UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 10053 / March 9, 2016

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3752 / March 9, 2016

ADMINISTRATIVE PROCEEDING
File No. 3-17162

In the Matter of **WESTLANDS WATER DISTRICT, THOMAS W. BIRMINGHAM, and LOUIE DAVID CIAPPONI** **Respondents.**	**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 Westlands Water District ("Westlands"), Thomas W. Birmingham, and Louie David Ciapponi (collectively "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted an Offer of Settlement (the "Offers") 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 them and the subject matter of these proceedings, which are admitted, and except as provided herein in Section V, Respondents consent 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 Respondents' Offer, the Commission finds[1] that:

Summary

1. This matter involves misrepresentations and omissions by Westlands in the Official Statement for its October 2012 offering of $77 million in Refunding Revenue Bonds, Series 2012A (the "2012 Bonds"). The Official Statement for the 2012 Bonds was misleading in its treatment of one key metric for Fiscal Year 2010: Westlands' debt service coverage ratio. The debt service coverage ratio is important to investors because it signals whether an issuer has sufficient ability to meet its debt service obligations. In prior bond offerings, Westlands had covenanted to fix and collect water rates at least sufficient to generate net revenues equal to at least 125% of its debt service payments for that year. Failure by Westlands to meet that 1.25 debt service coverage ratio could be a technical default on its bonds which could lead to undesirable outcomes, including higher interest rates on future bonds, ratings downgrades, and an inability to sell bonds in the following fiscal year.

2. The Official Statement for the 2012 Bonds contained a table representing that Westlands had met or exceeded the required debt service coverage ratio for each of the prior five years.[2] For fiscal year 2010, however, the revenue and coverage ratio reported in the table were misleading because Westlands failed to disclose: (1) that it had engaged in extraordinary accounting transactions in 2010 *solely* to recognize additional revenue for purposes of calculating the debt service coverage ratio without raising rates on customers, and (2) the impact of a 2012 prior period adjustment to account for expenses that would have decreased revenue in 2010 and negatively affected the ratio.

3. In the latter half of fiscal year 2010, Westlands staff informed Birmingham and Ciapponi that, because of reductions in water supply, Westlands would not generate sufficient revenue to achieve a 1.25 debt service coverage ratio. At Ciapponi's direction, Westlands staff consulted with its independent auditor about accounting transactions that could be implemented to avoid raising water rates in order to meet a 1.25 debt service coverage ratio. Subsequently, Westlands staff, including Birmingham and Ciapponi, advised Westlands' Finance and Administration Committee that it recommend to Westlands' Board of Directors (the "Board") to approve two accounting transactions to recognize additional revenue. These transactions and their effect on revenue and the debt service coverage ratio were not disclosed in the Official Statement for the 2012 Bonds. Separately, in 2012, Westlands adjusted the accounting for certain expenses. Had these expenses been recorded in 2010, the 2010 debt service coverage ratio would have been negatively affected. While this prior period adjustment was disclosed in the Official Statement for the 2012 Bonds, its impact on the 2010 debt service coverage ratio was not disclosed. If the effect of the 2010 and 2012 accounting transactions on the debt service

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

[2] Westland's fiscal year ends on February 28. Unless otherwise specified in this Order, references to specific years are to fiscal years.

coverage ratio had been disclosed, Westlands' coverage ratio for 2010 would have been 0.11, rather than the 1.25 which was reported in the Official Statement.

4. As a result of the conduct described herein, Westlands violated Section 17(a)(2) of the Securities Act and Birmingham and Ciapponi caused Westlands' violation.

Respondents

5. **Westlands Water District** is headquartered in Fresno, California and is the largest agricultural water district in California. Westlands is a public agency of the State of California, originally formed in 1952 for the primary purpose of providing irrigation water to customers within the district. Its customers are approximately 700 agricultural land owners and water users and approximately 200 municipal and industrial land owners and water users. Westlands' Board is elected by land owners in the district, and as a result, Westlands is managed by representatives of its customers. For 2014, Westlands had operating revenues in excess of $120 million.

6. **Thomas W. Birmingham**, age 60, of Sacramento, California, has served as the General Manager of Westlands, the highest executive level position, from October 2000 through the present. He is a member of the State Bar of California and also served as Westlands' General Counsel through May 2010 and was reappointed General Counsel in September 2015.

7. **Louie David Ciapponi** age 64, of Fresno, California, was the Assistant General Manager of Westlands from June 1995 to June 2012. Since June 2012 Ciapponi has been employed as the General Manager of a neighboring water district that had previously been annexed by Westlands. While employed at the other water district, Ciapponi continued to perform many of the same functions for Westlands that he had previously performed. He is also presently serving as Westlands' Secretary, a position he has held since 1995, and was Westlands' Treasurer from 1995 to December 16, 2015.

