INITIAL DECISION RELEASE NO. 275
ADMINISTRATIVE PROCEEDING
FILE NO. 3-11462

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

In the Matter of	:	
	:	
IRA WEISS, and	:	INITIAL DECISION
L. ANDREW SHUPE II	:	February 25, 2005
	:	
	:	

APPEARANCES: Christina Rainville and Mark R. Zehner for the Division of Enforcement, United States Securities and Exchange Commission

David J. Hickton for Ira Weiss

BEFORE: Lillian A. McEwen, Administrative Law Judge

SUMMARY

This Initial Decision concludes that Respondent Ira Weiss (Weiss) did not violate Section 17(a) of the Securities Act of 1933 (Securities Act), Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act), or Rule 10b-5 thereunder. It further concludes that Weiss did not cause the Neshannock Township School District of Lawrence County, Pennsylvania (School District) to violate Section 17(a) of the Securities Act, or Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. This Initial Decision dismisses all charges against Weiss.

PROCEDURAL HISTORY

The Securities and Exchange Commission (Commission) instituted this proceeding on April 22, 2004, pursuant to Section 8A of the Securities Act and Sections 15(b) and 21C of the Exchange Act.[1] Weiss filed a timely Answer. I held a four-day public hearing in Pittsburgh,

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[1] In connection with this matter, L. Andrew Shupe consented to the entry of sanctions barring him from association with any broker or dealer, ordering him to cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and ordering him to pay $15,043.00 in disgorgement. See L Andrew Shupe, 83 SEC Docket 2113 (Aug. 24, 2004).

Pennsylvania, from July 12-15, 2004, at which the Division of Enforcement (Division) called eleven witnesses and Weiss called three witnesses. Forty-one exhibits from the Division and ten exhibits from Weiss were admitted into evidence. The Division and Weiss filed their Post-Hearing Briefs and Proposed Findings of Fact and Conclusions of Law on September 10 and September 9, 2004, respectively. The Division and Weiss filed their Reply Briefs on September 30, 2004.[2]

ISSUES PRESENTED

The Order Instituting Proceedings (OIP) alleges that in June 2000 the School District fraudulently offered and sold $9,600,000 of General Obligation Notes, Series 2000, dated May 15, 2000 and maturing May 15, 2003 (Notes or Note Transaction). The OIP alleges that the Notes were offered and sold to investors based on a legal opinion, issued knowingly or recklessly by Weiss, to the effect that the interest thereon would be exempt from federal taxation, and on a representation that the note proceeds would be used to fund the School District's capital improvement projects. The OIP alleges that both of these statements were materially false and misleading and, additionally, that at the closing for the Notes Weiss knowingly or recklessly rendered another opinion to the effect that nothing had come to his attention that led him to believe that the Official Statement was materially inaccurate or incomplete.

The tax-exempt status of the Notes was dependent upon, among other matters, the School District reasonably expecting, on an objective basis, to spend substantially all of the proceeds of the Notes on capital projects within three years of the Notes' issuance. The OIP alleges that the School District explicitly advised Weiss that it had not made any final decisions on its primary capital projects and that it did not want to be locked into undertaking the controversial project of renovating or adding to an existing school building by virtue of the financing. The OIP charges that Weiss, nevertheless, reassured the School Board members that as long as they "intended" to undertake the aforementioned project, the School District was not actually required to spend the money or to do the project in order to keep the arbitrage profit.

The OIP further charges that thereafter, a School District official executed an inaccurate certificate, prepared by Weiss, that concerned the School District's plans to expend proceeds of the Notes during the three-year period on capital projects. The OIP alleges that, at all relevant times, the School District intended to use the Note proceeds solely to obtain $225,000 of interest rate arbitrage profit, which created significant risk that the interest from the Notes would not be exempt from federal income tax.

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[2] Citations to Weiss's Answer will be noted as "(Answer __.)." Citations to the transcript of the hearing will be noted as "(Tr. __.)." Citations to the Division's and Weiss's exhibits will be noted as "(Div. Ex. __.)," and "(Resp. Ex. __.)," respectively. Citations to the Division's and Weiss's Post-Hearing Briefs will be noted as "(Div. Post-Hearing Br. __.)," and "(Resp. Post-Hearing Br. __.)," respectively. Citations to the Division's and Weiss's Proposed Findings of Fact or Proposed Conclusions of Law will be noted as "(Div. Facts __ or Div. Law __.)" and "(Resp. Facts __ or Resp. Law __.)," respectively. Citations to the Division's and Weiss's Reply Briefs will be noted as "(Div. Reply __.)," and "(Resp. Reply __.)," respectively.

As a result of the conduct described above, the OIP alleges that Weiss: (1) violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and; (2) caused the School District to violate Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

If I conclude that the allegations in the OIP are true, I must then determine whether: (1) pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, Weiss should be ordered to cease and desist from committing or causing violations of and any future violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and; (2) pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, an order requiring disgorgement, including reasonable interest, should be entered against Weiss.

FINDINGS OF FACT

The findings and conclusions herein are based on the entire record. I applied preponderance of the evidence as the standard of proof for the Division's case. See Steadman v. SEC, 450 U.S. 91, 102 (1981). I have considered and rejected all arguments and proposed findings and conclusions that are inconsistent with this Initial Decision.

The School District

The School District, located in Northern Lawrence County, occupies approximately 17.6 square miles, and is located sixty minutes north of Pittsburgh, Pennsylvania. (Resp. Ex. 5.) It comprises Neshannock Township in Lawrence County, and it became effective before 1900. The superintendent, as chief administrative officer of the School District, has overall responsibility for all aspects of operations, including education, finance, budget, and financial operations. The School District operates an elementary school, and a junior and senior high school. (Resp. Ex. 5.) The elementary school, constructed in 1955, was renovated in 1964 and 1988. The high school, constructed in 1957, was renovated in 1966, 1984, and 1995. (Resp. Ex. 3 at 155.)

The School District is governed by the School Board (Board), made up of nine members who are elected for four-year terms, and who serve without compensation. Approval of an expenditure requires a favorable vote by five of the nine Board members. The Board hires several School District officials who are paid to administer the system; these officials include a superintendent, assistant superintendent, business manager and solicitor. (Resp. Ex. 3 at 146, 155.) The Board has broad powers, including spending, borrowing, and taxing. Revenue for the School District is determined by the rate of taxes levied by the School Board, in accord with Pennsylvania Act 511. For example, the Board's budget for 2001/2002 set tax rates on: real estate, expected to generate nearly $6,000,000; earned income, expected to generate more than $700,000; real estate transfers, expected to generate more than $100,000; per capita, expected to generate $60,000, and; occupational privilege, expected to generate $46,000. (Div. Ex. 28 at 2-3; Resp. Ex. 3 at 116, 143, 160.)

The members of the Board during the bond proposal in the instant case included a number of very sophisticated and experienced citizens. Harry Flannery, the president of the Board (President Flannery), had been a practicing attorney since 1973, when he received a Master of Laws and Taxation. He has been a utility company attorney since 1977. As an uncompensated, elected member of the Board, President Flannery was president of the voluntary Board when the Notes were issued. (Tr. 373-376.) He is also the brother of then-Board solicitor, Richard E. Flannery (Solicitor Flannery), who was the solicitor for the School District from 1978 through June 30, 2000. (Tr. 264.) Other members of the Board in 2000 included an additional attorney, Norman Levine, as well as a dentist, the owner of a printing company, a teacher, and a shopping center developer. (Tr. 392-93.) President Flannery was aware of arbitrage and had even discussed it with a Board member, Hank Forney, in January or February 2000. (Tr. 395-96.)

