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Fight Over High-Yield Muni Bonds Raises Questions Of Ethical Behavior.

A lawsuit that's heading to trial this week has pulled back the curtain on the niche corner of the municipal bond market that buys and sells high-yield bonds, revealing how clout drives deals, with questionable consequences for a \$500 billion market funded by public money.

Dallas-based Preston Hollow Capital LLC, a five-year-old investment firm that buys high-yield muni bonds, on February 28 sued mutual fund giant Chicago-based Nuveen Inc. Preston accused Nuveen of trying to shut it out of the high-yield market by threatening to withdraw business from any broker dealer or bank that works with Preston Hollow.

Ahead of a [trial](#), set for July 29 and 30 in Delaware Chancery Court, Preston won release of telephone transcripts that feature Nuveen employees, in hundreds of pages of conversations with bankers and other market participants, warning firms they will be put "in the box" if they conduct business with Preston Hollow. It was a "zero tolerance" policy dictated by the head of Nuveen's high yield muni fund, John Miller, who's also featured on the transcripts.

Preston Hollow is a relatively small and new market participant, holding \$1.8 billion in assets under management. In contrast, Nuveen's municipal bond holdings, at \$150 billion, dwarf Preston Hollow's. Nuveen is the largest high yield muni shop in the country, and quite often the largest revenue generator in a bank's portfolio.

Nuveen enjoys the clout and the market position to make demands of bankers that smaller firms would have a tough time getting away with.

Bankers in the transcripts use terms like stunned, devastated and feeling "punched in the stomach" when informed of Nuveen's new policy. At least one head of public finance [appears to have lost his job](#) over Nuveen's decision to yank its business. The bankers turn on each other, informing Nuveen of other banks' deals with Preston Hollow, and repeatedly asking Nuveen whether everyone on "the street" will be punished in the same way.

In court filings, Nuveen's attorneys don't deny the business practices but argue that the behavior is legal and a "privilege enjoyed by competitors in the same market to compete aggressively for market share."

The court will decide whether the behavior is a violation of New York State's Donnelly Act antitrust law, as Preston Hollow alleges. But market participants will have to decide for themselves whether the practices are ethical and whether they're allowed to become more common.

Nuveen's clout, and its willingness to deploy it, brings with it a heavy advantage that raises questions of fairness. The bankers seem driven only by a desire to preserve their relationships with their most profitable client, not by any other standard.

The question takes on more importance when we remember the fight takes place in a market

financed by taxpayer money, where an unfair or inefficient market could drive up borrowing costs for government entities, and ultimately tax rates for taxpayers.

Forbes

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Jul 30, 2019, 10:02am

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