



Municipal: Puerto Rico Special Revenues Update

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Chapter 9 versus PROMESA

Chapter 9

- Part of the U.S. Bankruptcy Code, Chapter 9 contains the exclusive provisions of the Bankruptcy Code that allow “municipalities” to adjust their debt
- Chapter 9 is voluntary — a municipality cannot be forced into bankruptcy
- States cannot utilize the Chapter 9 bankruptcy process
- The Commonwealth of Puerto Rico is a territory of the U.S., not a municipality. So Puerto Rico and its municipalities cannot utilize the Chapter 9 bankruptcy process

Puerto Rico's Financial Troubles

- Due to numerous factors (some of which have been developing for the past 70 years and more), Puerto Rico faces a serious and ongoing fiscal emergency.
- In recent years, Puerto Rico's debts included about \$74 billion in bond debt and \$49 billion in unfunded pension obligations.
- Puerto Rico's ~\$123 billion in debt and pension obligations is almost 7 times larger than Detroit's \$18 billion bankruptcy in 2013.
- Puerto Rico's status as a territory of the U.S. means it is unable to use Chapter 9 of the Bankruptcy Code to restructure its debt.

PROMESA

- In 2016, the U.S. Congress passed the Puerto Rico Oversight, Management, and Economic Stability Act (“PROMESA”), which borrowed heavily from Chapter 9, to provide a mechanism by which Puerto Rico can restructure its debts.
- PROMESA created a Financial Oversight and Management Board to approve fiscal plans for the Commonwealth of Puerto Rico and its instrumentalities and to file Title III petitions akin to bankruptcy on behalf of those entities.
- In May 2017, the Oversight Board commenced a debt adjustment proceeding under Title III on behalf of Puerto Rico.
- This is uncharted ground.

Puerto Rico Highways and Transportation Authority (PRHTA)

- The Puerto Rico Highways and Transportation Authority (“PRHTA”) was created in 1965 as an autonomous public corporation responsible for developing, operating and maintaining Puerto Rico’s toll roads, highways and other mass transportation facilities.
- PRHTA financed these critical infrastructure projects by issuing various series of special revenues bonds (“PRHTA Bonds”).
- PRHTA Bonds are insured by various bond insurers, including Assured Guaranty Corp. and Assured Guaranty Municipal Corp. (“Assured”), Financial Guaranty Insurance Company (“FGIC) and National Public Finance Guarantee Corporation (“National”).
- Assured insures approximately \$1.5 billion of PRHTA bonds, FGIC insures approximately \$447 million and National insures \$706 million.

Puerto Rico's Financial Troubles and the PHRTA's Special Revenue Bonds

- As Puerto Rico's fiscal situation worsened, in 2015 the Commonwealth began tapping PRHTA's revenues and applying them to other Commonwealth obligations.
- PRHTA bondholders were paid in 2015 out of debt service reserve funds.
- From January through July 2016, PRHTA failed to make over \$100 million in debt service payments.
- The Bond Insurers paid bondholders on behalf of PRHTA and claimed full subrogation to the rights of the bondholders against PRHTA as a result.

Puerto Rico's Financial Troubles and the PHRTA's Special Revenue Bonds

- In May 2017, the Oversight Board commenced a debt adjustment proceeding under Title III on behalf of PRHTA.
- Under a fiscal plan for PHRTA, the Oversight Board authorized the Commonwealth to redirect the pledged PRHTA revenues (i.e. toll revenues and special excise taxes) to non-bondholder obligations in excess of the necessary operating expenses mandated by Section 928(b) of the Bankruptcy Code (as incorporated into PROMESA).
- In June 2017, the Puerto Rico Fiscal Agency and Financial Advisory Authority (“AAFAF”) directed BNYM as fiscal agent to refrain from making a \$219 million payment to bondholders from the reserve funds due on July 3, 2017. AAFAF asserted that the funds in the reserve accounts were PRHTA's property and that making the payment would violate the Bankruptcy Code section 362(a) automatic stay incorporated into PROMESA.