In 1998, as vice president of the Board, President Flannery participated in bond financing for some of the School District's projects. (Tr. 400-01.) Solicitor Flannery had also worked on prior bond issues for the School District when four bond issues were done for the School District, all between 1995 and 1998. (Tr. 320-21.) For those bond issues, Solicitor Flannery had reviewed documents, written an opinion letter, and attended the closing. (Tr. 267-68.)

Capital Improvement Projects

On August 4, 1998, a report on the elementary school building was sent to then-Superintendent Joseph Scungio (Scungio). Four inspections had been conducted of the electrical and mechanical systems, roofs, and other structures. Engineers, designers, and architects associated with several professional companies performed the evaluation. (Div. Ex. 26 at 1-2.) As is typical with older school structures, the elementary school had an electrical system that would soon cause power fluctuations or "complete power loss" at full demand. (Div. Ex. 26 at 2.) Therefore, to bring the facility "up to code," replacement of most of the wiring would be necessary to upgrade and increase electrical capacity. (Div. Ex. 26 at 2.) Total electrical repairs, including replacement of all light fixtures and receptacles, would cost about $260,000. (Div. Ex. 26 at 4.)

Mechanical systems also posed risks. The hot water heating supply piping in the boiler room showed evidence of leaking and some deterioration was obvious. The fresh-air dampers were leaking and problems with control were present. Under the floor slab, the ventilator water supply pipes had started to leak. Although the heating system was operational, the equipment and material needed to be upgraded to "prevent major breakdowns." The estimate for these repairs, nearly $599,000, included costs for a new heating and air conditioning system. (Div. Ex. 26 at 2-4.)

A section of the roof was "in very poor condition" and required "immediate attention." Insulation had delaminated from the roof deck. Dry rot had set in the roof system. Replacement of the roof decking with a metal deck system would allow proper mechanical attachment of the installation as part of a new membrane roofing system. Another large section of the roof needed to be replaced within three to four years. Roof replacement that would not include asbestos remediation work was estimated to cost $254,000. The construction costs for the elementary

school repairs to be done in 1998 amounted to more than $1 million. As for project priority, the report recommended that the heating system be replaced immediately to prevent costly system failure. It also recommended the electrical system upgrades be commenced immediately due to their unsafe condition. (Div. Ex 26 at 6.) In 1998, bond financing paid for some capital improvements that were mandated by the Board. (Tr. 400-13.)

On July 27, 1999, Eckles Architecture (Eckles) submitted a report on the elementary school that included asbestos abatement and other more detailed costs, as well as the requirements listed in the August 4, 1998, report. The new estimate for the cost of the project was nearly $5 million. (Div. Ex. 27 at 1.) In 1999, Scungio retired, and a new superintendent, Dr. Ronald M. Mento (Mento), was hired by the Board. When he was hired, Mento was informed that part of his responsibilities would be ensuring that the elementary school and other areas in the school complex were improved. (Tr. 379.) By then, the Board knew that the total cost of renovations would be more than $10 million. (Tr. 375-79, 416; Div. Ex. 10.) The newly hired superintendent came from a school system that had been audited as a result of "irregularities" and he became controversial. (Tr. 420.) In preparation for its capital projects, the School District hired Thomas Graney, a municipal planning consultant, to do demographic work in March 2000. (Tr. 509-10; Div. Ex. 33.) His later report predicted student enrollment figures that were consistent with the work conducted by the Pennsylvania Department of Education. (Tr. 526-28; Div. Ex. 34.)

The Issuance of the Bonds

By May 2000, the Board began to explore the possibility of issuing bonds once more to fund its capital projects. (Tr. 213; Div. Ex. 11.) In Pennsylvania, some school district construction projects qualify for reimbursement from state tax revenue. (Tr. 667-70.) To qualify for state fiscal assistance school districts must follow a state mandated process known by the acronym PLANCON. (Tr. 669-70.) Of course, a school district may also decide to pay for projects locally, with the funding that is generated by taxes. (Tr. 671-73.) The School District's old buildings had been constructed through the issuance of bonds and the levying of taxes, combined with state reimbursement. (Tr. 674.) Repair projects are not reimbursable under PLANCON. (Tr. 673.) The elementary school and the middle school construction, however, would be reimbursable via PLANCON. (Tr. 839.) Pursuant to PLANCON, the project must be approved by the state before bids may be solicited. (Tr. 839-40.)

A municipal bond is a debt obligation of a state or local government entity. (Tr. 46.) A bank purchases the bond and acts as an underwriter, or middle man, accepting risk of nonpayment until their customers buy the bond. (Tr. 46.) The bank prices the bond so that it will sell quickly. (Tr. 47.) The issuer is the entity that borrows the money. (Tr. 47.) In the instant case, the School District was the issuer. (Tr. 47.) "[W]hen state and local governments borrow money, the interest is not subject to federal income tax. For that reason, these obligations bear interest at a much lower rate than taxable obligations such as Unites States Government bonds." (Tr. 47-48.) Municipalities are prevented by law from garnering arbitrage profit by issuing municipal bonds, and using the proceeds solely for investing tax free in Federal Government bonds at a higher interest rate. (Tr. 48-50.) The principal role of bond counsel in a municipal bond transaction is to give a legal opinion as to the validity of the bonds, and as to

federal income tax exemption status of the interest paid on the bonds. (Tr. 51.) Bond counsel's role evolved in the nineteenth century after municipalities defaulted on bonds, due to state constitutional debt limits, and other factors that were ignored by the issuer. (Tr. 51.) Purchasers of the bonds began to insist that a lawyer with recognized expertise in the area give an opinion as to the validity of the offering. (Tr. 51.)

Bond lawyers, such as Weiss, are listed in the Red Book, a national publication of the trade publishers of the Bond Guide. Division Exhibits 5 and 6 are the Model Opinion Report standards for bond lawyer practice in 1993 and 1997. (Tr. 53-62; Div. Exs. 5, 6.) If bond counsel concluded that it would be unreasonable for a court to rule against the bond counsel's opinion on tax matters, an unqualified opinion could be given as to a municipal bond issue. (Tr. 62-64; Div. Exs. 5, 6.) The Internal Revenue Service (IRS) has established a three-prong test for determining whether a bond complies with the arbitrage restriction rules that apply to municipalities. First, the expenditure test requires that eighty-five percent of the proceeds must be spent on capital projects within three years. Second, the time test requires that, within six months of issuance, the issuer must enter a substantial binding obligation to an outside party to expend at least five percent of the bond proceeds. And third, the due diligence test requires that the bond proceeds be used for completion of capital projects with due diligence. (Div. Ex. 9.) If the IRS concludes that any one prong of the test is not met, then the bonds will be classified as arbitrage bonds, and subject to federal income taxation. (Tr. 69-70; Div. Ex. 9.)

On April 10, 2000, a public meeting was announced as part of the process for making capital improvements to the school facilities. (Tr. 479-80; Div. Ex. 32.) No public meeting was held before the bonds were issued in June 2000. A "wish list" that included the elementary school renovations as well as other options, totaling $4 million to $10 million, had been made on February 23, 2000; however, no consensus was reached as of that date on proceeding with the work. (Tr. 480-84.) Although a five-year plan of major projects had been generated by the Board during the tenure of Mento's predecessor, the Board had not decided which part of the plan would be implemented first. (Tr. 500.)

