No. 19-387

IN THE

Supreme Court of the United States

AMBAC ASSURANCE CORP.,

Petitioner,

v.

FINANCIAL OVERSIGHT AND MANAGEMENT BOARD FOR PUERTO RICO, *et al.*,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the First Circuit

BRIEF FOR THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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INTEREST OF THE AMICUS CURIAE[1]

The Securities Industry and Financial Markets Association (*"SIFMA"*) represents the shared interests of hundreds of securities firms, banks, and asset managers, including many that actively participate in the revenue bond market, with a combined $34 trillion in assets under management in the United States.[2] SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation, and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. SIFMA seeks to foster stability in, and the continued availability of, a robust municipal bond market to assist local governments to finance infrastructure, provide vital services, and invest in projects required to allow municipalities and localities to compete in the global economy.

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[1] No counsel for a party authored this brief in whole or in part, and no person other than *amicus curiae*, its members, or its counsel made a monetary contribution to the preparation or submission of this brief. Counsel for *amicus* provided counsel for the parties' timely notice of *amicus*'s intent to file this brief, and all parties have consented to its filing.

[2] The SIFMA Asset Management Group (*"AMG"*) is the voice for the buy-side within the securities industry and broader financial markets. The clients of AMG member firms include, among others, registered investment companies, separate accounts, ERISA plans, and state and local government pension funds.

SUMMARY OF THE ARGUMENT

The First Circuit Opinions[3] undermine the stability of the municipal revenue bond market in the United States, injuring local governments and municipal bond investors. In fact, some of our nation's largest cities including Cleveland, Ohio and Dallas, Texas have already begun to experience the negative effects of the First Circuit Opinions.[4] The two rulings are in direct contravention to market expectations by holding that: (i) the plain language of 11 U.S.C. § 922(d) permits a debtor merely to pay creditors voluntarily during a bankruptcy proceeding; and (ii) because of the application of 11 U.S.C. § 904 (and 48 U.S.C. § 2165, which makes the substance of such provision applicable to Puerto Rico) creditors are not entitled to an enforcement mechanism in the face of nonpayment by a debtor in the debtor's bankruptcy proceeding, but rather must seek relief from the automatic stay contained in 11 U.S.C. § 362 and raise any claims in a separate action.[5] Before the First Circuit Opinions

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[3] *Assured Guaranty Corp. v. Fin. Oversight & Mgmt. Bd. for Puerto Rico*, 919 F.3d 121 (1st Cir. 2019) (the *"Assured Opinion"*) and *Ambac Assurance Corp. v. Commonwealth of Puerto Rico*, 927 F.3d 597 (1st Cir. 2019) (the *"Ambac Opinion"* and together with the *Assured* Opinion, the "*First Circuit Opinions*"). Because the First Circuit Opinions involve similar legal issues and address the treatment of the bonds issued by the Puerto Rico Highway Transportation Authority, SIFMA has submitted this brief in both proceedings.

[4] As discussed in Section II herein, certain revenue bonds issued by Cleveland, Ohio and Dallas, Texas have been downgraded by a ratings agency as a result of the First Circuit Opinions.

[5] *Assured Op.*, 919 F.3d at 130-31; *Ambac Op.*, 927 F.3d at 602-03. *But see Assured Guaranty Corp. v. Fin. Oversight & Mgmt.*

were issued, participants in the municipal market accepted as basic principle that 11 U.S.C. § 922(d) was a mandatory requirement. This accepted understanding preserved the benefit of the bargain provided to revenue bondholders that they would be repaid, even in the face of a municipal bankruptcy.[6]

The rulings are inconsistent with the purpose of the special revenue protections found in the U.S. Bankruptcy Code (the *"Bankruptcy Code"*), 11 U.S.C. §§ 902(2), 922(d), 927, and 928 (the *"Special Revenue Provisions"*),[7] and have created uncertainty and dislocation in the markets for revenue bonds. This uncertainty materially affects SIFMA's membership and the more than 90,000 local governments in the United States.[8] Market stability demands a set of laws that are interpreted in a uniform manner and as intended by Congress. If left in place, the First Circuit Opinions will create additional, unexpected investment risk that revenue

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Bd. for Puerto Rico, 931 F.3d 111, 119-35 (1st Cir. 2019), J. Lynch, dissenting (*"Assured II"*).

[6] *See In re Jefferson Cty., Ala.,* 474 B.R. 228, 268-74 (Bankr. N.D. Ala. 2012) (discussing requirement that a municipal debtor continue to pay bonds secured by a pledge of special revenues, subject to necessary operating expenses of the project or system).

[7] Municipal Bankruptcy Amendments, Pub L. No. 100-597, 102 Stat. 3028 (Nov. 3, 1988).

