

Bond Case Briefs

Municipal Finance Law Since 1971

Bond Insurers Sue Puerto Rico for Redirecting Debt-Payment Funds.

Units of bond insurers Ambac Financial Group Inc. and Assured Guaranty Ltd. on Thursday challenged Puerto Rico's move to pay some investors at the expense of others, escalating the U.S. commonwealth's struggle with creditors.

The insurers, which back almost \$8 billion of debt from the island between them, asked the U.S. District Court for the District of Puerto Rico to block the move, arguing it violates the U.S. Constitution. Puerto Rico this week missed about \$37 million in bond payments, after redirecting money collected to pay some debt toward bonds with stronger legal protections.

The commonwealth "is disregarding the priorities of its own Constitution and the rule of the law," Dominic Frederico, Assured's chief executive officer, said in a statement. "This confiscation of revenues pledged to bondholders is illegal."

Puerto Rico Gov. Alejandro Garcia Padilla said in a statement that such lawsuits have "been widely predicted and forewarned" because the U.S. Congress hasn't granted the island access to the municipal bankruptcy protections currently denied the commonwealth and its agencies.

"This latest development will force a race to the courthouse, and with no legal framework to handle this impending litigation crisis, both the commonwealth and its creditors will soon face the opposite of due process and rule of law," Mr. Garcia Padilla said.

Puerto Rico owes investors about \$70 billion and has struggled with a nearly decadelong recession and a steep population decline that last year led Mr. Garcia Padilla to declare its debts unpayable. The commonwealth began defaulting on debt with its weakest legal pledge in August and in December said it would begin diverting money toward bonds guaranteed by the island's constitution.

That move violates the U.S. Constitution's takings and contracts clauses, and the commonwealth isn't allowed to divert the money "where other available resources exist from which the public debt could be paid," the insurers said in the court filing.

Mr. Garcia Padilla said last week that the redirection would avert a wave of lawsuits that would have followed a default on debt backed by the commonwealth's full faith and credit.

The insurers' suit may renew pressure for action from the U.S. Congress, where Democrats and the Obama administration have sought legislation that would allow Puerto Rico to restructure its debt and proposed bills to temporarily stay lawsuits against the commonwealth. House Speaker Paul Ryan has called for lawmakers to find a "responsible solution" to the island's financial crisis by the end of March. Some investors oppose such a move, saying it is unneeded and won't solve Puerto Rico's problems.

Bond insurers, which make principal and interest payments when a state or local government that sold debt 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.

Nader Tavakoli, chief executive for Ambac, said Puerto Rico is attempting to blame its fiscal and structural problems on creditors, "in an effort to deflect responsibility and obtain retroactive application of bankruptcy laws."

The commonwealth's actions "stand in contrast" to last month's negotiated agreement with some bondholders and insurers to restructure the Puerto Rico Electric Power Authority, or Prepa, Assured's Mr. Frederico said.

While the deal over Prepa's \$9 billion of debt still requires legislation from Puerto Rico lawmakers, among other hurdles, it raised some hopes that talks can resolve some disputes over the commonwealth's debt in the absence of lawsuits or bankruptcy filings.

THE WALL STREET JOURNAL

By AARON KURILOFF

Updated Jan. 8, 2016 4:25 p.m. ET

Write to Aaron Kuriloff at aaron.kuriloff@wsj.com

Copyright © 2026 Bond Case Briefs | bondcasebriefs.com