[Most Dreaded Provision of Puerto Rico Law Seen Spurring Pact.](#)

What some Puerto Rico bondholders dreaded the most under the creation of a federal oversight board may end up leading to a long-sought resolution to the first debt-restructuring agreement reached by the commonwealth.

After coming to terms with creditors and bond insurers in January, the Puerto Rico Electric Power Authority, the island's main electricity provider, has been unable to close the deal, in part because of seven different lawsuits in Puerto Rico courts that oppose the $9 billion workout plan and a new customer surcharge that will repay the restructuring bonds.

Both creditors and the utility had pushed forward for nearly two years on the deal under the premise that an agreement would be more beneficial to all parties rather than having the matter resolved by a judge once the oversight board was in place. It turns out that the Promesa oversight law passed in June contains a provision, called Title III, that's similar to municipal bankruptcy and forces investors to take losses while also resolving legal suits.

"That proceeding will resolve all claims," said attorney James Spiotto, managing director at Chicago-based Chapman Strategic Advisors LLC, which advises on municipal restructurings. "It's to prevent the annihilating litigation that leads to meltdown, because that's in nobody's best interest because this is a necessary public service, electricity."

Bondholder Outlook

Under the agreement bondholders would take a 15 percent loss and wait longer to be repaid in exchange for new debt with stronger repayment pledges. While the accord is set to expire Dec. 15, the agency is working to extend the pact with creditors as it has done several times through the negotiations, according to Javier Quintana, executive director of the utility known as Prepa.

There are enormous opportunities for the board to help turn Puerto Rico around if there is the will to find consensual deals with creditors, Thomas Wagner, co-founding partner of Knighthead Capital Management, said Thursday during a Bloomberg Television interview. The New York-based hedge fund owns Prepa bonds.

"We are bullish on their long-term prospects to do that," Wagner said. "It will probably be a rocky road as it often is, but I do think that in the long run things will go quite well."

Not everyone is as optimistic. Prepa debt is trading below the potential 85-cents on the dollar recovery rate. Bonds maturing in 2040 with a 5.25 percent coupon changed hands Thursday at an average price of 67.9 cents, according to data compiled by Bloomberg.

A Prepa debt restructuring may offer a blueprint for other commonwealth entities seeking to lower their obligations. The control board is charged with lowering the island's $70 billion debt load and putting in place a structure to end budget deficits that have plagued the island for more than a decade. Part of that process includes analyzing the Prepa deal and voting on whether it should move forward.

Puerto Rico officials are seeking to reduce Prepa's debt payments so they can modernize a system that relies on petroleum to produce electricity rather than less-expensive natural gas or even solar power. The high cost of electricity has contributed to the shrinkage in economic growth over the past decade.

While the pact involves creditors holding 70 percent of the utility's securities and no more than $700 million in existing bonds would remain after a restructuring, Title III would force all creditors to accept a workout and leave no legacy debt. It could also give the deal a court validation that would resolve the lawsuits brought by unions, business groups and customers, Spiotto said.

"The Prepa advisory team is in the process of analyzing and evaluating the different alternatives available to Prepa under Promesa to implement its restructuring plan, which may involve, among other things, the commencement of a restructuring process under Title III or Title VI of Promesa," Quintana said in an e-mail.

Cramdown Concern

The control board would need to approve any plan to use the Promesa law to help push through Prepa's restructuring deal. Along with reviewing its options under Promesa, the utility is working on a five-year fiscal plan that the federal board requested from certain commonwealth agencies at its last meeting on Oct. 14.

While Congress was drafting Promesa, some bondholders and insurers objected to a provision similar to municipal bankruptcy that would allow a court to force creditors to accept a debt restructuring plan. For Prepa investors who have already agreed to the 15 percent haircut, the Promesa law could help to finally execute the debt exchange.

"Getting this deal done is a priority for all parties, and once completed, Prepa can finally move forward with its revitalization," Stephen Spencer, managing director at Houlihan Lokey, which is advising the group of bondholders, said in a statement. "The Prepa deal has received Puerto Rican legislative and energy commission approval, and positive support from all sides involved, other than a few individuals vested in Prepa's stagnation and retaining the status quo."

Remaining Obstacles

Even so, the deal still faces other hurdles such as a requirement for the new bonds to receive an investment-grade rating as well as remaining political questions. The utility currently carries a junk rating.

Governor Alejandro Garcia Padilla isn't seeking re-election. It's unclear whether the next administration will allow Prepa to renew contracts. A $3 million agreement with Millco Advisors LP, an affiliate of Washington-based Millstein & Co., which is advising Prepa on the restructuring plan, expires at the end of December. A pact with AlixPartners LLP, the utility's restructuring adviser, is set to end on Dec. 15.

Ricardo Rossello, who is leading in the latest polls going into the Nov. 8 election, said he's concerned about whether the deal would lower energy costs over the long term for residents and business.

"Our preference is to create public-private alliances so that we can have a generation of energy at a much lower cost,” Rossello said in a telephone interview.

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