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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA

SECURITIES AND EXCHANGE
COMMISSION,

Plaintiff,

vs.

KAREN MARIE MICHEL,

Defendant.

Case No. **'21CV1623 L BGS**

**COMPLAINT FOR INJUNCTIVE
AND OTHER RELIEF**

Plaintiff Securities and Exchange Commission (“the Commission”) alleges as follows:

INTRODUCTION

1. This matter involves a deceptive course of business, including material misstatements and omissions, by Karen Michel, the former Chief Financial Officer of Sweetwater Union High School District (“Sweetwater” or “the District”), in

1 connection with the sale of \$28 million of municipal bonds in April 2018 offered by
2 the District. The bonds were to be secured by and payable from *ad valorem* property
3 taxes assessed on taxable properties within the school district and collected by the
4 County of San Diego. The purpose of the bonds was to fund certain of Sweetwater's
5 capital projects.

6 2. In the documents Sweetwater and Michel used to offer the bonds to
7 investors – a Preliminary Official Statement and a Final Official Statement (together,
8 the “Offering Documents”) – Michel included misleading budget projections which
9 indicated that the District could cover its costs, when in reality the District's finances
10 were severely strained. Although Michel was aware of information showing that the
11 projections were untenable, she omitted this fact when she helped prepare and
12 reviewed the Offering Documents, which indicated that Sweetwater would end the
13 fiscal year with a positive general fund balance of approximately \$19.5 million.
14 Months later, when Sweetwater ultimately disclosed its true year-end financial
15 condition, it had to reveal that it had actually overspent its budget by \$28 million, and
16 had ended the year with a negative \$7.2 million fund balance.

17 3. The Offering Documents also misleadingly stated that Sweetwater had
18 obtained positive budget certifications for each of its state-mandated reporting
19 periods during the preceding five years and that its budget reporting incorporated
20 current financial information, while omitting the fact that the District made no effort
21 to incorporate known expenses into the projections used for the certified budgets.

22 4. The omitted information rendered the projections and statements about
23 Sweetwater's financial performance that were included in the Offering Documents
24 materially misleading. Michel also presented the deceptive budget figures to a credit
25 rating agency in connection with obtaining credit ratings related to the bond offering,
26 and submitted false certifications regarding the accuracy and completeness of the
27 Offering Documents to the team of professionals who worked on the deal. After the
28 deficit was discovered in the fall of 2018, the credit rating agency ultimately

1 published a downgrade in connection with the “significant deterioration” of the
2 District’s financial condition.

3 5. As a result of the conduct described above, Michel violated Section
4 17(a)(3) of the Securities Act of 1933 (“Securities Act”).

5 JURISDICTION AND VENUE

6 6. The Court has jurisdiction over this action pursuant to 28 U.S.C. § 1331
7 and Sections 20(b), 20(d), and 22(a) of the Securities Act [15 U.S.C. §§ 77t(b),
8 77t(d), 77v(a)].

9 7. Defendant has, directly or indirectly, made use of the means or
10 instrumentalities of interstate commerce or of the mails, in connection with the
11 transactions, acts, practices, and courses of business alleged in this Complaint.

12 8. Venue is proper in this district pursuant to Section 22(a) of the Securities
13 Act [15 U.S.C. § 77v(a)] because Sweetwater is located and Michel resides within
14 this district and certain of the transactions, acts, practices, and courses of conduct
15 constituting violations of the federal securities laws occurred within this district.

16 THE DEFENDANT

17 9. **Michel** resides in San Diego County, California. Michel worked in
18 Sweetwater’s Financial Services Department from 1996 through 2018, and led the
19 department as the District’s Chief Financial Officer and chief business officer from
20 2014 through 2018. As the CFO, Michel had primary responsibility over
21 Sweetwater’s bond, business, and finance programs. Michel retired from Sweetwater
22 in or around September 2018.