Leslie Andrew Shupe (Shupe), like several other businessmen involved in investment banking, learned from the newspaper that the School District was exploring issuing bonds. Like others, he contacted Mento with a preliminary proposal. When Shupe was mayor of a borough in Pennsylvania, Weiss was the solicitor, and he had previously worked with Weiss on approximately twenty municipal bond transactions. Shupe, therefore, contacted Weiss about becoming bond counsel for his proposal to the School District. (Tr. 212-14.)

After graduating from Duquesne University School of Law in 1973, Weiss clerked in Pennsylvania for an attorney who specialized in municipal and school law. In 1979, he opened his own practice in the same field. By the date of the hearing, Weiss had served as solicitor for more than a dozen school districts and municipalities, and as general counsel or special counsel for many others. Weiss has also served as a board member and chairman of the Allegheny County Sanitary Authority. Weiss's experience with municipal bonds and notes stems from his work as solicitor, bond counsel, issuer, or underwriter's counsel during his legal career. Weiss appeared in the Red Book in 1986, and has participated in about 100 bond transactions as note or bond counsel. (Tr. 650-54.) In 1999, Weiss had represented the School District in the trial and

successful appeal of a state tax matter. During the relevant time period, seven of nine members of the Board had also been active in the tax case. Weiss attended several Board meetings during which he was questioned as to tax matters. (Tr. 661-64.)

Weiss was retained by the School District for the transaction at issue. (Tr. 554.) Weiss knows that bond counsel is retained in a municipal bond transaction "to assure that the bonds are validly issued and to provide an opinion to that effect, as well as to the effect that they are issued on a tax-exempt basis . . . ." (Tr. 554.) Opinions of bond counsel are required so that purchasers can be assured that the interest on the bonds are "exempt from federal taxes." (Tr. 555.) Before issuing his opinion, Weiss ensures that the transaction meets all tax requirements. (Tr. 556.) Weiss considered the defined project in the instant case to be capital repairs, renovations, and an addition to the elementary school. (Tr. 556-57.) Mento, whom Weiss had known since 1994, was Weiss's primary contact with the School District. (Tr. 562-63.)

In the past, the School District had "bid out the investment counsel" who would cause the note to issue. For some earlier bond issues, Solicitor Flannery had selected bond counsel, and for another bond issue the bond counsel position "was bid." In April 2000, Mento called Solicitor Flannery about a bond plan that Solicitor Flannery "was not comfortable with." Mento told Solicitor Flannery that bond counsel for the April 2000 project would be Weiss. Mento had engaged Weiss when Solicitor Flannery "was in conflict," and Weiss "did very well for the district" on that occasion. (Tr. 269-72.) On May 2, 2000, Weiss faxed a letter to Solicitor Flannery (May 2 Letter) addressing issues that he had raised regarding the 2000 bond issue. (Tr. 272-73; Div. Ex. 12.) In the letter, Weiss addressed Solicitor Flannery's questions about the financing. (Tr. 273-74.) Weiss understood that the School District had intended to issue notes to pay for capital projects. (Div. Ex. 12.) Weiss wrote that the School District could issue notes for three years, and, provided they undertook the projects, they could invest the proceeds of the Notes during the three-year period. (Tr. 580, 590; Div. Ex. 12.)

In a later conversation, Weiss told Solicitor Flannery "that during the three-year period, provided the District was doing the projects, they could invest the money they weren't using and gain positive interest." (Tr. 590.) In his conversation with Weiss, Weiss made it clear to Solicitor Flannery that "there had to be projects intended . . . ." (Tr. 276.) Weiss stated that the bond proceeds "could have been spent any time during the three years, as long as it was spent on the projects." (Tr. 276-77, 364-65.) Weiss also made it clear to Solicitor Flannery that "until the [School] District proceeded with the projects, that they could legitimately earn interest on investments. . . ." (Tr. 277.)

Weiss did not tell Solicitor Flannery that the School District had to spend five percent of the notes within six months, but Weiss did not consider it to be an "issue," since the Board was "moving forward." (Tr. 590-91.) Weiss concluded from conversations with Solicitor Flannery and Mento that Eckles had an oral contract or commitment to perform work related to the listed projects. (Tr. 832-34.) In Pennsylvania, the architect receives the majority of his fee before the project is advertised for a bid. That fee is usually six or seven percent of construction costs. (Tr. 834-35.) From Mento, Solicitor Flannery, and the Board, Weiss concluded that an architect was on "board." (Tr. 559, 833-34.) Weiss knew that the Board was committed to "doing the elementary school," which had electrical wiring problems. (Tr. 591.) The Notes were structured

on a three-year basis with a one-year call. (Tr. 595.) Ultimately, the Board called the Notes at the end of the year. (Tr. 595.)

During a May 8, 2000, Board meeting (May 8 Meeting), Shupe presented his note proposal. Shupe told the Board about a "loophole" in the tax laws that would allow school districts to borrow tax-free money "as long as we had a pending building project." (Tr. 493-94.) This "loophole" would allow the School District to earn $225,000. (Tr. 495-96.) During the presentation Shupe told the Board that they could borrow money just to invest the proceeds for profit. (Tr. 474, 597.) Weiss knew Shupe was wrong, and contradicted him. Weiss informed the Board that what Shupe described "[was not] exactly the case." (Tr. 598-99.) Weiss told the Board "that they had to have projects, that they had to spend the money in three years and they had to proceed with [the projects]" and that "if they didn't want to do the project, [he] shouldn't be there." (Tr. 598.) President Flannery recalled that Weiss told the Board at the meeting that eighty-five percent of the proceeds of the Notes had to be spent on projects or contracted for before the end of the three years. (Tr. 382-83.) I credit President Flannery's testimony.

Weiss concluded that the projects that the Board decided to implement at the close of the school year would exceed the five percent expenditure requirement, and that, therefore, there was no need to emphasize that requirement at the meeting. (Tr. 601-02.) The Board members had nodded their heads in assent at the May 8 Meeting when Weiss mentioned an oral arrangement with Eckles, and Weiss interpreted that as a sign that the School Board had approved the architect's participation in the projects. (Tr. 833-34.) The Board asked "a lot of questions" about Shupe's proposal. (Tr. 284-85.) The Notes were being proposed as a way for the School District to make money, but the proposal came from Shupe "not by Mr. Weiss." (Tr. 287.) Shupe's scheme appealed to the Board's desire to make money, and was a common sales pitch, albeit irresponsible and dishonest. (Tr. 169-71.) At the time of the May 8 Meeting, President Flannery concluded that he and the entire Board had reasonable expectations that capital projects would be completed with the proceeds of the Notes. (Tr. 410-11.)

The Board had already decided to complete a number of projects that were discussed at the May 8 Meeting, and were to "start as soon as [they could]" on them. (Tr. 282.) Solicitor Flannery had previously spoken with Weiss about the fact that eighty-five percent of the proceeds had to be spent in three years, and "it was said" at the May 8 Meeting as well. (Tr. 285, 333, 365-66.) Solicitor Flannery received a copy of Shupe's proposal during the May 8 Meeting. Solicitor Flannery was not sure whether there was a consensus on the projects. (Tr. 280-82.)

