

Debt Restructuring Process Under Puerto Rico Oversight,
Management and Economic Stability Act
(PROMESA)

Sonia Colón, Esq.
Gustavo Chico Barris, Esq.

Ferraiuoli LLC
Looking Forward
221 Ponce de León Ave., Floor 5
Hato Rey, PR 00917
T. 787-766-7000

390 N. Orange Ave., Suite 2300
Orlando, FL 32801
T. 407-982-4182

scolon@ferraiuoli.com
gchico@ferraiuoli.com

- ▶ The contents of this presentation has been prepared solely for educational purposes. It is not intended as, nor does it constitute legal advice. It is recommended that anyone reading this presentation get legal advice from a lawyer before taking any action related to the procedures described in this presentation.

- I. BACKGROUND
- II. PROMESA
- III. POWERS OF OVERSIGHT BOARD
- IV. DEBT ADJUSTMENT
- V. CREDITOR COLLECTIVE ACTION

Commonwealth of Puerto Rico et al. v. Franklin California Tax Free-Trust et al. Case No. 15-233 (U.S. Sup. Ct. June 13, 2016).

- On June 13, 2016, the Supreme Court of the United States decided *Commonwealth of Puerto Rico v. Franklin California Tax-Free Trust*, holding that Chapter 9 of the federal bankruptcy code preempts Puerto Rico’s municipal debt restructuring law.
- The Supreme Court ruled that Puerto Rico’s instrumentalities are ineligible for municipal debt adjustment under Chapter 9 of the Bankruptcy Code, and that Puerto Rico cannot adopt local laws dealing with the insolvency of its units, such as municipal power and water companies.
- In 2014, Puerto Rico enacted a law allowing its public utilities to restructure its debts.
- The Supreme Court held that because the definition’s exception “unmistakably” exempts Puerto Rico from the definition of a “State” only for purposes of allowing it to define which municipalities may be a debtor, it does not exempt Puerto Rico for any other purpose. Had Congress intended to exclude Puerto Rico from preemption, it would have said so. Congress does not “hide elephants in mouseholes”.

Commonwealth of Puerto Rico et al. v. Franklin California Tax Free-Trust et al. Case No. 15-233 (U.S. Sup. Ct. June 13, 2016).

- Section 903(i) of the Bankruptcy Code, which pre-empts state bankruptcy laws that enable insolvent municipalities to restructure their debt over the objections of creditors and instead requires municipalities to restructure such debts under chapter 9 of the bankruptcy code, pre-empts the Puerto Rico Public Corporation Debt Enforcement and Recovery Act, which was enacted to enable the Commonwealth's public utilities to implement a recovery or restructuring plan for their debt.
- The Supreme Court held that Puerto Rico is a “State” for purposes of chapter 9’s preemption provision.

PROMESA

- ▶ On June 30, 2016 Congress adopted the “Puerto Rico Oversight, Management and Economic Stability Act” (PROMESA), which was immediately signed into law by President Obama.
- ▶ PROMESA creates a mechanism for debt adjustment proceedings and to generate the meaningful fiscal reforms that Puerto Rico needs while improving efficiency, transparency and internal control;
- ▶ PROMESA provides a framework for restructuring instrumentalities by incorporating provisions from Bankruptcy Code, other protocols used in restructuring sovereign debt.
- ▶ According to section 101 of PROMESA, the purpose of the Act is to provide a method for Puerto Rico to achieve fiscal responsibility and access to the capital markets.

Powers of Oversight Board

Composition of the Board (§ 101(c))

- Pursuant to section 101(c) of the Act, the Board shall consist of seven (7) members appointed by the President of the United States. The Board will be composed of two (2) members selected from the list submitted by the Speaker of the House of Representatives; two (2) members selected from the list submitted by the Senate Majority Leader; one (1) member selected from the list submitted by the Minority Leader of the House of Representatives; and one (1) member selected from the list submitted by the Senate Minority Leader.
- The Act provides that the governor shall be an ex officio member of the board without voting rights.
- Each member of the Board shall be appointed for three-year terms, but may be reappointed. The president may remove a member for cause.
- The members of the Board shall serve without pay and the Board shall have an office in the Commonwealth and an additional one as it deems necessary (§ 101 (g))

Oversight Board

- On August 24, 2016, President Obama appointed the following persons to serve on the Board:
 - [Arthur Gonzalez](#), senior fellow at New York University's school of Law and former Chief Judge of the U.S. Bankruptcy Court for the Southern District of New York
 - [Carlos Garcia](#), former president of Puerto Rico's Government Development Bank and Chief Executive officer of BayBoston Managers, LLC
 - [Andrew Biggs](#), resident scholar at the American Enterprise Institute
 - [David Skeel](#), University of Pennsylvania law professor
 - [Jose Carrion III](#),
 - [Jose Ramon Gonzalez](#), president and chief executive officer of the Federal Home Loan Bank of New York
 - [Ana Matosantos](#), served as California's budget director from 2009 to 2013
- The president appointed the members of the Board from lists provided by congressional leaders from both parties.
- In making the appointments, President Obama stated that “[w]ith a broad range of skills and experiences, these officials have the breadth and depth of knowledge that is needed to tackle this complex challenge and put the future of the Puerto Rican first”.

Bylaws for Conducting Business of Oversight Board (§101(h))

- ▶ As soon as practicable after the appointment of all members and appointment of the chair, the Board shall adopt bylaws, rules and procedures governing its activities under this Act, including procedures for hiring experts and consultants.
- ▶ Under the bylaws which will be adopted, the Board may conduct its operations under such procedures as it considers appropriate, except that an affirmative vote of a majority of the members of the Board's full appointed membership shall be required in order for the Board to approve a fiscal plan, approve a budget, cause a legislative act not to be enforced, or designate an infrastructure project as a critical project.

Operations of the Board

- ▶ On September 30, 2016, the Board held its first meeting to elect a chairman and to address other organizational matters.
- ▶ The members of the Board elected José B. Carrión as the chairperson at the meeting.
- ▶ The Board also requested from the Governor of Puerto Rico a fiscal plan as required by the Act, and addressed other organizational matters, such as:
 1. Adoption of the Board's bylaws
 2. Initial designation of covered entities under the Act
 3. Request of a Fiscal Plan and other information from the Governor of Puerto Rico
 4. Establish a process for the search of the Board's executive director and certain key personnel
 5. Other administrative matters
- ▶ The Board indicated that it expected to hold a meeting in mid-October and another in Puerto Rico in mid-November.