23 RELEVANT ENTITY

24 10. **Sweetwater** is a public school district based in Chula Vista, California
25 and serving approximately 47,000 students in San Diego County. It is governed by a
26 five-member elected Board of Trustees (the “Board”). Sweetwater operates on a July
27 1 to June 30 fiscal year.
28

1 FACTUAL ALLEGATIONS

2 **A. Sweetwater Did Not Accurately Consider Expenses Associated with**
3 **Recent Salary Increases in the District's 2018 Fiscal Year Budget.**

4 11. From 2014 through 2018, Michel ran Sweetwater's Fiscal Services
5 Division and was in charge of the District's budget and financial reporting processes.
6 These responsibilities included supervising the persons who generated Sweetwater's
7 budget estimates as well as associated reports comparing the budget estimates to
8 actual expenses incurred during the year. She was chiefly responsible for setting up
9 the control environment meant to ensure the accuracy of the budget estimates, and
10 was the primary communicator of the adopted and interim budget estimates to the
11 District's Board, the San Diego County Office of Education, and ultimately to
12 investors in the April 2018 bonds.

13 12. In June 2017, Sweetwater's Board completed its approval of salary raises
14 for most of the District's employees, retroactive to January 2017. Michel participated in
15 the Board meeting considering the raises, and assessed both their short-term and long-
16 term financial impact. Days after the June 2017 approval of the raises, Michel and
17 Sweetwater staff working under her direction, completed the proposed budget for the
18 July 1, 2017 through June 30, 2018 fiscal year (the "2018 Fiscal Year"). This budget
19 was then approved and adopted by the Board on Michel's recommendation. The
20 adopted budget, however, failed to accurately account for the 3.75% salary increases,
21 and instead included a less than 1% increase in employee salaries based on year-end
22 estimates for the prior fiscal year. The adopted budget further projected that
23 Sweetwater would end the year with an operating surplus and a positive general fund
24 balance of \$22.2 million.

25 **B. Michel Ignored Reports Showing That Sweetwater's Actual Expenses**
26 **Were Not in Line with Its Budget Projections.**

27 13. Throughout the 2018 Fiscal Year, Sweetwater's Fiscal Services Division
28 created multiple reports indicating that the District's year-end expenses were trending

1 much higher than it had anticipated in its adopted budget. Michel oversaw the creation
2 of these reports and was aware of their contents. As is required for public school
3 districts under California state law, Sweetwater reviewed its budget in a “first
4 interim” report, covering the months from July through October, and a “second
5 interim” report, covering the months from July through January.

6 14. California Assembly Bill 1200 (“AB 1200”), enacted into law in 1991,
7 defines a system of fiscal accountability for school districts designed, in part, to aid
8 county offices of education or other governing bodies to identify school districts’
9 potential year-end budget deficits. Among other things, the law requires public
10 school districts’ interim reporting to be based on current information. However,
11 despite AB 1200’s requirement that interim reporting use current financial information,
12 Sweetwater and Michel failed to implement any system or process for incorporating
13 actual expenditures into their interim projections. Thus, while Michel and her staff
14 reviewed Sweetwater’s expenditures for other purposes, and even created reports
15 directly comparing actual expenditures with incompatible year-end projections, Michel
16 failed to take any steps to make adjustments to the District’s budget projections based
17 on these comparisons.

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

23 16. Michel repeated the same process with the District’s second interim report,
24 which purportedly represented the District’s financial condition through January 2018.
25 As of January 31, 2018, the actual employee salary expenses indicated a year-end
26 budget variance of over \$12.5 million from Sweetwater’s second interim budget
27 projections and showed that the District was engaged in significant deficit spending.
28 However, Sweetwater and Michel failed to update the budget projections in

1 Sweetwater's second interim report, completed on or about March 9, 2018, to reflect the
2 increasing gap between the District's actual salary expenses and its budget. Instead,
3 Michel and Sweetwater continued to rely on the stale projections that misleadingly
4 showed that the District would end the fiscal year with a general fund balance of
5 approximately \$19.5 million.