Assured Guaranty Corp., et al. v. Commonwealth of Puerto Rico

- PRHTA defaulted on the PRHTA Bonds.
- The Bond Insurers filed suit seeking declaratory and injunctive relief that:
 - the PRHTA bonds are secured by a pledge of “special revenues” under the Bankruptcy Code;
 - this pledge continues post-petition and is not stayed by the filing of Title III proceedings;
 - payments of pledged revenues as collected, net of necessary operating expenses (operation and maintenance costs), should be paid to the revenue bondholders under Section 922(d) and 928 of the Bankruptcy Code (as incorporated into Title III);
 - PRHTA’s failure to remit those revenues during the Title III cases violated sections 922(d) and 928(a) of the Bankruptcy Code as incorporated into Title III;
 - all special revenues held in the reserve accounts are property of, or held in trust for, PRHTA bondholders

Federal District Court Decision (Judge Swain)

- On January 30, 2018, Judge Laura Taylor Swain of the Federal District Court (hearing the Puerto Rico debt adjustment proceeding under PROMESA) held that Section 922(d) does not *compel* a municipality to pay debt service payments when due following the bankruptcy filing, but rather that Section 922(d) *permits* a municipal debtor to pay its special revenue obligations despite the automatic stay of the Bankruptcy Code.
- This ruling startled the municipal market by pronouncing that, unless the municipality *voluntarily* decided to make the timely payment of special revenues pledged to the bondholders, the payment was stayed during the bankruptcy proceeding.
- The Bond Insurers appealed this decision to the First Circuit.

First Circuit Appellate Decision

- Contrary to market expectations, on March 26, 2019, a three-judge panel of the U.S. Court of Appeals for the First Circuit (“First Circuit”) ruled that the “special revenue” provisions of the U.S. Bankruptcy Code do not compel the payment of debt service on special revenue bonds during a bankruptcy proceeding. Rather, the special revenue provisions merely allow the voluntary payment of such debt service during a bankruptcy proceeding by a municipal debtor.
- The Court interpreted Section 922(d) as not permitting the timely payment during the Chapter 9 case of the pledged special revenues *not in possession of the indenture trustee on the petition date* to the revenue bondholders if the municipality chooses not to pay the bondholders.

Contrary to 30 Years of Market Expectations and Chapter 9 Legal Precedent

- Judge Swain's and the First Circuit's decision in the Puerto Rico PROMESA case holding that pledged special revenues will not be paid during the Chapter 9 proceeding unless the municipality as debtor chooses to do so is contrary to the decisions or practices of the numerous Chapter 9 courts (including in Jefferson County, City of Stockton, Detroit, Sierra King Health Care District, San Jose School District and other Chapter 9 cases).
- No Chapter 9 bankruptcy court has interpreted Section 922(d) to mean that payment of pledged special revenues to bondholders during the pendency of a Chapter 9 is voluntary (only if the municipality chooses) rather than mandatory.

How Did the Federal District Court and the First Circuit Get It So Wrong?

The First Circuit:

- Refused to consider the legislative history for the 1998 Municipal Bankruptcy Amendments holding that Sections 928(a) and 922(d) of the Bankruptcy Code were unambiguous.
- Found that, while the plain language of Section 922(d) establishes that the voluntary application of pledged special revenue payments is not a violation of the automatic stay, the language did not compel payment of special revenues by the debtor during the case.
- Suggested that a construction mandating payment could run afoul of Section 904 of the Bankruptcy Code (Section 305 of PROMESA) that prohibits judicial interference with the debtor's property or revenues.
- Erroneously cited *Collier* discussion and stated that *Jefferson County* was inapposite since the county did not contest whether it should turn over special revenues post-filing of a Chapter 9 proceeding which was not true.

How Did the Federal District Court and the First Circuit Get It So Wrong?

The First Circuit fails to see the tautology inherent in its interpretation of Section 922(d). This provision exempts the “application of pledged special revenues” from the automatic stay and in the First Circuit’s view, thereby permits bankrupt municipalities and others in possession of pledged special revenues to apply those revenues to the secured debt without running afoul of the stay, *but does not compel* debtors or third parties holding special revenues, to apply those special revenues to the secured debt. The First Circuit ignores the fact that a debtor does not need Section 922(d) to voluntarily pay its debts in Chapter 9. That means Section 922(d) stands for something other than what the First Circuit states it does. In fact, legislative history tells us what Section 922(d) means.

11 U.S. Code § 922 (d)

§ 922. Automatic stay of enforcement of claims against the debtor

(d) Notwithstanding section 362 of this title and subsection (a) of this section, a petition filed under this chapter does not operate as a stay of application of pledged special revenues in a manner consistent with section 927[8] of this title to payment of indebtedness secured by such revenues.