Operations of the Board

- ▶ On October 14, 2016, the Board held its second meeting.

- ▶ Even if Puerto Rico's 3.4 million residents keep tightening their belts, and even if the creditors who lent it \$74 billion agree to less than full repayment, the island will still “need the assistance of the federal government to bring this economic and humanitarian crisis to an end,” said Gov. Alejandro García Padilla, addressing the panel that the Obama administration set up to handle the territory's staggering debt.
- ▶ He urged the board's seven members to join him “in one voice before Congress” to seek help.
- ▶ Twenty floors below the room in Lower Manhattan where the governor made his remarks, protesters chanted their opposition to colonialism – which is how they view the power that the panel holds to make decisions about Puerto Rico's future.
- ▶ It was the first substantive meeting of the board, known in Spanish as the junta, the Spanish word for political group, that Congress created this year to direct Puerto Rico's financial affairs. The group is similar to the control boards that have led other distressed American jurisdictions, like New York City in the mid-1970s. But because of heightened sensitivities about Puerto Rico's colonial history, Congress gave Puerto Rico's governor, and not the board, the authority to draft the 10-year fiscal plan that will become the basic road map for moving Puerto Rico out of its financial troubles.

- ▶ Most of Friday's meeting was devoted to the governor's delivery of his fiscal plan and questions from the board. Next, the board will review the plan and decide whether amendments are needed.
- ▶ Puerto Rico has stopped paying its bondholders and would be mired in creditors' lawsuits by now if Congress had not proscribed most creditors from enforcing their claims for a few months. Lawsuits by creditors could resume as soon as February, which is one reason the governor urged the board to move quickly.
- ▶ "Puerto Rico needs a plan in place immediately," he said.
- ▶ But the board members seemed inclined to proceed cautiously. Puerto Rico's debt structure is dauntingly complex. And all board members are aware that their decisions could set a precedent: The arrangements they make for Puerto Rico could be sought in the future by severely troubled states such as Illinois, Pennsylvania or New Jersey. These states have some of the same problems as Puerto Rico – in particular, unfunded pension promises to retired public workers that are rising so fast that they are crowding out other essential government services and making it more expensive to borrow.

- ▶ Like Puerto Rico, America's states are barred from seeking help under Chapter 9 of the bankruptcy code, the chapter that distressed cities and other local governments can use. But the law that gave rise to the oversight board and the stay on lawsuits, known as Promesa, also gives Puerto Rico certain debt-restructuring powers that are normally available only in bankruptcy. Puerto Rico can use those powers only if a majority of the board members agree.
- ▶ During the meeting, Andrew G. Biggs, a board member who is a resident scholar at the American Enterprise Institute, seemed to be trying to figure out where Puerto Rico's cash had been moved to as the island's troubles accelerated last spring. He asked how much money the government had parked in commercial banks and how far it had fallen behind on paying its vendors.
- ▶ Juan Zaragoza, Puerto Rico's treasury secretary, gave a detailed description of how revenue arrives at the island's treasury and what the government is doing to collect more taxes. He said there were about \$1 billion worth of unpaid bills outstanding, and that the government had written about \$350 million in checks but had not yet sent them — a practice that could make it look as though the bills had been paid, even though vendors have not received their money.
- ▶ That prompted another board member, Carlos M. García, the head of a private equity firm in the Boston area, to question the governor's fundamental premise that Puerto Rico's government lacked enough money to govern.
- ▶ “You're currently at high tax collections, and you're currently not paying debt service,” he said. “Why does the government not have enough money to pay vendors or provide essential services?”

- ▶ Mr. García was a president of the Government Development Bank for Puerto Rico under a previous administration, which was led by a rival political party. He seemed skeptical in general of the governor's description of the island's problems and what had caused them.
- ▶ Mr. García Padilla did not waver. He said his fiscal plan called for Puerto Rico to improve its financial reporting, to merge branches of government to end duplication, to ease certain regulations and to court investors, especially those interested in financing infrastructure and energy projects.
- ▶ The governor also said that current efforts to collect more tax revenue and reduce government spending would continue, but he pleaded with the board not to “double down on austerity.”
- ▶ “You will soon realize that any reduction in spending implies intolerable effects in aggregate demand, and will further throw Puerto Rico into a death spiral that will directly affect creditors' recoveries across the board,” Mr. García Padilla said.
- ▶ Without help from Washington, he warned, the government could end up with a total accumulated debt of \$59 billion over the next 10 years.
- ▶ Federal assistance, Mr. García Padilla suggested, could take the form of improved Medicare and Medicaid programs, and tax measures that could help Puerto Rico become more competitive as an offshore manufacturing site for United States companies.

Board's Personnel: Appointment of Executive Director and the staff of the Oversight Board (§103)

- ▶ At the second meeting, the Board noted that it expects to appoint its executive director by mid-January 2017.
- ▶ The Act also provides for the appointment of a revitalization coordinator. The staff may include private citizens, employees of the federal government or employees of the Commonwealth's government.
- ▶ The executive director and staff of the Board may be appointed and paid without regard to any provision of the laws of the Commonwealth or the federal government governing appointments and salaries, or procurement laws.

Powers of the Board (§104)

- The Board may hold hearings, take testimony and receive evidence as it considers appropriate. It may also obtain official data from the federal government and the Commonwealth's government.
- The Board has subpoena power.
- The Board has jurisdiction to compel the attendance of witnesses and the production of materials.
- If a person refuses to obey a subpoena, the board may apply to the Commonwealth's court of first instance. Failure to obey the court order may be punished by the court in accordance with civil contempt laws of the Commonwealth. The subpoena shall be served in the manner provided by the Commonwealth's Rules of Civil Procedure.

