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Puerto Rico Loss Is Bondholders' Gain With Congress's Path Clear.

Things are starting to look up for Puerto Rico's bondholders after the U.S. Supreme Court struck down an island law that would have allowed some agencies to turn to court to restructure their debt.

The U.S. territory's securities climbed, with some bonds backed by sales-tax revenue reaching their highest since 2014, as the decision Monday eliminated a risk that Puerto Rican authorities would treat bondholders worse in a debt workout than a federal oversight board. Congress is advancing legislation to empower such a panel to help chart a path out of the island's fiscal crisis.

"Investors will doubtlessly fair better in a federally-directed restructuring program," Height Securities analyst Daniel Hanson said in a report. "The court's decision essentially holds that Puerto Rico has no authority under U.S. law to take action outside the ultimate source of authority — the U.S. Congress."

The relationship between investors and Governor Alejandro Garcia Padilla has become increasingly adversarial since his administration began defaulting on some securities in August, saying it doesn't have enough money to repay its \$70 billion debt without shutting off services crucial to its 3.5 million residents. The court decision Monday eliminated a way for Puerto Rico to escape from some debt on its own.

Puerto Rico enacted the Recovery Act in 2014 to give bankruptcy-like powers to some agencies that, unlike many U.S. local governments, can't file for court protection from creditors. If allowed to stand, the law would have affected more than \$20 billion in debt and strengthened the commonwealth's hand in negotiations aimed at persuading investors to accept less than they are owed.

The court ruled 5-2 in favor of bondholders who argued that the measure was barred under the federal bankruptcy law, which doesn't apply to the territory. The decision upheld a lower court ruling against the Puerto Rico law.

"Our constitutional structure does not permit this court to rewrite the statute that Congress has enacted," Justice Clarence Thomas wrote for the majority. Justices Sonia Sotomayor and Ruth Bader Ginsburg dissented, saying that Congress didn't intend to leave the island without access to either a federal or local restructuring law.

The decision leaves Puerto Rico largely dependent on Congress, which is advancing legislation to extricate the island from its difficulties. The U.S. House on Thursday passed a bill, called Promesa, that would establish a seven-member board to manage a restructuring of the commonwealth's debt and oversee its finances. The panel could ask a judge to order a forced restructuring if the government can't reach a deal with bondholders, ensure that the budget is balanced and recommend sales of assets to produce cash.

The Senate plans to take up the measure in the next several weeks, before July 1, when Puerto Rico

owes \$2 billion on a variety of securities.

Promesa is likely a “much better outcome” for creditors than the Recovery Act, according to Charles Tyson, an analyst at Keefe Bruyette & Woods who follows municipal-bond insurers. The local law had “some provisions even more draconian” than those in Chapter 9 bankruptcy, according to Mark Palmer at BTIG LLC.

The outcome of the crisis, which has been building over the past year, is far from certain and bondholders are still unlikely to recoup the full value of their investments. Garcia Padilla has said the government can’t afford to cover all that it owes next month, which may mark its first default on general-obligation bonds. In December, holders of Puerto Rico’s electric utility debt agreed to accept a 15 percent loss on their investments, though aspects of that deal are still in flux.

The verdict was welcome news to investors because reinstating the law would have injected fresh uncertainty just as Congress is moving to address the crisis. The most-traded fixed-rate senior sales-tax bonds, known as Cofinas, climbed to 64 cents on the dollar Monday, after last changing hands at 55 cents in April. Zero-coupon Cofina bonds due in 2047 traded on the highest volume since February at 13.3 cents, the highest since June 2013.

Securities due in 2038 from the Puerto Rico Aqueduct and Sewer Authority, which would have been included in the local Recovery Act, climbed from an average of 68.8 cents Friday to as much as 72.3 cents, the highest price since September.

Puerto Rico’s benchmark general obligations, which have an 8 percent coupon and are due in 2035, were little changed after the ruling, trading Tuesday at the highest average price since May 24, Bloomberg data show. Three of the five other general-obligation securities with at least \$1 million worth of trades on Monday increased in price.

While the federal control board could ultimately force creditors to accept a restructuring in court if the parties failed to reach consensus, the Supreme Court’s decision makes it less likely for Puerto Rico to use the legal system to reduce its obligations, Hanson said.

“This idea that Puerto Rico’s going to go to court and make some persuasive police-powers argument that gets them out of paying debt seems somewhat less persuasive in the context of the Supreme Court ruling,” Hanson said in an interview.

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