Between the May 8 Meeting and the closing date, Solicitor Flannery initiated an investigation to determine whether the note issue should go forward. (Tr. 339-40.) After reviewing the list of intended projects and speaking with Weiss, Solicitor Flannery was "absolutely" convinced that the note issues should be completed because the School District would "proceed with projects." (Tr. 342.) Solicitor Flannery also discussed the issue of the architect with Mento and concluded that "[w]e already were on board with an architect." (Tr. 344-45.) Solicitor Flannery did not view his legal representation of the School District to include "follow-up" to ensure that the School District acted consistently after the Notes closed because he was paid at an hourly rate for his work. (Tr. 354.) Indeed, for the earlier bond issues, he never conducted any follow-up work or due diligence. (Tr. 354-55.) Before the date of closing

Solicitor Flannery reviewed and read the documents, including the Non-arbitrage Certificate. (Tr. 289; Div. Ex. 8.)

Shupe showed Weiss a proposal for an illiquid investment for a fixed period, after the May 8 Board Meeting. When Weiss objected to the proposal as generating a possible penalty, Shupe eliminated it from his final proposal, which was presented to the Board at a May 31, 2000, Board meeting (May 31 Meeting). Weiss never mentioned this matter to the Board because he considered it to be a "dead issue" that had been eliminated from the proposal. (Tr. 607-10.)

Gina Marie Hennon (Hennon), a college graduate working in the medical field, was elected to the School Board in 1991 and served through 2003. (Tr. 470.) Hennon had participated in a federal-state school financing system in the past. (Tr. 472.) She knew that the three-year bond financing scheme originally proposed by Mento was too good to be true. (Tr. 472-74.) At that time, there was no consensus on whether to proceed with a middle school. (Tr. 428.) Indeed, no middle school was ever constructed, and no major construction project was started until 2002. (Tr. 478.) If Weiss had told the Board that they were obligated to spend five percent of the proceeds within the first six months after issuance of the Notes, Hennon would have insisted on a firmer project or not done the bond issuance at all. (Tr. 485.) While the Board had retained Solicitor Flannery to do an independent investigation of the legality of the bond transaction, Hennon relied on the advice of both Solicitor Flannery and Weiss. (Tr. 486.) The Board redeemed the Notes when Mento told them that favorable "rates" would enable them to "capture the proceeds." (Tr. 486.)

Karen L. Houk (Houk), a retired teacher, was a Board member for eight years. (Tr. 492-93.) At the May 8 Meeting, she learned more about Mento's idea to issue three-year notes, an idea that Mento had already discussed with her. (Tr. 493.) Houk was absent for the May 31 Meeting when the Board approved the issuance of the Notes, and was also absent for the closing of the Notes. (Tr. 507-08.) She never met or spoke with Weiss about the transaction before or after the May 8 Meeting. (Tr. 507-08.)

The day after the May 31 Meeting, Weiss sent a letter to Mento requesting a list of projects and associated costs that the Board "contemplated undertaking," so that they could approve them at a Board meeting, scheduled for June 15, 2000. (Tr. 611-13; Div. Ex. 37.) The Board had not advertised for bids on the projects yet. (Tr. 613-14.) The Board's approval of the list provided assurance to Weiss that they would proceed with the projects that were the basis for the issuance of the Notes. (Tr. 614-15.) In reply, Mento sent a June 15, 2000, letter to Weiss that listed thirty-three projects, without the associated costs. (Tr. 615-16; Div. Ex. 11.) Mento refused to provide cost estimates when Weiss's later requested them. (Tr. 616-17.) Bernadette Barattini (Barattini) of the Pennsylvania Department of Community Economic Development, the agency responsible for approving state debt issuance by government entities, approved the School District debt plan submitted by Mr. Weiss. Thus, he had no need to press Mento for more specific figures after Mento responded to his letter. (Tr. 791-92.) The Debt Act approval by Barattini is included in the closing documents because bond counsel's opinion must indicate that the state government's pledge is legally enforceable against the issuer pursuant to Pennsylvania law. (Tr. 793-94.)

Weiss gave the Non-Arbitrage Certificate to Solicitor Flannery for his review eight days before the closing date, and Weiss relied upon it for the issuance of his opinion. (Tr. 627-28.) The description of the capital projects in the Non-Arbitrage Certificate is consistent with the plans described by the Board, Mento, Solicitor Flannery, and other project language in similar certificates that Weiss had seen and generated in his legal career. (Tr. 627-30; Div. Ex. 8.) Weiss is familiar with the U.S. Treasury Regulations relevant to this transaction and concluded that the Non-arbitrage Certificate in the instant case met the Regulations. (Tr. 632-34.) Weiss prepared the standard solicitor's opinion for the signature of Solicitor Flannery. (Tr. 639.) He also issued his unqualified Bond Opinion as to tax-exempt status of the Notes. (Tr. 641-42; Div. Ex. 14.) "The purpose of the Notes was to fund capital improvement projects." (Tr. 644-45; Div. Ex. 22.) However, no proceeds from the sale of the Notes were used to provide funds for the capital improvements of the School District. (Tr. 645-46.) Weiss received a fee of $9,000, plus costs of $509.63 for his work in the instant case. (Tr. 646.) The Notes were issued at closing on June 28, 2000. (Tr. 646-47.)

The Bond Proceeds

On July 7, 2000, Solicitor Flannery forwarded Weiss a letter that he had written to Shupe. (Tr. 300-01; Div. Ex. 24.) Solicitor Flannery wanted to ensure that the School District did not lose money on the investments that Shupe recommended. (Tr. 301-04; Div. Ex. 24.) Shupe's plan was to "sell off the long three-year piece of paper and provide cash for them" if the Board started a project. (Tr. 238-39.)

The Board appointed Eckles on October 11, 2001, with a contract that "might have been retroactive from 1998." (Tr. 389-91; Div. Ex. 16 at 2.) The architect prepares the specifications for bid, even for a leaking roof, since any work over $10,000 must be competitively bid. The architect ensures that the performance and bid bonds are in order and oversees the work. For concrete repair work, the architect analyzes the structure to determine whether test borings must be performed to the subsurface. The architect would compare bid specifications in terms of materials and would inspect the work before the School Board could approve payment to the contractor. The architect assists the School Board in reviewing the lowest responsible bids, and makes recommendations. The time between preparations of bid specifications to bid awards could be as long as a month. (Tr. 835-39.)

The proceeds of the Notes were initially invested in money-market funds because "the yields were dropping" in the Treasury Market. (Tr. 420.) Shupe eventually purchased $8.2 million in Federal Home Loan Bank securities so that the School District could earn the $225,000 profit it sought. (Tr. 240.) Shupe prepared Division Exhibit 17 for Carol Robinson (Robinson), the School District's business manager, so that the securities could be delivered. (Tr. 241; Div. Ex. 17.) Shupe generated Division Exhibit 18 so that the Notes could be called at the first call date, May 15, 2001, about one year after the issue date. (Tr. 242; Div. Ex. 18.) Shupe discovered that the Board was "muddling around, procrastinating a lot" in reference to the projects. Noteholders were paid at the first call date. The School District was left with a balance of $150,000 after completing the call. Weiss never expressed concern about the investment of the Note proceeds, and he never told Shupe that the funds should be kept available for use on

projects. (Tr. 241-44.) Weiss merely reviewed the documents that Shupe mailed describing the use of the proceeds of the Notes. (Tr. 248-51; Div. Exs. 22, 23.)

The School District had bought Treasury strips so that interest would be paid to the noteholders on, or about, the date that the strips matured. Noteholders were paid interest from profits, although no money had been spent on construction or project contracts. (Tr. 175-76.) An architect was hired more than a year after the Notes issued, not within the required six months. (Tr. 389-91.) Finally, the Board's investment exposed them to market risk. (Tr. 176-77; Div. Exs. 17, 18.)