Approval of Fiscal Plans (§201)

- ▶ Pursuant to the Act, the Board shall deliver a notice to the governor providing a schedule for the process of development, submission, approval and certification of fiscal plans, as soon as practicable after all of the members and the chair have been appointed.
- ▶ It is important to note that the governor submitted the CW's fiscal plan at the second meeting held on October 14, 2016.
- ▶ A fiscal plan developed shall endeavor to provide a method to achieve fiscal responsibility and access to the capital markets, and provide for estimates of revenues and expenditures in conformance with agreed-upon accounting standards, and be based on applicable laws or specific bills that require enactment in order to reasonably achieve the projections of the fiscal plan.
- ▶ The Board shall ensure that assets, funds or resources of a instrumentality are not loaned to, transferred to or otherwise used for the benefit of the Commonwealth or an instrumentality, unless permitted by the Constitution or agreed to by a certified voluntary agreement under § 104(i), an approved adjustment plan under title III, or a qualifying modification approved under title VI; and *respect the relative lawful priorities or lawful liens, as may be applicable, in the Constitution, other laws or agreements in effect prior to the date of enactment of this Act.*

Fiscal Plan

- ▶ **The fiscal plan developed and approved by the Board must, among other things:**
 - Ensure that assets, funds, or resources of an instrumentality are not loaned to, transferred to, or otherwise used for the benefit of Puerto Rico or another instrumentality, unless permitted by Puerto Rico's constitution, an approved plan of adjustment, or an approved "Qualifying Modification" (as defined under PROMESA)
 - Respect the relative lawful priorities or lawful liens in the constitution, other laws, or agreements of Puerto Rico or a covered instrumentality.
- ▶ PROMESA purportedly does not discharge obligations of Puerto Rico or its instrumentalities or release, invalidate or impair any security interest or lien securing such obligations.
- ▶ Puerto Rico and its instrumentalities must make interest payments on outstanding debt when such payments become due during the length of the automatic stay, to the extent the Oversight Board determines that making such payments is feasible.
- ▶ PROMESA is not intended to impair or affect the implementation of a restructuring support agreement executed by Puerto Rico or its instrumentalities prior to enactment of PROMESA or to impair or affect the obligations of Puerto Rico or its instrumentalities to proceed in good faith as set forth in such restructuring support agreement. (§ 405)
- ▶ Secured creditors may bring an action to challenge inter-debtor transfers that violate applicable law (§ 407).

Effect of Finding of Noncompliance with Budget (§103)

- ▶ The Board shall deliver a notice to the governor and legislature providing a schedule for developing, submitting, approving and certifying budgets for a period of not less than one fiscal year following the fiscal year in which the notice is delivered.
- ▶ If the governor develops an instrumentality budget that is a compliant budget by the day before the first day of the fiscal year for which the instrumentality budget is being developed, the Oversight Board shall issue a compliance certification to the governor for such budget.
- ▶ Within 15 days from the last day of each quarter, the governor shall submit to the Board a report with the actual cash revenues, cash expenditures and cash flows from the preceding quarter as compared with the projected revenues, expenditures and cash flows included in the certified budget for such preceding quarter.
- ▶ If the Board determines that such information is not consistent with the certified budget for such quarter, the Board shall require the Commonwealth to provide additional information and (2) correct the inconsistency by taking remedial action.
- ▶ If the Board determines that the governor and legislature have failed to correct the inconsistencies identified by the Board, the Board shall (1) make appropriate reductions in debt expenditures to ensure that the actual quarterly revenues and expenditures are in compliance with the certified budget; (2) institute automatic hiring freezes; (3) prohibit the Commonwealth from entering into any contract or engaging in any financial or other transactions, unless the contract or transaction was previously approved by the Board.

Review of Activities to Ensure Compliance with Fiscal Plan, Financial Stability and Management Responsibility (§204)

- The Act includes restrictions on budgetary adjustments.
- The Act specifically states that the legislature shall not adopt a reprogramming, and no officer or employee of the territorial government may not carry out any reprogramming, until the Board has provided the legislature with an analysis that certifies that such reprogramming will not be inconsistent with the fiscal plan and budget.
- The Act provides that *during the period prior to the appointment of all members and the chair of the Board, the Commonwealth shall not enact new laws that either permit the transfer of any funds or assets outside the ordinary course of business or that are inconsistent with the Constitution or laws of the territory as of the date of enactment of this Act, provided that any executive or legislative action authorizing the movement of funds or assets during this time period may be subject to review and reversal by the board upon appointment of the board's full membership.*

Review of Activities to Ensure Compliance with Fiscal Plan, Financial Stability and Management Responsibility (§204)

- ▶ The Board may, at any time, submit recommendations to the governor or the legislature, including recommendations relating to modifications of the types of services that are delivered by entities other than the Commonwealth government under alternative service delivery mechanisms, and the privatization and commercialization of entities within the territorial government.

Oversight Board Duties Related to Restructuring (§206)

- ▶ Prior to issuing a restructuring certification regarding an entity, the Board shall determine, in its sole discretion, that (1) the entity has made good-faith efforts to reach a consensual restructuring with creditors; and (2) *the entity has adopted procedures necessary to deliver timely audited financial statements, and made public draft financial statements and other information sufficient for any interested person to make an informed decision with respect to a restructuring.*
- ▶ The issuance of a restructuring certification under this section requires a vote of no fewer than five (5) Board members in the affirmative, which shall satisfy the requirement set forth in § 302(2) of this Act.

Debt Issuance (§207)

- ▶ During the operations of the Board, the Commonwealth or its instrumentalities may *not*, without the Board's approval, issue debt or guarantee, exchange, modify, repurchase, redeem or enter into similar transactions with respect to its debt.

Adjustment of Debts

- ▶ The Act provides a mechanism for debt restructuring proceedings:
 - Puerto Rico or the covered instrumentality, with the approval of the Oversight Board, may file a petition with the federal district court seeking to restructure its debts.
- ▶ Cases will be similar but to a chapter 9 case, with some distinctions.

Who May Be a Debtor (§302)

- ▶ Puerto Rico entities are considered debtors if (1) a territory that has requested the establishment of an Oversight Board or has had a board established for it by the U.S. Congress; (2) a covered territorial instrumentality of a territory; (3) the Board has issued a restructuring certification under § 206(b) for such entity; and (4) the entity desires to effect a plan to adjust its debts.
- ▶ The issuance of restructuring certificate requires that:
 - ▶ The Commonwealth has completed the process set forth in Title VI;
 - ▶ the entity has adopted procedures necessary to deliver audited financial statements;
 - ▶ the entity has adopted or is subject to a certified fiscal plan;
 - ▶ the entity is insolvent;
 - ▶ and appropriate consideration has been given to the relative priority of claims as established by law so that no one group or class of creditors gain an advantage that did not exist prior to the Board's determination.
- ▶ The approval of at least five (5) of the seven (7) members of the Board.

