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Fitch Ratings: Appeals Court Ruling on Special Revenues Could Affect Municipal Debt

Fitch Ratings-New York-28 March 2019: Fitch Ratings is evaluating the potential rating implications of Tuesday's ruling by the United States Court of Appeals for the First Circuit regarding the bondholder protections provided by special revenue status under the bankruptcy code. The ruling, in a case brought by Assured Guaranty Corp, and three other bond insurers regarding the Puerto Rico Highways and Transportation Authority's (PRHTA) special revenue bonds, affirms a 2018 district court decision regarding special revenues as defined in Chapter 9 of the U.S. Bankruptcy Code. The circuit court ruling is in response to a creditor appeal of the district court's dismissal of claims regarding payment of the PRHTA bonds. The insurers have several avenues of appeal, and Fitch will monitor the court proceedings as they occur.

In the ruling, the circuit court agrees with the district court's opinion that section 922(d) of Chapter 9 grants permission to, but does not require, a municipality to continue paying special revenue obligations during a bankruptcy proceeding. This is contrary to the long-established belief in the municipal market that payment on special revenue debt, such as that issued by utility systems, was required throughout the automatic stay period. 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.

The circuit court opines that since the plain language of the code is unambiguous, there is no need to rely on the legislative history of Chapter 9 to interpret them. However, the legislative history appears to clearly indicate the intent to limit the reach of the automatic stay for municipal entities and to make it inapplicable to pledged special revenues.

Credit ratings that could be negatively affected by the decision, if it stands, include bonds secured by utility, transportation and tax revenues that are currently rated above the municipality's Issuer Default Rating (IDR). Although technically the decision only affects districts within the first Circuit (Maine, Massachusetts, New Hampshire, Puerto Rico and Rhode Island), Fitch believes that this decision will be influential in municipal bankruptcy cases nationwide given the overall lack of municipal bankruptcy case law.

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