Solicitor Flannery investigated the Federal Home Loan investment that Shupe handled and concluded that it was legal and appropriate. During the first two months of 2001, Mento called Solicitor Flannery to inform him that the Notes were being recalled on the recommendation of Weiss. Mento explained that, because of the "investment rates," this would be the "prudent thing to do." (Tr. 305-07.) Weiss's work was complete at the closing on June 28, 2000. (Tr. 696.) Mento asked Weiss, however, to help with the early redemption of the bonds, which Weiss told the Board to complete by April 2001. (Tr. 697-99; Div. Ex. 39.)

Board's Distractions

The Board was indeed "muddling around" after the issuance of the Notes because it had become paralyzed by an unanticipated series of complex and emotionally charged events. By the May Board meetings, President Flannery was already "very concerned about a football coach problem" and "high numbers of people in attendance" at the Board's meetings. (Tr. 381; Resp. Ex. 6.)

In 1999, the Board became involved in a crisis over the replacement of a popular senior high school football coach. (Tr. 418-19; Resp. Ex. 6.) The newly hired superintendent, Mento, had also been hired away from a school system that had been audited as a result of "irregularities." (Tr. 420.) The Board also became distracted from its work by employee personnel problems that resulted in two dismissals. Additionally, a student filed a complaint in federal court alleging a violation of privacy in reference to a cheating allegation. (Resp. Ex. 6.) These and other "side shows" competed for the Board's time with the construction project. (Tr. 420-21.) By the date of the hearing in the instant case, construction had been completed to transform the school building and grounds. (Tr. 422.) The projects "did go forward" after President Flannery left. (Tr. 422, 424.) During President Flannery's tenure, the Board also hired several principals and administrators to fill an unusually high number of vacancies. The Board executive meetings often lasted until midnight. (Tr. 423-25.) Finally, Board member Gary Clobus, the owner of a printing company, and chair of the Building and Grounds Committee in 2000, became ill with cancer in early 2000 and missed several meetings during the early PLANCON process that started in June 2000. (Tr. 539, 547-448.)

On November 8, 2000, the IRS sent a letter to the School District. (Tr. 692; Div. Ex. 38.) The School District is one of thirteen Pennsylvania School districts that the IRS determined had issued taxable arbitrage bonds between 1999 and 2001. (Tr. 152-53.) The IRS has a Web site dedicated to bond material, and the director, a bond lawyer, and the chief counsel answer

telephone inquiries to provide answers to tax questions. (Tr. 154.) Weiss did not learn that the Board had placed the proceeds of the Notes in a three-year investment until he received a copy of the Board's bank statement that the IRS requested. (Tr. 683.) The Board's solicitor and business manager are responsible for ensuring that the Board acts consistently with the representations they made at closing. (Tr. 685-86.) Solicitor Flannery was responsible for ensuring that the Board acted with due diligence to complete the projects. (Tr. 687.)

At a June 14, 2001, Board meeting, the Board received bids on bus garage re-roofing and grandstand refurbishing. (Tr. 456-58.) These were the first bids received by the Board related to the capital projects described in 1999. (Tr. 458.) In May 2003, the Board's decision to make additions and alterations to the elementary school resulted in work being started on the project. (Tr. 468-69.) In December 2002, a public hearing was held on the issue of the middle school construction. (Tr. 692-93.)

The School District ultimately entered into a settlement with the IRS in which it agreed to pay $150,056.07 to the IRS. (Tr. 308-09; Div. Ex. 20.) The School District also entered into a settlement with the Commission on April 22, 2004, in which it agreed to pay disgorgement, plus pre-judgment interest, in the amount of $28,904. See Neshannock Township School District, 82 SEC Docket 2718 (April 22, 2004).

CONCLUSIONS OF LAW

The OIP alleges that Weiss violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. The OIP also alleges that Weiss caused the School District to violate of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Although the Division's primary concern is violation of Section 17(a)(1), it also alleges that Weiss violated Sections 17(a)(2) and 17(a)(3). (Div. Post-Hearing Br. at 53-54.) By invoking Section 17(a) in its entirety, the OIP gave appropriate notice that all subsections would be in issue. Therefore, I reject Weiss's claim that the Division tried to turn this into "trial by ambush by inserting negligence into [the] case" because the OIP does not allege negligence under Section 17(a)(2) and 17(a)(3). (Weiss Reply at 2, 32-33.)

A. Legal Standards

Section 17(a) of the Securities Act prohibits fraudulent conduct in the offer and sale of securities, and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder prohibit fraudulent conduct in connection with the purchase and sale of securities. These provisions essentially prohibit the same type of conduct. See United States v. Naftalin, 441 U.S. 768, 773 n.4 (1979).

To establish violations of Section 17(a)(1) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, the Division must establish: (1) misrepresentations or omissions of material facts or other fraudulent devices; (2) made in connection with the offer, sale, or purchase of securities; and (3) that the respondent acted with scienter. Scienter is not necessary to prove violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act; rather, liability may be established by merely showing negligence. Aaron v. SEC, 446 U.S. 680, 697

(1980); SEC v. Solucorp Indus., 274 F. Supp. 2d 379, 419 (S.D.N.Y. 2003); SEC v. Scott, 565 F. Supp. 1513, 1525-26 (S.D.N.Y. 1983).

A fact is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision and would view disclosure of the fact as having significantly altered the total mix of information made available. Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988); TSC Indus. Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976). Materiality is a mixed question of law and fact. TSC Indus., 426 U.S. at 450.

Scienter is defined as "a mental state embracing intent to deceive, manipulate or defraud." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976). The scienter requirement may be satisfied by a showing of recklessness. Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1568-69 (9th Cir. 1990); David Disner, 52 S.E.C. 1217, 1222 & n.20 (1997) (citation omitted). Recklessness is defined as "an extreme departure from the standards of ordinary care … present[ing] a danger of misleading buyers or sellers that is either known to the [respondent] or is so obvious that the [respondent] must have been aware of it." Sundstram Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1044-54 (7th Cir. 1977) (citation omitted), cert. denied, 434 U.S. 875 (1977). Proof of scienter can be demonstrated by circumstantial evidence. Herman & MacLean v. Huddleston, 459 U.S. 375, 390 n.30 (1983).

Section 8A of the Securities Act and Section 21C of the Exchange Act authorize the Commission to order any person who was a cause of a violation, due to an act or omission the person knew or should have known would contribute to such violation, to cease and desist from committing or causing such violation and any future violation. For such an order, the Division must prove: (1) a primary violation occurred; (2) there was an act or omission by the respondent that was a cause of the violation; and (3) respondent knew, or should have known, that his conduct would contribute to the violation. Robert M. Fuller, 80 SEC Docket 3538, 3545 (Aug. 25, 2003) (citing Erik W. Chan, 77 SEC Docket 851, 859-60 (Apr. 4, 2002)), appeal pending, No. 03-1334 (D.C. Cir.). The "should have known" language is akin to negligence. KPMG Peat Marwick LLP, 74 SEC Docket 384, 421-23 (Jan. 19, 2001).

B. Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder

The Division alleges that Weiss violated the antifraud provisions by making several material misrepresentations and omissions during the course of his representation in the Note Transaction. (Div. Post-Hearing Br. at 44.) The Division alleges that Weiss knew, or was reckless, in not knowing that the Notes were issued solely to gain illegal arbitrage profit when he: reviewed the preliminary official statement and Official Statement which represented that the issuance of the Notes was to provide funds for capital improvements; issued his unqualified Bond Opinion that the Notes would be exempt from federal income taxation; and, issued his Supplemental Opinion to the effect that nothing had come to his attention that led him to believe that the Official Statement was materially inaccurate or incomplete. Specifically, the Division alleges that the representations communicated to noteholders in the Bond Opinion, the Supplemental Opinion, and the Official Statement, are the basis for Weiss's direct violations of

the securities laws. (Id.) The Division argues that the misrepresentations and omissions made to the School District serve as evidence of scienter. (Id.)

The Division alleges that Weiss either knew the School District issued Notes for the sole purpose of obtaining arbitrage profit, or was reckless or negligent in not knowing, because he failed to follow industry standards. (Div. Post-Hearing Br. at 52.) The Division alleges that the following facts are evidence of Weiss's knowing or reckless misconduct: The May 2 Letter from Weiss to the Solicitor Flannery, in which Weiss misstated both his experience and the law (specifically, 26 C.F.R. § 1.148-2(e)) (Div. Post-Hearing Br. at 19); The May 8 Meeting and Weiss's reactions/communications in which he failed to advise the School Board that the transaction was illegal (pursuant to 26 C.F.R. § 1.148-2(e)); Solicitor Flannery raised concerns with Weiss and pointed out that the School District had not decided what projects they were going to undertake; Board members asked Weiss "pointed questions," including what happens if the School District does not spend the money; Shupe presented Weiss with a document prior to the Note issue showing Shupe's intention to tie the money up for three years in an illiquid investment; Weiss failed to obtain cost estimates from the School District for the projects, despite a Treasury Regulation that requires estimates as a part of the process; and, When the IRS began its investigation, Weiss assisted the School District in redeeming the Notes, rather than advising the School District to quickly enter into binding commitments as there was still time to meet the Treasury Regulation requirements (Div. Post-Hearing Br. at 3-4.) The Division, additionally, alleges that Weiss failed to investigate whether the School District took any of the required steps required by Pennsylvania law to undertake construction projects. (Div. Post-Hearing Br. at 11.)

The Division's position fails to take into account the unique events that affected the Board's decisions. It also mischaracterizes the relationship between Weiss and the Board members. Weiss acted with the requisite standard of care. Weiss contacted Mento, who informed him that the School District was committed to renovations and other repairs, and that there was an architect on board. (Tr. Weiss Facts at 9-10.) When he met with Mento, he advised Mento of the pertinent Treasury Regulations, and was informed that the School District was "committed" to renovations. (Id. at 11-12.) During the May 8 Meeting, Weiss contradicted Shupe, after Shupe told the Board that they could borrow money in advance of construction projects and legally keep the investment earnings. (Id. at 13-14.) At the May 8 Meeting, he advised the School Board that this was not the case. (Id.) While he never received the estimates for the projects that he requested from Mento, Weiss reasonably believed he could issue his opinion based on his conversation with School Officials and his own experience. (Id. at 17.) Weiss also attended two Board meetings and forwarded the closing documents to solicitor Flannery eight days before closing. I conclude that Weiss's actions were consistent with the actions of a reasonable bond counsel. This conclusion is based on the expert opinions of Weiss's witnesses, Henry Klaiman and Wayne Gerhold. (Tr. 702-33, 761-99.)

I conclude that the School District did not issue the Notes solely for the purpose of obtaining arbitrage profit. I also conclude that Weiss did not act recklessly, or negligently, during the course of his representation of the School District for the Note Transaction. I reject the opinions of the Division's expert witnesses, Joseph H. Johnson and Charles Anderson. (Tr. 66-99, 175-92.) The securities laws generally define recklessness as an act so highly

unreasonable and such an extreme departure from the standard of ordinary care to the extent that the "danger" was either known or so obvious that the accused must have been aware of it. See Phillips v. LCI Int'l, Inc., 190 F.3d 609, 621 (4th Cir. 1999). The parties are in agreement that at the time of the Note issuance the prevailing standard of practice for counsel issuing a tax opinion was set forth in the National Association of Bond Lawyer's (NABL) Model Bond Opinion Report for 1997, (Weiss Facts at 8; Div. Post-Hearing Br. at 6), which states:

> Bond counsel should not render an unqualified opinion as to the validity and tax exemption of bonds unless it has concluded that it would be unreasonable for a Court to hold to the contrary. Bond counsel may reach such a conclusion as to federal income tax issues addressed in the opinion by determining that there is no reasonable possibility that the [IRS] would not concur or acquiesce in the opinion if it considered all material legal issues and relevant facts.

The plain language of the NABL Model Bond Opinion Report for 1997 is clear: a bond counsel's opinion must be reasonable, and, in reference to tax matters, there must be no reasonable possibility that, if it considered all material legal issues and relevant facts, the IRS would not concur. Taking the material legal issues and relevant facts into account, it would be an impermissible extension of the legal responsibility of bond counsel to conclude that Weiss violated the antifraud provisions of the securities laws.

Bond proceeds, in a three-year issuance, may be invested in higher yielding investments without being classified as arbitrage bonds if the issuer reasonably expects to satisfy the expenditure, time, and due diligence tests. 26 C.F.R. § 1.148-2. The expenditure test is met if at least eighty-five percent of the net proceeds are allocated to expenditures on the capital project by the end of the three-year period. 26 C.F.R. § 1.148-2(e)(2)(i)(A). The time test is met if the issuer incurs a substantial binding obligation to a third party to expend at least five percent of the net proceeds of the issue on capital projects within six months of the issue date. 26 C.F.R. § 1.148-2(e)(2)(i)(B). The due diligence test is met if completion of the capital projects and the allocation of the net proceeds moves forward with due diligence. 26 C.F.R. § 1.148-2(e)(2)(i)(C). If any one of the three tests is not met, then the bonds may be arbitrage bonds and, therefore, taxable. 26 C.F.R. § 1.148-2(a).

The determination of whether bonds meet the exception to the arbitrage bond rules "is based on the issuer's reasonable expectations as of the issue date." 26 C.F.R. § 1.148-2(b)(1). The issuer's "expectations or actions are reasonable only if a prudent person in the same circumstances as the issuer would have those same expectations or take those same actions, based on all objective facts and circumstances." 26 C.F.R. § 1.148-2(b). Bond counsel's role in issuing its bond opinion is to make sure that the bond issuance meets all the tax requirements. The bond lawyer accomplishes this by gathering information from the issuer to show that what the issuer is doing meets the requirements of the tax laws. (Tr. 556.) A bond opinion, however, is not a guarantee; it merely serves as the lawyer's informed judgment as to a specific question of law on the date of issuance; specifically, in this case, Treasury Regulation § 1.148-2. (Div. Exs. 1, 5.) This is because "certain post issuance events may result in the interest on the bonds becoming taxable as of some future date after the date of issuance." (Div. Ex. 1 at 5.)