Eligibility Requirements

- ▶ The entity is Puerto Rico or one of its covered instrumentalities;
- ▶ The Board has issued a certification for such entity;
- ▶ The entity desires to affect a plan to adjust its debts.
- ▶ Prior to permitting an entity to commence a Title III case, the Board, in its sole discretion, must certify that:
 - ▶ The entity has made good-faith efforts to reach a consensual restructuring with its creditors;
 - ▶ The entity has adopted procedures necessary to deliver timely audited financial statements and has delivered draft financial statements and other information sufficient for an interested person to make an informed decision;
 - ▶ The entity has a fiscal plan in place;
 - ▶ No order approving a "qualifying modification" (as provided in section 601 of PROMESA) is in place.

Petition and Proceedings Relating to Petition (§304)

- ▶ The Board, on behalf of debtors, may file petitions or submit or modify adjustment plans jointly if the debtors are affiliates, provided, however, that nothing in this title shall be construed as authorizing substantive consolidation of the cases of affiliated debtors.
- ▶ If the Board, on behalf of a debtor and one or more affiliates, has filed separate cases and the Board, on behalf of the debtor or one of the affiliates, files a motion to administer the cases jointly, *the court may order a joint administration of the cases.*

Petition and Proceedings Relating to Petition (§304)

- ▶ The Act provides that it may not be construed to permit the discharge of obligations arising under federal police or regulatory laws, including laws relating to the environment, public health or safety or territorial laws implementing such federal legal provisions. This includes compliance obligations, requirements under consent decrees or judicial orders, and obligations to pay associated administrative, civil or other penalties.
- ▶ The Act specifically states that nothing in this section shall prevent the holder of a claim from voting on or consenting to a proposed modification of such claim.

Automatic Stay Precludes Most Creditor Remedies

- ▶ Creditors who hold liability claims (generally, bonds, notes and other financial debt obligations) are automatically stayed, or prevented, from taking action against Puerto Rico, its instrumentalities or its property *to collect debts that could have been commenced before the date of enactment.*
- ▶ By its terms, the automatic stay operates as a general moratorium and court-ordered injunction, and no court order is necessary as the injunction is automatically triggered by the enactment of PROMESA.
- ▶ The automatic stay can be enforced by court order if necessary, and violators risk the assessment of damages, costs, and attorneys' fees incurred in defending any action taken in violation of the automatic stay.
- ▶ Unless modified by the federal district court, the automatic stay remains in effect until the later of *February 15, 2017 or six months after the establishment of the Oversight Board for Puerto Rico, subject to extension as provided in section 405(d) of PROMESA.*

Types of action covered by the automatic stay include, but are not limited to, the following:

- ▶ commencing or continuing lawsuits against Puerto Rico, its instrumentalities or its officers;
 - ▶ obtaining possession of the property of Puerto Rico or its instrumentalities or exercising control over property of Puerto Rico or its instrumentalities;
 - ▶ creating, perfecting or enforcing most liens against property of Puerto Rico or its instrumentalities;
 - ▶ setting off any debt owed to Puerto Rico or its instrumentalities against any liability claim owed to such creditor that arose prior to the enactment of PROMESA.
- Any party in interest may ask the district court to relieve it from the automatic stay "for cause". In order to obtain relief, the party in interest will need to show that the hardship to the party in interest will significantly outweigh the hardship to Puerto Rico if the stay remains in place.

Powers of Federal District Court are Limited

- ▶ Section 305 of PROMESA provides that, absent consent by the Oversight Board or a provision in the entity's debt adjustment plan, the federal district court may not, interfere with:
- ▶ Any of the political or governmental powers of the debtor; or any of the property or revenues of the debtor; or the debtor's use or enjoyment of any income-producing property.
- ▶ Thus, the debtor, maintains control of most of its financial affairs and operations to operate and to provide services.

Limitations on Power of Federal District Court

- ▶ **The federal district court may not do the following, absent consent by the Board:**
 - ▶ take over debtor's operations;
 - ▶ remove members of debtor's governing board or appoint a trustee or receiver;
- ▶ **Federal district court powers are generally limited to:**
 - ▶ approving the petition (finding that eligibility criteria have been met);
 - ▶ permitting the assumption or rejection of executor contracts and unexpired leases, including collective bargaining agreements;
 - ▶ approving compensation of professionals;
 - ▶ allowing or disallowing claims; confirming a plan of adjustment; and
 - ▶ monitoring implementation of the plan.

Actions Not Requiring Court Approval

- ▶ Puerto Rico may do the following without court approval (but subject to Board approval):
 - Spend money, use, sell or lease property, including cash collateral (Bankruptcy Code section 363 is not incorporated into a Title III debt adjustment case under PROMESA);
 - Pay debt incurred prior to enactment of PROMESA, if it chooses; and
 - Pay expenses in connection with the operation of the debtor's affairs; and o retain professionals.

Jurisdiction and Venue (§§ 306 & 307)

- ▶ The district courts shall have original and exclusive jurisdiction of all cases under this title; except in those cases where an Act of Congress confers exclusive jurisdiction on a court or courts other than the district courts.
- ▶ The district court, in which a case under this title is commenced or is pending, shall have exclusive jurisdiction of all property, wherever located, of the debtor as of the commencement of the case.
- ▶ The district court in which a case under this title is pending shall have personal jurisdiction over any person or entity.
- ▶ A party may remove any claim or cause of action in a civil action, other than a proceeding before the U.S. tax court or a civil action by a governmental unit to enforce the police or regulatory power of the governmental unit, to the district court for the district in which the civil action is pending, if the district court has jurisdiction of the claim or cause of action under this section

Jurisdiction and Venue (§§ 306 & 307)

- ▶ The district court to which the claim or cause of action is removed may remand the claim or cause of action on any equitable ground.
- ▶ A district court shall transfer any civil proceeding arising under this title, or arising in or related to a case under this title, to the district in which the case under this title is pending.
- ▶ An appeal shall be taken in the same manner as appeals in civil proceedings generally are taken to the courts of appeals from the district court.
- ▶ The court of appeals for the circuit in which a case under this title has venue pursuant to § 307 of this title shall have jurisdiction of appeals from all final decisions, judgments orders and decrees entered under this title by the district court.
- ▶ If the Oversight Board determines, in its sole discretion, that venue shall be proper in the district court for the jurisdiction in which the board maintains an office located outside of Puerto Rico.

