Bond Case Briefs

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Judge Refuses to Stay Puerto Rico Bondholder Suit.

WASHINGTON – A federal judge in Puerto Rico has refused to temporarily halt a lawsuit in which bondholders claim Gov. Alejandro García Padilla violated PROMESA by declaring a moratorium on constitutional debt payments after the law was enacted but before a control board was established.

The lawsuit, which was filed on July 20 by Delaware-based Lex Claims LLC and other companies that hold Puerto Rico's constitutionally backed debt, focuses on three actions the government took that allegedly violated PROMESA after President Obama signed it into law on June 30. They are seeking a declaration that the government violated PROMESA as well as an injunction halting the violations.

Puerto Rico fought the lawsuit claiming it should be stayed or temporarily halted under PROMESA. But Judge Francisco Besosa ruled on Sept. 2 that the stay doesn't apply to this lawsuit.

John Mudd, a Puerto Rico lawyer who has closely followed PROMESA, said the decision against the stay on litigation may be a first step toward an ultimate ruling that García Padilla and the government infringed on PROMESA. The case will likely continue into October, he said, and there is a chance the seven-member oversight board created under the law could also weigh in on the government's cited actions before a ruling is handed down.

The plaintiff companies charge in their complaint that the governor's Executive Order 2016-30, which was also issued on June 30, violated a section of PROMESA that prohibits Puerto Rico from enacting new laws that either permit the transfer of any funds or assets outside the ordinary course of business or that are inconsistent with the constitution or laws of the territory between the date of the law's enactment and the time the oversight board and its chair have been appointed.

The complaint also claims that the commonwealth's fiscal year 2017 budget violates that section because it "makes huge transfers outside the ordinary course of business and diverts vast resources to purposes that apparently enjoy political favor but are indisputably junior to constitutional debt." The companies cite a roughly $800 million contribution to the pension system in the budget as well as about $250 million from the territory's general fund to "prop up its insolvent Government Development Bank."

"All of this is well outside the 'ordinary course of business' and flouts the Puerto Rico constitution, which expressly requires appropriations for full payment of constitutional debt," the companies said in their complaint.

They also allege that a commonwealth law enacted on July 20 that allows the commonwealth, without approval of the oversight board, to take on responsibility for debts owed to the GDB by other, independent entities violates Section 207 of PROMESA. That section says Puerto Rico cannot "issue debt or guarantee, exchange, modify, repurchase, redeem, or enter into similar transactions with respect to its debt" without getting the oversight board's approval.

The commonwealth responded to the complaint by arguing it triggered a provision of PROMESA that puts an automatic stay on debt litigation against the commonwealth.

“This is, in short, precisely the sort of bondholder litigation against Puerto Rico that PROMESA sought to halt for a temporary period to allow the commonwealth to stabilize its financial situation and to give the oversight board time to set up and review,” the commonwealth said in a document filed with the court.

But Besosa’s ruling that the stay did not apply was based mostly on considerations regarding the timing of the suit and whether the plaintiffs’ requested relief claims could be considered monetary relief.

The first way a stay could be triggered is if the judicial actions “against the government of Puerto Rico … [were] or could have been commenced before the enactment of [PROMESA],” Besosa wrote in his order. He found that because the plaintiffs’ complaint seeks an injunction enjoining commonwealth action that took place after PROMESA’s enactment, the plaintiffs could not have brought the case before the enactment of the law and the case did not meet that requirement necessary to trigger the stay.

A suit could also be subject to the stay if it is a judicial action to recover a “liability claim” against the government of Puerto Rico that arose before the enactment of PROMESA, the judge said. The law associates “liability claim” with monetary relief, defining it as a claim that relates to liability, right to payment, or right to an equitable remedy for breach of performance if such breech gives rise to a right to payment, he said.

“In their amended complaint, plaintiffs expressly state that their lawsuit ‘does not seek to compel payment on plaintiffs’ bonds.’ Rather, plaintiffs seek only declaratory and injunctive relief,” Besosa wrote. “Thus, plaintiffs do not seek to recover a right to payment that arose before PROMESA’s enactment” and the suit does not meet that requirement for a stay.

The Bond Buyer

By Jack Casey

September 7, 2016