By Rick B. Antonoff

"Application of Pledged Special Revenues" Under § 922(d)

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The title III debt-adjustment proceedings for the Commonwealth of Puerto Rico and its agencies have yielded several important and, in some cases, groundbreaking rulings by the U.S. District Court for the District of Puerto Rico and the U.S. Court of Appeals for the First Circuit. While some of these rulings have limited application beyond the title III cases and the Puerto Rico Oversight Management and Economic Stability Act (PROMESA), under which the cases are proceeding, one recent ruling by the First Circuit, involving the treatment of special revenues under § 922(d) of the Bankruptcy Code, might have far-reaching implications potentially affecting the nearly $4 trillion municipal bond market. The ruling conflicts with the only other published opinion on § 922(d) and has yielded a dissenting opinion squarely addressing the statute's ambiguity and calling for further review "if not by this court, then by the [U.S.] Supreme Court."[1]

The issue in these cases is whether an exemption from the automatic stay under § 922(d) *requires* municipal debtors to continue making debt-service payments to bondholders with liens on special revenues during the debt-adjustment proceedings, or instead merely *authorizes* such debtors to do so. In January 2012, the U.S. Bankruptcy Court for the Northern District of Alabama concluded that the exemption from the stay means that municipal debtors are required to make debt-service payments on pledged special revenues.[2] In March 2019, the First Circuit concluded and ruled that § 922(d) permits municipal debtors to voluntarily pay special-revenue bondholders, but does not require them to do so.[3] The First Circuit said further that § 922(d) therefore does not permit bondholders to enforce their rights and remedies without first obtaining relief from the automatic stay.

Section 922(d) was added to the Bankruptcy Code in 1988 as part of a comprehensive set of amendments addressing municipal bankruptcy cases. The statute states in pertinent part as follows:

> 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 of this title to payment of indebtedness secured by such revenues.[4]

The central questions raised by § 922(d) are about the meaning of the phrase "application of pledged special revenues ... to payment of indebtedness."

The *Jefferson County* Case

In *Jefferson County*, which is the only other published decision on § 922(d), the central issue was whether "pledged special revenues" as used in the statute is limited to those revenues collected by the debtor and already paid over to the bondholders or their custodian (*i.e.*, an indenture trustee) as of the petition date, or whether it also includes revenues yet to be collected by the debtor post-petition that it would then be required to pay over to the bondholders. The debtor argued that the phrase is limited to revenues already in the bondholders' possession, while the bondholders argued for the broader interpretation. The bankruptcy court interpreted the phrase broadly to mean all revenues that are subject to the bondholders' lien, whether already in the bondholders' possession or yet to be collected by the debtor and paid over to them.[5]

The *Jefferson County* court further concluded that the broader interpretation is consistent with Congress's intent "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."[6] This and other language in the opinion strongly indicates the court's view that municipal debtors are required to continue paying debt service to bondholders with liens on pledged special revenues during a chapter 9 case, and that bondholders may enforce their rights and remedies without regard to the automatic stay.

1 *Assured Guaranty Corp. v. The Fin. Oversight & Mgmt. Bd. for P.R. (In re The Fin. Oversight & Mgmt Bd. for P.R.)*, 931 F.3d 111, 119 (1st Cir. 2019) (Lynch, J. dissenting) (hereafter, the "*Rehearing Decision*").

2 *See In re Jefferson Cty.*, 474 B.R. 228, 236, 273-74 (Bankr. N.D. Ala. 2012).

3 *Assured Guaranty Corp. v. The Fin. Oversight & Mgmt. Bd. for P.R. (In re The Fin. Oversight & Mgmt. Bd. for P.R.)*, 919 F.3d 121, 132-33 (1st Cir. 2019) (hereafter, the "*Panel Decision*").

4 11 U.S.C. § 922(d). Section 922(a) is a stay of actions (1) against officers of the debtor that seek to enforce claims against the debtor and (2) enforcement of tax liens against the debtor. Section 922(a) operates "in addition to" the stay provided for in § 362(a) of the Bankruptcy Code. The statute's reference to § 927 is uniformly recognized to be a scrivener's error (*see Rehearing Decision* at 120, n.5). The correct reference is to § 928, which provides that a pre-petition lien on special revenues continues in place with respect to special revenues acquired by the debtor post-petition notwithstanding the applicability of § 552(a) of the Bankruptcy Code, which ordinarily prohibits pre-petition liens from attaching to property acquired by the debtor post-petition.

5 474 B.R. at 274.

6 *Id.*

Title III Proceedings Under PROMESA

Although *Jefferson County* was a chapter 9 case, title III of PROMESA is largely based on chapter 9 and specifically incorporates nearly all of chapter 9's substantive provisions, including § 922(d).[7] PROMESA was enacted by Congress in June 2016 to address the financial crisis in Puerto Rico. PROMESA created an Oversight and Management Board (the "Oversight Board") with authority to certify fiscal plans for Puerto Rico and its agencies. Under title III of PROMESA, the Oversight Board may commence debt-adjustment proceedings — sometimes referred to as "quasi-bankruptcy" proceedings — for Puerto Rico and its agencies.[8]

Assured Guaranty vs. Oversight Board

In May 2017, the Oversight Board commenced a debt-adjustment proceeding under title III for the Puerto Rico Highway and Transportation Authority (HTA). It was established by the Commonwealth to "oversee and manage the development of roads and various means of transportation."[9] HTA issued several series of bonds secured by revenues from highway tolls, gasoline taxes and vehicle license fees.[10] Soon after its title III case was commenced, HTA stopped making debt-service payments to bondholders, asserting that such payments would violate the automatic stay under § 362(a) of the Bankruptcy Code as an act "to exercise control" over HTA's property. HTA's nonpayment resulted in a default under the bond indentures.

