[Bond Case Briefs]

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[Puerto Rico Seeks to Have $9 Billion in Debt Ruled Unconstitutional.]

The government oversight board leading Puerto Rico through its $123 billion debt crisis sued dozens of banks and financial firms on Thursday, saying that they had helped the island issue $9 billion of debt illegally, and that the people of Puerto Rico should not have to repay it.

The board said the debt should be voided because it exceeded the territory's constitutional debt limit, and it added that Puerto Rico would try to recover hundreds of millions of dollars in interest and principal payments that it has already made.

The board was joined in the litigation by the official committee representing Puerto Rico's unsecured creditors in the territory's bankruptcy-like legal proceedings. Both plaintiffs said they understood they were making an unusual request, but asserted that no other approach would be legal or fair.

"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," the plaintiffs said in one of several complaints.

The lawsuit names as defendants a large number of major financial institutions just as the oversight board is trying to work with them to restructure billions of dollars in debt.

Matt Fabian, a partner at Municipal Market Analytics, a research firm that is not involved in the litigation, said he thought the lawsuits would make it harder for Puerto Rico to negotiate with its creditors. In some cases, he said, the institutions being sued were the same ones that Puerto Rico would seek assistance from in the future, once the current restructuring is finished and the island needs to issue new debt.

Citibank, one defendant, is working as an adviser to the oversight board on the debt restructuring. "How do you sue?" Mr. Fabian asked. "It's like going in for a root canal and suing the dentist while you're still in the chair."

Municipal bonds are very seldom voided, and there is no precedent for such a step under Promesa, the bankruptcy-like law enacted by Congress to handle Puerto Rico's debt crisis. As a territory, the island is legally barred from using Chapter 9 municipal bankruptcy to restructure, and Promesa has not been used before. But such maneuvers have been employed in other municipal bankruptcies.

The complaints named a number of financial-services firms that underwrote the bonds, because the board and creditor group said the firms should have understood that the bonds would have put the territory beyond its debt limit. The defendants include Citigroup, Goldman Sachs and JPMorgan Chase and a number of other major banks. Citigroup and Goldman declined to comment, as did JPMorgan.

Also named in the complaints were firms involved in selling Puerto Rico financial instruments meant to protect the territory in the event the interest rates on the bonds rose.

The complaints also named the law firm Sidley Austin as a defendant, claiming that it had improperly determined that the bonds were in compliance with the debt limit. The firm said the complaint, which seeks the return of fees paid to it, was "untimely and entirely without merit," said Linton Childs, the firm's general counsel.

Advocacy groups have been calling for months for at least some of Puerto Rico's debt to be voided, but a legal analysis commissioned by the board said it would be difficult to do, in part because much of the debt was issued years ago and the statute of limitations would have run out. The oversight board had asked the court for more time to consider its options, but the court said no, leaving Friday as the deadline for any possible lawsuits.

The actions of the oversight board, and the details of the restructuring, have attracted the attention of members of Congress. The House Natural Resources Committee, which has oversight of United States territories and drafted Promesa, heard from the board's executive director and the territory's governor in a hearing on Thursday.

Ricardo Rosselló, Puerto Rico's governor and a critic of the board, told lawmakers that it had not achieved its objectives and had overstepped its bounds. The board's executive director, Natalie Jaresko, defended the board and said 30 percent of the island's debt had already been restructured and discussed its claims concerning the validity of some of the bonds.

The lawsuits center on Puerto Rico's constitutional debt limit, which establishes a ceiling for the amount of general-obligation bonds the island's government can issue. The limit does not apply to other types of debt, however, and the lawsuits argue that the banks helped Puerto Rico's government design and market bonds that appeared to be something other than general-obligation bonds, thereby circumventing the limit and, ultimately, making the island's insolvency much worse.

For example, the complaint said, bonds issued by Puerto Rico's Public Buildings Authority to build and maintain public schools were to be repaid by rental payments on the buildings. That made them seem like revenue bonds, which are not counted toward the debt ceiling. But in fact, the rent payments were made by the government's general fund — the same source of money that repays the general-obligation bonds. For that reason, the school-construction bonds should have been counted as general-obligation bonds, the lawsuit says.

Had all of the government's bonds been properly classified, it would have been clear that Puerto Rico had exceeded its constitutional debt limit, the lawsuit said.

In addition to the $4 billion of bonds issued by the Public Buildings Authority, the lawsuits said general-obligation bonds issued in 2011 and 2014 exceeded the debt ceiling and should be voided.

"It would not be equitable, or legal, to ask the taxpayers and legitimate creditors or Puerto Rico to bear a burden from which they are protected by their own Constitution and statutes," one complaint said. "That burden should instead be shouldered by those who, knowing of Puerto Rico's increasingly dire financial crisis, chose to lend to Puerto Rico, or purchase Puerto Rico debt that carried high effective interest rates as a reflection of risk."

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By Mary Williams Walsh

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