

# **Bond Case Briefs**

*Municipal Finance Law Since 1971*

---

## **Scalia, Alito Court Absences Shape Puerto Rico Debt-Relief Bid.**

Two empty chairs at the U.S. Supreme Court could be full of significance as the remaining justices consider whether Puerto Rico can ease its fiscal crisis with a law that would let the island's public utilities restructure more than \$20 billion in debt.

The U.S. territory will make its case Tuesday to what probably will be a seven-member court, a rarity caused by the unexpected death of Justice Antonin Scalia in February and a financial conflict that may force Justice Samuel Alito to recuse himself.

The case, part of a multi-fronted battle over Puerto Rico's financial future, directly affects more than \$20 billion owed by the commonwealth's utilities, including \$9 billion owed by the Puerto Rico Electric Power Authority, known as Prepa. A decision upholding Puerto Rico's restructuring measure may give the island leverage to reach deals with creditors over other parts of its \$70 billion in debt.

The law "gives Puerto Rico more weapons to threaten creditors to get a better settlement than they would otherwise," said Matt Fabian, a partner at Municipal Markets Analytics, a research firm based in Concord, Massachusetts.

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.

The high court case could affect a tentative agreement between 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.

Tuesday's 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.

Under U.S. law, states can authorize federal bankruptcy filings by their municipalities, including public utilities, but Puerto Rico and the District of Columbia can't. Puerto Rico sought to skirt that provision in 2014 by passing a measure known as the Recovery Act to let utilities restructure their debts under local law.

A U.S. appeals court ruled unanimously that federal bankruptcy law bars the Puerto Rico measure. The three-judge panel said Congress reserved for itself the power to decide how Puerto Rican debt should be restructured.

Alito didn't participate when the agreed to hear Puerto Rico's appeal in December. The justice's most recent financial disclosure report indicates that either he or his wife own shares in a Franklin fund that holds Puerto Rican municipal bonds. Barring a last-minute sale of those holdings, Alito presumably won't take part Tuesday either.

## **Seven-Justice Court**

Scalia's Feb. 13 death added a new dynamic by creating a seven-justice court for the case. Puerto Rico now needs to persuade only four justices, not five, and the court's four Democratic appointees will outnumber their three Republican-selected colleagues.

Losing Scalia may deprive the bondholders of one of their most likely allies, said John Pottow, a bankruptcy law professor at the University of Michigan Law School. Scalia was a stickler for adhering to statutory text, even when it was ambiguous, rather than looking beyond the words to the broader purpose lawmakers might have had.

"If you were a strict textualist, I think you would find the arguments against Puerto Rico's position more attractive," Pottow said.

The high court case turns on the impact of a 1984 amendment to the federal bankruptcy law. The amendment for the first time explicitly said that Puerto Rico and the District of Columbia were to be considered states for bankruptcy purposes. An exception to the amendment said Puerto Rico and the district can't authorize their utilities to file under Chapter 9 of the bankruptcy code, the federal provision for reorganizing municipalities.

The bondholders say a separate, longstanding provision also bars states and Puerto Rico from using their own laws to authorize non-consensual restructurings.

## **'No Man's Land'**

Puerto Rico counters that Congress didn't intend to leave the commonwealth in a "no man's land" with its utilities unable to seek debt relief under either federal or local law.

The island's financial problems are also an issue in Congress, where House Republicans are drafting a bill to help Puerto Rico with its debt problems.

The measure is expected to include a financial control oversight board that has powers to negotiate with the island's creditors. It's not expected to make the island eligible for federal bankruptcy protection, which Democrats and President Barack Obama have pushed. If enacted, the legislation could trump whatever the high court decides.

The Supreme Court case "is probably being overshadowed a bit by the potential for something coming out of Congress," said Lyle Fitterer, head of tax-exempt debt at Wells Capital Management, which oversees \$39 billion of municipal securities.

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

## **Bloomberg Business**

by Greg Stohr and Micheele Kaske

March 21, 2016 — 2:00 AM PDT