Bond Case Briefs

Municipal Finance Law Since 1971

The Curious Case of Aurelius Capital v. Puerto Rico.

How a hedge fund's efforts to take the island territory to the cleaners wound up before the Supreme Court — with ordinary Puerto Ricans arguing in the hedge fund's favor.

Puerto Rico filed for bankruptcy protection at 11:32 in the morning on May 3, 2017; by 11:33, the magnitude was obvious. No American territory had ever defaulted on so much debt. "A bankruptcy without precedent" ran a morning-after headline in the tabloid El Vocero, in an issue that also quoted leftist politicians warning readers not to be fooled: The filing, they claimed, was a prelude to more austerity. The island owed $72 billion. Already there was out-migration of 60,000 people a year and 10.5 percent unemployment. There were reports that vendors, owed millions of dollars, would no longer deliver food to Puerto Rican prisons.

The following month, an inconspicuous complaint was filed in federal court in San Juan. The plaintiffs were a group of hedge funds that had purchased Puerto Rican bonds around 2015 and were concerned that the bankruptcy would prevent them from recouping the bonds' full value. According to the complaint, the Puerto Rican Constitution mandated the repayment of certain types of bond debt, but the island's latest budget was instead pouring money into services that were "nonessential," leaving the bondholders high and dry. The hedge funds argued that this was illegal and sought to point out some "nonessential" expenses to the court.

The hedge funds scoured the island's budget. The Department of Sports and Recreation's allotment of $39.2 million: Nonessential, the lawsuit said. Ditto the $12.6 million for the Institute of Puerto Rican Culture; $7.3 million for the Corporation for Public Broadcasting; $1.8 million for the Boys & Girls Club; and the $88,000 commitment to a nonprofit ballet company. One assertion in particular stood out. Puerto Rico's budget had set aside $205 million in discretionary money for things like disaster relief. "While a 'rainy-day fund' is nice to have," the hedge funds conceded in Paragraph 159, "it is impossible to see how this is an 'essential service' or how it can be justified," in part because natural disasters were not "likely to occur" in the coming fiscal year. Three months later, Hurricane Maria made landfall. The presiding judge dismissed the complaint.

Continue reading.

The New York Times

By Jesse Barron

Nov. 26, 2019, 5:00 a.m. ET