

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 10981 / September 16, 2021

ADMINISTRATIVE PROCEEDING
File No. 3-20560

In the Matter of

**SWEETWATER UNION
HIGH SCHOOL DISTRICT,**

Respondent.

**ORDER INSTITUTING CEASE-AND-
DESIST PROCEEDINGS PURSUANT TO
SECTION 8A OF THE SECURITIES ACT
OF 1933, MAKING FINDINGS, AND
IMPOSING A CEASE-AND-DESIST
ORDER**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 (“Securities Act”), against Sweetwater Union High School District (“Sweetwater,” the “District,” or “Respondent”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Making Findings, and Imposing a Cease-and-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

Summary

1. This matter involves material misstatements and omissions, as well as a deceptive course of business, by Sweetwater Union High School District in a \$28 million April 2018 municipal bond offering (the "April 2018 Bonds"). In that offering, Sweetwater, a school district in San Diego County, California, included misleading budget projections which indicated the District could cover its costs and would end the year on June 30, 2018 with a general fund balance of approximately \$19.5 million, when in reality the District's finances were severely strained. In fact, when Sweetwater ultimately disclosed its true year-end financial condition, it revealed that it had overspent its budget by \$28 million, leaving it with a negative \$7.2 million ending fund balance.

2. The misleading budget projections were primarily the result of Sweetwater failing to accurately budget for a 3.75% pay raise approved shortly before the beginning of the 2018 fiscal year. Sweetwater failed to accurately budget for these pay raises in its 2018 budget, and, instead, projected expenses that were nearly identical to the expenses incurred in the 2017 fiscal year. Notably, Sweetwater's mid-year budget monitoring reports consistently showed that the District's actual expenses were trending significantly higher than its budgeted projections. Despite this, Sweetwater made no effort to bring its budget into line with actual expenses. Instead, Sweetwater continued to use stale budget projections in its interim budget reports.

3. These reports were incorporated into misleading disclosures made to investors, as well as to the industry professionals involved in the offering. Specifically, in the April 2018 Bonds' offering documents, Sweetwater presented the misleading budget projections while failing to disclose: (i) its true financial condition; (ii) that the 2018 fiscal year-end budget projections included in the offering documents were inconsistent with Sweetwater's actual expenses; and (iii) that Sweetwater's budget monitoring procedures did not consider current conditions.

4. By making misleading statements and omissions to investors, as well as to the bonds' credit rating agency and other municipal industry professionals on the transaction, Sweetwater violated Sections 17(a)(2) and 17(a)(3) of the Securities Act.

Respondent

5. **Sweetwater Union High School District** is a California public school district based in Chula Vista, California and serving approximately 47,000 students in San Diego County. It is governed by a five-member elected Board of Trustees. Sweetwater operates on a July 1 to June 30 fiscal year.

¹ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

Other Relevant Individual

6. **Karen Michel**, age 67, is a resident of San Diego County, California. Michel worked in Sweetwater's Financial Services Department from 1996 through 2018, and led the department as the District's Chief Financial Officer and chief business officer from 2014 through 2018. As the Chief Financial Officer ("CFO"), Michel had primary responsibility over Sweetwater's bond, business, and finance programs. Michel retired from Sweetwater in or around September 2018.

Sweetwater Did Not Accurately Anticipate Expenses Associated with Recent Salary Increases In Its 2018 Fiscal Year Budget

7. In June 2017, Sweetwater's Board of Trustees (the "Board") completed its approval of salary raises for most of the District's employees, retroactive to January 2017. Sweetwater's CFO, Karen Michel, participated in the Board meeting considering the salary raises, and assessed both the short term and long term financial impact of these raises.

8. Days after the June 2017 approval of the salary raises, Michel and the Sweetwater staff working under her direction completed the proposed budget for the July 1, 2017 through June 30, 2018 fiscal year (the "2018 Fiscal Year"). This budget was then approved and adopted by the Board on Michel's recommendation. The adopted budget, however, failed to accurately account for the 3.75% salary increase, and instead anticipated a less than 1% increase in employee salaries based on year-end estimates for the prior fiscal year. The adopted budget further projected that Sweetwater would end the year with an operating surplus and a positive general fund balance of over \$22.2 million.

Sweetwater Unreasonably Ignored Reports Showing That Its Actual Expenses Were Not In Line With Its Budget Projections

9. Michel ran Sweetwater's Fiscal Services Division and was in charge of the District's budget and financial reporting processes. These responsibilities included supervising the persons who generated Sweetwater's budget estimates as well as associated reports comparing the budget estimates to actual expenses incurred during the year. She was chiefly responsible for setting up the control environment meant to ensure the accuracy of the budget estimates, and was the primary communicator of the adopted and interim budget estimates to the District's Board, the San Diego County Office of Education, and ultimately to investors in the April 2018 Bonds.

