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The Far-Reaching Effects if Puerto Rico Snubs Precedent and the Rule of Law.

'Oversight Board ignores U.S. Supreme Court precedent, dating back to the 19th century'

Editor's note: The following is a commentary by Dominic Frederico, CEO of bond insurer Assured Guaranty.

The current Financial Oversight and Management Board for Puerto Rico (Oversight Board) is attempting to invalidate more than $6 billion of general obligation bonds and to initiate clawbacks of principal and interest payments to bondholders. It claims that the bonds were issued in excess of a Puerto Rico constitutional debt limit, notwithstanding the Commonwealth's specific representations to the contrary when the bonds were issued. In taking these actions, the Oversight Board ignores U.S. Supreme Court precedent, dating back to the 19th century, that if an issuer specifically represents the validity of its bonds to investors at the time of issuance, it is barred from later denying repayment based on a claim of invalidity. The actions also violate the basic tenets of the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA), which the U.S. Congress enacted in June 2016 to provide a formal process for Puerto Rico's debt restructuring, restoration of its capital market access and to provide supervision of its financial management by the Oversight Board.

Dubious legal assertions aside, how does trying to repudiate previous debt issued and approved by the duly authorized Puerto Rico government help to restore its capital markets access? This illustrates how far the current Oversight Board has strayed from the purpose of PROMESA.

The Oversight Board has initiated multiple lawsuits not just against bondholders to invalidate liens, but also against hundreds of vendors and contractors who worked for the Puerto Rico Government, in an attempt to claw back billions in payments. In fact, it has allocated $1.5 billion of Puerto Rico taxpayers' money towards litigation and consultant fees.

Rather than continue to deny valid legal obligations, invalidate lawful liens, and ignore decades of municipal finance custom and practice, the Oversight Board should join with other parties to work in good faith to end costly adversarial legal proceedings. If Puerto Rico does not emerge from Title III bankruptcy proceeding soon and instead remains mired in decades of litigation, it will hurt Puerto Rico's economy and its residents. This will also raise borrowing costs for local and state governments across the U.S. as concern about contagion from Puerto Rico's unresolved debt crisis spreads.

On February 15, 2019, the U.S. Court of Appeals for the First Circuit held that PROMESA's procedure for appointing Oversight Board members is unconstitutional. The appeals court allowed 90 days for President Trump and the Senate to appoint and confirm a new board or reappoint some or all of the current board, later extending the deadline to July 15. The U.S. Supreme Court has agreed to hear arguments as to the constitutionality of the Oversight Board appointments later this year.

This First Circuit decision creates an opportunity for a newly reappointed board to fulfill PROMESA's stated goals for Puerto Rico: achieving fiscal responsibility and regaining access to the capital markets. By improving transparency and fiscal governance, and by promoting consensual agreements between creditors and the government, the Oversight Board can create the conditions for swiftly resolving the debt restructuring process, achieving long-term economic growth and restoring the capital markets access that is critical for a vibrant economic future for Puerto Rico and the modernization of its infrastructure.

Restoring the Commonwealth's credit access through adherence to the rule of law is essential for ensuring that municipal bond investors, U.S. municipal officials, U.S. taxpayers – and all Americans who benefit from lower-cost financing for the construction of utilities, hospitals, bridges, schools and other public works – have confidence that even in tough situations, the laws governing the municipal bond markets function as they should.

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