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Puerto Rico's Bondholders Divided in Fight Over Federal Rescue.

Puerto Rico bondholders are lining up on different sides of the battle in Congress over legislation to rescue the island from financial collapse as lawmakers rewrite the bill in an effort to overcome opposition from Democrats and Republicans.

Hedge funds that own about \$5 billion of Puerto Rico's general-obligation bonds, which are guaranteed under the island's constitution, are fighting the House measure that would give the U.S. territory ability to write off some of its \$70 billion in debt. Firms that own securities backed by sales taxes are working to ensure its passage, seeing it as a way to protect their investment from a cascading series of defaults.

The fracture is adding to the political discord over the broadest effort yet in Washington to address the Puerto Rican debt crisis, which has been building over the past 10 months as the island's government runs out of cash and can no longer borrow money to remain afloat. After members from both parties bristled at aspects of the bill, the House Natural Resources Committee last week abruptly canceled a planned vote so legislators could revise it. Representative Rob Bishop, who heads the committee, said Tuesday he thinks most Republicans will ultimately support the measure.

"The conflicting messages that lawmakers are getting from investors is making them less likely to want to be seen picking one creditor group over another," said Daniel Hanson, an analyst at Height Securities, a Washington-based broker dealer. "There are disagreements among House members over which credits are strongest and what's the right way to proceed."

Puerto Rico is veering toward major bond defaults in May and July after Governor Alejandro Garcia Padilla signed a law allowing him to suspend debt payments through January. He has pushed Congress to give his government legal powers to restructure debt in court, which it currently cannot do, to avert painful spending cuts on an island where nearly half the residents live in poverty and the economy has been contracting for a decade.

Rival Creditors

If not addressed, the crisis threatens to leave owners of Puerto Rico's varying securities — with differing legal protections or promised rights to certain revenue — fighting in court over whatever money Puerto Rico brings in.

Garcia Padilla has proposed preventing that by allowing investors to voluntarily exchange their bonds for new securities, though no formal offer has been extended as his administration waits on action from Washington. In its most recent proposal, Puerto Rico said it would pay 74 cents on the dollar for general-obligation and government-guaranteed debt and 57 cents for sales-tax securities.

The creditor schism on Capitol Hill between investors with competing interests underscores the obstacles that Puerto Rico faces in reaching a timely agreement to reduce its debt, which was issued by 17 different arms of the government, including \$13 billion of general obligations and \$15 billion

of sales-tax bonds. It took more than a year for its electric company to reach such a deal in December — and it still hasn't been completed.

A group of general-obligation bondholders that includes Monarch Alternative Capital, Davidson Kempner Capital Management and Stone Lion Capital Partners are among those opposed to the House legislation, which would give a federally-appointed board power to oversee Puerto Rico's budget and a restructuring with creditors. The bondholders, who have hired former U.S. Representative Connie Mack to lobby on their behalf, say the legislation threatens their rights to be paid back first.

"The House Super Chapter 9 bankruptcy legislation would violate the priority given to general-obligation bonds under Puerto Rico's constitution, which Congress has already twice affirmed," Andrew Rosenberg, a lawyer at Paul Weiss Rifkind Wharton & Garrison, which is representing the GO bondholder group, said in a statement. "As a result, the holders of \$18 billion of GO and commonwealth-guaranteed bonds could assert takings claims against the U.S. government."

That position has put them at odds with a rival group that holds \$1.6 billion of securities known as Cofinas that are backed by a share of Puerto Rico's sales taxes. The group includes GoldenTree Asset Management, Merced Capital, Tilden Park Capital Management and Whitebox Advisors. Judd Gregg, a former U.S. Senator from New Hampshire, is advising the group.

Those bondholders anticipate that the federal oversight panel would honor their claims more than Puerto Rico, which has already siphoned off gas- and rum-tax revenue pledged to some debt to avoid defaulting on general obligations. The group is concerned that Puerto Rico may begin redirecting sales-tax revenue as soon as July to help pay other expenses, something the House bill may prevent.

"We feel that the chances of our property rights being properly respected are greater in the hands of disinterested, dispassionate control board members than they would be in the hands of the administration in Puerto Rico, which seems to treat all property as house money," said Susheel Kirpalani, a partner at Quinn Emanuel Urquhart & Sullivan, which is representing the holders of the sales-tax debt.

Republicans' Conditions

House lawmakers were shooting to have a legislative fix for Puerto Rico done by the end of March, only to see the process take longer than anticipated. Bishop, the chairman of the House Natural Resources Committee, said the panel could act on a revised bill as early as next week, though others said such a vote may be delayed until May.

An influential group of about three-dozen fiscally conservative Republicans in the House, known as the Freedom Caucus, met Monday evening to discuss bill. Before they can endorse it, they want assurance that it treats different classes of creditors fairly and doesn't open the door to a push for states to restructure their debts, according to a member who spoke on the condition he not be identified.

The legislation initially released by the committee would allow a federal board to weigh in on Puerto Rico budgets, oversee a debt restructuring that creditors would be able to vote on through collective action, and put bondholder lawsuits temporarily on hold, a provision known as a stay. Many Republicans objected to allowing the territory to cut its debt, while Democrats said the board would wield excessive power over the island's finances and decisions.

While general-obligation bondholders also favor a federal oversight panel, they want the House bill

to exempt constitutionally-guaranteed debt from restructuring or give the securities the top claim on the government's funds, according to three investors who asked for anonymity because lawmakers are still working on the legislation. They also want to be able to sue the commonwealth if it defaults on \$805 million that's due on July 1, the people said.

Cofina investors have more time. Puerto Rico already directed \$696 million this fiscal year to cover payments through August, according to Standard & Poor's. The next Cofina payment isn't due until Feb. 1, just a few weeks before the legal stay is lifted.

"It's a very tricky situation," said Mikhail Foux, head of municipal strategy at Barclays Plc. "GO bondholders will be saying they're backed by the constitution and Cofina bondholders will be saying they're backed by a specific stream of revenues."

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by Michelle Kaske and Billy House

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