Sally J. Hewitt of the Municipal Securities and Public Pensions Unit with assistance from John E. Birkenheier, John E. Kustusch, and Jean M. Javorski in the SEC's Chicago Regional Office and Mark R. Zehner, Deputy Chief of the Municipal Securities and Public Pensions Unit.

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## Related Materials

- SEC order against Allen Park, Mich.
- SEC complaint against Burtka
- SEC complaint against Waidelich