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Puerto Rico Fights to Restore Law Allowing Public Debt Revamp.

Puerto Rico is trying to revive a law allowing its public agencies and utilities to restructure their mounting debt as Detroit and other U.S. cities have done.

Creditors won the first fight in the case by persuading a federal judge in San Juan to throw out bankruptcy protections similar to those alloted municipal entities in the 50 U.S. states.

Puerto Rico on Wednesday is asking the U.S. Court of Appeals in Boston to reverse that ruling as the commonwealth struggles with $73 billion in debt.

By blocking enforcement of the restructuring law, the lower court relegated Puerto Rico "to an anomalous legislative no man's land," lawyers for Governor Alejandro Garcia Padilla and Secretary of Justice Cesar R. Miranda Rodriguez said in a court filing. "If Congress had intended to leave utilities, and the people they serve, at the mercy of their creditors, it surely could and would have so indicated."

Franklin Resources Inc. and OppenheimerFunds Inc. investment funds and BlueMountain Capital Management LLC won a ruling in February from the judge in San Juan that the local restructuring law was in "irreconcilable conflict" with federal statutes. The firms, which at one time held about $2 billion in bonds issued by the Puerto Rico Electric Power Authority, alleged that the new law might force them to accept unfavorable restructuring terms if the heavily indebted utility sought to use it.

Congressional Intent

The dispute springs from the island's status as a U.S. territory dependent on federal lawmakers to grant it benefits provided states. Congress intended to exclude Puerto Rico from Chapter 9 bankruptcy protections, the investment funds argue.

Commonwealth officials "argue for a topsy-turvy world, where Congress' expressed preemption of state-enacted municipal bankruptcy laws becomes an option for states to enact such laws," lawyers for some of the investment funds said in court filings.

The island's agencies may seek protection under those provisions "only if the legislative body that exercises ultimate control over them — Congress — determines to so authorize," lawyers for the funds said.

After years of borrowing to balance budgets, Puerto Rico and its agencies have racked up $73 billion of debt, more than any U.S. state except California and New York. Because most of the debt is tax-exempt nationwide, it's held by mutual funds and individual investors.

Creditor Negotiations

The island has struggled to grow since 2006 and is losing population, spurring speculation it will fail to repay the obligations. Puerto Rico's power utility has been negotiating with creditors and may ask them to take a loss, which would be the biggest restructuring ever in the municipal-bond market.

The commonwealth's debt has been trading at distressed levels since August 2013. Prices on Puerto Rico's newest general obligations touched the weakest yet after the governor's tax overhaul proposal was rejected by lawmakers.

Bonds maturing in July 2035 traded May 1 at an average price of 77.57 cents on the dollar, the lowest since they were issued in March 2014, according to data compiled by Bloomberg. The average yield on the tax-exempt securities was 10.74 percent.

The Puerto Rico Public Corporations Debt Enforcement and Recovery Act was passed under threat of "fiscal emergency" last year, the bondholders alleged. Investors called the law a "harsher copy" of federal bankruptcy provisions that allow financially distressed municipal entities to seek protection from creditors while negotiating changes to debt terms.

The island's representative in Congress, Pedro Pierluisi, has been advocating for a bill to amend the bankruptcy code to include Puerto Rico. The measure, which was a subject of a House Judiciary Committee subcommittee hearing this year, is supported by most of the island's creditors, Pierluisi said in a statement in February.

The case is Franklin California Tax-Free Trust v. Commonwealth of Puerto Rico, 15-1218, U.S. Court of Appeals for the First Circuit (Boston).

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