Facts

Westlands' Rate Covenant

8. In most years, Westlands purchases the majority of the water it sells to its customers from the United States Bureau of Reclamation ("USBR") and is required to pay a share of USBR's capital costs and operations and maintenance expenses. In drought years such as 2010, the USBR often reduces the quantity of water it makes available to Westlands, forcing Westlands to purchase water from other, more expensive, sources. Westlands charges its customers for the cost of water it sells and collects additional fees both for its own operational expenses and the share of the USBR expenses it pays.

9. In prior debt offerings, Westlands had covenanted, to the fullest extent permitted by law, to fix and prescribe, and collect customers' water rates and charges at least sufficient during each fiscal year to yield net revenues equal to 125% of the debt service payable in that fiscal year. The purpose of this covenant is to assure investors and others, including ratings agencies, that Westlands will have sufficient ability to meet its debt service obligations on the

bonds. Westlands has significant incentive to maintain the 1.25 ratio because a failure to do so could preclude Westlands from issuing bonds in the following fiscal year. Failure to maintain the ratio could also result in higher borrowing costs in future debt offerings and could negatively affect Westlands' debt ratings.

10. The Official Statement for the 2012 Bonds included a table reporting the debt service coverage ratio for fiscal years 2008 through 2012. The table contains, among other operating data, columns showing five years of summary income statement information and the ratio for each year, derived from Westlands' audited financial statements, which reflects that Westlands maintained a debt service ratio of exactly 1.25 for 2010. The bond sale transaction closed on October 25, 2012.

Extraordinary Accounting Transactions in Fiscal Year 2010 to Increase the Debt Service Coverage Ratio

11. In October 2009, Ciapponi learned that the projected full year revenue for fiscal year 2010 would be approximately $10 million short of what was required to maintain the 1.25 debt service coverage ratio. Westlands' fiscal year ends February 28, so it had very little time to rectify the revenue shortfall for fiscal year 2010 in order to maintain the 1.25 ratio for that year.

12. In order to meet the ratio, Westlands could have collected additional revenue by raising the water rates or other charges on its customers. This would have meant increasing water rates and land charges by about 11.6%. Westlands decided not to do so because management, including Birmingham and Ciapponi, wanted to minimize the costs on Westlands' customers. Instead, Westlands decided to reclassify certain assets as revenue. Ciapponi instructed Westlands staff to meet with Westlands' independent auditor to discuss this potential alternative to raising water rates. A memo prepared by Westlands employees and sent to Westlands' auditor in November 2009 described the proposal to "reclassify cash reserves or retained earnings" to record additional revenue "in lieu of collecting current revenue while maintaining the required debt coverage ratio." Westlands staff met with the auditor in January 2010. The auditor informed the Westlands staff that he believed the suggested transactions were permissible and subsequently issued an unqualified opinion on Westlands' 2010 audited financial statements. The auditor was not asked whether, or how, disclosure of the transactions should be made in the Official Statement. These reclassification transactions would not increase cash collections and were merely accounting transactions done for the sole purpose of maintaining the ratio.

13. Westlands staff, through Birmingham, as General Manager/General Counsel, and Ciapponi, as Assistant General Manager, presented a memorandum to Westlands' Finance and Administration Committee describing the various accounting transactions that were proposed to achieve a 1.25 debt service coverage ratio. The Finance and Administration Committee decided, based on the recommendation of staff, including Birmingham and Ciapponi, to recommend to the Westlands Board that it approve the reclassification transaction in lieu of increasing rates and charges that would be offset by credits. Subsequently, the Westlands Board approved the Finance and Administration Committee's recommendation.

14. Some of the reclassified assets came from "payable" accounts consisting of amounts that were collected from customers in previous periods but for which revenue was never recorded in the financial statements. The original intent of these accounts was to collect and retain funds to be used for the payment of certain expenses of Westlands and USBR. In the event the funds were not needed in the current fiscal year, they were retained by Westlands until they were needed for the stated purpose or otherwise dispensed at the direction of Westlands' Board. Westlands decided to reclassify $8.3 million from these accounts to revenue for 2010. Westlands had never previously reclassified funds from these accounts in a similar manner.

15. In addition, Westlands decided to record $1.46 million of revenue in 2010 by means of a "return of equity" to landowners in the district. The "equity" came from a reserve fund originally established to ensure debt service payments in future years, related to a 1999 debt issue and had been funded through a rate component of customer charges collected between 1999 and 2002. Together, the two sets of transactions would result in $9.8 million in additional revenue being recorded, solely to meet the debt service ratio covenant. Without the transactions, Westlands would have reported a debt service coverage ratio of .63.