10. Throughout the 2018 Fiscal Year, Sweetwater's Fiscal Services Division created reports indicating that the District's year-end expenses were trending much higher than it had anticipated in its adopted budget.

11. By September 2017, Sweetwater had substantially completed its annual financial report for the previous fiscal year, ending on June 30, 2017 (the "2017 Fiscal Year"). This report revealed that the District had incurred higher salary expenses for the 2017 Fiscal Year than

Sweetwater had assumed when it generated its 2018 Fiscal Year budget. Sweetwater now knew that the projected salary expenses for the 2018 Fiscal Year were nearly identical to the actual 2017 expenses, notwithstanding the substantial salary raises. The 2017 report thus served as an early indicator of the defects in the 2018 Fiscal Year budget. Despite this, Sweetwater failed to correct its projections for the 2018 Fiscal Year.

12. In the months leading up to the April 2018 bond offering, Sweetwater continued to ignore reports showing that its budget for the 2018 Fiscal Year was untenable.

13. As is required for public school districts under California state law, Sweetwater reviewed its budget in a “first interim” report, covering the months from July through October, and a “second interim” report, covering the months from July through January. California Assembly Bill 1200, enacted into law in 1991 (“AB 1200”) defines a system of fiscal accountability for school districts designed, in part, to aid county offices of education or other governing bodies to identify school districts’ potential year-end budget deficits. Among other things, the law requires public school districts’ interim reporting to be based on current information.

14. However, despite AB 1200’s requirement that interim reporting use current financial information, Sweetwater and Michel failed to implement any system or process for incorporating actual expenditures into their interim projections. Thus, while Michel and her staff reviewed actual expenditures for other purposes, and even created reports comparing actual expenditures with anticipated year-end expenses, Sweetwater and Michel failed to take any steps to make adjustments to the projections based on these comparisons.

15. Specifically, by December 2017, Sweetwater’s first interim report showed that the District’s monthly salary expenditures significantly exceeded the amounts anticipated in its budget. Nevertheless, Sweetwater made no effort to incorporate these actual expenses into the year-end projections included in the same report. Instead, the District continued to rely on stale projections more aligned with its months-old adopted budget.

16. Sweetwater and Michel repeated the same process with the District’s second interim report, which purportedly represented the District’s financial condition through January 2018. As of January 31, 2018, the actual employee salary expenses indicated a year-end budget variance of over \$12.5 million from Sweetwater’s second interim budget projections. However, Sweetwater again failed to update the budget projections in its second interim report, completed on or about March 9, 2018, to reflect the increasing gap between its actual salary expenses and its budget.

Sweetwater Used Its Misleading Budget Projections to Facilitate Its Sale of \$28 Million in Bonds to Investors

17. On February 26, 2018, Sweetwater’s Board voted to approve the issuance of \$28 million in general obligation bonds, and to authorize Michel to act on behalf of Sweetwater for all of the District’s tasks essential to the offering. The bonds were to be secured by and payable from *ad valorem* property taxes assessed on taxable properties within the school district and

collected by the County of San Diego. The purpose of the bonds was to fund certain of Sweetwater's capital projects.

18. In her role as CFO, Michel ran Sweetwater's bond program for the District. Pursuant to the February 26, 2018 Board resolution, Michel was authorized to enter into agreements on behalf of the District, execute all required documents, and provide all information necessary for the offering. In March and April 2018, Michel executed all of the District's certificates, agreements, and other representations made in furtherance of the April 2018 Bonds, and also represented the District at a meeting with the credit rating agency where the District's financials were presented.

19. Michel or others acting at her direction were primarily responsible for providing Sweetwater's financial information in support of the bond offering. From February through April 2018, they repeatedly provided misleading interim budget projections to the credit rating agency and potential bond investors.

20. Michel or others acting at her direction also provided this same inaccurate information, while Michel simultaneously attested to its accuracy, to the professionals facilitating the offering, including the underwriter and its counsel, bond counsel, disclosure counsel, and Sweetwater's municipal advisor (collectively, the "Bond Deal Team Members"). These disclosures were misleading and deceptive in light of the facts that Sweetwater and Michel were aware of information indicating that the budget projections underestimated the actual expenses already incurred, and that Sweetwater and Michel knew that the District had no processes for incorporating actual expenses into its interim reports.

