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First Circuit Provides Clarity to Puerto Rico Creditors Seeking Relief

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February 23, 2017 - The First Circuit's recent opinion on the Puerto Rico Oversight, Management, and Economic Stability Act ("PROMESA", 48 U.S.C §§ 2101-2241) outlines initial guidelines for possible future actions against the Puerto Rican government as a result of the Commonwealth's ongoing debt crisis. *Peaje Investments LLC v. García–Padilla*, 845 F.3d 505 (1st Cir. 2017). Congress enacted PROMESA in June 2016 to create, among other things, a temporary stay of debt-related litigation against the government of Puerto Rico. The temporary stay was set to expire automatically on February 17, 2017, but has been extended until May 1, 2017. The First Circuit permitted one creditor to move immediately for relief from the stay, but blocked another creditor's bid. The decision serves as a template for how creditors may move against the Commonwealth when the PROMESA stay expires later this spring.

In *Peaje Investments LLC v. Garcia-Padilla*, the First Circuit considered the appeal of two creditors whose motions for relief from PROMESA's stay had been denied by the District Court of Puerto Rico without a hearing. The denied creditor, Peaje Investments LLC ("Peaje"), argued that the stay should be lifted so it could challenge the government's diversion of toll revenues. The successful creditors, the Altair movants, similarly sought relief based on their interest in certain employee contributions diverted by the Commonwealth. The First Circuit applied the Bankruptcy Code's "lack of adequate protection" standard to determine cause for lifting the stay.

In Peaje's case, the creditor alleged that a bond resolution required the government to deposit toll revenues with a fiscal agent to serve as collateral for bonds issued by the Puerto Rico Highways and Transportation Authority. The First Circuit affirmed the District Court's denial of Peaje's motion because "toll revenues are 'constantly replenished,'" allowing Peaje's security interest to continue as a "stable, recurring source of income that will eventually provide funds for the repayment" of the bonds.[1]

The Altair movants similarly alleged that the Commonwealth had suspended transfers of employee retirement contributions, which served as collateral for their bonds, to the required fiscal agent. The Altair movants, crucially, included in their filings a statement by the Commonwealth's Employees Retirement System that "uncertainty about future employee contributions could affect" repayment of the bonds held by the Altair movants. The District Court characterized these contributions as "a perpetual revenue stream whose value is not decreased by the Commonwealth's acts," much like Peaje's collateral, but the First Circuit reversed course. It found that the Altair movants deserved a hearing to demonstrate the "alleged uncertainty" of the Commonwealth's ability to repay the bonds.[2]

The stay will expire in May, at which point an influx of actions against the government of Puerto Rico relating to the debt crisis is expected. The First Circuit's decision is limited in scope due to the PROMESA stay's anticipated expiration, but creditors pursuing litigation against the government after the stay is lifted may choose to heed the opinion's underlying guidance: do not hold back in initial pleadings.

Footnotes

[1] *Peaje Investments LLC v. García–Padilla*, 845 F.3d 505, 511 (1st Cir. 2017)

[2] *Id.*

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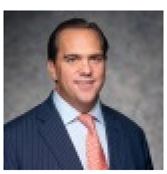

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