[8] *See* Number of Local Governments by State, GOVERNING, https://www.governing.com/gov-data/number-of-governments-by-state.html (last visited Oct. 21, 2019) (aggregating 2017 data estimates from U.S. CENSUS BUREAU, 2017 CENSUS OF GOVERNMENTS: ORGANIZATION COMPONENT ESTIMATES (2019) https://www.census.gov/data/tables/2017/econ/gus/2017-governm ents.html).

bond investors will not be repaid in a bankruptcy, even if sufficient revenues are collected from a project.

In addition to the investment risk concerns of SIFMA's membership triggered by the First Circuit Opinions, SIFMA's U.S. members are also concerned about the increased costs of municipal services that could occur across the country. While the impact of the the First Circuit Opinions on financially healthy municipalities remains to be seen, the First Circuit Opinions will have the effect of increasing borrowing costs of financially troubled municipalities, thus adding greater stress on those distressed municipalities. These increased and unintended costs resulting from increased risks to investors may cause local governments to increase usage fees and taxes.

These are the primary reasons why the impact of the First Circuit Opinions is of immediate national importance.[9] The First Circuit Opinions not only affect outstanding revenue bonds issued by the Puerto Rico Highway Transportation Authority, but also the over $2.4 trillion in revenue bonds currently outstanding across the United States[10] and puts at risk future revenue bonds issued by U.S. municipalities for essential capital projects, such as projects to provide safe

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[9] In her dissent in *Assured II*, Judge Lynch noted: "This issue is of extraordinary importance: it goes well beyond the Title III proceedings in the Commonwealth as to both potential municipal and state defaults, affects special revenue bonds nationwide, and has Constitutional implications." *Assured II*, 931 F.3d at 119.

[10] SIFMA, MUNICIPAL BOND CREDIT REPORT FOURTH QUARTER AND FULL YEAR 2018 19 (2019), https://www.sifma.org/wp-content/uploads/2019/02/US-Municipal-Report-2019-02-11-SIFMA.pdf (last visited Oct. 21, 2019) [hereinafter SIFMA 2018 Bond Report].

drinking water to residents[11] and investments to build and repair critical infrastructure.[12]

Review of the First Circuit Opinions is warranted because SIFMA believes that the First Circuit has misinterpreted the Special Revenue Provisions, destabilizing the municipal market. By interpreting the protections afforded to investors through the Special Revenue Provisions in a manner contrary to longstanding market expectations and violative of the clear statutory text, the First Circuit Opinions deny market participants important protections on which they have relied. The uncertainty created by the First Circuit Opinions has wide-reaching, negative national implications that warrants review and should be corrected.

[11] *See, e.g.,* City of Kalamazoo, County of Kalamazoo, State of Michigan, Water Supply System Revenue Bonds, Series 2019 (Final Official Statement Dated June 4, 2019), https://emma.msrb.org/ER1231667-ER963700-ER1364637.pdf (bonds payable solely with net system revenues).

[12] *See, e.g.,* Triborough Bridge and Tunnel Authority Triborough Bridge and Tunnel Authority (MTA Bridges and Tunnels) (General Revenue Bonds, Series 2019A Official Statement), (May 15, 2019) https://emma.msrb.org/EP1036504-EP803095-EP1204628.pdf (bonds payable from revenues collected from certain New York City bridges and tunnels).

ARGUMENT

I. The Decision Upsets the Settled Expectations of the Municipal Markets

A. Since 1988, the Municipal Revenue Bond Market Has Enjoyed Substantial Stability Because of the Accepted Market Understanding of Chapter 9 of the U.S. Bankruptcy Code

In 1987, before Congress approved the Special Revenue Provisions as a part of amendments approved in 1988 (the *"1988 Amendments"*), municipalities issued approximately $60 billion in revenue bonds.[13] In 2018 alone, by contrast, $200 billion in long-term revenue bonds were issued by U.S. municipalities.[14] Taking inflation into account, the 2018 municipal revenue bond market was approximately 36% larger than its pre-1988 Amendments counterpart. This increase was largely due to the stability provided to the market by the 1988 Amendments.[15]

The 1988 Amendments were incorporated into the Bankruptcy Code, in part, to address the concerns of participants in the municipal marketplace – including many of SIFMA's members – with certain provisions of the Bankruptcy Reform Act of 1978 (the *"1978 Act"*) that had imported a business bankruptcy provision (11

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[13] *See* S. REP. NO. 100-506, at 4 (1988) [hereinafter the *"1988 Senate Report"*].

[14] *See* SIFMA 2018 Bond Report at 12.

