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Puerto Rico Gets Mixed Reception at U.S. Supreme Court.

Puerto Rico got a mixed reception at the U.S. Supreme Court as the justices debated a local law that would let the island's debt-ridden public utilities restructure their obligations.

Puerto Rico is aiming to revive the law, which directly affects more than \$20 billion in utility debt and would give the commonwealth leverage in handling the rest of the \$70 billion it owes. A federal appeals court said a U.S. bankruptcy law bars Puerto Rico from setting up its own debt-restructuring system.

The hour-long hearing Tuesday in Washington made clear that at least some of the justices were still formulating their views, and the case ultimately may divide the court. Justice Sonia Sotomayor, whose parents moved to New York from Puerto Rico, emerged as the island's strongest supporter.

Justice Ruth Bader Ginsburg also hinted she might back the commonwealth. She voiced doubt that Congress would have left Puerto Rico's utilities unable to use either the federal bankruptcy system or a local restructuring law.

"Why would Congress put Puerto Rico in this never-never land?" Ginsburg asked.

Under federal law, states can authorize bankruptcy filings by their municipalities, including public utilities, but Puerto Rico and the District of Columbia can't. Puerto Rico sought to get around that provision in 2014 by passing a local law that offers an option similar to bankruptcy.

Appeals Court

A U.S. appeals court ruled in July that Congress had reserved for itself the power to decide how Puerto Rican debt should be restructured.

"Congress has for a long time micromanaged Puerto Rico's debt," Matthew McGill, the lawyer representing funds that hold Puerto Rican municipal bonds and are challenging the Recovery Act, told the justices.

McGill drew his strongest support from Chief Justice John Roberts. Two other justices, Elena Kagan and Stephen Breyer, asked questions of both sides, while Justices Anthony Kennedy and Clarence Thomas said nothing.

The Supreme Court is considering the case two justices short of its usual complement of nine. Justice Antonin Scalia died last month, and Justice Samuel Alito has a financial conflict.

'Nonsensical' Argument

Puerto Rico's lawyer, Christopher Landau, told the justices it was "nonsensical" to think Congress meant to leave the island without access to either federal or local restructuring law.

Roberts questioned that assertion, saying Congress has a different relationship with Puerto Rico

than it has with the states.

“Why would it be irrational for Congress to say, ‘All right, this is the system we’re going to apply to all the states, but when it comes to Puerto Rico, if they want changes, we want them to come to us?’” Roberts asked.

That drew a sharp response from Sotomayor, who didn’t even give Landau a chance to answer Roberts’s question.

“Why not treat it like every other territory?” Sotomayor asked. “If you’re going to treat it differently, wouldn’t you expect them to say that?”

Sotomayor Alone

The case turns on the impact of a 1984 amendment to the federal bankruptcy code. The amendment said that Puerto Rico and the District of Columbia were to be considered states for bankruptcy purposes. An exception to the amendment said that, unlike states, Puerto Rico and D.C. can’t authorize their utilities to file for bankruptcy under federal law.

Puerto Rico says that amendment implicitly freed the island to pass its own restructuring law, known as the Recovery Act. The bondholders say the Recovery Act is barred under an older, separate provision that prohibits states and Puerto Rico from enacting local bankruptcy laws.

Early in the argument, Sotomayor looked as though she might be alone in backing Puerto Rico. Two other Democratic appointees, Breyer and Kagan, both suggested that they couldn’t square Puerto Rico’s contentions with the language of the U.S. bankruptcy code.

“I can’t say that an airplane means a horse,” Breyer said.

Evolving Kagan

Kagan questioned whether Congress would have made the “major change” of allowing Puerto Rico to enact a local restructuring law in such a “cryptic, odd way.”

Later, however, Kagan said her thinking had evolved as she better understood Puerto Rico’s argument about the statute’s language. She asked McGill why Landau’s interpretation of the statute isn’t “just as good, if not better, than yours.”

“I didn’t come in here thinking that, but now I kind of am thinking that,” Kagan said.

The dispute is part of a multi-front battle over Puerto Rico’s financial future. Lawmakers in Congress have been negotiating for months over legislation to help Puerto Rico, though Republicans are reluctant to grant the kind of restructuring authority the U.S. Treasury Department and the island’s leaders want.

Governor Alejandro Garcia Padilla has warned the island will default May 1 on a \$422 million debt payment unless the commonwealth reaches an agreement with its creditors. Puerto Rico and its agencies face another \$2 billion payment due July 1.

The high court case could affect a tentative agreement between Puerto Rico Electric Power Authority, known as Prepa, and most of its creditors. A decision upholding the Puerto Rico law might give Prepa a chance to try to pay them less than the 85 cents on the dollar promised by the accord.

The high court case involves creditors that reached settlements over more than \$2 billion in Prepa bonds, including BlueMountain Capital Management LLC and funds managed by Franklin Advisers Inc. and OppenheimerFunds Inc.

The cases are Puerto Rico v. Franklin California Tax-Free Trust, 15-233, and Melba Acosta-Febo v. Franklin California Tax-Free Trust, 15-255.

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