Selection of a Presiding Judge (§308)

- ▶ For cases in which the debtor is the Commonwealth, the Chief Justice of the United States shall designate a district court judge to sit by designation to conduct the case.
- ▶ For cases in which the debtor is not the Commonwealth, and no motion for joint administration of the debtor's case with the case of the Commonwealth has been filed, the chief judge of the court of appeals for the circuit shall designate a district court judge to conduct the case.

Applicable Rules of Procedure (§310)

- ▶ The Federal Rules of Court Procedure shall apply to a case under the title and to all civil proceedings arising in or related to cases.
- ▶ The Board may take any action necessary on behalf of the debtor to prosecute the case of the debtor.
- ▶ The Board is the only one that can, after the issuance of a certificate pursuant to § 104(j) of this Act, file an adjustment plan of the debts of the debtor.
- ▶ If the Board does not file an adjustment plan with the petition, the Board shall file an adjustment plan at the time set by the court

Leases (§311)

- ▶ The Act provides that a lease to the Commonwealth or its instrumentalities shall not be treated as an executory contract or unexpired lease for purposes of § 365 or 502(b)(6) of the Bankruptcy Code, solely because the lease is subject to termination in the event that the Commonwealth fails to appropriate rent.

Filing an Adjustment Plan (§312)

- ▶ The Board is the only entity that may file an adjustment plan of debts.
- ▶ If it does not file the plan with the petition, the Board shall file the same at the time set by court.

Plan Exclusivity

- ▶ The Board is the one (not the debtor) may file a plan for adjustment of the debts of the debtor.
- ▶ Creditors may not file competing plans.
- ▶ PROMESA does not fix a specific deadline by which the Oversight Board must file a plan. Section 312 provides that if a plan for adjustment of debts is not filed with the petition, the Oversight Board shall file such plan at such later time as.

Confirmation of Plan

The federal district court may confirm a debt adjustment plan if it meets the following requirements:

- ▶ Complies with the provisions of the Bankruptcy Code made applicable to a Title III case under PROMESA;
- ▶ complies with the provisions of PROMESA;
- ▶ the debtor is not prohibited by law from taking any action necessary to carry out the plan;
- ▶ any legislative, regulatory, or electoral approval necessary under applicable law in order to carry out any provision of the plan has been obtained, or such provision is expressly conditioned on such approval;
- ▶ provides that on the effective date, each holder of an administrative claim will receive on account of such claim cash equal to the allowed amount of such claim;
- ▶ is in the best interests of creditors and is feasible; and
- ▶ is consistent with the applicable fiscal plan certified by the Board.

Confirmation (§314)

- ▶ For confirmation purposes, the plan *shall be feasible and in the best interests of creditors*, which shall require the court to consider whether available remedies under the non bankruptcy laws and constitution of the Commonwealth would result in a greater recovery for the creditors than is provided by such plan; and be consistent with the applicable fiscal plan.
- ▶ Although the Act incorporates the requirements of § 1129(a) of the Bankruptcy Code, it states that if a case includes only one class of impaired claims that has not accepted the plan, the court may confirm the same notwithstanding the requirements of such § 1129(a)(8) *if the plan is fair and equitable and does not discriminate unfairly with respect to such impaired class.*

Role and Capacity of the Board (§315)

- ▶ The Board may take any action necessary to prosecute the case including (1) filing the petition; (2) submitting or modifying an adjustment plan; and (3) submitting filings in relation to the case with the court.
- ▶ The Board is the representative of the debtor.

Compensation of Professionals and Interim Compensation (\$316)

- ▶ After notice to the parties in interest and the U.S. Trustee and a hearing, the court may award to a professional person employed by the debtor (in the debtor's sole discretion), the Board (in the Board's sole discretion), a committee under § 1103 of title 11, U.S. Code, or a trustee appointed by the court under § 926 of title 11, U.S. Code –
 1. reasonable compensation for actual, necessary services rendered by the professional person, or attorney and by any paraprofessional person employed by any such person; and
 2. reimbursement for actual, necessary expenses.
- ▶ The court may, on its own motion or on the motion of the U.S. Trustee or any other party-in-interest, award compensation that is less than the amount of compensation that is requested.

Post petition Financing

PROMESA incorporates Bankruptcy Code sections 364(c) and (d) into a Title III debt adjustment case to enable Puerto Rico or its covered instrumentality to borrow such post petition credit can be incurred on one of three bases

- ▶ An unsecured "super-priority" basis with priority over all priority claims for administrative expenses;
- ▶ Secured but subject to existing liens;
- ▶ Secured by a lien equal or senior to existing lien, if the debtor cannot otherwise obtain credit and if the existing lien holder receives "adequate protection."
- ▶ Administrative expenses that are subordinate to the post petition financing are those expenses incurred directly in connection with the Title III case itself, such as court costs, attorneys' fees, costs of distribution of the plan and solicitation of acceptances

Creditor Collective Action

- ▶ **Consensual Modification of Bond Claims?**
 - Sections 601 and 104(i) of PROMESA provide a process for submission and approval of a voluntary agreement modifying Bond Claims. The modification may be proposed by the issuer of the Bond or by one or more holders of the right to vote the issuer's outstanding Bonds. If proposed by one or more holders of the right to vote, the Board may accept the proposed modification on behalf of the issuer.
- ▶ Pursuant to the Creditor Collective Action provisions of PROMESA two thirds majority of creditors could agree to a restructuring plan that would bind all creditors including those that did not agree to the restructuring.
- ▶ These collective action clauses were incorporated from sovereign debt insurances in Europe to address hold-out creditors in restructuring.
- ▶ These collective action provisions would work parallel to the bankruptcy provisions and would be voluntary. They can retroactively change or alter creditor's rights.
- ▶ Modification is Binding on all Holders. A qualifying modification will be conclusive and binding on all holders of Bonds whether or not they have given consent, and on all future holders of those bonds.