[15] Inflation calculated using U.S. Bureau of Labor Statistics CPI Inflation Calculator. U.S. BUREAU OF LABOR STATISTICS, *Calculation of Inflation*, https://www.bls.gov/data/inflation_calculator.htm (Input $60, set initial date as December 1988 and current date as September 2019, and click "Calculate", returning $127.85).

U.S.C. § 552) better suited to commercial, not municipal, finance into the Bankruptcy Code's municipal bankruptcy section.[16] The concern arose because Section 552 cuts off, at the bankruptcy petition date, a consensual prepetition pledge of property to a debtor, except for a security interest in after-acquired "proceeds, products, offspring, or profits" of property to which the security interest had attached prepetition.[17] Section 552 is ill-suited to municipal revenue financing because state laws ordinarily do not permit a municipality to mortgage the physical assets of a municipal-owned project or system. Because municipalities typically pledge the revenue stream from a project or system rather than the project or system itself, one could argue that under the application of Section 552, municipal revenue bondholders are rendered unsecured by a municipality's bankruptcy. This is because the bondholders (or indenture trustee) have not been mortgaged the physical project or system that produces the revenues that become the after-acquired "proceeds, products, offspring, or profits", but only the revenue stream itself. Because of state law proscriptions, measures to preserve the value of the pledged revenues and to ensure the continued and timely application to revenue bond obligations are of paramount importance to revenue bond investors and constitute their principal security.

The 1988 Amendments were meant to correct this problem by ensuring that important traditional principles of municipal revenue bond financing (such as the use of a revenue pledge to secure bonds) would survive a municipal issuer's bankruptcy filing, and, thus,

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[16] Pub. L. No. 95-598, 92 Stat. 2549 (1978), enacting 11 U.S.C. § 901(a) (*"1978 Act"*); *see also* 1988 Senate Report, *supra* note 13, at 3-4).

[17] 11 U.S.C. § 552(b).

prevent the diversion of investors' security and source of repayment. In particular, the 1988 Amendments provided that: (i) a municipal revenue bondholder's lien continues to attach to postpetition special revenues;[18] (ii) the automatic stay is inapplicable to the application of pledged special revenues;[19] (iii) the debtor may only use pledged special revenues derived from a project or system to pay for the necessary operating expenses of such project or system and then must apply the pledged special revenues pursuant to the terms of the underlying agreement;[20] and (iv) unless the underlying bond documents permit otherwise, a creditor secured by a pledge of special revenues may not seek repayment from other payment sources.[21] These specific provisions were incorporated into the municipal bankruptcy provisions of the Bankruptcy Code, which already contained Section 904 (11 U.S.C. § 904) of the Bankruptcy Code.

Municipal revenue bond investors have relied on (i) the Special Revenue Provisions and Congressional statements made contemporaneous with the 1988 Amendments and (ii) Chapter 9 revenue bond case law as the basis for their continued investment in the municipal revenue bond market.[22] The First Circuit Opinions contradict those assurances and undercut Congress's express intent by jeopardizing bondholders' rights to special revenues in municipal bankruptcies. The First Circuit found, contrary to market expectation, clear statutory text, and Congressional intent,

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[18] 11 U.S.C. § 928(a).

[19] 11 U.S.C. § 922(d).

[20] 11 U.S.C. § 928(b).

[21] 11 U.S.C. § 927.

[22] *See In re Jefferson Cty., Ala.*, 474 B.R. at 268–74.

that Section 922(d) does not compel a municipality to continue to make its debt service payments as they come due following a municipality's bankruptcy filing, but rather that Section 922(d) merely permits a municipal debtor to pay voluntarily its special revenue obligations despite the automatic stay of the Bankruptcy Code.[23] This finding warrants review by the Court.

The First Circuit Opinions already have adversely affected the municipal revenue bond market, including the ratings downgrades described herein. If left in place, the First Circuit Opinions will almost certainly hit hardest financially troubled municipalities. This is because the plain text of Section 922(d) provides that the filing of a bankruptcy petition does not operate "as a stay of application of pledged special revenues [consistent with Section 928] . . . to payment of indebtedness secured by such revenues."[24] The First Circuit Opinions found otherwise. If the First Circuit's interpretation of the Special Revenue Provisions is allowed to stand, it is likely that: (i) the risk premium demanded by investors on revenue bonds will increase; (ii) risk-averse investors will leave the revenue bond market due to the new uncertainty; (iii) transaction costs for revenue bond financings will increase due to revenue bond legal structures being more highly scrutinized, structured and negotiated by investors; and (iv) fewer critical infrastructure projects will be financed by municipalities as a result of the higher costs of such financings. As a result,

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[23] *Assured Op.*, 919 F.3d 121 at 132–33.

[24] 11 U.S.C. § 922(d).

municipalities will be denied the full benefits of the revenue-backed bond market that Congress sought to protect.