6 **C. Michel Used the Misleading Budget Projections to Facilitate Sweetwater's**
7 **Sale of \$28 Million in Bonds to Investors.**

8 17. On February 26, 2018, Sweetwater's Board voted to approve the issuance
9 of \$28 million in general obligation bonds.

10 18. On or about February 27, 2018, Michel represented Sweetwater during a
11 meeting with a credit rating agency to present the April 2018 bonds and to provide
12 financials relevant to the District's credit profile. As part of the meeting, Sweetwater's
13 municipal advisor presented the District's misleading budget projections from its
14 interim reporting, which Michel and her staff had provided. Even though Sweetwater's
15 municipal advisor had specifically informed Michel that the financial information
16 provided to the credit rating agency needed to be complete and accurate, Michel failed
17 to disclose that the District's actual expenses were trending significantly higher than the
18 budget projections that were provided and that the projections were not supported by
19 more recent internal reports.

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

27 20. On March 22, 2018, Sweetwater disseminated the April 2018 bonds'
28 Preliminary Official Statement ("Preliminary OS") to potential bond investors, which

1 included the misleading budget projections from the District's interim reporting.
2 Specifically, in the Preliminary OS, Sweetwater represented that it projected a
3 \$19.5 million year-end general fund balance for the 2018 Fiscal Year, while omitting
4 the fact that the projections were at odds with internal reports of known actual expenses.

5 21. Additionally, Sweetwater and Michel represented that the District filed
6 positive certifications for each reporting period in the previous five years in accordance
7 with AB 1200, noted that a "positive certification is assigned to any school district that
8 will meet its financial obligations for the current fiscal year and subsequent two fiscal
9 years," and described AB 1200's requirement that interim reporting be based on current
10 information, while misleadingly omitting the fact that the District made no effort to
11 incorporate current expense data into its interim projections.

12 22. On April 4, 2018, Sweetwater disseminated the April 2018 bonds' Final
13 Official Statement ("Final OS") to investors, making the same misrepresentations and
14 omissions as in the Preliminary OS.

15 23. Michel was substantially involved in the drafting and dissemination of the
16 misleading information in the Offering Documents to investors. She and staff that she
17 oversaw within Sweetwater's Fiscal Services Division provided the misleading budget
18 projections to the counsel responsible for drafting the Preliminary OS and Final OS.
19 Michel then reviewed drafts of both documents, and took steps to facilitate their
20 dissemination. On behalf of the District, she signed a certificate authorizing the
21 dissemination of the Preliminary OS to investors, and ultimately provided the issuer
22 signature in the Final OS representing that Sweetwater had "authorized and approved"
23 the document.

24 24. Additionally, Michel sent false certifications to the underwriter and other
25 gatekeepers to the bond offering. On April 4, 2018, Michel signed a "bond purchase
26 agreement" in which she and the District "represent[ed], warrant[ed] and agree[d]" that
27 (i) the Preliminary OS and Final OS did not contain any untrue statement of material
28 fact or omit to state any material fact necessary to make the statements therein not

1 misleading; and (ii) that the financial statements included in the Final OS fairly
2 presented the financial position of Sweetwater for the periods they purported to
3 represent. The bond purchase agreement was provided to the group of professionals
4 facilitating the offering, including the underwriter and its counsel, bond counsel,
5 disclosure counsel, and Sweetwater's municipal advisor (collectively, the "Bond Deal
6 Team Members").

7 25. On April 25, 2018, Michel signed a closing certificate on behalf of
8 Sweetwater in which she represented that she had reviewed the Final OS, and then
9 misleadingly certified that the Final OS did not contain any untrue statement of a
10 material fact required to be stated therein, or necessary to make the statements therein,
11 in light of the circumstances in which they were made, not misleading. This
12 certification was provided to the underwriter, underwriter's counsel, and bond counsel.

13 26. Michel never informed any of the Bond Deal Team Members that the
14 budget projections included in the Offering Documents were contradicted by the
15 District's known actual expenses and the District had no process in place to incorporate
16 actual expenditures into its projections.

