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Court Ruling in Puerto Rico Bankruptcy Fans Revenue Bond Fears.

CHICAGO, March 28 (Reuters) – A decision this week by a U.S. Appeals Court in a lawsuit related to Puerto Rico's bankruptcy raises concerns over the payment of municipal bonds backed by specific revenues during future Chapter 9 cases, Fitch Ratings said on Thursday.

The Boston-based First Circuit court on Tuesday determined that municipalities are not required to make payments on debt secured by special revenues while bankruptcy proceedings are ongoing, although municipalities can voluntarily opt to do so.

"The ruling, by stating such payments are optional, creates uncertainty about full and timely payment of special revenue obligations during bankruptcy of the related municipality," Fitch said.

The credit rating agency added that if the ruling stands, it could negatively affect ratings on certain bonds secured by utility, transportation and tax revenue.

The appeals court affirmed a ruling by U.S. District Court Judge Laura Taylor Swain, who is overseeing the island's bankruptcy, which was filed in 2017 in an effort to restructure about $120 billion of the U.S. commonwealth's debt and pension obligations.

Swain had dismissed a lawsuit by insurance companies guaranteeing payments on defaulted Puerto Rico Highways and Transportation Authority bonds. The bond insurers claimed that payments on the debt from pledged toll and other revenue should not be halted during the bankruptcy.

Assured Guaranty Corporation, one of the plaintiffs in the lawsuit, said on Thursday it is assessing options, including an appeal to the U.S. Supreme Court.

"We disagree with the court's ruling, which is at odds with prior court decisions and the legislative history relating to special revenue bonds and has potential negative implications for revenue bonds throughout the municipal bond market," Assured said in a statement.

Chapter 9 municipal bankruptcy expert James Spiotto, managing director of Chapman Strategic Advisors, said the appeals court decision came as a surprise to the municipal bond market, which had assumed Swain's ruling would be reversed.

"This could have a very adverse effect on the use of special revenues all over," he said.

Revenue bonds accounted for an average of 64 percent of annual issuance in the $3.8 trillion municipal market since 1990, according to Refinitiv data. Not all revenue bonds qualify as being backed by special revenues under the bankruptcy code, which specifies special excise taxes or revenue derived from governmental projects or systems providing transportation, utilities or other services.

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