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Puerto Rico Governor Weighs Asking Creditors for More Concessions.

Some investors fear shift by governor reflects higher chance of bankruptcy

Many bond investors have viewed Puerto Rico's new governor, Ricardo Rosselló, as a likely ally in their fight to get repaid. Now that hope is starting to dwindle.

Gov. Rosselló wrested control Friday of negotiations over the only bond restructuring agreement Puerto Rico has reached thus far, a \$9 billion deal struck in 2015 covering a public electricity utility known as Prepa, and is preparing to change terms of the deal, people familiar with the matter said.

Prepa's board was on the verge of completing the settlement when representatives of the governor informed board members and their advisers on a phone call Friday morning that they were relieved of their negotiating duties and that the island's Fiscal Agency and Financial Advisory Authority, known as AAFAF, would take over, the people said. The governor made the move to consolidate the negotiation process under an entity that is fully empowered to approve a deal, a person involved in the process said.

The utility's bonds were unchanged Friday, but the decision rattled bondholders who had hoped the governor would quickly approve the Prepa agreement. That pact had been lauded as a road map for consensual restructurings of the island's other bonds. Campaign promises by Gov. Rosselló to mend fences with bondholders raised hopes among investors that they could avoid lengthy court fights to determine how much Puerto Rico will repay its various creditors.

But Gov. Roselló is evaluating potential changes to the settlement, a person familiar with the matter said. Getting more concessions from creditors could allow Prepa to moderate rate increases on customers, potentially offsetting politically unpopular fiscal tightening in other areas.

The governor also struck a populist tone in a recent public spat with the federal oversight board managing Puerto Rico's financial rehabilitation. Investors increasingly fear there will be a bankruptcy, which could mean deep losses for many holders of the commonwealth's approximately \$70 billion of debt.

"We're legitimately concerned that the Commonwealth's administration and the oversight board may choose to let it fall apart on the 1-yard line," said Stephen Spencer, a banker advising bondholders of the Puerto Rico Electric Power Authority.

The governor hasn't decided whether to renegotiate the Prepa agreement and is waiting for more clarity on the fiscal plan for the island before making a decision, said Elias Sanchez, the governor's representative to the oversight board. The governor is committed to reaching consensual deals with creditors, he said.

Puerto Rico has time to reach a negotiated settlement. The U.S. Congress passed a debt-relief law in June granting the island a standstill on creditor litigation until Feb. 15, and the federal oversight

board says it supports extending the stay until at least May 1.

Gov. Rosselló is trying to balance the demands of bondholders and his electorate while placating the oversight board, which is pushing for creditors and Puerto Rico's budget to share significant reductions, a bid to stabilize the economy.

"He seemed more creditor friendly in the campaign, but now that he's the chief officer of the island, he faces harsh realities and different pressures," says Joe Rosenblum, director of municipal research at investment firm AllianceBernstein, who has been bearish on Puerto Rico bonds for several years.

Complicating matters, Puerto Rico's bondholders are divided among themselves.

Gov. Roselló also is pushing for financial relief from the U.S. Congress with measures such as higher health-care funding that could mitigate the need for cost cuts.

The debt-relief law passed by Congress last year allows the commonwealth to restructure all its debts through consensual negotiations, while allowing for a switch to a bankruptcy-like process known as Title III that can bind all creditors should talks fail. Nevertheless, it remains unclear whether the new administration can reach a settlement with bondholders that voters and the oversight board would also accept.

"The numbers are so huge, it's hard to see how they're going to be able to negotiate a deal," Mr. Rosenblum said.

Tensions erupted into public view this month when the oversight board published a letter prodding Gov. Rosselló to make \$4.5 billion in fiscal measures by 2019. It also projected a 79% shortfall in the island's funds for debt repayment. The governor responded with a letter calling the board's focus on budget cuts "unacceptable."

Friction also is growing between the new administration and Prepa and its bondholders, including mutual-fund companies OppenheimerFunds Inc. and Franklin Templeton Investments and hedge funds BlueMountain Capital Management LLC, Knighthead Capital Management LLC and Marathon Asset Management.

Bondholders had been working with Lisa Donahue, the utility's chief restructuring officer, to complete terms and have been asking the Rosselló team since December to confirm his support for the agreement but have received no response, people familiar with the matter said.

"We believe this is the best deal for Prepa and the island," said Ms. Donahue, before her removal from negotiations. "We will continue providing the governor and his advisers information to that effect."

To be sure, the new administration could still renegotiate Prepa's debts outside of bankruptcy court and may propose only modest changes to avoid alienating bondholders, especially Franklin and Oppenheimer, which own billions of dollars of the island's other municipal bonds.

But it may be far harder to reach out-of-court deals with large holders of Puerto Rico's \$13 billion of general obligation bonds, such as Aurelius Capital Management LP, Autonomy Capital LP and Monarch Alternative Capital LP, as well as owners of \$17 billion bonds backed by sales taxes, including bond insurers Ambac Financial Group Inc. and hedge funds like Whitebox Advisors LLC. The factions are already litigating over who should be repaid more.

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