11 U.S. Code § 928 (a)

§ 928. Post petition effect of security interest

- (a) Notwithstanding section 552(a) of this title and subject to subsection (b) of this section, special revenues acquired by the debtor after the commencement of the case shall remain subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case.
- (b) Any such lien on special revenues, other than municipal betterment assessments, derived from a project or system shall be subject to the necessary operating expenses of such project or system, as the case may be.

Sections 303 and 305 of PROMESA (Sections 903 and 904 of US Bankruptcy Code)

- Section 303 of PROMESA follows Section 903 of the Bankruptcy Code that prohibits any impairment or limitation of the state power to control by legislation OR otherwise the exercise of a municipality of governmental power including as to expenditures (such as payment of special revenues).
- Section 305 of PROMESA substantially mirrors Section 904 of the Bankruptcy Code, which prohibits the Bankruptcy Court from interfering with:
 - (i) the governmental powers of the debtor;
 - (ii) the property or revenues of the debtor; or
 - (iii) the use or enjoyment of income producing property.
- The First Circuit interpreted this section as a limitation of the Court's power to interfere with the debtor's property and revenues without the debtor's consent, including as to pledged revenues pledged to the revenue bondholders and even the reserve funds held by the bond trustee.

How Did the Federal District Court and the First Circuit Get It So Wrong?

The P.R. District Court justified its ruling on its interpretation of Section 904 of the Bankruptcy Code (Section 305 of PROMESA) and Section 922(d) as well as *Collier on Bankruptcy* which is flawed. The Jefferson County Court explained why *Collier on Bankruptcy* (part of the support for the P.R. Court ruling) was incorrect:

"The County's position [as well as the P.R. Court's ruling] on the § 922(d) "pledged special revenues" is in many respects identical to that espoused in 6 *Collier on Bankruptcy* ¶ 922.05[2]. This bankruptcy treatise's conclusions are cited to this Court as authority for the County's. One problem with Collier's viewpoint is the authority Collier's cites to in its footnote 4 is a quote from legislative history that does not uphold Collier's reading of § 922(d). See 6 *Collier on Bankruptcy* ¶ 922.05[2] n. 4. Careful reading of the quote evidences that it supports the broader view that a pledge as used in § 922(d) is for all monies pledged including those possessed by a creditor and those not in the creditor's possession. The Collier position has also been disagreed with by others."

Jefferson County Special Revenues in Chapter 9

- On November 9, 2011, Jefferson County, Alabama filed the then largest Chapter 9 case.
- The County's position. The County took the position that only the special revenues, if any, in the possession of the indenture trustee for the warrants at the beginning of the case were unaffected by the automatic stay. Ignoring the broad language of Section 928 confirming that special revenues acquired post-petition remain subject to any lien resulting from a prepetition security agreement, the County seized on the words "pledged special revenues" in Section 922(d) exempting special revenues imposed by the Bankruptcy Code. The County argued that the use of "pledged" rendered the stay exception limited to a possessory lien.

Jefferson County Special Revenues in Chapter 9

- The trustee and sewer warrant holders' position. The trustee and the sewer warrant holders asserted all net revenues of the sewer system (net of maintenance and operation cost as defined in the indenture) held by the trustee as collected during the Chapter 9 were pledged special revenues that were to be timely paid to the trustee for the benefit of the warrant holders and could not be used for any other purpose.

Jefferson County Special Revenues in Chapter 9

The Jefferson County Court found that:

Not only does Alabama case law and its governing statute for the sewer warrants support an interpretation of "pledge" in the municipal financing setting to be more than a possessory lien, so does the Indenture...System Revenues are under § 1.1 of the Indenture monies and income from all sources thereafter "received by or on behalf of the County from whatever source derived from the operation" of the sewer system. Under § 2.1 of the Indenture, the County "does hereby grant, bargain, sell and convey, assign, transfer and pledge" to the Indenture Trustee various property, interests and rights to secure payment of the warrants. The wording of the Indenture makes clear that the Pledged Revenues are all revenues against which the Indenture Trustee is given a lien and not solely those in its possession. (emphasis added)

Jefferson County Special Revenues in Chapter 9

The Jefferson County Court then ruled:

"In summary, this Court's analysis of the interplay of section 922 with section 928 of chapter 9, 11 U.S.C. §§ 922, 928, is that "pledged special revenues" as used in § 922(d) includes all special revenues against which the County granted a lien under the Indenture, not just those in the possession of the Indenture Trustee or Receiver. It encompasses those Net Revenues that are received from the sewer system before and after the filing of the County's chapter 9. The structure and intent of what Congress enacted by its 1988 amendments to chapter 9 was to provide a mechanism whereby the pledged special revenues would continue to be paid uninterrupted to those to which/whom payment of the sewer system's indebtedness is secured by a lien on special revenues. The result is that 11 U.S.C. § 922(d) excludes continued payment of these "pledged special revenues" to the lienholder from being stayed under 11 U.S.C. § 362(a) or 11 U.S.C. § 922(a)." (emphasis added)

Special Revenues Chapter 9 Legal Precedent

- Vallejo, CA and Stockton, CA bankruptcies: In *Vallejo* and *Stockton* bankruptcies, there was recognition of the mandated payment and the timely payment of special revenue bond issues (even though there was a dispute over lease financing relating to extent of the collateral and payments with one major holder).
- Detroit Water and Sewer Bonds: In *Detroit*, the special revenues of the water and sewer bonds were timely paid (by voluntary settlement). In fact, unlimited tax general obligation (UTGO) bondholders in Detroit as part of a settlement received an approximately 74% recovery from Detroit (insured bonds received 100% recovery with 26% from insurers), whereas holders of Detroit's special revenue sewer bond claims received 100% recovery.

How did the Federal District Court and the First Circuit get it so wrong?

- The First Circuit failed to appreciate 30 years of market expectation and existing legal precedent that runs contrary to the holding which alone makes legislative history a relevant and critical consideration in interpreting those sections of the US Bankruptcy Code

Legislative History of 1988 Amendments

The 1988 Amendments legislative history of the Senate Report quoted in *Collier on Bankruptcy* as footnote 4, specifically stated:

⁴ See S. Rep. No. 100-506, 100th Cong., 2d Sess., 11, 13 (1988) ("In this context, "pledged revenues" includes funds in the possession of the bond trustee as well as other pledged revenues.")

In fact, the full quote reads:

"Likewise, the automatic stay that becomes effective against creditors of a municipality is made inapplicable to the payment of principal and interest on municipal bonds paid from pledged revenues. In this context, "pledged revenues" includes funds in the possession of the bond trustee as well as other pledged revenues." Senate Report at 13.

Legislative History of 1988 Amendments

The legislative history of the 1988 Amendments supports the timely and unimpaired payments of special revenues:

- The 1988 Amendments added the special revenue protections into Chapter 9.
- The Senate Report accompanying the 1988 Amendments indicates that the special revenue provisions were consistent with the understanding at the time that mandated timely payment of pledged revenues as the benefit of the nonrecourse bargain and the right of the revenue bondholders.
- "Reasonable assurance of timely payment is essential to the orderly marketing of municipal bonds and notes and continued municipal financing ...". Senate Report at 21.

Legislative History of 1988 Amendments

The 1988 Amendments were to protect the benefit of the bargain of revenue bond financing: the unimpaired right in Chapter 9 for the payment of pledged revenues to revenue bondholders.

"The amendments protect the future effectiveness of revenue bond financing against the possibility of an adverse judicial determination in connection with municipal bankruptcy ...".

"Various questions have been raised that a pledge of municipal revenues and the lien created thereby will be terminated in a municipal bankruptcy due to the application of Section 552(a) to Chapter 9. To eliminate the confusion and to confirm various state laws and constitutional provisions regarding the rights of bondholders to receive the revenues pledged to them in payment of debt obligations of a municipality, a new section is provided in the amendments to ensure that revenue bondholders receive the benefit of their bargain with the municipal issuer and that they will have unimpaired rights to the project revenues pledged to them." Senate Report at 12.

Legislative History of 1988 Amendments

The automatic stay is supposed to be inapplicable to the timely payment of principal and interest to revenue bondholders from pledged special revenues collected during a Chapter 9.

"Likewise, the automatic stay that becomes effective against creditors of a municipality is made inapplicable to the payment of principal and interest on municipal bonds paid from pledged revenues. In this context, "pledged revenues" includes funds in the possession of the bond trustee as well as other pledged revenues."
Senate Report at 13.

Significance of Puerto Rico Assured Decision for Municipal Special Revenues Outside of PR

What does this mean for Special Revenues?