The proposed modification also must be approved by the Board, which must determine and certify that it complies with the conditions in section 104(i)(1) of PROMESA:

- ▶ **Certified by the Board.** If an applicable fiscal plan has been certified, the voluntary agreement with holders of the affected Bond Claims provides for a sustainable level of debt for Puerto Rico or the related issuer, as applicable, and is in conformance with the applicable certified fiscal plan
- ▶ **Not Certified by the Board.** If an applicable fiscal plan has not been certified by the Board, the voluntary agreement provides, in the Board's sole discretion, for a sustainable level of debt for Puerto Rico or the related issuer, as applicable; or
- ▶ The voluntary agreement is limited solely to an extension of applicable principal maturities and interest on Bonds issued by Puerto Rico or the related issuer, as applicable, for a period of up to one year during which no interest will be paid on the Bond Claims affected by the voluntary agreement.
- ▶ Voting requirements set forth in section 601 of PROMESSA have been satisfied;
- ▶ PROMESA provides for certification by the Board of a modification of Bond Claims pursuant to a pre-existing voluntary agreement if the modification is consistent with a restructuring support or similar agreement executed prior to May 18, 2016 by the issuer and holders of a majority in amount of Bond Claims that are to be affected by such modification.

Determination of Pools for Voting and Information Delivery Requirement (§601(d))

- The Act provides that the administrative supervisor, in consultation with each issuer, shall establish pools according to the following principles:
 1. Not less than one pool shall be established for each issuer;
 2. A pool that contains one or more bonds that are secured by a lien on property shall be a secured pool;
 3. For each issuer that has issued multiple bonds that are distinguished by specific provisions governing priority or security arrangements, including bonds that have been issued as general obligations of the Commonwealth to which the Commonwealth pledged the full or good faith, credit and taxing power of the Commonwealth, separate pools shall be established corresponding to the relative priority or security arrangements of each holder of bonds against each issuer.
- Notwithstanding the foregoing, a pre-existing voluntary agreement may classify insured bonds and uninsured bonds in different pools and provide different treatment thereof so long as the pre-existing voluntary agreement has been agreed to by (1) holders of a majority in amount of all uninsured bonds outstanding in the modified pool; and (2) holders (including insurers with power to vote) of a majority in amount of all insured bonds.

Qualified Modification (§601(g))

- ▶ A modification is a qualifying modification if:
 1. The issuer proposing the modification has consulted with holders of bonds in each pool of such issuer prior to soliciting a vote on such modification; or
 2. The modification is certified by the administrative supervisor as being consistent with the requirements set forth in § 104(i)(1) and is in the *best interests of the creditors and is feasible*.

Solicitation (§601(h))

- ▶ Upon receipt of a certification from the administrative supervisor under the subsection, the information agent shall submit to the holders of any outstanding bonds of the relevant issuer information in order to solicit the vote of such holders to approve or reject the qualifying modification.

Who May Propose a Modification (§601(i))

- ▶ For each issuer, a modification may be proposed to the administrative supervisor by the issuer by one or more holders of the right to vote on the issuer's outstanding bonds.
- ▶ To the extent that a modification proposed by one or more holders of the right to vote outstanding bonds, the administrative supervisor may accept such modification on behalf of the issuer.

Voting (§601(j))

- ▶ Requires two-thirds (2/3) majority of the outstanding principal amount of the bonds in each pool.
- ▶ Note: In the case of those outstanding bonds that are insured bonds, the monoline insurer insuring such insured bond shall have the right to vote.

- ▶ The requisite majorities of Holders of the Bonds in the affected pool of the issuer have consented to or approved the modification;
- ▶ **Cramdown.** With respect to a Bond Claim that is secured by a lien on property and with respect to which the holder of such Bond Claim has rejected or did not consent to the qualifying modification, the holder of such Bond retains the lien securing such Bond Claims or receives on account of such Bond Claim, through deferred cash payments, substitute collateral, or otherwise, at least the equivalent value of the lesser of the amount of the Bond Claim or of the value of the collateral securing such Bond Claim;
- ▶ The federal district court, on motion of the applicable issuer, enters an order that the requirements of section 601 have been satisfied. **The voluntary modification may be approved by the federal district court and made binding on all holders only where at least 50% of the principal amount of the affected Bond in the particular pool vote or consent to the voluntary modification and, of those who cast a vote, at least 2/3rds of the aggregate principal amount of the affected Bonds in the particular pool approves the proposed modification.** If so approved by the holders and the federal district court, the modification will bind all affected holders within the applicable pool.

Judicial Review (§601(n))

- ▶ The U.S. District Court for the District of Puerto Rico shall have original and exclusive jurisdiction over civil actions arising under this section.
- ▶ The district court shall nullify a modification and any effects on the rights of the holders of bonds resulting from such modification if and only if the district court determines that such modification is *manifestly inconsistent with this section*

Binding Effect (§601(m))

A qualifying modification will be conclusive and binding on all holders of all series of bonds whether or not they have given such consent if –

1. the holders of the right to vote the outstanding bonds in each pool of the issuer have consented to or approved the qualifying modification; and
2. the administrative supervisor certifies that:
 - A. the voting requirements of this section have been satisfied (that is, the modification obtained two-thirds (2/3) of the votes);
 - B. the qualifying modification complies with the requirements set forth in § 104(i)(1); and
 - C. except for such conditions that have been identified in the qualifying modification as being non-waivable, any conditions on the effectiveness of the qualifying modification have been satisfied or, in the administrative supervisor's sole discretion, satisfaction of such conditions has been waived with respect to a bond claim that is secured by a lien on property and with respect to which the holder of such bond claim has rejected or not consented to the qualifying modification, the holder of such bond –
 - i. retains the lien securing such bond claims; or
 - ii. receives on account of such bond claim, through deferred cash payments, substitute collateral, or otherwise, at least the equivalent value of the lesser of the amount of the bond claim or of the collateral securing such bond claim.

