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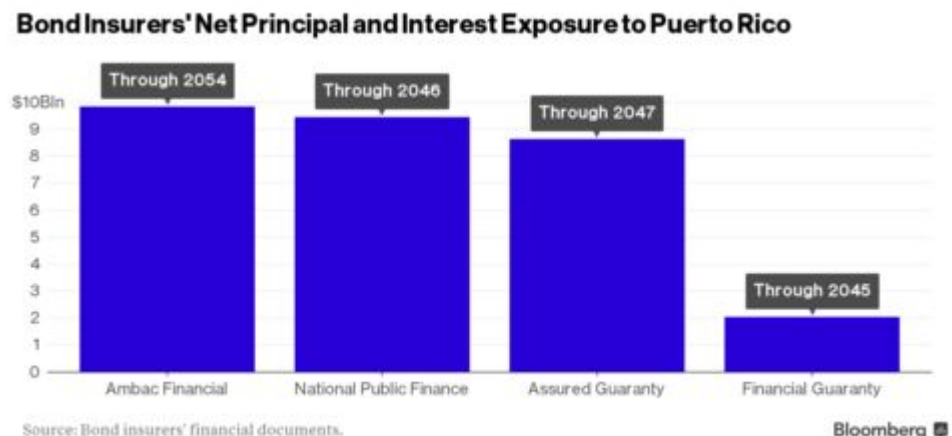
Bond Insurers Sue Puerto Rico to Stop Revenue Diversion.

Insurance companies that guarantee Puerto Rico municipal debt filed a lawsuit challenging the commonwealth's decision to divert revenue designated for some bonds to pay other creditors.

Ambac Financial Group Inc. and Assured Guaranty Ltd. said the clawback of revenue pledged to bond issues violates the U.S. Constitution by interfering with debt-holders' contractual rights. The suit filed in U.S. District Court in Puerto Rico seeks to have the clawback declared unlawful and asks the court to issue an injunction against implementation, according to a statement.

"This may well just be the beginning," Mark Palmer, a managing director at BTIG LLC who analyzes Puerto Rico and municipal bond insurers, said Friday. Bond insurers and investors "are going to use every means at their disposal to hold Puerto Rico to the letter of the law."

Puerto Rico Governor Alejandro Garcia Padilla announced in December that the commonwealth would divert the revenue in order to fund its general-obligation debt payments, which have the highest priority under the island's constitution. Puerto Rico defaulted on about \$37 million in agency bond payments at the start of the year, saying it would focus on providing essential services as the commonwealth's financial situation worsened.



"The commonwealth has committed itself to a 'scorched earth' strategy of blaming its fiscal and structural problems on lenders, Congress and others, in an effort to deflect responsibility and obtain retroactive application of bankruptcy laws," Nader Tavakoli, chief executive officer of Ambac, said in the statement late Thursday.

Lobbying Congress

The insurers are the first to sue over the diversion. They claim a clawback can only be implemented if the commonwealth's funds are insufficient to cover general-obligation debt service. Puerto Rico estimates approximately \$9 billion of available resources in the fiscal year ending June 30, 2016,

which vastly exceeds debt service on the public debt of approximately \$1.85 billion, according to Ambac. Judge Jose Antonio Fuste will preside over the case, court documents show.

To help address its debt crisis, Puerto Rico officials have urged Congress to allow some commonwealth public corporations access to bankruptcy, the same as mainland localities and agencies. That would give the island a legal guideline for how to restructure much of its \$70 billion of debt. The commonwealth, as well as states, is prohibited from using bankruptcy to reorganize its finances.

“This latest development will force a race to the courthouse,” Garcia Padilla said in a statement Friday.

“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. This reality causes great uncertainty for all parties involved.”

Rum Tax

The targeted clawback revenue comes from the Puerto Rico Highways and Transportation Authority, the Puerto Rico Convention Center District Authority and the Puerto Rico Infrastructure Financing Authority, known as Prifa. Ambac paid \$10.3 million in interest that was due Jan. 1 for the Prifa bonds.

The Prifa default was the second by a Puerto Rico agency. The Public Finance Corp. in August began missing monthly debt-service payments because lawmakers failed to allocate the funds. The PFC also missed a Jan. 1 payment.

Shares of Ambac dropped 9 cents Friday to \$12.74, the lowest level since the insurer emerged from bankruptcy in May 2013. Assured Guaranty declined 36 cents to \$25.15 as of 2:44 p.m. in New York.

Financial Guaranty Insurance Co. will pay 22 percent of \$6.4 million in Prifa interest it insures. Edward Turi, general counsel for FGIC, didn't immediately respond to an e-mail and phone message seeking comment on the Ambac and Assured Guaranty suit.

Prepa Deal

Less than two weeks before Prifa's payment default, Assured Guaranty, along with MBIA's National Public Finance Guarantee Corp., agreed to restructure \$8.2 billion of Puerto Rico Electric Power Authority debt. While the utility's funds aren't subject to clawback, Garcia Padilla's revenue diversion goes against the restructuring pact, Dominic Frederico, Assured Guaranty's president and chief executive officer, said in a statement Thursday.

“These actions stand in contrast to the consensual agreement that we and other creditors recently reached with Puerto Rico's electric utility, Prepa,” Frederico said.

In a Dec. 29 letter to the governor and his administration, bond insurers said the commonwealth should return rum-tax revenue to Prifa. The insurers calculate as much as \$94 million was redirected before Dec. 1. That's when Garcia Padilla signed an executive order to begin the clawback.

The Highways and Transportation Authority and the Convention Center District Authority said last month that they would use reserve cash to repay investors after Puerto Rico redirected their revenue, according to regulatory filings.

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by Michelle Kaske

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