

Bond Case Briefs

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Puerto Rico Court Rulings Favor Bondholders.

Puerto Rico bondholders have reason to be optimistic about overturning the island's debt payment moratorium in court, based on rulings by the judge handling most of the litigation.

"If you're reading tea leaves there seems to be an indication that the court may not agree with the moratorium," said James Spiotto, managing director at Chapman Strategic Advisors.

Nearly all the Puerto Rico debt cases are being heard in the United States District Court for the District of Puerto Rico. The court is assigning all the cases to Judge Francisco Besosa, who is currently handling at least 11 of them.

Besosa issued a ruling last week that opens the door to declaring Puerto Rico's moratorium unconstitutional, Puerto Rico attorney John Mudd said.

Gov. Alejandro García Padilla signed the law that he says gives Puerto Rico the right to declare a debt moratorium in April, and invoked it to justify nonpayment of debt in May. The governor introduced the law after taking steps to increase revenues and cut spending to deal with Puerto Rico's debt and deficit problems. Puerto Rico, its public corporations, and municipalities have about \$69 billion in outstanding debt.

A directive from the Puerto Rico Department of the Treasury in December 2015 changed the government's payment priority and this "may still constitute a violation of the Equal Protection, Due Process, Takings, and Contracts Clauses as asserted by plaintiffs," Besosa wrote. He went on to write about the governor's executive orders invoking the moratorium law on debt payments, implying that these also may have violated these constitutional provisions.

Besosa wrote this in a joint ruling on two cases, one filed by Assured Guaranty Corp. et al. and another filed by Financial Guaranty Insurance Co.

In these cases Puerto Rico argued that the 11th Amendment to the U.S. Constitution barred the litigants' claims. Besosa rejected this argument, saying there is an exception to it for injunctive relief. The decision "eliminated a defense that Puerto Rico has," Spiotto said.

The Puerto Rico Oversight, Management and Economic Stability Act allowed for a stay on litigation concerning the debt to continue until at least Feb. 15 and, depending on how one reads the law, possibly as late as June 15.

This has not prevented several parties from filing lawsuits and, in some cases, saying that the PROMESA stay doesn't apply to their claims.

"I believe the judge will lift the stay on at least one, but probably two of the cases and rule on the constitutionality of [Puerto Rico's] Moratorium Act, which is also an issue on the Assured/Ambac cases," Mudd wrote in a blog post on his site controlboardwatch.org.

In the Assured and FGIC decision Besosa wrote that in "cases of an unbalanced budget, the

commonwealth constitution establishes a priority system detailing in what order appropriations will be paid.” Under the Puerto Rico constitution, he wrote, “first priority is assigned to ‘interest on the public debt and amortization thereof.’”

Mudd said this passage could be a “harbinger of Judge Besosa’s position on these issues.”

In 1976 in the *Flushing National vs. Municipal Assistance Corp.* a New York State court struck down a moratorium on debt payments by New York City because the court said it violated the state’s constitution priority on debt payment. While Besosa is a federal judge and not a state one, Spiotto said it is quite possible that he will be influenced by this earlier ruling.

Mudd said that PROMESA currently allows the extension of the litigation stay until not later than May 1. It is unlikely that the Puerto Rico Oversight Board will have completed approval of a five year fiscal plan by then. And without this plan, the oversight board will to be able to petition a court for a bankruptcy process. So even if the courts don’t overturn the litigation stay before May 2, at that point the commonwealth may have to deal with a court order to pay all or part of the due debt.

The Bond Buyer

By Robert Slavin

October 12, 2016