17 27. Michel failed to exercise reasonable care when she used misleading
18 budget projections to sell the April 2018 bonds. Her use of, and representations relating
19 to, these budget projections in communications with investors, the credit rating agency,
20 and the Bond Deal Team Members was not reasonable in light of contrary and more
21 recent internal reports known to Michel.

22 **D. Sweetwater's New CFO Uncovers the District's Substantial Deficit,**
23 **Leading to a Rating Downgrade.**

24 28. In or around September 2018, Michel retired from Sweetwater and was
25 replaced by a new CFO. Under the new CFO's direction, the District completed its
26 unaudited actual financial report for the 2018 Fiscal Year, finding that year-end
27 salary expenditures were approximately \$309.6 million – \$18.7 million higher than
28 estimated in the second interim report and as presented to investors in the Offering

Documents. As a result of these expenses, as well as a shortfall in projected revenue, Sweetwater's unaudited general fund balance dropped to approximately negative \$2.87 million, approximately \$22.4 million less than was reported in the Offering Documents.

29. On October 26, 2018, after learning of the District's strained financial condition, the credit rating agency downgraded Sweetwater's issuer-default rating two notches from "A" to "BBB+," with a negative outlook. In explaining the downgrade, the credit rating agency noted that its action was "triggered by significant deterioration in the District's financial position compared to prior expectations" and stated a "concern that expenditure control needed to stabilize its finances will be a challenge for the district." Additionally, another credit rating agency, which covered an earlier series of Sweetwater's general obligation bonds, downgraded its rating of the prior bonds two notches from "A1" to "A3" with a negative outlook. In reporting its downgrade, this credit rating agency cited, among other things, the District's "materially weakened financial position" and "poor financial reporting."

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

CLAIM FOR RELIEF

Violation of Section 17(a)(3) of the Securities Act

31. Paragraphs 1 through 30 are hereby re-alleged and are incorporated herein by reference.

32. By reason of the foregoing, Michel directly or indirectly, in the offer or sale of securities, by use of the means or instruments of transportation or communication in interstate commerce or by use of the mails, engaged in transactions, practices, or courses of business which operated or would operate as a fraud or deceit upon the purchasers.

33. By reason of the foregoing, Michel directly or indirectly, violated and unless enjoined will continue to violate, Section 17(a)(3) of the Securities Act [15 U.S.C. § 77q(a)(3)].

PRAAYER FOR RELIEF

WHEREFORE, the Commission respectfully requests that the Court:

I.

Issue findings of fact and conclusions of law that Defendant violated Section 17(a)(3) of the Securities Act [15 U.S.C. § 77q(a)(3)].

II.

Issue a judgment permanently restraining and enjoining Defendant and her agents, servants, employees, and attorneys, and those persons in active concert or participation with any of them, who receive actual notice of the judgment by personal service or otherwise, from directly or indirectly violating Section 17(a)(3) of the Securities Act [15 U.S.C. § 77q(a)(3)].

III.

Issue a judgment permanently restraining and enjoining Defendant from participating in any offering of municipal securities, including engaging in activities with a broker, dealer, or issuer for purposes of issuing, trading, or inducing or attempting to induce the purchase or sale of any municipal security; provided however, that such injunction shall not prevent Defendant from purchasing or selling municipal securities for her own personal accounts.

IV.

Order Defendant to pay civil penalties pursuant to Section 20(d) of the Securities Act [15 U.S.C. § 78t(d)].

V.

Retain jurisdiction of this action in accordance with the principles of equity and the Federal Rules of Civil Procedure in order to implement and carry out the terms of all orders and decrees that may be entered, or to entertain any suitable application or

1 motion for additional relief within the jurisdiction of this Court.

2 VI.

3 Grant such other relief as this Court may deem just and appropriate.

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5 Dated: September 16, 2021

Respectfully Submitted,

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8
9 /s/ Jessica A. Adams

10 Jessica A. Adams

11 Attorney for Plaintiff

12 SECURITIES AND EXCHANGE
13 COMMISSION
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