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## **Puerto Rico to Skip Some Payments, Likely Prompting Turmoil.**

Puerto Rico is scheduled to pay some investors at the expense of others today, likely opening new clashes with creditors that threaten to exacerbate the commonwealth's financial crisis and adding to calls for action from the U.S. Congress.

Gov. Alejandro Garcia Padilla last week said the commonwealth would make about \$330 million in payments on its constitutionally guaranteed general obligation bonds after diverting money from debt with weaker legal protections. The island also plans to miss about \$37 million in bond payments, most from the Puerto Rico Infrastructure Financing Authority, or Prifa.

Several analysts said Puerto Rico's ongoing defaults may provoke lawsuits as soon as this week against the commonwealth and its agencies, which lack access to the legal process used for U.S. municipal bankruptcies. The governor said the island will avoid a surge of litigation that would have followed a missed payment on general obligation debt.

Puerto Rico owes investors about \$70 billion and has struggled with a 10-year recession and a steep population decline that last year led Mr. Garcia Padilla to declare its debts unpayable. The commonwealth began defaulting in August on debt with its weakest legal pledge, and the governor has said he would prioritize public services over bondholders.

The defaults may also renew pressure for action from the U.S. Congress, where the Obama administration and congressional Democrats have sought legislation that would allow Puerto Rico to restructure its debt, and proposed bills to temporarily stay lawsuits against the commonwealth.

Matt Fabian, partner at the research firm Municipal Market Analytics, said redirecting tax money from one set of bonds to another opens Puerto Rico to lawsuits from the insurers or investors who may have legal remedies when the commonwealth defaults, either by breaching bond contracts or failing to pay.

"People who don't get paid sue," he said.

Bond insurers Ambac Financial Group Inc. and Financial Guaranty Insurance Co. last week demanded a halt to the island's redirection of funds, calling it illegal in a letter to the governor and other top Puerto Rico officials. The companies, which combined insure more than \$860 million of Prifa bonds, said redirecting the rum taxes that back the debt violates the U.S. and Puerto Rico constitutions and the "pattern of activity is unacceptable." Ambac shares fell about 2.7% last week after the governor's announcement.

Bond insurers, which make principal and interest payments when the state or local government that sold them fails to pay, are central to any restructuring effort in Puerto Rico because they back a wide variety of bonds from the commonwealth's nearly 20 debt-issuing entities, complicating the island's ability to prioritize payments. The situation also threatens to derail a modest comeback for the insurers, who suffered losses in the 2008 financial crisis after guaranteeing risky mortgage-

backed securities.

While Puerto Rico's approach shouldn't cause significant strain on insurers in the short term, "it's not good news for them," said Rob Haines, an analyst at the research firm CreditSights.

Mark Palmer, an analyst at BTIG, said the island's crisis was entering a new phase in which lawsuits were likely, yet a pattern has emerged in which "Puerto Rico announces the least impactful default possible, that doesn't involve constitutionally protected debt, then uses that as a platform to lobby Congress" for bankruptcy protections.

Puerto Rico, investors and bond insurers did reach a negotiated accord last month, inking a deal to restructure the Puerto Rico Electric Power Authority, or Prepa. While that still requires legislation from Puerto Rico lawmakers, along with other hurdles, it raised hopes that negotiations can resolve some disputes in the absence of either bankruptcy filings or lawsuits.

John Miller, co-head of fixed income at Nuveen Asset Management LLC, which manages about \$100 billion of municipal bonds, said Puerto Rico's payment strategy was "the least disruptive to the marketplace" and "an effort to demonstrate their commitment to bondholder negotiations" while the island seeks debt relief from Congress.

"The ability of Puerto Rico to keep making all but a few smaller payments may actually add to the skepticism there, and cause U.S. politicians to push for the release of current financials and the imposition of a control board," he said.

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