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Puerto Rico board hits Wall Street banks, bondholders with lawsuits

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SAN JUAN (Reuters) - Puerto Rico's federally created financial oversight board said on Thursday it sued some owners of potentially invalid bonds of the bankrupt U.S. commonwealth, as well as Wall Street banks and firms that participated in various debt issuances in an effort to recoup more than \$1 billion.

FILE PHOTO: The flags of the U.S. and Puerto Rico fly outside the Capitol building in San Juan, Puerto Rico May 4, 2017. REUTERS/ Alvin Baez

The litigation, which was in the works since last month, follows more than 230 complaints the board filed in U.S. District Court in Puerto Rico earlier this week against private companies, individuals and service providers that received about \$4.2 billion in payments from the island's government as far back as four years before its May 3, 2017, bankruptcy filing.

The board, which had only two years from that date under a statute of limitations to file certain claims, was denied an extension last week by a federal judge hearing Puerto Rico's cases aimed at restructuring about \$120 billion of debt and pension obligations.

At issue is more than \$6 billion of general obligation bonds sold in 2012 and 2014 that the board contends exceeded a debt limit in Puerto Rico's constitution. The validity of some bonds issued by the island's Public Buildings Authority, as well as pension bonds, is also being questioned. Judge Laura Taylor Swain has yet to rule in the matter.

The lawsuits contend that bond underwriters, attorneys and advisers “aided and abetted” Puerto Rico in failing to meet its fiduciary duties, as it issued debt unlawfully and while being “clearly insolvent.” In participating in these transactions, the defendants acted “for their own profit and unjust enrichment,” according to the litigation.

Defendants include many of Wall Street’s biggest investment banks, as well as law firm Sidley Austin.

Linton Childs, Sidley Austin’s general counsel, said, “We believe that putative claims asserted against the firm are both untimely and entirely without merit.”

The board argued that the proceeds and profits made by the defendants “are recoverable as fraudulent transfers” and that the court should award damages.

In the case of \$3.5 billion of junk-rated GO bonds sold in 2014, the board alleged that underwriters and advisers “knew or should have known” that the transaction ran afoul of the commonwealth’s constitutional debt limit. It also contended underwriters bought these bonds at discount, allowing them to “reap large profits” from the resale of the bonds to investors.

In addition, the board sued individual investors and banks that owned at least \$2.5 million of the bonds between May 2013 and May 2017 in an effort to recoup debt service payments they received.

“The oversight board did not take the decision to claw back payments lightly,” said David Skeel, a member of the board’s Special Claims Committee, in a statement. “However, Puerto Rico’s taxpayers should not have to shoulder payments the government made to big investors that should never have been made in the first place.”

The board said while it is “sympathetic” to bondholders, Puerto Rican law limits government borrowing authority to avoid “sacrificing services necessary to maintain the health, safety, and welfare of Puerto Rico and its people.”

Various investment banks were also sued as parties to interest rate swap agreements with the commonwealth that earned them almost \$400 million in termination fees. According to the board, these institutions “knew that the underlying bonds tied to these swap transactions carried substantial risk,” which would result in an unfavorable outcome to the commonwealth.

“Despite this knowledge, the swap counterparty defendants continued to recommend and cause Puerto Rico issuers to enter into additional swap transactions on bonds they themselves underwrote,” the lawsuit stated.

Reporting by Luis Valentin Ortiz in San Juan and Karen Pierog in Chicago; Editing by Matthew Lewis

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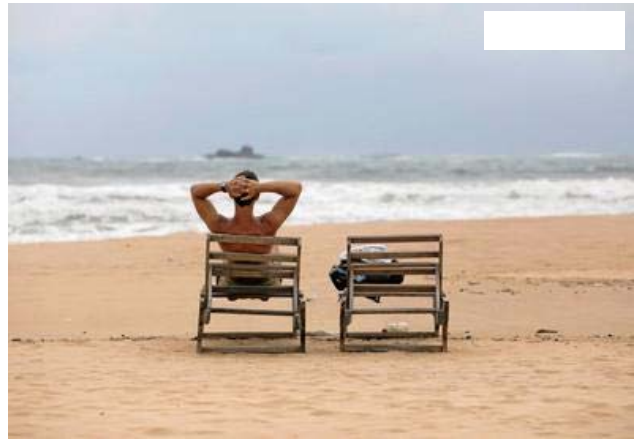
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