- Low probability that *Assured* case will be reheard by First Circuit *en banc*. 3-judge panel's ruling was unanimous and included the chief judge.
- Low probability that Supreme Court will hear this case any time soon.
 - Plaintiffs can request a writ of certiorari with SCOTUS, but 4 of the 9 justices must vote to accept a case
 - SCOTUS usually hears cases that have either national significance, conflicting circuit court decisions and/or have precedential value
- While technically the First Circuit ruling only affects regions in that circuit, which is most of New England (Maine, Massachusetts, New Hampshire and Rhode Island) plus Puerto Rico, it could impact another circuit's decision if another Chapter 9 arose. However, another Circuit Courts of Appeal should be able to disagree with or distinguish the First Circuit ruling. The existence of the First Circuit ruling could make it difficult to reach a clean legal opinion on special revenues without clear state law mandating payment.

Significance of Puerto Rico Assured Decision for Municipal Special Revenues Outside of PR

What does this mean for Special Revenues?

- The good news is the First Circuit and lower court Puerto Rico rulings recognize that the lien on special revenue continues and is not terminated or diminished post filing a Chapter 9.
- The ruling raises unaddressed issues as to how special revenues can be used for anything other than payment of the revenue bonds without providing “adequate protection” for bondholders (Section 361 of Bankruptcy Code) for the use of the collateral or whether default interest may be obtained, etc.
- Are “special revenues” now more like statutory liens, which will be paid but there may be a delay? Probably yes, but will depend on particular state law and transaction documents.
- Much depends on particular state law and the transaction documents.

Fitch Places Seven USPF Special Revenue Ratings on Negative Watch Pending Court Decision

April 11, 2019

Fitch Ratings placed the seven U.S. Public Finance ratings that are more than six notches higher than the Issuer Default Rating (IDR) for the associated local government on Rating Watch Negative. This action is in response to the March 26, 2019 ruling by the United States Court of Appeals for the First Circuit regarding the bondholder protections provided by special revenue status under Chapter 9 of the U.S. bankruptcy code.

Source: <https://www.fitchratings.com/site/pr/10069117>

Rating Sensitivities

1 – 3 Notches Above IDR

- "The rating is unlikely to be affected by a recent ruling by the United States Court of Appeals for the First Circuit regarding the protections provided to holders of bonds secured by pledged special revenues. Fitch believes those protections warrant a distinction in ratings above the IDR regardless of the outcome of the case."

4 – 6 Notches Above IDR

- "The rating may be affected by the recent appeals court ruling regarding the protections provided to holders of bonds secured by pledged special revenues. Fitch believes those protections warrant a distinction in ratings above the IDR regardless of the outcome of the case. However, a final decision consistent with the First Circuit's ruling may result in security ratings closer to the IDR."

CA School District Rating Sensitivity

“The rating may be affected by the recent appeals court ruling regarding the protections provided to holders of bonds secured by pledged special revenues. Fitch believes those protections warrant a distinction in ratings above the IDR regardless of the outcome of the case. However, a final decision consistent with the First Circuit's ruling may result in security ratings closer to the IDR. Given state constitutional and statutory restrictions, Fitch believes potential rating changes would be modest.”

Fitch Places Seven USPF Special Revenue Ratings on Negative Watch Pending Court Decision (continued)

Key Rating Drivers

- **Ratings Most Affected:** The ratings placed on Rating Watch Negative have the highest ratings relative to their associated governments' IDRs. Ratings on special revenue bonds that are closer to the associated government's IDR are less likely to be affected by a re-evaluation of special revenue protections. While special revenues offer substantial protections in the event of a bankruptcy filing, the ruling creates uncertainty about full and timely payment of special revenue obligations during the bankruptcy of the associated government. The potential impact of the ruling on such ratings will be reflected through tailored sensitivities. For more information, see "Fitch Ratings: Rating Sensitivities will Indicate Vulnerability to Special Revenue Bond Ruling," dated April 11, 2019.
- **Ruling Affirms District Court Decision:** In the ruling, the circuit court agrees with a 2018 district court opinion concerning Puerto Rico Highways and Transportation Authority (PRHTA) bonds 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. By stating such payments are optional, the ruling creates uncertainty about full and timely repayment of special revenue obligations during bankruptcy of the related municipality.
- **Inconsistent With Historical Treatment:** The decision affirming the 2018 district court ruling was inconsistent with Fitch's and market participants' general understanding of the meaning of section 922(d) and the treatment of special revenue obligations in bankruptcy since the code was amended in 1988. Nevertheless, with an appeals court validation Fitch believes its impact on ratings must be evaluated.
- **Influential Nationwide:** While the ruling only directly affects districts in the First Circuit (Maine, Massachusetts, New Hampshire, Puerto Rico and Rhode Island), Fitch believes that this decision would be influential in future municipal bankruptcy cases nationwide.
- **Timing Uncertain:** The plaintiffs in the PRHTA case have multiple avenues of appeal. Fitch will monitor any court proceedings as they occur and incorporate the results into any affected ratings.

