

Puerto Rico District Court Strikes Down Debt Restructuring Law

By John Flynn, J.D. Candidate 2016 | February 24, 2015

Puerto Rico's recently enacted debt restructuring law was struck down. On February 6, 2015, Judge Francisco Besosa of the United States District Court in Puerto Rico ruled that the law was unconstitutional and enjoined its enforcement.

The Puerto Rico Public Corporations Debt Enforcement and Recovery Act was proposed by Puerto Rico Governor Alejandro Padilla and passed by the commonwealth's legislature [last summer](#). It was limited to public entities like the Puerto Rico Electric Power Authority (PREPA) and the Highway Transportation Authority, which respectively held debts of approximately \$8.6 billion and \$5 billion. Puerto Rico is unable to seek protection from creditors under federal bankruptcy law, and the Recovery Act would have allowed public corporations to [renegotiate](#) their billions of dollars in municipal bond and other debt through supermajority creditor approval and judicial involvement.

According to William C. Dudley, the CEO of the Federal Reserve Bank of New York, Puerto Rico's public corporations "[account for almost 40 percent of the Island's total debt](#)." Hedge fund investors had been purchasing bonds issued by PREPA and other public entities at "[distressed prices](#)," and were shaken up when the Recovery Act was first passed because it showed the commonwealth's willingness to "unilaterally change the rules." Although Puerto Rico's commonwealth bonds were already rated as junk, passage of the Recovery Act resulted in a series of downgrades by the ratings firm, Moody's. In response to the district court's ruling, Standard & Poor's [downgraded Puerto Rico's GO debt rating](#) from BB to B as Puerto Rico struggles to "face a major reduction in its ability to obtain external liquidity at a reasonable cost."

The investor plaintiffs held nearly \$2 billion in bonds issued by PREPA. In his [75-page opinion](#), Judge Besosa held that the Recovery Act was preempted by the federal bankruptcy code and therefore void under the Supremacy Clause of the United States Constitution. Although some hedge fund investors hail the opinion as a [triumph for the rule of law](#), the question remains as to how to deal with Puerto Rico's public corporation debt.