The 1988 Amendments gave investors the comfort needed to invest in revenue-backed structures and provided municipalities with a cost-effective method of borrowing, thereby allowing municipalities to build and maintain critical infrastructure projects without incurring additional general tax burdens. The First Circuit Opinions destabilized this critical financing mechanism. By their plain meaning and as stated in attendant legislative history, the Special Revenue Provisions and Section 48 U.S.C. § 2161 (applying the Special Revenue Provisions to Puerto Rico) require the timely payment of postpetition special revenues in accordance with the underlying bond documents, subject only to necessary operating expenses of the project or system. The Special Revenue Provisions are not altered by Section 904 of the Bankruptcy Code (11 U.S.C. § 904), as they are specific provisions that were approved well after Section 904 was incorporated into the Bankruptcy Code and were meant to provide clarification that a local government must follow the terms of its underlying revenue bond contracts and state law. Because of our country's significant need for a stable revenue bond market, the granting of the Petitions is, as Judge Lynch described, of "extraordinary importance."[25]

B. The Questions Presented are of Extreme National Importance

The effects of the First Circuit Opinions are wide ranging and will affect negatively the safety, welfare,

[25] *Assured II*, 931 F.3d at 119.

and quality of life of Americans across the country. Revenue bonds, and the ability of local governments to issue such bonds, are vital to maintain our country's competitive advantage and standard of living. In most cases, municipalities finance critical municipal infrastructure projects by issuing revenue bonds, which are secured solely by, and repaid solely from, revenues generated from the projects or systems they finance, or from a dedicated special tax stream. Revenue bonds allow municipalities to finance infrastructure and other improvement projects without saddling taxpayers with higher property taxes. Revenue bonds also provide financing for projects where debt limits or other restrictions make municipal general obligation debt — that is, debt secured by a municipality's full taxing power — unavailable.

In part, because of this system of revenue financing, the United States boasts the most extensive public works system in the world, comprised of approximately 4,165,349 miles of roadways, 614,386 bridges, 19,636 airports, 25,000 miles of navigable waterways, 90,000 dams, 49,133 community water systems, and 14,748 wastewater treatment plants, all built and maintained, at least in significant part, by municipal entities.[26]

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[26] *See* BUREAU OF TRANSP. STATISTICS, U.S. DEP'T OF TRANSP., 2018 NATIONAL TRANSPORTATION STATISTICS Tables 1-1, 1-3 (2018); AM. SOC'Y OF CIVIL ENG'RS, INFRASTRUCTURE REPORT CARD, *Dams* (2017), https://www.infrastructurereportcard.org/cat-item/dams/; AM. SOC'Y OF CIVIL ENG'RS, INFRASTRUCTURE REPORT CARD, *Bridges* (2017), https://www.infrastructurereportcard.org/cat-item/bridges/; U.S. ENVTL. PROT. AGENCY, COMMUNITY WATER SYSTEM SURVEY 7 (2006), https://nepis.epa.gov/Exe/ZyPDF.cgi?Dockey=P1009JJI.txt; AM. SOC'Y OF CIVIL ENG'RS, INFRASTRUCTURE REPORT CARD (WASTEWATER) (2017), https://www.infrastructurereportcard.org/cat-item/wastewater/; MUNICIPAL SECURITIES RULEMAKING BOARD, MUNICIPAL SECURITIES: FINANC-

The American Society of Civil Engineers (*"ASCE"*) estimates that the cost to maintain our country's infrastructure will exceed $4.59 trillion by 2025, or more than three times the annual tax revenues for all state and local governments.[27] Inattention and insufficient funding for infrastructure have caused this number to increase by $1 trillion since 2013.[28] Any further deferral of needed infrastructure improvement could have devastating results.[29]

Set against this backdrop, the First Circuit Opinions have created financial uncertainty that is likely to result in further repair and modernization delays and an increase in infrastructure costs, especially for financially troubled municipalities. The First Circuit Opinions eliminate the assurance of timely payment

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ING THE NATION'S INFRASTRUCTURE 3 (2019), http://www.msrb.org/~/media/Files/Resources/MSRB-Infrastructure-Primer.ashx.

[27] *See* AM. SOC'Y OF CIVIL ENG'RS, 2017 INFRASTRUCTURE REPORT CARD, A COMPREHENSIVE ASSESSMENT OF AMERICA'S INFRASTRUCTURE 8 (2017), https://www.infrastructurereportcard.org/wp-content/uploads/2016/10/2017-Infrastructure-Report-Card.pdf; U.S. CENSUS BUREAU, *2017 Quarterly Summary of State & Local Tax Revenue Tables* (Table 1), https://www.census.gov/data/tables/2017/econ/qtax/historical.html (sum of row 19, times three, equals $4.13 billion).