Source: <https://www.fitchratings.com/site/pr/10069117>

Significance of Puerto Rico Assured Decision for Municipal Special Revenues Outside of PR

Where do we go from here?

- Pay attention to language in special revenues authorizing documents, segregation of pledged revenues and the application of pledged revenues by debtor
- Contractual agreement by debtor in authorizing documents that specifically state or provide:
 - Pledged Revenues constitute “special revenues” for purposes of and as defined in 11 U.S.C. § 902(2);
 - It is the intention of the debtor that the pledge of the Pledged Revenues constitutes a pledge of “special revenues” for purposes of 11 U.S.C. § 901 et seq.;
 - A petition filed by debtor under 11 U.S.C. § 901 et seq., will not operate as a stay under 11 U.S.C. § 362 of the application of Pledged Revenues to payment when due of the debt service on each payment due date in accordance with the bond documents;
 - Use of lock box for direct deposit of special revenues or special accounts for direct payment into account held by the trustee for payment to bondholders to protect against commingling or diversion of special revenues;
 - Debtor agrees to voluntarily apply all Pledged Revenues (net of necessary operating costs) to pay debt service when due during Chapter 9 or special default rate

What are Special Revenues?

Section 902(2) of the Bankruptcy Code defines special revenues as:

- (2) "special revenues" means—
- (A) receipts derived from the ownership, operation, or disposition of projects or systems of the debtor that are primarily used or intended to be used primarily to provide transportation, utility, or other services, including the proceeds of borrowings to finance the projects or systems;
 - (B) special excise taxes imposed on particular activities or transactions;
 - (C) incremental tax receipts from the benefited area in the case of tax-increment financing;
 - (D) other revenues or receipts derived from particular functions of the debtor, whether or not the debtor has other functions; or
 - (E) taxes specifically levied to finance one or more projects or systems, excluding receipts from general property, sales, or income taxes (other than tax-increment financing) levied to finance the general purposes of the debtor.

11 U.S. Code § 903

§ 903. Reservation of State power to control municipalities

This chapter does not limit or impair the power of a State to control, by legislation or otherwise, a municipality of or in such State in the exercise of the political or governmental powers of such municipality, including expenditures for such exercise[.]

Is a Model State Law Needed or Required?

- The First Circuit recognized that the Court does not have the power to order, stay, decree or interfere with the use of revenues of a municipality under Section 904 of the Bankruptcy Code (Section 305 of PROMESA).
- Section 903 of the Bankruptcy Code (Section 303 of PROMESA) prohibits any limitation or impairment of the state's power to control its municipality's exercise of a governmental power including as to expenditures (such as state mandated payment of special revenues to bondholders).
- Revenue bond financing permitted by state law varies from state to state with no model language or consistency as to whether the purpose and intent of the law is that special revenues must be paid even after filing a Chapter 9. A Model State Law would have settled purpose, intent and interpretation without variation.

Is a Model State Law Needed or Required?

- Under municipal law the state controls the actions of its municipalities and may through state law mandate that a municipality must timely pay special revenues to the bondholders as collected.
- This mandated “voluntary” payment as required by state law would be consistent with Section 903 and 904 of the Bankruptcy Code and the spirit and tone of the First Circuit ruling. A municipality cannot legally act contrary to a requirement under state law. With a state law mandating payment, a bankruptcy court should not confirm any plan of adjustment that does not provide for timely payment during and after Chapter 9 as required by state law.

Is a Model State Law Needed or Required?

- The Model State Law would be a reaffirmation and, if necessary, clarification of the purpose and intent of revenue bond financing and may incorporate previously enacted state law permitting revenue bond financing and provide:
 - Definition of key words and specific references to what is deemed special revenue
 - Specific statement of legislative intent and purpose so that special revenues are timely paid to bondholders before and after filing of Chapter 9 – no discretion in applying special revenues
 - Pledge and lien on special revenues immediately effective, legal, binding, valid, perfected, enforceable against all other parties, without notice or any further acts including under any other state law including the Uniform Commercial Code

Is a Model State Law Needed or Required?

