
Bernie Sanders Slams White House Compromise on Puerto Rico Debt.

Conservative political groups and hedge funds that bought Puerto Rico's debts have some surprising company in their quest to block bipartisan legislation that could allow some of those bonds to be written down. Vermont Sen. Bernie Sanders is also rallying his Senate colleagues to oppose the bill.

Mr. Sanders and Wall Street bondholders have very different reasons for opposing the legislation, but the episode illustrates the challenge of getting Congress to agree on how to address the island's debt and economic crises.

The Obama administration and House Speaker Paul Ryan (R., Wis.) have engaged in delicate negotiations for the past month on a bill that would allow Puerto Rico to restructure its $70 billion debt load, and they finally settled on a compromise last week.

Democrats have been pushing for broader latitude for the commonwealth to write down its debts. Unlike municipalities in some U.S. states, public entities in Puerto Rico don't have access to bankruptcy courts because Puerto Rico is not a state. The Treasury Department says without any debt-restructuring ability, Puerto Rico faces larger defaults and a creditor brawl that will make it even harder for the island to escape a recession that has lasted for most of the last decade.

Some Republican oppose debt restructuring because they say it would be unfair to the island's creditors, and some of those bondholders want to defeat the legislation because it would force them to accept losses upfront. Republicans have insisted that any legislation include a federal oversight board, modeled on the one imposed for Washington, D.C., in the 1990s, to restore financial accountability to the deeply indebted territory.

The current bill essentially combines some of what the Republicans want with some of what the Democrats want, though in the nature of such compromises, no one got everything they wanted. A House committee is set to markup the legislation this week.

Mr. Sanders objects to the imposition of an oversight board and to language throughout the bill designed to assuage Republicans that creditors' rights will be respected. He outlined his initial objections last week, just as the Obama administration had nearly wrapped several months of negotiations with House lawmakers, and he elaborated on them in a letter to Senate colleagues on Monday entitled, "We must stop treating Puerto Rico like a colony."

Even though the debt legislation is relatively obscure as policy issues go, it highlights the contrast between Mr. Sanders and Hillary Clinton, the Democratic front-runner, in substance and style. They face off in the Puerto Rico primary on June 5.

Mrs. Clinton has adopted the position of the Obama administration, saying that while the bill isn't perfect, it's probably the best deal that Puerto Rico is likely to get in the current political environment. "Without any means of addressing this crisis, too many Puerto Ricans will continue to suffer," she said in a statement last week.

Mr. Sanders is advocating a separate and more complex policy proposal that for now has no clear political support. His solution has two basic features. The first would require Congress to grant Puerto Rico's public corporations access to bankruptcy protection. The Obama administration rejected this step last year because it says giving Puerto Rico access to Chapter 9 of the bankruptcy code isn't sufficient to deal with all of the island's $70 billion debt load, since it excludes debts incurred by the central government.

Mr. Sanders also has proposed a plan that he says doesn't require congressional action. Instead, it calls on the Federal Reserve to provide emergency loans to Puerto Rico using the same authority that the government used to bail out American International Group in 2008.

Would this put taxpayers on the hook for Puerto Rico's debts while bailing out the hedge funds and mutual funds that bought up those bonds? Possibly, though Mr. Sanders opposes this.

Forcing investors to take haircuts could invite a constitutional "takings" lawsuit along the lines of one filed by some AIG shareholders. They argued that their property had been seized without proper compensation and while many legal experts initially dismissed their chances, a federal court ruled in their favor in 2014. The government is appealing that case.

Warren Gunnels, policy director for the Sanders campaign, says all of this can be avoided by requiring public entities to buy back their debts through a reverse Dutch auction, or a descending-price auction, allowing the Fed to refinance those holdings at less than full value.

"If the Federal Reserve can use its emergency lending authority to bail out huge Wall Street banks, it can use that same authority to help the same 3.5 million U.S. citizens who live in Puerto Rico," said Mr. Gunnels.

To be sure, the Fed used many of those authorities after majorities in Congress approved legislation in 2008. It's hard to imagine the Fed acting unilaterally and without broad political support for Puerto Rico because Fed officials have said the island's economic crisis poses no systemic threat to the broader municipal market or U.S. economy.

Moreover, some analysts have said such a move could backfire on the Fed by giving ammunition to Fed critics already looking to curtail its authority.

The bipartisan bill has the support of House Minority Leader Nancy Pelosi (D., Calif)., and one of the lead negotiators for Democrats on the House legislation was Rep. Raul Grijalva (D., Ariz.), who was the first lawmaker to endorse Mr. Sanders.

For now, few Democrats have signed onto Mr. Sanders's proposal, though some influential groups—including several large labor unions—have announced that they oppose the bipartisan legislation.

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