[28] In 2013, ASCE's number for the estimated investment needed by 2020 was $3.6 trillion. AM. SOC'Y OF CIVIL ENG'RS, *Report Card for America's Infrastructure* (2013), http://2013.infrastructurereportcard.org/.

[29] *See* AM. SOC'Y OF CIVIL ENG'RS, *Failure to Act: Closing the Infrastructure Investment Gap for America's Economic Future* (2016), at 1–7, https://www.infrastructurereportcard.org/wp-content/uploads/2016/10/ASCE-Failure-to-Act-2016-FINAL.pdf; U.S. CENSUS BUREAU, *2017 Quarterly Summary of State & Local Tax Revenue Tables (Table 1)*, https://www.census.gov/data/tables/2017/econ/qtax/historical.html.

of revenue bonds by municipalities in the context of a municipal bankruptcy proceeding. By subverting the Special Revenue Provisions and making the determination that a municipal debtor's payments on bonds secured by a "pledge of special revenues" after the filing of a bankruptcy is voluntary rather than compulsory, the First Circuit Opinions have the unintended consequence of limiting municipal access to revenue bond financing (especially by financially troubled municipalities), because the cost of financing will increase based on the increased risk caused by the First Circuit Opinions.

Although unique state and local legal requirements and characteristics apply to any particular bond issue, it has been commonly understood within the municipal bond industry and many states laws require that revenue bonds are secured only by the revenues or fees pledged to pay such bonds, and are not secured by the unlimited taxing power of a municipality.[30] This typical structure was incorporated into the Bankruptcy Code through Section 927 (11 U.S.C. § 927), which contains an explicit prohibition on holders of bonds secured only by a pledge of special revenues from receiving a distribution from the general revenues of a municipality. The First Circuit Opinions are especially troublesome to SIFMA and its membership because, as a result of this typical financing structure, a bondholder's only recourse with

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[30] For example, *see* City of Baltimore, (Maryland Project Revenue Bonds (Stormwater Projects) Series 2019A Official Statement) (May 16, 2019), https://emma.msrb.org/ES1273514-ES996698-ES1398127.pdf at cover page (noting that the bonds were special obligations of Baltimore "and neither the faith and credit nor the taxing power of the City or the State of Maryland" is pledged for payment of the bonds).

respect to a municipal revenue bond is the revenue stream that was pledged to secure the bond issuance.[31] So long as the Special Revenue Provisions are interpreted consistent with market understanding and expectations, this bargain was acceptable for investors.

In contrast, the First Circuit Opinions strip the benefit of the bondholders' bargain. Until the First Circuit Opinions, revenue bond investors had confidence that so long as a project was producing revenues, those investors would continue to be timely paid on their bonds even if the underlying municipality was eligible to file a municipal bankruptcy petition under Chapter 9 of the Bankruptcy Code.[32] This confidence no longer exists and this is why the granting of the Petitions here is of such national significance.

II. The Aftermath of the First Circuit Opinions Has Had the Precise Consequences That the 1988 Amendments Were Meant to Avoid

It is ironic that the legislative history surrounding the 1988 Amendments demonstrates that the amendments were intended in part to address a situation

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[31] 11 U.S.C. § 927. "Many municipal obligations are, by reason of constitutional, statutory or charter provisions, payable solely from special revenues and not the full faith and credit of the municipality. This amendment leaves these legal and contractual limitations intact without otherwise altering the provisions with respect to non-recourse financing. Thus, this section avoids the potential conversion of revenue bonds into [g]eneral [o]bligation bonds. . . ." 1988 Senate Report, *supra* note 13, at 22.

[32] *See, e.g., Jefferson Cty., Ala.*, 474 B.R. at 268–75 (revenue bondholders continued to receive payment during Chapter 9 proceeding, subject to necessary operating expenses).

involving Cleveland, Ohio and, following the First Circuit Opinions, Cleveland was one of the first municipalities to be injured as a direct result of the First Circuit Opinions.[33] In 1979, Cleveland was facing a financial crisis. Cleveland needed additional financing, but lenders were unwilling to lend to the city citing the incorporation of Section 552 into Chapter 9 of the Bankruptcy Code as a reason.[34] This was not surprising, because it was unlikely that a lender would want to lend to a troubled municipality if it knew that the lien on its only source of revenue would be cut off upon a bankruptcy filing. The 1988 Amendments were thus passed to redress the difficulty faced by municipalities like Cleveland.

Unfortunately, Cleveland found itself back in the limelight following the First Circuit Opinions. In July 2019, Moody's Investors Service (*"Moody's"*), one of the country's primary securities ratings agencies, downgraded $431 million of outstanding senior lien revenue bonds and $61 million of second lien revenue bonds that had been issued to fund Cleveland's water system.[35] Those bonds were secured by a pledge of special revenues. Moody's cited the First Circuit's decision as the reason for the downgrade. Moody's noted that its downgrade reflected a closer alignment of Cleveland's general obligation bond rating with its

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[33] 1988 Senate Report, *supra* note 13, at 4.

