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BANKRUPTCY - PUERTO RICO

In re Financial Oversight and Management Board for Puerto Rico

United States Court of Appeals, First Circuit - March 26, 2019 - 919 F.3d 121

Financial guarantee insurers that had insured various bonds issued by certain public corporations of the Commonwealth of Puerto Rico, including the Puerto Rico Highways and Transportation Authority (PRHTA), commenced adversary proceedings within the Commonwealth's and PRHTA's larger debt adjustment cases under Title III of the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA), alleging, inter alia, that the Commonwealth's and PRHTA's fiscal plans authorized the Commonwealth to redirect and misappropriate PRHTA pledged special revenues from PRHTA to the Commonwealth unlawfully, and seeking declaratory and injunctive relief.

Defendants filed motion to dismiss. The United States District Court for the District of Puerto Rico granted motion, and insurers appealed.

The Court of Appeals held that:

- Provision of Chapter 9 governing postpetition effect of security interests merely exempts consensual prepetition liens on special revenues that bankrupt municipality acquires postpetition from bankruptcy statute governing postpetition effect of security interests in general, and
- Provision of Chapter 9 exempting "application of pledged special revenues" from automatic stay enables bankrupt municipalities to apply those revenues to the relevant debt, but does not address actions to enforce liens on special revenues.

By its plain terms, provision of Chapter 9 governing the postpetition effect of security interests merely exempts consensual prepetition liens on special revenues that a bankrupt municipality acquires postpetition from bankruptcy statute governing the postpetition effect of security interests in general, a statute which would otherwise have invalidated such liens with respect to revenues acquired by municipality postpetition; provision contains no language that might be construed to implicate the payment of special revenues to bondholders or the timing thereof, but clearly and simply provides that certain prepetition liens will remain in place after the filing of the petition, notwithstanding the Bankruptcy Code's general protection of after-acquired property from prepetition liens.

By its plain terms, provision of Chapter 9 exempting "application of pledged special revenues" from both the automatic stay applicable in all bankruptcy cases and from the expanded stay applicable in Chapter 9 cases thereby permits bankrupt municipalities and others in possession of pledged special revenues to apply those revenues to the relevant debt without running afoul of stay, but does not address actions to enforce liens on special revenues, which are otherwise stayed; provision does not allow for compelling debtors, or third parties holding special revenues, to apply those special revenues to outstanding obligations.

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