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Puerto Rico Board's \$1 Billion Lawsuit Escalates Bond Feud.

- **Cases seek more than \$1 billion from investors, banks**
- **Move may strengthen Puerto Rico's hand in creditor talks**

Puerto Rico's federal oversight board sued dozens of banks and bondholders to claw back more than \$1 billion in fees and interest payments tied to debt the government claims is null and void.

The suits, filed just before a May 2 deadline, escalate the board's conflict with hedge funds and other investors who hold some \$6 billion of Puerto Rico general-obligation debt. The cases are part of an effort by island officials to cancel large chunks of general-obligation bonds issued in 2012 and 2014. The board, and some island creditors, argue the debt was sold after the government overshot its constitutional debt limit.

The latest legal challenges pose a risk for banks including Barclays Plc, Bank of America Corp., Morgan Stanley, JPMorgan Chase & Co, Goldman Sachs Group Inc., Banco Santander SA and others that underwrote or otherwise helped engineer Puerto Rico's debt as its financial troubles escalated. Representatives of those banks declined to comment or didn't immediately respond.

"The laws of Puerto Rico limit government borrowing authority for a reason: to prevent the government and its financiers from hitching the commonwealth and its instrumentalities, as well as taxpayers and legitimate creditors, to a level of debt that cannot be repaid without sacrificing services necessary to maintain the health, safety, and welfare of Puerto Rico and its people," one of the suits said.

Negotiating Tactic

The moves are aimed at bringing money back to the island and may strengthen the oversight board's hand in negotiations with owners of debt backed by the territory's central government, the biggest chunk that has yet to be restructured in its record-setting bankruptcy.

"They're doing it as a negotiating technique, trying to use that to leverage a more reduced payment," said Jim Spiotto, managing director at Chapman Strategic Advisors. "It's more of a negotiating tactic than actual reality."

Any ruling invalidating the bonds would free up cash for other creditors and could have broader implications for the \$3.8 trillion municipal-debt market, a haven where investors rely on the assertions of governments and attorneys that securities are legitimately issued. A successful effort to persuade the court to void the bonds could also jeopardize Puerto Rico's ability to finance needed work on its infrastructure.

"Puerto Rico has to realize if you basically mug the bondholders, what's your future?" Spiotto said. The financial rescue law that allowed for the territory's bankruptcy "is there to build financial credibility in the capital markets so they would have access to the market in the future. What they're doing is the opposite."

The lawsuits were filed by New York bankruptcy attorney Ed Weisfelner, whose law firm, Brown Rudnick, was hired by the board to pursue the cases. Last week, in an interview and at a court hearing, Weisfelner said he planned to target dozens of underwriters and advisers and to recoup interest payments from the biggest bondholders.

Smaller investors won't be affected. The suits seek to recover interest payments on the disputed bonds from investors holding at least \$2.5 million of the securities.

Some of the Puerto Rico general-obligation bonds that the panel is challenging trade for about 51 cents on the dollar, indicating that investors don't expect to be entirely wiped out. But that risk may encourage them to strike a deal with Puerto Rico to write off some of the debt in court, as the government has already done with bonds backed by sales-tax revenue and the island's government development bank.

The federal board in January asked the court to declare general-obligation debt sold in 2012 and 2014 as null and void, claiming the sale of those securities pushed Puerto Rico over its legal debt limit.

To compensate bondholders for having their debt canceled, the lawsuits against the underwriters may be turned over to investors to try to collect on as part of a debt restructuring plan, Weisfelner said. In bankruptcy, lawsuits are often treated as assets, which creditors can use to recover what they are owed.

The official committee of unsecured creditors unsuccessfully sought to bring additional lawsuits, arguing they would be more aggressive and less likely to encounter any conflicts of interest. The committee has claimed the board has close ties to some individuals or institutions responsible for Puerto Rico's debt crisis. U.S. Bankruptcy Judge Laura Taylor Swain rejected that request.

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