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## **Puerto Rico Signals Chapter 9 Push With Ex-Detroit Judge on Board.**

NEW YORK — When Puerto Rico hired former Detroit judge Steven Rhodes it sent a signal to creditors that one possible solution it sees is the one thing it cannot do now: declare bankruptcy.

Gaining access to the U.S. Chapter 9 bankruptcy laws for the commonwealth would give a framework for creditors and debtors of public corporations to work out their differences. Allowing the Commonwealth itself to follow the same path as the city of Detroit, which emerged from bankruptcy last year, would be a further step.

“The parallels between Detroit and Puerto Rico are strong enough that I think any of the public corporations or the commonwealth itself could take advantage of the same kind of process that we used in Detroit,” Rhodes told Reuters.

A more concerted push for a bankruptcy framework concerns some creditors, who fear it will weaken their negotiating position and reduce their chances of recovering their money.

“Every time Chapter 9 is used, bondholders get destroyed,” said one creditor source.

In testimony ahead of a February congressional hearing on a proposal to allow Puerto Rico to apply the code to its municipalities, Thomas Mayer, a partner at Kramer Levin law firm representing PREPA utility’s bondholders, cited recoveries in Detroit, Stockton, Vallejo and Jefferson County and concluded that the code hurt bondholders.

Puerto Rico’s Governor Alejandro Garcia Padilla dropped a bombshell on holders of its \$73 billion debt on Monday by saying that he wants to restructure debt and postpone bond payments. He also called on Washington to make changes to U.S. bankruptcy laws to include Puerto Rico.

Padilla’s office had hired Rhodes, who is retired, on June 1, to use his experience from presiding over Detroit – the biggest U.S. municipal bankruptcy. Rhodes will be devoting 25 percent of his time to the island, he said.

“(Rhodes) has made a very public statement about wanting Chapter 9 applied to the Commonwealth,” said David Tawil, president of New York-based hedge fund Maglan Capital, which sold its Puerto Rico exposure about a year ago. “It’s a big deal.”

The creditor source said Rhode’s appointment gave them the impression that Puerto Rico was “hiring him to help push for Chapter 9,” because of his experience.

Chapter 9 is the bankruptcy statute governing municipal filings. Puerto Rico’s entities now cannot use the statute because it only covers political subdivisions or public agencies of a state.

The island’s congressional delegate, Democrat Pedro Pierluisi, has already proposed legislation to allow Puerto Rico’s public corporations such access.

Rhodes said that creditors “need to accept that the island, the commonwealth and its public corporations are simply not able to pay their obligations as they come due.”

“What bondholders need to understand is that the filing of a bankruptcy by itself doesn’t create any harm to any creditors,” Rhodes said. “What creates the harm to creditors is the inability of public corporations to pay their debt.”

## CHAPTER 9 STRETCH

Allowing Puerto Rico to use Chapter 9 as it is currently proposed would not apply to general obligation debt issued by its government because the statute excludes states from restructuring their own debt, said Daniel Hanson, analyst at Height Securities.

“To give them a special ability to restructure their obligations on a state level would be different to what the rest of the states have,” said Hanson. “It seems extraordinarily unlikely to pick up any kind of political traction.”

One large Puerto Rico bondholder said that anything that opened the door to a restructuring of the island’s general obligation bonds would be negative for the bonds, but played down such a possibility.

“They will have a hard time defending why bondholders should be getting less than they are currently getting.”

Puerto Rico would have to amend the bankruptcy laws to have it considered a state for the purpose of Chapter 9; and then get a provision to allow it to file its state debt.

Pierluisi himself sees no appetite in Congress for giving Puerto Rico more favorable treatment than the states have, his spokeswoman said.

But Rhodes said there could be less resistance to allowing such an option for the territory than it would have been with a state.

“Territories are not sovereign entities in our constitutional structure the same way states are,” Rhodes said. “So while from a constitutional perspective, Congress probably could even authorize a state to file bankruptcy, the political, legal and constitutional sensitivities are very much stronger when you are dealing with a state compared to a territory.”

The push for Chapter 9 took on more importance when a U.S. federal judge in February voided a restructuring law Puerto Rico had introduced to make some of its agencies eligible for court-supervised debt restructuring.

But Chapter 9 also looks like a long shot and some negotiations go on despite the lack of a legal framework. Puerto Rico’s utility PREPA continues to negotiate a restructuring of its \$9 billion debt and on Wednesday struck a deal to avoid default. Puerto Rico could also consider setting up a financial control board, such as that used by the then nearly-bankrupt District of Columbia in 1995.

Rhodes said some form of a settlement was still the best option, but that could be facilitated if Chapter 9 were available, even if it were not used.

“All parties would much rather have an out of court solution,” said Rhodes, who is not expecting to play any role in negotiations with creditors. “Bankruptcy is always the last resort.”

By REUTERS

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(Additional reporting by Edward Krudy and a contributor in San Juan; Editing by Tomasz Janowski)

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