
Hedge Funds Holding Puerto Rico GOs Sue Over Sales-Tax Bonds.

Hedge funds holding Puerto Rico's general-obligation bonds are asking a court to stop the commonwealth from directing sales-tax revenue to repay other debt backed by that money because it violates the island's constitution.

It is the first legal action for the U.S. territory that pits general-obligation bondholders against investors of sales-tax debt. Puerto Rico's constitution states its general obligations must be repaid before other expenses. A portion of the island's sales-tax revenue is dedicated to repaying bonds, called Cofinas by their Spanish acronym.

Entities managed by Aurelius Capital Management, Autonomy Capital, Covalent Partners, FCO Advisors, Monarch Alternative Capital and Stone Lion Capital Partners in July sued Governor Alejandro Garcia Padilla in U.S. District Court in San Juan to stop the administration from transferring funds away from bondholders. The hedge funds say it violates a federal law, called Promesa, which prohibits the island from enacting new legislation to divert revenue or assets that would go against its constitution.

The hedge funds filed an amended complaint Friday. It adds the Puerto Rico Sales Tax Financing Corp., issuer of the Cofina bonds, as a defendant.

The commonwealth defaulted on almost $1 billion of principal and interest on July 1, including $780 million for general obligations. It's the largest such payment failure in the $3.8 trillion municipal-bond market.

Puerto Rico continues to repay Cofina bondholders on time and in full and allocates sales-tax revenue to the bond's trustee every month.

General Obligations

Puerto Rico needs to follow its constitution and repay its general obligations, especially since Cofina bonds were sold as a way to avoid the commonwealth's debt ceiling, the hedge funds said. Puerto Rico owes almost $13 billion of general obligations and about $15.2 billion of Cofinas.

"Cofina's primary purpose is to serve as a vehicle for the commonwealth to borrow large sums of money in a way that circumvents the carefully prescribed debt limitations and priorities contained in the Puerto Rico constitution," according to the amended complaint.

In a separate legal case, a federal board charged with overseeing Puerto Rico's finances is seeking more time to weigh in on whether certain lawsuits against the commonwealth should be postponed, according to a court filing Friday.

The seven-member control board, which met for the first time last week in New York, is asking U.S. District Judge Francisco Besosa to allow the panel until Oct. 21 to file its position on a legal stay, which halts creditor lawsuits against Puerto Rico seeking repayment. The provision is part of the Promesa law, which created the control board to restructure the island's $70 billion debt load and help end a decade-long trend of borrowing to fill budget gaps. It's the first instance of the panel seeking to intervene in a court case.

Besosa last month heard testimony from bondholder advisers and bond-insurance companies on why the court should lift the stay, which lasts through mid-February. Outside consultants for the commonwealth argued that Puerto Rico needs a temporary suspension from such legal battles while it restructures its debt.

Bloomberg Business

by Michelle Kaske

October 7, 2016 — 3:48 PM PDT