After Weiss was retained by the School District, he faxed his May 2 Letter to Solicitor Flannery. The May 2 Letter was preliminary in nature, as evidenced by the fact that Weiss did not go into great detail regarding the transaction and in the closing wrote: "I would be glad to discuss these matters with you at your earliest convenience" (Div. Ex. 12.) I conclude that the May 2 Letter, while containing some puffery concerning Weiss's qualifications, did not misstate the law. In a later phone conversation, Weiss more directly addressed Solicitor Flannery's concerns and informed him that as long as the School District was doing the projects, they could invest the proceeds from the Notes that were not being used and gain positive interest. (Tr. 590.) Weiss never told Solicitor Flannery that the School District had to spend five percent of the Notes within six months because Solicitor Flannery represented to Weiss, that Eckles was "on board" as the architect for the projects, whose fee could account for up to seven percent of the proceeds. (Tr. 559, 788-89.) Under these facts and circumstances, Weiss attended the May 8 Meeting.

At the May 8 Meeting, Weiss corrected Shupe and told the Board that they had to have projects, that they had to spend eighty-five percent of the proceeds within the three-years, and that if they did not have projects he should not even be there. (Tr. 598-99.) Weiss's statements were consistent with the representations he had made earlier to Solicitor Flannery. (Tr. 285, 333.) When asked whether there was an agreement with Eckles, the Board nodded their heads in assent. (Tr. 833-34.) The Board also indicated that it would implement some of the projects at the end of the year. (Tr. 601-02.) Weiss, therefore, reasonably decided that it was unnecessary to discuss the five percent expenditure requirement. (Tr. 833-34.) At the May 8 Meeting President Flannery, as well as the Board, had reasonable expectations that capital projects would be completed with the proceeds of the Notes. (Tr. 410-11.) No witness testified to the contrary.

After the May 8 Meeting, Shupe showed Weiss a proposal that contained an illiquid investment. (Tr. 607.) Weiss objected to this investment, because he knew that it was contrary to the Treasury Regulations and would generate a possible penalty. (Tr. 607-09.) This investment "option" was eliminated from the final proposal that was presented to the Board at the May 31 Meeting. (Tr. 610.) After the May 31 Meeting, Weiss requested that Mento provide him with a list of projects, along with cost estimates, to submit to state officials for approval. (Tr. 611-13.) Mento responded in a June 15, 2000, letter which listed thirty-three projects, however, without the requested associated estimates. (Tr. 615-16.) Weiss had requested this information because he wanted to be sure that the School District was going to proceed with the projects. (Tr. 614-15.) Weiss never received cost estimates from Mento. (Tr. 616-17.) Barattini, the state official who approved the issuance of the Notes, reviewed the same project list that Weiss obtained from Mento and signed the documents so that the Board could proceed to closing. (Tr. 794.)

I conclude that Weiss's failure to include cost estimates does not make him reckless or negligent. With his vast experience in municipal and school law, and with the material facts and circumstances known to him at the time, it was reasonable for Weiss to issue his opinion without cost estimates in the closing documents. He knew that the projects would cost $10 million to complete and he knew that the projects had been planned for years and were overdue. Weiss completed the Non-Arbitrage certificate, and gave it to Solicitor Flannery for review eight days before the transaction closed on June 28, 2000. (Tr. 627-28.) The Non-Arbitrage Certificate

stated that the purpose of the Notes was to fund "capital projects in the [School] District," and also set out the expenditure, time, and due diligence tests in Treasury Regulation § 1.148-2. (Div. Ex. 8.) Weiss's representation of the School District ended when the transaction closed.

At no time before the Notes closed on June 28, 2000, did anyone associated with the School District indicate that they planned to abandon the projects in order to enrich the School District's coffers with arbitrage profits. To the contrary, it is clear that at the time of the closing for the Notes, the School District reasonably expected to proceed with the projects. There were newspaper articles about the School Districts engaging in capital projects and Mento had been hired for the express purpose of leading the completion of the capital projects. (Tr. 213, 379.) The School District had also hired a municipal consultant to perform demographic work and, at the very least, consulted with an architect who provided cost estimates for several projects. (Tr. 509-10; Div. Ex. 27.) The School District knew that renovations were long overdue and that the total cost would be over $10 million. (Div. Ex. 26, 27.)

Thus, at the time the Notes were issued, the School District reasonably expected to satisfy Treasury Regulation § 1.148-2. I credit the testimony of President Flannery who concluded that at the time of the May 8 Meeting, he and the entire Board had reasonable expectations that capital improvement projects would be completed with the proceeds from the Notes. (Tr. 382-83.) I therefore conclude that a prudent person in the same circumstances would have reached the same expectations and taken the same actions. The School District stated that it reasonably expected to satisfy the expenditure, time, and due diligence tests, but was "thrown into turmoil due to several highly contentious, controversial, and largely unforeseeable events" immediately after the issuance of the Notes. (Resp. Ex. 6.) Although the School District ultimately settled with the IRS, the closing agreement between the School District and the IRS specifically states that the School District "contends that it issued the [Notes] with the reasonable expectations to use the bonds for governmental purposes." (Div. Ex. 20.) The Division fails to take into account the Board's reasonable explanation for its own conduct.

In a case nearly on point, the United States District Court for the Western District of Oklahoma held that a bond counsel's opinions regarding the tax-exempt status of bonds were violations of the issuer, not the issuer's attorney, even if the bond opinions were wrong. SEC v. Haswell, 1977 WL 1074 (W.D. Okla. 1977), aff'd, 654 F.2d 698 (10th Cir. 1981). In Haswell, a bond attorney, in issuing his tax opinion, failed to insist upon viewing the underwriter's final form of the offering circular, which improperly omitted financial projections. Id. at *3-4. The Commission characterized this as a violation of the antifraud provisions of the federal securities laws, alleging that his bond opinions as to the tax-exempt status of the bonds were falsely issued. Id. While stating that "a more careful attorney would have insisted" upon reviewing the final offering circular, the court held that failure to do so did not necessitate a finding of fraudulent or reckless behavior. Id. In making its decision, the court found that the bond opinions were carefully considered and made in "utmost good faith." Id. at 4.

It would be an impermissible interpretation of the law to conclude that Weiss violated the antifraud provisions of the federal securities laws. The Division points out, correctly, that the bond opinions in Haswell were never challenged by any governmental agency charged with enforcement of the Internal Revenue Code, while the IRS has "determined" that the Notes in the

case at hand were not tax-exempt. (Div. Reply at 15.) A settlement agreement, even one with the IRS, is not binding as to any legal issue in this case. In fact, the closing agreement states that it is binding between the School District and IRS, and is limited specifically to those parties and to the issue of the tax-exempt status of the Notes. (Div. Ex. 20.) The facts show that Weiss followed the then-applicable standards when arriving at the conclusions in his bond opinions and that in doing so he acted in good faith. I therefore conclude that Weiss's opinions were not fraudulently, recklessly, or negligently issued. To find otherwise would be to hold Weiss responsible for the inaction of the School District after the issuance of the Notes. In making my determination I have accepted the opinions of Weiss's experts, Henry Klaiman and Wayne Gerhold. I reject the opinions of the Division's Expert witnesses, Joseph H. Johnson, and Charles Anderson, as inconsistent with credible testimony and exhibits admitted into evidence at the hearing.

C. Section 8A of the Securities Act and Section 21C of the Exchange Act

The School District is alleged to have violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder. The OIP alleges that the School District issued the Official Statement which contained information that was materially false, including the description of the purpose of the Notes, the statement that the Notes were "NOT ARBITRAGE NOTES," and the descriptions of Weiss's opinions. (Div. Post-Hearing Br. at 55.) The Division alleges that the false statements and omissions in the Official Statement were material to investors, as similar false statements have "routinely been found to violate the securities laws." (Id.) The Division argues that the essence of the transaction was to make arbitrage profit and that testimony from witnesses at the hearing and the steps the School Board took both before and after the issuance are evidence of this. (Id. at 9-12.)