[34] *Id.*

[35] *Rating Action: Moody's Downgrades Cleveland, OH's Senior Lien Water Revenue Bonds to Aa2; Outlook Stable,* MOODY'S INVESTORS SERVICE (July 29, 2019), https://www.moodys.com/research/Moodys-downgrades-Cleveland-OHs-senior-lien-water-revenue-bonds-to--PR_905922284?WT.mc_id=AM%7ERmluYW56ZW4ubmV0X1JTQl9SYXRpbmdzX05ld3NfTm9fVHJhbnNsYXRpb25z%7E20190729_PR_905922284#.

water system rating because of the strong legal and governance linkages because the water system was a department of the city. "In the event of serious fiscal stress of the city, there is a greater risk for system creditors that the city could impair pledged revenue than if the system were legally independent of the city."[36] Prior to the First Circuit's decision, Moody's did not specifically tie a municipality's revenue bond rating to its general obligation rating.[37]

The effects of the First Circuit Opinions are real. Cleveland has already indicated that it will need to issue additional revenue bonds to fund additional projects related to its water system.[38] But with the ratings of its water bonds reduced on the basis of the First Circuit Opinions, future water bonds may require a higher yield to attract investors.[39] This, in

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[36] *Id.*

[37] *Compare U.S. Public Finance Special Tax Methodology,* MOODY'S INVESTORS SERVICE (July 19, 2017) at 6, https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBM_1077147 (noting that Moody's as a part of its methodology developed in 2017 does not "explicitly" limit the amount by a which a revenue bond can exceed a municipality's general obligation rating) *with Rating Action: Moody's Places 8 Ratings Under Review for Downgrade in Wake of Recent Court Ruling on Special Revenue Pledges*. MOODY'S INVESTORS SERVICE (May 13, 2019), https://www.moodys.com/research/Moodys-places-8-ratings-under-review-for-downgrade-in-wake--PR_905836610 (noting linkage between a revenue bond rating and general obligation bond rating of a municipality following the *Assured* Opinion).

[38] Nora Calomer, *Why a Cleveland Rating Took Collateral Damage from Puerto Rico*, The Bond Buyer (July 30, 2019 4:04 PM), https://www.bondbuyer.com/news/cleveland-water-revenue-bonds-take-puerto-rico-related-downgrade.

[39] A "yield" is "[t]he annual rate of return on an investment, based on the purchase price of the investment, its coupon rate and the length of time the investment is held. The yield of a municipal security moves inversely to the price." MUNICIPAL

turn, may result in Cleveland avoiding such transactions, reducing the funds available to maintain and improve its water system, or cause Cleveland to pass the higher transactional costs on to its citizens in the form of higher water usage rates. These effects are a direct result of the legal uncertainty introduced by the First Circuit Opinions. Municipal market participants need legal predictability and the ability to enforce their security rights to keep borrowing rates low and maintain investor participation. By erroneously determining that a debtor municipality can choose whether or not to pay its revenue debt, the First Circuit has undermined market confidence, and thus the First Circuit Opinions warrant review and reversal.

As noted, following the First Circuit Opinions, many of the major ratings agencies acted swiftly to tie more closely a municipality's revenue bond rating to its general obligation bond rating. Moody's, for instance, placed additional municipal revenue bond issuances beyond Cleveland's on downgrade review, a position that affected approximately $13.8 billion in outstanding debt.[40] In fact, revenue bonds issued by municipalities across the United States have been affected, including bonds issued by Chicago, Illinois; Dallas, Texas; the Granite City Wastewater Treatment Plant Enterprise, Illinois; the Lynn Water & Sewer Commission, Massachusetts; the Monroe County Water Authority, New York; Center City District

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SECURITIES RULEMAKING BOARD, *Glossary of Municipal Securities Terms*, http://www.msrb.org/Glossary/Definition/YIELD.aspx.

[40] *Rating Action: Moody's Places 8 Ratings Under Review for Downgrade in Wake of Recent Court Ruling on Special Revenue Pledges*. MOODY'S INVESTORS SERVICE (May 13, 2019), https://www.moodys.com/research/Moodys-places-8-ratings-under-review-for-downgrade-in-wake--PR_905836610.