- Pledged special revenues could not be used for any other purpose until obligation to pay bonds timely has been satisfied
- The mandated payment of special revenues to bondholder applies to all bonds designated in the Model State Law, whether issued prior to, on, or after the effective date of the Model Law
- The mandate of timely payment of special revenues as collected is irrevocable while any bonds issued under the Model Law are outstanding and have not been paid in full
- Recognition this is a state law mandate under Sections 903 and 904 and the municipality is not authorized under state law to act or consent to any action contrary to the Model State Law and timely payment of special revenues during a Chapter 9 and thereafter cannot be limited or impaired in any way by the Bankruptcy Code or the order decreed, stayed or otherwise interfered with by the Bankruptcy Court

Is a Model State Law Needed or Required?

- This would create predictable priorities in Chapter 9 and pricing for the market.
- Outside Chapter 9 payment is enforceable. Outside of a Chapter 9 proceeding, participants would be protected through enforcing payment by writ of mandamus or other remedies and the fact that a governmental officer must comply with the mandate of state law or suffer the penalties.

For additional details and a Model State Law, see the forthcoming article in the Municipal Finance Journal, Vol. 39, No. 4, “The History and Justification for Timely Payments of Statutory Liens and Pledged Special Revenue Bond Financing in a Chapter 9 Municipal Debt Adjustment Proceeding: Is a Model State Law Necessary or Required?”

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Juliet Huang is a partner in Chapman's Public and Institutional Banking & Finance Group as well as the National Public and Health & Education Finance Department. Juliet represents clients in a wide variety of public finance transactions, including direct lending, credit-enhancement, muni-leasing, public offerings, secondary market tax-exempt securitizations, and municipal distress workouts and restructurings. Juliet regularly serves as counsel to a broad range of financial institutions that are direct purchasers of municipal obligations and/or that provide credit and liquidity in public finance transactions. A significant portion of Juliet's practice focuses on the municipal leasing industry and the origination, placement, and securitization of tax-exempt and taxable installment purchase, lease-purchase, and other non-bond financing and operating lease arrangements with state and local governments (including for the benefit of qualified 501(c)(3) entities) for the acquisition, construction, equipping, and installation of a broad range of essential government buildings, facilities, equipment, and other real and personal property.

Juliet has considerable experience in financings for renewable energy, solar, and energy efficiency projects. Juliet also represents bank-affiliated and independent lenders, investors, leasing companies, servicers, and buyers and sellers in municipal asset portfolio transactions, syndications, pooled securitizations, and other secondary market municipal asset products.

Juliet has been elected to the Board of Directors of the Association for Governmental Leasing and Finance for a three-year term and is a member of the National Association of Bond Lawyers. Juliet is a frequent speaker on topics relevant to financial institutions and investors in the municipal bond market.

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Jim Spiotto is a Managing Director of Chapman Strategic Advisors LLC, a consultancy providing educational and strategic insights to market participants concerning municipal finance topics of interest. He is also the co-owner and co-publisher of MuniNetGuide.com, an online resource specializing in municipal-related research and information concerning state and local government, including public finance, infrastructure, job market data, and economic statistics and analysis.

Prior to joining Chapman Strategic Advisors LLC, Jim was a partner in the law firm of Chapman and Cutler LLP where he represented issuers, indenture trustees or bondholders in litigation, bankruptcy or workouts of over 400 troubled debt financings in over 35 different states and in foreign countries as well.

Jim has contributed significantly to thought leadership around municipal defaults and bankruptcy, including co-authoring *Defaulted Securities: The Guide for Trustees and Bondholders* and *Municipalities in Distress? How States and Investors Deal with Local Government Financial Emergencies* (both published by Chapman and Cutler LLP and available from Amazon.com) and *Primer on Municipal Debt Adjustment*, published by Chapman and Cutler LLP and available upon request from the firm.

In May 2014, the National Federation of Municipal Analysts honored Jim with an award for his contributions as a thought leader within the municipal bond industry. He was recognized for his "prominent voice" on the topic of municipal bankruptcy and his years of groundbreaking research and analysis that have long aided municipal analysts with the intricacies of Chapter 9 bankruptcy.

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