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of Labor and
Congress of Industrial
Organizations**

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May 16, 2018

*Sent via e-mail to: enforcement@sec.gov, tradingandmarkets@sec.gov,
munis@sec.gov, and help@sec.gov*

Ms. LeeAnn G. Gaunt, Chief, Public Finance Abuse Unit
U.S. Securities and Exchange Commission
100 F Street, NE Washington, DC 20549

Dear Ms. Gaunt:

I am writing on behalf of the American Federation of Labor and Congress of Industrial Organizations (the “AFL-CIO”), our 55 affiliated unions and their 12.5 million members, to urge the Securities and Exchange Commission (the “Commission” or “SEC”) to investigate potentially illegal insider trading of Puerto Rican bonds or other fraudulent behavior prior to the February 13, 2018 release of the Puerto Rican Governor’s Fiscal Plan. Given the relationships and communication between the Governor’s office and bond investors, and the substantial movement in the bond price following the release of the report, the situation merits further examination.

Puerto Rican bonds have traded at a deep discount since the island began defaulting on its debt in 2015. Those prices collapsed further in the wake of Hurricane Maria; general obligations traded at or below 25 cents on the dollar for all of December and most of January.¹

On Tuesday, February 13th, however, the Governor’s office released its updated fiscal plan for the island, which projected a budget surplus of \$2.8 billion through FY 2023.² On that news, bond prices jumped considerably. For instance, on Monday, February 12th, general obligations with an 8% coupon and a maturity date of 2035 (“2035 GO Bonds”) traded at a high of 25 cents on the dollar; by Friday those bonds were trading at a high of 33 cents on the dollar.³ There also appears to be some irregular trading patterns in the market for these bonds

¹ Michelle Kaske and Danielle Moran, “Puerto Rico Bonds Stage Record Rally as Surplus Projected” *Bloomberg Markets* (February 14, 2018).

² *Id.*

³ Trading data for COMMONWEALTH OF PUERTO RICO / GENERAL OBLIGATION BONDS OF 2014, SERIES A. CUSIP: 74514LE86* *Electronic Municipal Market Access* MSRB available at:
<https://emma.msrb.org/SecurityDetails/TradeActivity/A3D0CE166B87A6DC0C8739309AD0E8522>

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leading up to the release of the Governor's Fiscal Plan. The 2035 GO Bonds in particular saw a jump in trading activity the week before the plan was announced.⁴

The Governor of Puerto Rico has personal connections to the financial sector. His campaign for governorship accepted campaign donations from a number of investors who may have substantial exposures to Puerto Rican debt.⁵ His intention to pay bondholders was publicly celebrated by some of the island's biggest bondholders - currently involved in litigation over that debt.⁶ The confluence of these factors create the need for further investigation by the Commission.

While this may raise a novel question of law, i.e. a government insider creating tippee liability by gifting nonpublic information about municipal bonds, the facts surrounding the potential abuse get directly at the heart of the prohibition on illegal insider trading: A duty-bound insider with access to market moving information makes use of that information for private gain in violation of their duties to the information's source. Any such action could violate Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 [17 C.F.R. § 240.10b-5] promulgated thereunder, or Section 17(a) of the Securities Act [15 U.S.C. § 77q(a)].

In 2016, former Enforcement Division Director Andrew J. Ceresney stated, "Public finance, and the municipal securities market in particular, is a critically important area, and one on which the Enforcement Division needs to be, and has been, focused over the last few years. [The SEC's] numerous recent enforcement actions have resulted in significant changes in the public finance market, where the Commission has brought many first-of-their-kind actions and used a range of legal theories and remedies."⁷

Here again the Commission has an opportunity to address an area of significant importance and potential abuse. The SEC has a long history of applying the antifraud provisions of the securities laws to public officials and private parties in municipal bond transactions.⁸ Both the letter and the intention of insider trading prohibitions are directly implicated here.

⁴ *Id.*

⁵ See Contralor Electoral. Available at: <http://www.oce.gov.pr/index.php/es/candidatos/ricardo-rossello>.

⁶ Joel Cintrón Arbasetti and Carla Minet, "Los principales postores en la quiebra de Puerto Rico" *Centro Periodismo Investigativo* (October 19, 2017). Available at: <http://periodismoinvestigativo.com/2017/10/los-principales-postores-en-la-quiebra-de-puerto-rico/>.