16. At the public Board meeting at which the transactions were discussed, Birmingham and Ciapponi recommended that the Board approve the transactions. They told the Board that Westlands needed additional revenue to achieve a 1.25 debt ratio and the Board could either increase rates and charges or approve the transactions. When one Board member, who was also a Westlands customer, began to question whether rates and charges in an area in which he owned land would be raised as a result of having to meet the covenant, Birmingham joked that they were engaging in "a little Enron accounting." Birmingham went on to state: "We're not collecting any more money from the rate payers, nor are we paying any more money than we would otherwise pay under that the . . . um . . . to pay off the debt. All we're doing is we're taking money and saying we are reclassifying it from an account payable to income. And I'm told by Mr. Ciapponi that that satisfies – and he's vetted it – that that satisfies our debt coverage with the bonds."

17. The Board voted to approve the transactions, which were recorded as part of the year end closing process for fiscal year 2010. Other than customers who were present at the Board meeting, Westlands' customers were not made aware that their "equity" had been returned to them. The benefit of these transactions to Westlands and its customers was twofold. First, Westlands avoided reporting a debt service coverage ratio of 0.63 for 2010 and any potential negative consequences associated with failing to meet its covenant under prior bond issuances. Second, Westlands was able to meet the debt service coverage ratio without raising its customers' water rates.

The 2012 Prior Period Adjustment

18. Two years later, and separate from the transactions described above, Westlands changed the way it accounted for advance operations and maintenance payments made to the USBR in 2010 and 2011, classifying them as expenses instead of their original capitalization. Had these expenses been recorded in 2010, Westlands debt service coverage ratio would have been even lower unless Westlands had raised rates and land charges or lowered expenses in

2010. In 2012, when it changed the method by which it accounted for these payments, Westlands recorded a prior period adjustment for the fiscal year 2010 expenses, but in accordance with Generally Accepted Accounting Principles did not restate net revenue for that year. If the payments initially had been recorded as expenses in 2010, net revenue would have decreased and Westlands' debt service coverage ratio for 2010 would have been 0.73 rather than 1.25 (excluding the impact of the 2010 accounting transactions described above).

19. Westlands disclosed this prior period adjustment in a note to its audited financial statements for fiscal year 2012, which were appended to the Official Statement for the 2012 Bonds. However, Westlands did not correct the coverage ratios reported in the Historic Operating Results table for 2010 to account for the adjustment.

20. Westlands did not consider in 2012 whether the debt service coverage ratio reported for 2010 should have been revised as a result of the prior period adjustment. Ciapponi understood that, if the payments made to the USBR in 2010 had been treated in 2010 as an expense, the net revenue for that year would have been reduced, but he did not consider whether it would have affected the 2010 debt service ratio. Similarly, Birmingham was aware of the adjustment but he did not consider its effect on the 2010 debt service ratio.

<u>The Official Statement for the 2012 Bonds Contained False and Misleading Statements Concerning the 2010 Debt Service Coverage Ratio</u>

21. The Official Statement for the 2012 Bonds was false and misleading because it represented that Westlands' debt service coverage ratio for 2010 was 1.25 and, therefore, that Westland had complied with its covenants to fix water rates at levels reasonably expected to yield a debt service coverage ratio of 1.25. Westlands did not disclose that the ratio was met only because of the extraordinary transactions undertaken in 2010 to create additional purported revenue, nor did it disclose the effect the 2012 prior period adjustment would have had on the debt service coverage ratio for 2010. Had Westlands disclosed in the Official Statement the combined effect of both the 2010 transactions and the 2012 prior period adjustment, it would have reported its debt service coverage ratio for 2010 as 0.11– less than 10% of what was required. In addition, the failure to disclose the nature of the 2010 and 2012 transactions in the Official Statement masked the fact that Westlands had experienced a significant drop in net revenue in 2010.

22. The dramatic drop in Westlands' 2010 net revenue, its negative effect on the debt service coverage ratio for that year, and the effect of the 2012 prior period adjustment on the 2010 debt service coverage ratio, would have been material to investors in the 2012 Bonds.

<u>Birmingham and Ciapponi Certified the Accuracy of the Official Statement on Behalf of Westlands</u>

23. Both Birmingham and Ciapponi were involved in the issuance of the 2012 Bonds and the Official Statement. On behalf of Westlands, both Birmingham and Ciapponi signed the 2012 Bond Purchase Contract with the underwriter. As part of that contract, they certified to the underwriter that the Preliminary Official Statement and the Official Statement "contain no

misstatement of any material fact and do not omit any statement necessary to make the statements contained therein, in light of the circumstances in which such statements were made, not misleading." Birmingham also made a similar representation in the Closing Certificate he signed on behalf of Westlands.