Thank You

In case of questions or copies of this presentation, email Ferraiuoli's Bankruptcy and Creditors' Rights attorneys:

➤ scolon@Ferraiuoli.com Sonia Colón, Chair

Practice Professionals:

➤ jsanmiguel@Ferraiuoli.com Jorge San Miguel
➤ gchico@Ferraiuoli.com Gustavo Chico
➤ jdiaz@Ferraiuoli.com José A. (Josean) Díaz-Brugueras
➤ csomoza@Ferraiuoli.com Camille Somoza

**Program: “The Future of Puerto Rico”
AIRA's Annual Advanced Restructuring and Plan of Reorganization
Conference in New York (“NY POR”)**

By: Sonia Colon, Esq.
Ferraiuoli, LLC

A Review of Puerto Rico’s Economic Fiscal Crisis

By: Sonia Colón
November 11, 2016

Background

The Commonwealth, its municipalities and its public corporations have financed a significant portion of their spending through bond issuances. After using the proceeds of bond issuances for funding infrastructure improvements and recurring expenses, the Commonwealth, its municipalities and its public corporations have amassed an overwhelming amount of debt.

Decades ago, Congress approved tax breaks to spur investments in manufacturing and pharmaceutical businesses on the island. These tax concessions ended completely in 2006. Consequently, businesses began to leave and unemployment began to rise. Moreover, tax revenues no longer were enough to cover the government’s obligations. Rather than dealing with this problem head-on, local leaders began issuing general obligation bonds (GOs) to cover debt payments, exacerbating the problem. Currently, that debt equals approximately \$70 billion, and the Commonwealth can no longer borrow to cover its obligations.

Current Public Debt and Fiscal Crisis

The Commonwealth’s debt aggregates to \$73 billion according to generally accepted figures, and as much as \$167 billion according to recent figures. With a population of approximately 3.5 million, the Commonwealth carries more debt than every U.S. state other than California (population approximately 38 million) and New York (population of approximately 19.5 million). Of the \$73 billion in public debt, approximately \$20 billion is owed by the Commonwealth’s three main public corporations: the Electric Power Authority (“PREPA”); the Aqueduct and Sewer Authority (“PRASA”); and the Highway and Transportation Authority.

The Commonwealth’s debt burden was compounded by at least two other factors. First, the liquidity situation of the Government Development Bank (“GDB”), which has the statutory role of serving as financial adviser and fiscal agent to, inter alia, the Commonwealth’s public corporations. Secondly, the Commonwealth’s public corporations do not have any legal mechanism through which to seek to restructure their debts in an orderly manner. More specific issues that have also contributed to the current fiscal crisis

**Program: “The Future of Puerto Rico”
AIRA's Annual Advanced Restructuring and Plan of Reorganization
Conference in New York (“NY POR”)**

By: Sonia Colon, Esq.
Ferraiuoli, LLC

include:

- Large and complex pile of government debt resulting from the government flouting constitutional debt limit by issuing additional debt through conduits and public companies;
- Failure to meet constitutional requirement to pass a balanced budget in 5 of the last 6 years;
- Failure to meet budgets, which were missed by a wide margin, in 14 of the past 15 years;
- Failure to comply with bond documents to timely report audited financial statements in 10 of the past 13 years. In addition, the Commonwealth has stopped publishing interim reports in favor of inviting certain creditors to sign NDA's to review certain financial information in a blatant program of selective disclosure;
- PREPA corruption scandal and PRASA complaint;
- Due to lack of internal controls, the U.S. Department of Justice has listed several Commonwealth government agencies as high risk;

• Secretly hired bankruptcy advisors and prepared a bankruptcy bill before issuing \$3.5 billion of GO debt in March 2014. Two days after the closing, the bankruptcy bill was filed on the senate floor and the Treasury and GDB issued a press release disclaiming any knowledge of the bill. On June 28, 2014 Puerto Rico enacted Act No. 71, also known as the “Puerto Rico Public Corporation Debt Enforcement and Recovery Act”.

**Puerto Rico Public
Corporation Debt
Enforcement and
Recovery Act (the
“Recovery Act”)**

The purpose of the Recovery Act, also known as “La Quiebra Criolla.” was to provide for a mechanism to address the “state of fiscal emergency” facing some of the Commonwealth’s public corporations and potentially jeopardizing their ability to continue to provide essential public services. The Recovery Act sought to end the exclusion in the Bankruptcy Code by giving the Commonwealth’s public corporations access to a new bankruptcy-like regime, through which the debts of the Commonwealth’s public corporations could potentially be restructured without unanimous creditor consent pursuant to two procedures, before a newly created local court.

It provided for a consensual debt amendment procedure order Chapter 2 that would bind an entire class of creditors to a court-supervised restructuring transaction if at least fifty percent (50%) of the creditors in that class voted and at least seventy-five percent (75%) of participating voters approved. In other words, Chapter 2 regulates a consensual debt relief process, which provides a

**Program: “The Future of Puerto Rico”
AIRA's Annual Advanced Restructuring and Plan of Reorganization
Conference in New York (“NY POR”)**

By: Sonia Colon, Esq.
Ferraiuoli, LLC

mechanism for eligible public corporations to adopt a recovery program with minor court intervention.

Chapter 3 of the Recovery Act (“Chapter 3”) also provided for a more traditional bankruptcy process including a Commonwealth’s court confirmation of a restructuring plan, with the potential to a “cramdown” dissenting creditors. The debt enforcement process contemplated in Chapter 3 is similar to the procedures found in Chapters 9 and 11 of the Bankruptcy Code.

Franklin California Tax-Free Trust, et al., v. Commonwealth of Puerto Rico, et al.

On June 29, 2014, Franklin California Tax-Free Trust, Oppenheimer Rochester Fund Municipals, and Blue Mountain Capital Management LLC filed complaints against the Commonwealth and its Governor, challenging the constitutionality of the Recovery Act. Plaintiffs contended that the Commonwealth was preempted from enacting the Recovery Act and the District Court of the United States for the District of Puerto Rico (the “District Court”) on February 6, 2015 ruled in favor of plaintiffs, declaring the Recovery Act as preempted by the Bankruptcy Code.