21. On or about February 27, 2018, Michel represented Sweetwater during a meeting with the credit rating agency to present the April 2018 bond offering and provide financials relevant to the District's credit profile. As part of this presentation, Sweetwater's municipal advisor presented Sweetwater's budget projections from the District's 2018 Fiscal Year interim reporting, which Michel and her staff had provided.

22. As part of the ratings process, the municipal advisor specifically informed Michel that the financial information provided to the credit rating agency had to be complete and accurate. Despite this, Michel unreasonably failed to disclose contrary information known to her and the District. At no point leading up to or following the bond offering did she or Sweetwater disclose to the credit rating agency that actual expenses were trending significantly higher than the projections contained in the first and second interim reports.

23. Based in part on Sweetwater's misleading financial information, on or about March 9, 2018, the credit rating agency published an issuer-default rating for the District of "A," explaining to investors, among other things, that the rating agency "expects reserves to hold above the state's 2% minimum fund balance requirement for the district due to strong state oversight of the district's budgets," "[t]he district budgets conservatively," and the rating agency "expects the district to actively manage expenditures to address potential budget gaps."

24. On March 22, 2018, Sweetwater disseminated the April 2018 Bonds' Preliminary Official Statement ("Preliminary OS") to potential bond investors. In the Preliminary OS, Sweetwater represented that it projected a \$19.5 million year-end general fund balance for the 2018 Fiscal Year based on current interim reporting, while omitting the fact that the projection was actually at odds with the known actual expenses and internal reports. Further, while misleadingly omitting the fact that the District made no effort to incorporate known expense data into its interim projections, Sweetwater: (i) represented that it filed positive certifications for each reporting period in the last five years in accordance with AB 1200; (ii) noted that a "positive certification is assigned to any school district that will meet its financial obligations for the current fiscal year and subsequent two fiscal years;" and (iii) described AB 1200's requirement that interim reporting be based on current information. On April 4, 2018, Sweetwater disseminated the April 2018 Bonds' Final Official Statement ("Final OS"), signed by Michel, to potential bond investors, making the same misrepresentations and omissions as in the Preliminary OS.

25. On April 4, 2018, Michel also signed on behalf of Sweetwater a "bond purchase agreement" in which Sweetwater "represent[ed], warrant[ed] and agree[d]" that (i) the Preliminary OS and Final OS did not contain any untrue statement of material fact or omit to state any material fact necessary to make the statements therein not misleading; and (ii) that the financial statements included in the Final OS fairly presented the financial position of Sweetwater for the periods they purported to represent.

26. On April 25, 2018, Michel signed a certificate to sell the bonds to the underwriter on behalf of Sweetwater. In it, Sweetwater and Michel represented that Michel had reviewed the Final OS, and misleadingly certified that the Final OS did not contain any untrue statement of a material fact required to be stated therein, or necessary to make the statements therein, in light of the circumstances in which they were made, not misleading. This certification was provided to the underwriter who purchased the bonds from Sweetwater to facilitate the sale to investors, as well as the underwriter's counsel and bond counsel.

27. Sweetwater acted unreasonably in disseminating misleading financial information to, and omitting material facts from, investors, the Bond Deal Team Members, and the credit rating agency. The interim expense reporting known to Sweetwater and Michel should have indicated to them that the District's budget projections were misleading. Additionally, through Michel, Sweetwater knew or should have known the importance of conveying accurate and complete financial information in the Preliminary OS, Final OS and in other communications with the credit rating agency and Bond Deal Team Members.

Sweetwater's New CFO Uncovers the District's Substantial Deficit, Leading to a Rating Downgrade

28. In or around September 2018, Michel retired from Sweetwater and was replaced by a new CFO. Under the new CFO's direction, the District completed its unaudited actual financial report finding that June 2018 year-end salary expenditures were approximately \$309.6 million – \$18.7 million higher than estimated in the second interim report and as reported in the Preliminary OS and Final OS. As a result of these expenses, as well as a shortfall in projected revenue,

Sweetwater's unaudited general fund balance dropped to approximately negative \$2.87 million, representing a shortfall of approximately \$22.4 million compared to figures included in the Preliminary OS and Final OS.

29. On October 26, 2018, after learning of the District's strained financial condition, the credit rating agency downgraded Sweetwater's issuer-default rating two notches from "A" to "BBB+," with a negative outlook. According to the rating agency, this action was "triggered by significant deterioration in the District's financial position compared to prior expectations" and a "concern that expenditure control needed to stabilize its finances will be a challenge for the district."

30. On December 5, 2018, Sweetwater's independent auditor completed its audit of the District's 2018 Fiscal Year financial report. The audited financials revealed an even worse year-end general fund balance of negative \$7.2 million based on total deficit spending of approximately \$28.7 million.

