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Puerto Rico Fights for Chapter 9 Bankruptcy in Supreme Court.

WASHINGTON — Debt-laden Puerto Rico went toe to toe with its creditors at the Supreme Court on Tuesday, arguing that it has been wrongly locked out of the bankruptcy courts, the only place it can reasonably expect to restructure its crushing debt.

“We’ve talked a lot about legal principles,” said the lawyer Christopher Landau, summing up his arguments on behalf of the commonwealth. “But this is also a flesh-and-blood situation in Puerto Rico.”

Hanging on the outcome, he said, were questions like “whether people in a village in Puerto Rico will be able to get clean water.”

Puerto Rico is struggling with \$72 billion in debt and has been saying for more than a year that it needs to restructure at least some of it under Chapter 9, the part of the bankruptcy code for insolvent local governments. But Puerto Rico cannot do so, because Chapter 9 specifically excludes it, although it is unclear why.

In 2014, the island tried to get around that exclusion by enacting its own version of a bankruptcy law, designed for its big public utilities, which account for about \$26 billion of the total debt. But that attempt ran afoul of yet another provision of the code, which says that only Congress can enact bankruptcy laws.

“Congress has shut the door,” said Mr. Landau. “There is no door for Puerto Rico, and no key for Puerto Rico.”

Many of the justices’ questions, and the parties’ responses, involved possible rationales for tying Puerto Rico’s hands, as Congress went out of its way to do in 1984. Its amendment that year also barred the District of Columbia, without leaving any legislative history or indication of intent.

“Why would Congress preclude Puerto Rico from Chapter 9?” asked Chief Justice John G. Roberts Jr.

“Why would Congress put Puerto Rico in this never-never land?” asked Justice Ruth Bader Ginsburg. “Why in the world? What explains Congress wanting to put Puerto Rico in this anomalous position of not being able to restructure its debt?”

“It’s the question that everyone asks when they pick up this case,” said Mr. Landau.

He and the lawyer representing Puerto Rico’s creditors, Matthew D. McGill, agreed that no one knew for sure, but both offered theories.

Mr. McGill said the 1984 amendment was not all that mysterious if you considered that Congress had a long history of micromanaging Puerto Rico’s indebtedness. He cited a 1917 federal law that specifically limited the amount of debt that Puerto Rico could take on, which remained in force until

Puerto Rico ratified its own constitution in 1952. Even then, he said, Congress agreed to lift its own debt restriction only because Puerto Rico had included a similar restriction in its new constitution.

He also said that Congress had tacitly encouraged the widespread purchasing of Puerto Rican debt, by permitting Puerto Rico to market its bonds as triple-tax-exempt in all American states and cities. As a result, Puerto Rican debt is exceptionally widely held across the United States mainland, and Congress may have wanted to protect investors by making it hard for Puerto Rico to renege.

Plan to Rescue Puerto Rico Advances, Led by House Republicans MARCH 25, 2016

"The third reason is that by 1984, Puerto Rico and D.C. were the two most indebted territories, by a lot," he said. Under those circumstances, Congress was unlikely to have wanted to "allow the District of Columbia and Puerto Rico to write their own municipal bankruptcy laws, that may or may not treat their nationwide creditors fairly."

Mr. Landau offered an entirely different theory as to why Congress had enacted the laws at issue. He said the legal provisions were being misread, and that Congress had not really intended to shut Puerto Rico out of bankruptcy.

While lawyers, judges and policy makers have grappled with these issues, Puerto Rico's finances have gone from bad to worse. The island has already defaulted on about \$221 million of debt, prompting lawsuits by some of the affected creditors. And bigger, far more contentious defaults appear imminent.

On May 1 the island's all-important Government Development Bank must make debt payments of \$422 million, which it does not seem to have. Two months later, about \$2 billion is due from the central government and a number of big public enterprises: the electric power authority, the water and sewer authority and the highway authority, among others. Puerto Rico's constitution effectively guarantees at least some of those payments, but the money to make them appears to have dried up.

Gov. Alejandro García Padilla has said that he will not make debt payments if it means depriving the Puerto Rican people of essential services. But skipping the big payments due in May and July would probably mean many more creditor lawsuits.

And a default by the Government Development Bank, which oversees the island's finances, could set off a far-reaching chain reaction. The bank has guaranteed the debts of numerous other agencies and private companies, and insured hundreds of personal mortgages. Those guarantees and insurance would presumably lose value in a default, hurting the balance sheets of any number of institutions.

Analysts have warned that it could take years to sort out the resulting mess, and in the meantime, Puerto Rico would be a pariah, less and less able to protect the safety and well-being of its more than three million residents.

When it first enacted its own version of bankruptcy in 2014, Puerto Rico had hoped to restructure only a few large government enterprises.

But two big mutual fund companies, Franklin Advisers and Oppenheimer Funds, filed suit on the same day the law was enacted. They argued that no matter how much Puerto Rico might want to take shelter from creditors, the bankruptcy code clearly said it could not file for Chapter 9 protection, nor could it enact its own bankruptcy law. The United States District Court in San Juan and the Court of Appeals for the First Circuit agreed.

As the case inched along through the courts, it became increasingly clear that restructuring the

public enterprises alone would not be nearly enough to solve Puerto Rico's problems.

Last year, certain congressional committees began working with the Treasury Department on legislation that would give Puerto Rico a legal framework for restructuring all of its debts under the Territorial Clause of the United States Constitution. That approach would help Puerto Rico cope without running into the special exclusion that has been keeping the island out of Chapter 9.

"Isn't there also legislation to put Puerto Rico back in Chapter 9?" Justice Ginsburg asked on Tuesday.

"Yes there is," said Mr. McGill. "Congress is considering a range of options for Puerto Rico, including Chapter 9, just as Congress considered a range of options for the District of Columbia during its own financial crisis in the 1990s, which resulted in a financial control board rather than Chapter 9."

A House bill is expected to be introduced by the end of March, in keeping with instructions issued by the speaker, Paul D. Ryan. A Senate bill is likely to follow. They are expected to provide some framework for restructuring other than Chapter 9. Congressional action is likely to come well before any court ruling.

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