(Philadelphia), Pennsylvania; and Sheffield, Alabama, which were all placed on downgrade review by Moody's.[41] In making its determinations, Moody's noted: "The uncertainty regarding the interpretation of 'special revenue' resulting from the federal appeals court ruling underscores the importance of the linkage between a local government's general credit quality and that of its enterprises. The ruling has implications even for those entities located outside the [First] Circuit or not currently eligible to file for bankruptcy."[42]

Similarly, Fitch Ratings (*"Fitch"*), another leading securities rating agency, has placed six municipal revenue bond issuances on credit watch negative due to the instability created by the First Circuit Opinions.[43] Specifically, Fitch placed revenue bonds issued by the Chicago Board of Education, Maricopa County Special Healthcare District (Arizona), Oakland Unified School District (California), Palomar Health (California), Sacramento City Unified School District (California), and Sweetwater Union High School District (California) on credit watch negative because it determined that these revenue bond issuances should be more closely tied to the rating of the underlying municipality. In other words, Fitch (like Moody's) placed certain revenue bonds on watch for a downgrade because it determined that those revenue bonds may be rated too highly when compared to the lower-rated municipality issuing those bonds. Similar to Moody's, Fitch noted that "[w]hile

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[41] *Id*. Moody's subsequently has downgraded bonds issued by Cleveland, Center City District, the Granite City enterprise and Dallas, but confirmed the remaining ratings.

[42] *Id*.

[43] *Fitch Maintains Rating Watch Negative on Six Special Revenue Ratings*, FITCHRATINGS (Oct. 9, 2019 12:43 PM), https://www.fitchratings.com/site/pr/10089502.

special revenues offer substantial protections in the event of a bankruptcy filing, the March 2019 ruling [the *Assured* Opinion] creates uncertainty about full and timely payment of special revenue obligations during the bankruptcy of the associated government."[44] Other prominent ratings agencies have also expressed varying levels of concern about the First Circuit Opinions.[45]

Lowering the rating of a revenue bond to tie it more closely to the rating of the municipality in which the project is located affects more than the price of those bonds on the secondary trading market. The recent experience of the City of Chicago illustrates how the First Circuit Opinions have and will make municipal borrowing more costly. For example, before the First Circuit Opinions were issued, in January 2017, the City of Chicago, Illinois, sold certain general obligation bonds known as the General Obligation Bonds, Project and Refunding Series 2017A (the *"Chicago GO*

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[44] *Id*.

[45] *See, e.g., First Circuit Follies: Puerto Rico Ruling Slams Municipal Investors . . . Again,* KROLL BOND RATING AGENCY (Apr. 2, 2019), http://documents.krollbondratings.com/report/17230/public-finance-first-circuit-follies-puerto-rico-ruling-slams-municipal-investors-again (noting that "investor rights will suffer, issuers' costs will rise, and taxpayers will ultimately pay more to finance municipal infrastructure"); *Credit FAQ: Has S&P Global Ratings' View on Special Revenue Debt Changed Following the First Circuit Decision?,* S&P GLOBAL RATINGS, (May 1, 2019), https://www.spglobal.com/ratings/en/research/articles/190501-credit-faq-has-s-p-global-ratings-view-on-special-revenue-debt-changed-following-the-first-circuit-decision-10971767 (noting that the First Circuit's decision in the *Assured* Opinion "differs from a long-held view of many in the municipal market that Chapter 9 of the federal bankruptcy code compels a debtor to pay bonds secured by special revenues while in bankruptcy," but asserting that the opinion will have little effect on S&P Global's ratings methodology).

Bonds"). The Chicago GO Bonds were rated BBB+ by S&P Global Ratings and one bond in the series had a yield of 6.2%.[46] By comparison, in June 2017, the City of Chicago sold Chicago O'Hare International Airport General Airport Senior Lien Revenue Refunding Bonds, Series 2017B, which are secured by a pledge of special revenues (the *"Chicago O'Hare Revenue Bonds"*). The Chicago O'Hare Revenue Bonds were rated A by S&P Global Ratings, and one bond in the series had a yield of 3.22%.[47] Adjusting for differences in market timing by comparing the respective yield of the Chicago GO Bonds and the Chicago O'Hare Revenue Bonds to the Thomson Reuters Municipal Market Data AAA Curve (the *"MMD Curve"*)[48] at the time and based on research conducted by members of SIFMA, the Chicago GO Bonds were *329 basis points* above the MMD Curve, whereas the Chicago O'Hare Revenue Bonds were only *62 basis points* above the MMD Curve. In comparison to the Chicago GO Bonds, it is clear that the Chicago O'Hare Revenue Bonds provided substantial savings for the City of Chicago. These bonds provided Chicago with the option to spend additional funds to improve and maintain other critical infrastructure needs, rather

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[46] *See* City of Chicago, (General Obligation Bonds, Project and Refunding Series 2017A and Taxable Project Series 2017B Official Statement) (January 19, 2017), https://emma.msrb.org/EP975272-ER800979-ER1202127.pdf.