Violations

31. A statement or omission is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988).

32. As a result of the conduct described above, Sweetwater violated Section 17(a)(2) of the Securities Act, which proscribes obtaining money or property through misstatements or omissions about material facts, and Section 17(a)(3) of the Securities Act, which proscribes any transaction or course of business that operates or would operate as a fraud or deceit upon a purchaser of securities. A violation of these provisions does not require scienter and may rest on a finding of negligence. *See Aaron v. SEC*, 446 U.S. 680, 685, 701-02 (1980).

Undertakings

Respondent has undertaken to:

33. Within 180 days of the Order, establish appropriate and comprehensive written policies and procedures and periodic training regarding all aspects of Sweetwater's municipal securities disclosures, including formal policies and procedures to be followed for the preparation, review and approval of official statements and continuing disclosures, and the designation of an individual officer of Sweetwater responsible for ensuring compliance by Sweetwater with such policies and procedures and responsible for implementing and maintaining a record (including attendance) of such training.

34. Retain an independent consultant with municipal finance experience (the "Independent Consultant"), not unacceptable to the Commission staff, to conduct a review of Sweetwater's policies and procedures as they relate to all aspects of Sweetwater's municipal securities disclosures. The Independent Consultant shall not have provided consulting, legal,

auditing or other professional services to, nor had any affiliation with, Sweetwater during the two years prior to the institution of these proceedings.

35. Require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Sweetwater, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Division of Enforcement, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Sweetwater, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement. The agreement will also provide that, within 180 days of the institution of these proceedings, the Independent Consultant shall submit a written report of its findings to Sweetwater, which shall include the Independent Consultant's recommendations for improvements to Sweetwater's policies and procedures.

36. The report by the Independent Consultant will likely include confidential financial, proprietary, competitive business or commercial information. Public disclosure of the report could discourage cooperation, impede pending or potential government investigations or undermine the objectives of the reporting requirement. For these reasons, among others, the report and the contents thereof are intended to remain and shall remain non-public, except (1) pursuant to court order, (2) as agreed to by the parties in writing, (3) to the extent that the Commission determines in its sole discretion that disclosure would be in furtherance of the Commission's discharge of its duties and responsibilities, or (4) is otherwise required by law.

37. Adopt all recommendations contained in the Independent Consultant's report within 90 days of the date of that report, provided, however, that within 30 days of the report, Sweetwater shall advise in writing the Independent Consultant and the Commission staff of any recommendations that Sweetwater considers to be unduly burdensome, impractical, or inappropriate. With respect to any such recommendation, Sweetwater need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedures, or system designed to achieve the same objective or purpose. As to any recommendation on which Sweetwater and the Independent Consultant do not agree, Sweetwater and the Independent Consultant shall attempt in good faith to reach an agreement within 60 days after the date of the Report. Within 15 days after the conclusion of the discussion and evaluation by Sweetwater and the Independent Consultant, Sweetwater shall require the Independent Consultant inform Sweetwater and the Commission staff in writing of the Independent Consultant's final determination concerning any recommendation that Sweetwater considers to be unduly burdensome, impractical, or inappropriate. Within 10 days of this written communication from the Independent Consultant, Sweetwater may seek approval from the Commission staff to not adopt recommendations that Sweetwater can demonstrate to be unduly burdensome, impractical, or inappropriate. Should the Commission staff agree that any proposed recommendations are unduly burdensome, impractical,

or inappropriate, Sweetwater shall not be required to abide by, adopt, or implement those recommendations.

38. Disclose in a clear and conspicuous fashion the terms of this settlement in any final official statement for an offering by Sweetwater within five years of the institution of these proceedings.

39. Certify, in writing, compliance with the undertakings set forth above in paragraphs 33-38. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Sweetwater agrees to provide such evidence. The certification and supporting material shall be submitted to LeeAnn G. Gaunt, Chief, Public Finance Abuse Unit, with a copy to the Office of Chief Counsel of the Division of Enforcement, no later than sixty (60) days from the date of the completion of the undertakings.

40. For good cause shown, the Commission staff may extend any of the procedural dates relating to these undertakings. Deadlines for procedural dates shall be counted in calendar days, except that if the last day falls on a weekend or federal holiday, the next business day shall be considered the last day.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Sweetwater's Offer.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 8A of the Securities Act, Respondent Sweetwater cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act.

B. Respondent shall comply with the undertakings enumerated in paragraphs 33 to 40 above.

By the Commission.

Vanessa A. Countryman
Secretary