24. Birmingham received drafts of the Official Statement for the 2012 Bonds. He was aware of the extraordinary 2010 transactions Westlands used to record revenue solely to achieve a 1.25 debt service coverage ratio without raising rates or other charges, but did not take any steps to disclose their effect on the 2010 debt service coverage ratio reported in the Official Statement. Similarly, despite being aware that the 2012 prior period adjustment affected Westland's net revenue for 2010, Birmingham did not consider whether the 2010 debt service coverage ratio reported in the Official Statement should have been revised.

25. Ciapponi reviewed each draft of the Official Statement as well as the final version. He was aware of the extraordinary 2010 transactions Westlands used to record revenue in order to meet the debt service coverage ratio, but did not take any steps to disclose their effect on the 2010 debt service coverage ratio which was reported in the Official Statement. Similarly, despite being aware that the 2012 prior period adjustment affected Westland's net revenue for 2010, he did not consider whether the 2010 debt service coverage ratio reported in the Official Statement should have been revised.

Legal Discussion

Respondents' Violations

26. Section 17(a)(2) of the Securities Act makes it unlawful "in the offer or sale of any securities . . . directly or indirectly . . . to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." 15 U.S.C. § 77q(a)(2) (2012). Negligence is sufficient to establish a violation of Section 17(a)(2) and no finding of scienter is required. See Aaron v. SEC, 446 U.S. 680, 696-97 (1980). The Commission has held that the "knew or should have known" standard is appropriate to establish negligence. See KPMG, LLP v. SEC, 289 F.3d 109, 120 (D.C. Cir. 2002). A misrepresentation or omission is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988).

27. The Commission may institute cease-and-desist proceedings against any person held to be a cause of violations of the federal securities laws due to acts or omissions such person knew or should have known would contribute to the violation. See Valicenti Advisory Servs., Inc., Inv. Advisors Act Rel. No. 1774, 1998 SEC LEXIS 2497, at *16, n.11 (Nov. 18, 1998), 53 S.E.C. 1033, 1040 n.11 (Nov. 18, 1998), aff'd, Valicenti Advisory Servs., Inc. v. SEC, 198 F.3d 62 (2d Cir. 1999). Negligence is sufficient to establish a violation for causing the primary violation. See KPMG Peat Marwick L.L.P., Exchange Act Rel. No. 43862, 2001 SEC LEXIS 98, at *102 (Jan. 19, 2001), 54 S.E.C. 1135, 1185, aff'd, 289 F.3d 109 (D.C. Cir. 2002).

28. Birmingham and Ciapponi each knew, or should have known, that Westlands' revenue and debt service coverage ratio for 2010 as reported in the Official Statement for the 2012 Bonds were misrepresented as a result of the extraordinary transactions recorded in 2010. They were also negligent for failing to consider the effect of the 2012 prior period adjustment on the revenue and the debt service coverage ratio calculation that was reported in the Official Statement for the 2012 Bonds. The negligent conduct of Birmingham and Ciapponi is imputed to Westlands.

29. As a result of the conduct described herein, Westlands violated Section 17(a)(2) of the Securities Act and Birmingham and Ciapponi caused Westlands' violations.

Cooperation and Remedial Efforts

30. In determining to accept Respondents' offers, the Commission considered the Respondents' cooperation and prompt remedial actions, including the development of written financial disclosures policies, and staff training related to Westlands' debt offerings.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondents' Offers.

Accordingly, it is hereby ORDERED that:

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

B. Within ten (10) days of the entry of this Order, Westlands shall pay a civil money penalty in the amount of $125,000 and Birmingham shall pay a civil money penalty in the amount of $50,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717. Ciapponi shall pay a civil money penalty in the amount of $20,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). Payment shall be made by Ciapponi in the following installments: $10,000 due ten (10) days from the date of the Order, and $10,000 due twelve (12) months from the date of the Order. If any payment from Ciapponi is not made by the date the payment is required by this Order, the entire outstanding balance of his civil penalty, plus any additional interest accrued pursuant to 31 U.S.C. § 3717, shall be due and payable immediately, without further application. Payment by the Respondents must be made in one of the following ways:

(1) Respondents may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondents may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondents may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Westlands, Birmingham, or Ciapponi, respectively, as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to LeeAnn Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, Securities and Exchange Commission, 33 Arch Street, 23rd Floor, Boston, MA 02110-1424.

C. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondents agree that in any Related Investor Action, they shall not argue that they are entitled to, nor shall they benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondents' payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondents agree that they shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondents by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

V.

It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S. C. §523, that the findings in the Order are true and admitted by Respondents Birmingham and Ciapponi, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondents Birmingham and Ciapponi under the Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Respondents Birmingham and Ciapponi of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. §523(a)(19).

By the Commission.

Brent J. Fields
Secretary