[47] *See* Chicago O'Hare International Airport, (General Airport Senior Lien Revenue Refunding Bonds Series 2017B Official Statement) (June 21, 2017), https://emma.msrb.org/Security/Details/AEC70F4A94A1FAAD586BFAA42D3C23029.

[48] For a discussion of municipal market benchmarks, including the MMD Curve, *see* MUNICIPAL SECURITIES RULEMAKING BOARD, *Understanding Municipal Market Indices, Yield Curves and Benchmarks* (Aug. 2017), http://www.msrb.org/msrb1/pdfs/MSRB-Indices-Defined-Report_FINAL.pdf.

than be used to fund the higher borrowing costs that Chicago would have incurred had the bonds not contained certain protections, such as the security of a pledge of special revenues protected by the 1988 Amendments.

By comparison, in December 2018, after the district court's opinion, but before the *Assured* Opinion upholding the district court's opinion, the City of Chicago issued its Chicago O'Hare International Airport General Airport Senior Lien Revenue Refunding Bonds, Series 2018B (the *"2018B O'Hare Bonds"*).[49] Similar to the Chicago O'Hare Bonds discussed in the previous paragraph, the 2018B O'Hare Bonds were rated A by S&P Global Ratings.[50] The yield for the 2018B O'Hare Bonds maturing in 2039 equaled 3.67%, however, which was greater than the 3.22% yield of the Chicago O'Hare Bonds that also mature in 2039.[51]

Because many of the ratings agencies have now more closely tied a municipality's revenue bond rating to its general obligation credit rating, the savings that revenue bonds once provided to municipalities for critical infrastructure may erode. While the savings erosion may appear less significant for municipalities with an investment-grade rating, for financially weaker municipalities, even if a strong underlying fee base secures a revenue bond, that revenue bond's rating may nonetheless be implicated under the methodology

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[49] *See* Chicago O'Hare International Airport, (General Airport Senior Lien Revenue Bonds Series 2018B Official Statement) (December 4, 2018), https://emma.msrb.org/Security/Details/AC780E1DB459685AE3BAD5AB5AB15339D.

[50] *Id.* at 93.

[51] *Id.* at Series 2018B (Non-AMT) Maturity Table. Municipal finance professionals consider myriad factors in calculating a yield, and one such factor generally is the safety of a revenue source in a bankruptcy proceeding.

of some of the ratings agencies, thereby increasing the price of that bond. This also means that if the financial market believes a municipality's finances are such that a municipal bankruptcy petition is more than a theoretical possibility, the market will assess a risk premium to that municipality's revenue debt and likely require additional structuring protections, which will increase borrowing costs.

As an example, the difference between an AAA-rated bond and a risky bond could be at least 200 basis points (a 2 percent increase) on principal amount per year, which is the equivalent of 2% additional interest cost per year.[52] This 2 percent increase significantly increases the financial burden on local governments. For example, if an additional interest cost of 2 percent per year is required by the financial markets for revenue bond financing due to the failure to provide appropriate assurances to investors that pledged revenues will be timely paid to revenue bondholders in a municipal bankruptcy, this would result in the additional present value cost to the municipality equal to about 25% of the original principal (based on a 20-year bond with bullet maturity at a 5% discount rate). The savings from eliminating that additional cost represents a diversion of funds from needed governmental services and improvements.

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[52] *See, e.g.*, *Chicago Schools Sell Upsized Bond Deal Ahead of Schedule*, REUTERS (May 17, 2018 3:58 PM), https://www.reuters.com/article/chicago-education-bonds/chicago-schools-sell-upsized-bond-deal-ahead-of-schedule-idUSL2N1SO1Z1 (noting that uninsured bonds that the Chicago Public Schools planned to issue were rated B with a positive outlook by S&P Global Markets, and the uninsured bond spread on the MMD Curve ranged from 193 basis points to 224 basis points).

For the last 30 years, the Special Revenue Provisions have provided the municipal bond market with the dedication of repayment required to provide low-cost borrowing access to municipalities to maintain and improve vital infrastructure. Municipal bond investors and ratings agencies had confidence in the pledge and strength of the underlying revenue stream in pricing revenue bonds because the Special Revenue Provisions provided holders comfort that they would continue to receive timely payment in the event of a municipal bankruptcy, subject only to the necessary operating expenses of the project or system in question. The First Circuit Opinions have produced significant uncertainty in the market and, if not reversed, will remove the guarantees that Congress intended with respect to the Special Revenue Provisions, and on which investors have bargained and legitimately relied. The consequence will ultimately be born by all Americans who either use municipal services or invest in the municipal bond market.

CONCLUSION

For these reasons, the Petitions should be granted.

Respectfully submitted,

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