Assured Guaranty and other financial insurance companies that guarantied the bonds filed an adversary complaint in the district court against the Oversight Board and HTA. They sought a declaration that the bondholders' right to payment of the pledged revenue bonds is exempt from the automatic stay and that HTA's failure to pay debt service during the pendency of the title III case violates §§ 922(d) and 928 of the Bankruptcy Code.[11]

Following a hearing on the Oversight Board's and HTA's motion to dismiss the complaint, the district court held that although § 922(d) "excepts the 'application' of special revenues from the automatic stay," it does not "except actions to enforce special revenue liens" or "otherwise impose a payment obligation."[12] The district court dismissed the adversary complaint.

On appeal, the First Circuit affirmed, finding that § 922(d) is unambiguous and that while it "permits a debtor to pay creditors voluntarily during the pendency of the bankruptcy case ... [n]othing in the statute's plain language, however, addresses actions to enforce liens on special revenues, which are specifically stayed by Section 362(a) of the Bankruptcy Code, or allows for the compelling of debtors, or third parties holding special revenues, to apply special revenues to outstanding obligations."[13] Unlike *Jefferson County*, which looked to legislative history and congressional intent to conclude that payment is mandatory, the First Circuit found the statute's language unambiguous and reasoned that "there [was] no need to rely on legislative history."[14]

The *Panel Decision* distinguished *Jefferson County* by noting that because the issue in that case "was what revenues were covered by the lien," the decision "did not address whether the debtor's payments were voluntary or mandatory."[15] In fact, *Jefferson County* held that because future special revenues are covered by the lien, the payment of debt service is mandatory.[16]

The *Rehearing Decision*

Assured filed a petition for rehearing and rehearing *en banc* seeking review of the Panel's decision. The First Circuit denied rehearing, and a majority of the active First Circuit judges declined to rehear the case *en banc*. However, in light of a dissent to the denial of rehearing, the order denying rehearing includes a written opinion, joined by four of the other judges, responding to the dissent and elaborating on their support for the *Panel Decision*. For its part, the dissent expresses "grave doubts about the panel's holding," which "stints on the analysis required by rules of construction."[17] The dissent continues:

> I disagree with the panel opinion that the statutory exceptions to the stay are limited to giving the debtor the voluntary option of payment and disagree that the text is unambiguous. Any interpretation of the text of Section[s] 922(d) and 928 ... requires resort[ing] to both context and legislative history.[18]

The dissent reasoned that doing the necessary analysis — considering the context of the 1988 amendments and the legislative history — "supports the Insurers' position" that payment of special revenue is mandatory and that bondholders can therefore bring an action to enforce their liens without first obtaining relief from the stay.[19] In response, the First Circuit majority parts ways with the *Panel Decision* by conceding that the statute is ambiguous — particularly the term "application" — but nevertheless faults the bondholders and the dissent for using this ambiguity "as license to hunt the legislative record for bigger game."[20]

Conclusion

On Sept. 20, 2019, Assured Guaranty filed a petition for a *writ of certiorari* in the Supreme Court seeking a review of the First Circuit's *Panel Decision*.[21] A decision by the Supreme Court on whether to grant review will come some weeks or months after Nov. 25, 2019.

The problem with § 922(d) is that if Congress intended debt payments on special-revenue bonds to be mandatory, the statute as drafted does not make that clear. As the First

7 Puerto Rico, Management, and Economic Stability, 48 U.S.C. § 2161, *et al.*
8 48 U.S.C. § 2164(a); *Panel Decision*, 919 F.3d at 124-25.
9 *Panel Decision*, 919 F.3d at 125 (quoting *Assured Guaranty Corp. v. Commonwealth of P.R. (In re Fin. Oversight & Mgmt. Bd. of P.R.)*, 582 B.R. 579, 585-86 (D.P.R. 2018)).
10 *Id.* at 125.
11 *Id.* at 126.
12 *Id.* at 126-27 (quoting *Assured Guaranty*, 582 B.R. at 594, 596).
13 *Id.* at 130.
14 *Id.* at 132.
15 *Id.*
16 *See supra* notes 5 and 6 and accompanying text.
17 *Rehearing Decision*, 931 F.3d at 119-20.
18 *Id.* at 120.
19 *Id.*
20 *Id.* at 114.
21 *Assured Guaranty Corp. v. Fin. Oversight & Mgmt. Bd. for P.R.*, No. 19-391 (U.S. Sept. 20, 2019).

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Circuit points out in the *Panel Decision*, "[w]hen Congress wants to command performance, turnover or payment, it knows how to do so expressly."[22] Providing an exception to the automatic stay for the "application of pledged special revenues ... to payment of indebtedness" falls short of such express mandatory language.

22 *Panel Decision*, 919 F.3d at 130 (citing 11 U.S.C. §§ 365(d)(5) (compelling payment of rent under personal property lease), 542(a) (compelling delivery of debtor's property in possession of third parties) and 542(b) (compelling payment of debt that is property of the estate)).

On the other hand, as the *Jefferson County* court found, the language of the statute together with the legislative history of the 1988 amendments supports the view that Congress intended the payment of special revenues to be mandatory. If the Supreme Court grants a request for *writ of cert*, it will have the last word, unless Congress disagrees with the Supreme Court and subsequently acts to clarify § 922(d) one way or the other. abi