As evidence of scienter, the Division claims that the testimony from all of the witnesses at the hearing, other than Weiss, stated that the purpose of the Notes was to make money on the difference in interest rates. (Div. Post-Hearing Br. at 9.) The Division argues that actions taken, or lack thereof, were consistent with this. The Division argues that Weiss was the cause of the School District's violations by virtue of his misrepresentations and omissions to the School District. (Div. Post-Hearing Br. at 44, 55.)

In support of its argument the Division cites SEC v. Fehn, 97 F.3d 1276 (9th Cir. 1996), cert. denied, 522 U.S. 813 (1997), in which the Ninth Circuit affirmed a permanent injunction, finding that an attorney aided and abetted securities laws violations when: he reviewed and altered an initial draft of a 10-Q that misstated or omitted material facts; and, he failed to instruct the issuing company to disclose previous violations of federal securities laws. The court found that the attorney "substantially assisted" the primary violator because the attorney had a hand in creating the 10-Q and knew that it was inaccurate. Id. at 1295. The court rejected the attorney's good faith defense, stating that his actions were not "'reasonable' in light of the well-established disclosure requirements imposed by. . . SEC regulations." Id. at 1294.

I agree with Weiss's assessment that the statements in the Official Statement were not false because the School District "reasonably expected" that it would spend the Note proceeds on

capital projects. (Weiss Facts at 35-36.) Even though the School District invested in high-yield securities after the transaction closed, the statement in the Tax Certificate that the School District intended to proceed with the projects is evidence of their "reasonable expectation." In support, Weiss cites In Re Phillips Petroleum Sec. Litig., 881 F.2d 1236, 1245 (3rd Cir. 1989), which stands for the proposition that statements of intent are required to be true when made. Id.

Solicitor Flannery, paid by the hour, had responsibility for general legal advice to the Board. Weiss was not responsible for actions that the School District took after his representation concluded. (Weiss Law at 36.) The huge discrepancy between the set fee paid to Shupe and the fee paid to Weiss also demonstrates that the Board did not expect Weiss to be its primary business or financial advisor. Weiss was unaware that the School District might improperly invest the Note proceeds because he reasonably relied on the School District's representations to the contrary. (Id.) The School District represented, in the Official Statement, that it was going to follow the expenditure requirements of the tax laws, and he was entitled to rely on those representations. (Id.) (citing Model Bond Report, National Association of Bond Counsel 2003 at 12 ("'counsel may make assumptions or conditions (e.g. based on a certificate or documentation), unless bond counsel has knowledge that any such assumption or condition is false, or has knowledge of facts that, under the circumstances, would make it unreasonable so to assume.'"))

Weiss's May 2 Letter was preliminary in nature and, the language used therein was appropriate and consistent with what he was told by the Mento, as well as with the Treasury Regulations. The "contemplated" language of the May 2 Letter does not deviate materially from the "reasonably expected" language of the tax law; and, taken within the context of the facts, they are synonymous. (Weiss Law at 28-29.)

At all times Weiss acted properly and without knowledge of any intent by the School District to fail to use the Note proceeds as described in the Official Statement, and there was no way that he could have reasonably anticipated that the School District would not use the Note proceeds as planned. (Weiss Law at 37.) Weiss's May 2 Letter, his talk with the Solicitor Flannery, and the events of the May 8 Meeting all show that the School District represented that it was planning complete construction projects. (Id.) At no time was there ever a reason for Weiss to believe that the representations made to him were false and, therefore, he had no duty to investigate further. (Id. at 38.) The School District was responsible for a physical plant that was in dire need of renovation. There is no proof that the School District was in need of funds from arbitrage; it could have used its taxing power to raise the necessary funds. Shupe had planned to take the funds from the "illiquid" investment when the Board decided to act. The IRS's involvement merely served to unnerve the already distracted and overworked Board, causing them to call the Notes.

The Division bases its Section 8A Securities Act claim and Section 21C Exchange Act claim on the same theory on which it based Weiss's primary violations of the antifraud provision of the federal securities laws. That is: the School issued a false Official Statement and Weiss, in preparing the Non-Arbitrage Certificate, Bond Opinion, and Supplemental Opinion, caused the School District to violate the antifraud provisions of the federal securities laws. For the same reasons that Weiss did not violate Section 17(a) of the Securities Act and Section 10(b) of the

Exchange Act, and Rule 10b-5 thereunder, I conclude that Weiss did not cause the School District to violate the antifraud provision of the federal securities laws.

The Division has failed to prove by a preponderance of the evidence that this sophisticated, experienced School District violated the antifraud provisions of the federal securities laws. The Division alleges that the School District violated Section 17(a) of the Securities Act and 10(b) of the Exchange Act, and Rule 10b-5 thereunder. As detailed above, at the time that the School District issued the Notes they reasonably expected to use the bonds for governmental purposes; however, several unforeseen distractions caused it to fail to follow through with the requirements of Treasury Regulation § 1.148-2. The possibility that some Board members believed that they could invest bond proceeds for mere arbitrage profits does not prove that they, or the Board as a whole, planned to do so at the time of issuance. Even if the Division had proven that the School District had violated the antifraud provisions Weiss would not have been the cause. Weiss followed the applicable standards when arriving at the conclusions in his bond opinions and in doing so he acted in good faith. For these reasons the Division's reliance on Fehn is misplaced.

In Fehn, the underlying disclosure documents misstated and omitted material facts known by the attorney, who had inaccurately advised the issuer that it was unnecessary to disclose those facts. 97 F.3d at 1293-94. The case at hand is distinguishable, as there were no misstated or omitted material facts. When the Notes closed, the School District reasonably expected to use the bonds for governmental purposes. Secondly, even if there had been material misstatements and omissions, Weiss did not posses the requisite scienter to be the cause of any resulting federal security law violations. Weiss, throughout his representation, acted reasonably and in good faith.

D. Conclusion

I conclude that the Division has failed to prove by a preponderance of the evidence that Weiss violated Section 17(a) of the Securities Act, or Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. I further conclude that the Division has failed to carry the necessary burden and prove that, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, Weiss caused the School District to violate Section 17(a) of the Securities Act, or Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder. Thus this matter must be dismissed.

CERTIFICATION OF RECORD

Pursuant to Rule 351(b) of the Commission's Rules of Practice, 17 C.F.R. § 201.351(b), I hereby certify that the record includes the items set forth in the record index issued by the Secretary of the Commission on November 3, 2004.

ORDER

Based on the findings and conclusions set forth above:

IT IS ORDERED THAT the proceeding brought against Respondent Ira Weiss be and it hereby is DISMISSED.

This Initial Decision shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission's Rules of Practice, 17 C.F.R. § 201.360. Pursuant to that Rule, a party may file a petition for review of this Initial Decision within twenty-one days after service of the Initial Decision. A party may also file a motion to correct a manifest error of fact within ten days of the Initial Decision, pursuant to Rule 111 of the Commission's Rules of Practice, 17 C.F.R. § 201.111. If a motion to correct a manifest error of fact is filed by a party, then that party shall have twenty-one days to file a petition for review from the date of the undersigned's order resolving such motion to correct a manifest error of fact. The Initial Decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or a motion to correct a manifest error of fact or the Commission determines on its own initiative to review the Initial Decision as to a party. If any of these events occur, the Initial Decision shall not become final as to that party.

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Lillian A. McEwen
Administrative Law Judge