⁷ Andrew J. Ceresney, SEC Director, Division of Enforcement "The Impact of SEC Enforcement on Public Finance" Keynote Address at Securities Enforcement Forum (October 13, 2016). Available at: <https://www.sec.gov/news/speech/speech-ceresney-10132016.html>

⁸ See, for example, *SEC v. Webb*, Case: 1:17-cv-08685, December 1, 2017, alleging a pay-to-play scheme between a mayor and a contractor using municipal bonds.

"The antifraud provisions of the federal securities laws, while not imposing a structured form of disclosure as required for the offering of non-exempt securities pursuant to the Securities Act of 1933, do prohibit the deception of investors in connection with the offering of exempt securities." SEC, *Staff Report on*

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Per the SEC website,

“Illegal insider trading refers generally to buying or selling a security, in breach of a fiduciary duty or other relationship of trust and confidence, while in possession of material, nonpublic information about the security. Insider trading violations may also include “tipping” such information, securities trading by the person “tipped,” and securities trading by those who misappropriate such information.”⁹

Courts have long recognized the duty public officials owe to the government.¹⁰ The presence of those duties in the context of insider trading has been recognized by the Commission.¹¹ The Stop Trading On Congressional Knowledge Act of 2012 (the “STOCK Act”) further confirmed the illegality of government insiders leveraging nonpublic information acquired in their professional capacity for private gain.¹² While the STOCK Act does not directly address state level public officials, the precedent is clear. Governor Rosello and his staff have precisely the “relationship of trust and confidence” to the territory and people of Puerto Rico that insider trading laws stem from.

Transactions in the Marine Protein Corporation Industrial Development Revenue Bonds, Exchange Act Release No. 15719 (April 11, 1979).

⁹ “Insider Trading” Securities and Exchange Commission Website, accessed April 26, 2018. Available at: <https://www.sec.gov/fast-answers/answersinsiderhtm.html>

¹⁰ *United States v. Lopez-Lukis*, 102 F.3d 1164, 1169 (11th Cir. 1997) (“Elected officials generally owe a fiduciary duty to the electorate.” See also, *Shushan v. United States*, 117 F.2d 110, 115 (5th Cir. 1941), overruled on separate grounds by *United States v. Cruz*, 478 F.2d 408 (5th Cir. 1973) (“No trustee has more sacred duties than a public official and any scheme to obtain an advantage by corrupting such an one must in the federal law be considered a scheme to defraud.”)

United States v. Podell, 436 F. Supp. 1039, 1042 (S.D.N.Y. 1977) (citing *Trist v. Child*, 88 U.S. (21 Wall.) 441, 450 (1874)). See also *United States v. Carter*, 217 U.S. 286, 306 (1910) (“The larger interests of public justice will not tolerate, under any circumstances, that a public official shall retain any profit or advantage which he may realize through the acquirement of an interest in conflict with his fidelity as an agent.”).

“A public official stands in a fiduciary relationship with the United States, through those by whom he is appointed or elected. *Trist v. Child*, 88 U.S. (21 Wall.) 441, 450, 22 L.Ed. 623 (1874). If he secretly advances interests adverse to those of the government which he serves, it is a breach of confidence and he must account to his “master” for the benefits received as a result, irrespective of consideration of fraud or damage. See *United States v. Carter*, 217 U.S. 286, 305-06, 30 S.Ct. 515, 54 L.Ed. 769 (1910); *United States v. Drisko*, *supra*, at 860.” US v Podell p1042.

¹¹ Robert Khuzami, SEC Director, Division of Enforcement, “Statement on the Application of Insider Trading Law to Trading by Members of Congress and Their Staffs” Before the United States Senate Committee on Homeland Security and Governmental Affairs (December 1, 2011) “...trading by Members of Congress or their staff is not exempt from the federal securities laws”. Available at:

https://www.sec.gov/news/testimony/2011/ts12011rsk.htm#P37_14193

¹² Apr. 4, 2012, Pub.L. 112-105, 126 Stat. 291. Available at:

<https://www.congress.gov/112/plaws/publ105/PLAW-112publ105.pdf>

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If any member of Governor Rosello's staff shared this information with an outside party, it would trigger the tipper-tippee liability described in the SEC's definition of insider trading above.¹³ Under the misappropriation theory of insider trading, tippee liability may arise where one "misappropriate[d] confidential information for securities trading purposes, in breach of a duty owed to the source of the information."¹⁴ Similarly, under the "disclose or abstain" theory, the recipient of nonpublic material information acquires the tipper's duty to disclose or abstain from trading.¹⁵ The requirement of showing a "personal benefit" to the tipper can be satisfied where the insider "makes a gift of confidential information."¹⁶

Here it appears possible that public officials in the Governor's office shared information with agents of the hedge funds with whom they work so closely. Even if the public official communicated the information in some legitimate capacity, the private party may still be held liable for breaching a relationship of trust and confidence.¹⁷

Early knowledge of the contents of the Governor's Fiscal Plan would constitute possession of material, nonpublic information. Materiality has been defined by the Supreme Court as information that would be "viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."¹⁸ The projected five-year surplus reported in the Fiscal Plan was material as was clearly evidenced by the substantial swing in the trading price of Puerto Rico's bonds as any reasonable investor might have expected.

¹³ "Insider Trading" Securities and Exchange Commission Website, accessed April 26, 2018. Available at: <https://www.sec.gov/fast-answers/answersinsiderhtm.html>

See also, *United States v. Bryan*, 58 F.3d 933 (4th Cir. 1995), Corporate insiders, such as directors and managers, and so-called temporary insiders, such as underwriters, accountants, lawyers, or consultants working for a corporation, are under a duty to disclose or abstain, as are tippees of either group.

¹⁴ *United States v. O'Hagan*, 521 U.S. 642 (1997) at 652.

¹⁵ *Salman v. United States*, 137 S. Ct. 420, 423 (2016) citing *Dirks v. SEC*, 463 U. S. 646 (1983).

"These persons also may not tip inside information to others for trading. The tippee acquires the tipper's duty to disclose or abstain from trading if the tippee knows the information was disclosed in breach of the tipper's duty, and the tippee may commit securities fraud by trading in disregard of that knowledge. In *Dirks v. SEC*, 463 U. S. 646 (1983), this Court explained that a tippee's liability for trading on inside information hinges on whether the tipper breached a fiduciary duty by disclosing the information. A tipper breaches such a fiduciary duty, we held, when the tipper discloses the inside information for a personal benefit."

¹⁶ *Salman v. United States*, 137 S. Ct. 420, 423 (2016) at 1093 (quoting *Dirks v. SEC*, 463 U.S. 646, 664 (1983)). The personal benefit requirement is met not only when the tipper receives monetary gain, but also "where an 'insider makes a gift of confidential information to a trading relative or friend.'"

¹⁷ *United States v. O'Hagan*, 521 U.S. 642 (1997), A tippee has a fiduciary duty based on a "relationship of trust and confidence" if: the tippee agreed to maintain info in confidence; parties have a "history, pattern, or practice of sharing confidences" that would lead the tipper to reasonably expect confidentiality; or if family.

¹⁸ *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976) at 449.

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Information is considered to be nonpublic “when it has not been disseminated in a manner making it available to investors generally.”¹⁹ The Fiscal Plan and in particular the information regarding the projected surplus was also not available to the public until the report was released by the Governor’s office on the morning of February 13th.²⁰

For all of the aforementioned reasons, we urge the Commission to investigate the trading of Puerto Rican bonds leading up to the release of the Governor’s Fiscal Plan. Please feel free to reach out to Corey Klemmer with any additional questions at (202) 637-5379 or cklemmer@aflcio.org.

Sincerely,



Damon Silvers
Policy Director and Special Counsel to the President

cc: Stephanie Avakian, Co-Director, Division of Enforcement
Steven Peikin, Co-Director, Division of Enforcement
Brett Redfearn, Director, Division of Trading and Markets
Rebecca Olsen, Acting Director, Office of Municipal Securities

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¹⁹ *In re Investors Management Co.*, 44 SEC 633, 643 (1971), (citing *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 854 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969)).

²⁰ Oficina del Gobernador “Reduce el déficit el Plan Fiscal Revisado presentado por el Gobierno de Puerto Rico” (February 13, 2018), Available at: <http://bit.ly/2otpBEJ>; See also twitter announcement (February 13, 2018, 06:26 am). Available at <http://bit.ly/2BRZvTg>.