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MBIA Sues Nine Puerto Rico Bond Underwriters.

Bond insurers MBIA Insurance Corp. and National Public Finance Guarantee Corp. sued nine Wall Street firms on Thursday for their actions while underwriting Puerto Rico bonds.

MBIA (MBI) and its subsidiary National are seeking at least \$720 million from UBS Financial Services, UBS Securities, Citigroup Global Markets, Goldman Sachs (GS), J.P. Morgan Securities, Morgan Stanley (MS), Bank of America (BAC) as successor to Merrill Lynch, RBC Capital Markets, and Santander Securities.

The bond insurers filed their suit in the Court of the First Instance, Superior Court of San Juan, in Puerto Rico.

Essentially, the insurers argued that the financial firms provided them incomplete and misleading information about the Puerto Rico issuers' financial conditions prior to the insurers agreeing to insure the bonds.

Official Statements are examples of this information. The insurers said that under federal securities laws the issuers were required to investigate the information in the official statements. "The banks did not scrutinize these materials as they assured the market they would," the insurers said.

In the documents the financial firms handed to the insurers prior to the bond sales, "the issuers' debt service coverage ratios were overstated, and they had not spent and likely would not spend their funds as represented."

"Just like the commonwealth and the people of Puerto Rico, National was misled by the underwriters of the commonwealth's bonds," said Bill Fallon, chief executive officer of MBIA (MBI).

In their suit, the insurers acknowledge that they have no statutory claims against the financial firms. They say their suit is under "doctrina de actos propios" (doctrine of proper acts) and the doctrine of unilateral declaration of will. Both have roots in Spanish law, which still underpin much of Puerto Rico's local laws.

All the defending firms in this case were offered a chance to provide a statement to The Bond Buyer. They all failed to do so or said they had no comment.

The financial firms were underwriters for Puerto Rico public sector bonds.

National has paid over \$720 million in claims on its insured Puerto Rico bonds and is expecting to pay out hundreds of millions of dollars more. This is the origin of the insurers' claim for at least \$720 million.

National insured more than \$11 billion of Puerto Rico bonds. National said it insured the bonds when they were issued from 2001 to 2007.

The doctrina de actos propios "is designed to protect 'legitimate expectations' and 'good faith' and

to ‘prohibit ... behavior that would result in an unreasonable interference with a legitimately created trust relationship, that allowed the other party to reasonably rely on the original conduct,’” the insurers said in its suit.

The claim of unilateral declaration of will applies when “‘a person might have an obligation towards another person, as long as their intention is clear, arises from a suitable judiciary act and is not contrary to the law, the moral or the public order,’” the insurers said, quoting from a 2014 court decision.

The insurers’ losses wouldn’t be so large if Puerto Rico and its Oversight Board had chosen to observe basic principles of municipal finance since the bankruptcy, said Chapman Strategic Advisors Managing Director James Spiotto. Spiotto pointed to Puerto Rico and the board’s unwillingness to observe guarantees for paying special revenues in bankruptcy and the Puerto Rico Constitution’s priority on paying general obligation interest.

If these were followed, the insurers would probably be less interested in launching their lawsuit against the financial firms, Spiotto said.

Vicente & Cuebas and Selendy & Gay are the law firms representing the insurers.

By Robert Slavin

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