On Feb. 6, 2015, the District Court issued an opinion striking down the Recovery Act as unconstitutional. Specifically, the District Court granted PREPA bondholders’ motion for summary judgment that the Recovery Act is “preempted by the federal Bankruptcy Code” and is therefore “void under the Supremacy Clause of the United States Constitution,” i.e., the exclusive authority of the U.S. Congress to prescribe bankruptcy laws. The matter was appealed to Court of Appeals for the First Circuit. The Court of Appeals confirmed the holding of the District Court on July 6, 2015. The Commonwealth of Puerto Rico appealed the decision and, ultimately, the Supreme Court of the United States upheld the Court of Appeals decision on June 13, 2016 by holding that the Bankruptcy Code pre-empts Puerto Rico’s Recovery Act.

Puerto Rico Chapter 9 Uniformity Act of 2015

The Chapter 9 Uniformity Act of 2015 (the “Uniformity Act”) was filed in Congress as H.R. 870. The bill sought to amend the Bankruptcy Code to allow the Commonwealth’s public corporations to avail themselves of Chapter 9 of Title 11 of the Bankruptcy Code (“Chapter 9”) relief to the extent they are insolvent since Puerto Rican public entities and governmental units are not eligible to seek bankruptcy protection under Chapter 9. This would allow various state agencies to then make use of Chapter 9 bankruptcy laws to undergo a smooth set of legal proceedings much like the City of Detroit has since filing for bankruptcy on July 18,

**Program: “The Future of Puerto Rico”
AIRA's Annual Advanced Restructuring and Plan of Reorganization
Conference in New York (“NY POR”)**

By: Sonia Colon, Esq.
Ferraiuoli, LLC

2013.

Within the definition of State, Congress redacted the following: The term “State” includes the District of Columbia and Puerto Rico, except for the purpose of defining who may be a debtor under Chapter 9. Thus, Congress expressly excluded the applicability of Chapter 9 for Puerto Rican municipalities.

The problem with the proponents of inclusion of the Commonwealth in Chapter 9 is that they concentrate only on debt restructuring, and omit reference to fiscal problems. Although the purpose of Chapter 9 is to provide a financially-distressed municipality protection from its creditors while it develops and negotiates a plan for adjusting its debts, the Commonwealth’s public corporations need much more than debt-negotiation. They need to implement meaningful fiscal reforms in order to improve efficiency, transparency and internal controls.

Many of those involved considered that the Commonwealth’s government needs to implement meaningful fiscal and structural reforms in order to improve efficiency, transparency and internal controls. For instance, the government could: centralize and better manage procurement, including procurement of federal funds; consolidate and rationalize government from 78 municipalities and 134 government agencies; implement a privatization program in order to remove over ¼ of the debt from the government’s balance sheet allocated to government employment; device a regulatory reform; modernize labor laws, permitting laws, etc.; and, make the island an attractive place to invest and employ.

Congressional Hearings

Thereafter, Congress expanded congressional hearings to evaluate different issues related to the fiscal crisis. However, credibility has been an issue given the Commonwealth’s failure to produce audited financial statements. The Commonwealth mostly relies on the Anne Krueger Report which outlines the key fiscal challenges facing Puerto Rico. In July 2015, Anne Krueger, Ranjit Teja and Andrew Wolfe, put out an excellent, independent summary of Puerto Rico’s fiscal challenges. They argue Puerto Rico should adopt various structural reforms, namely urging that “local laws that raise input costs should be liberalized and obstacles to the ease of doing business removed”. They also suggested that public enterprise reform should be another key strategy in returning to fiscal solvency.

In a presentation before Congress, Carlos Colón de Armas, Ph.D., noted that contrary to what most people are saying,

**Program: “The Future of Puerto Rico”
AIRA's Annual Advanced Restructuring and Plan of Reorganization
Conference in New York (“NY POR”)**

By: Sonia Colon, Esq.
Ferraiuoli, LLC

the available evidence indicates that the fiscal crisis was not caused by a weakening economy. The downward trends in the economy began almost three decades before the fiscal problems started; public expenses started to get out of line at the same time that General Fund revenues were increasing at a healthy pace. The Government sacrificed limited borrowing capacity (that should have been utilized to finance public investment) to finance spending. As a result, a fragile economy experienced a significant loss of investments and further deteriorated. Fixing the economy, while necessary, will not repair the fiscal crisis. To fix the latter, the Government must cut spending. To fix the economy, public and private investments must increase and the business climate must improve.

Defaults

On May 1, Puerto Rico defaulted on \$370 million in bond payments. Moreover, Government Development Bank (“GDB”) bondholders sued to challenge aspects of a the Debt-Moratorium Law that island officials say is crucial to maintaining essential services as the U.S. territory struggles under a nearly \$70 billion debt load. GDB bondholders argue that amendments to the law prioritize the rights of certain creditors at the expense of others in violation of U.S. and Puerto Rican law.

Gov. Alejandro García Padilla said the lawsuit’s challenge of the Debt Moratorium and Financial Recovery Act could affect the Commonwealth’s ability to have police in the streets, teachers in the classrooms and nurses in hospitals. He said because Congress excluded Puerto Rico from the Bankruptcy Code in 1984 without any explanation, and the federal courts have impeded past attempts to create a local bankruptcy law, the Act is the Commonwealth’s only option to restructure its debt.

Other creditors also challenged an executive order issued this year by García Padilla to “claw back” revenue supporting different bonds and use the money for to pay for essential services and government debt obligations. Furthermore, on May 2016, bond insurer Ambac Assurance Corp. filed suit to seek the appointment of a receiver at the Puerto Rico Highways & Transportation Authority, charging that the government was illegally taking money from the public corporation to pay for other debts.

On July 1, 2016, there was a \$2 billion payment due by the Commonwealth Puerto Rico. That amount includes more than \$700 million in GOs that are guaranteed repayment under the island’s constitution. However, Puerto Rico defaulted on \$911 million dollars, not covering payments

Program: “The Future of Puerto Rico”
AIRA's Annual Advanced Restructuring and Plan of Reorganization
Conference in New York (“NY POR”)

By: Sonia Colon, Esq.
Ferraiuoli, LLC

The Puerto Rico
Oversight, Management
and Economic Stability
Act (“PROMESA”)

due in GOs.

On June 30, 2016 President Obama signed into Law the Puerto Rico Oversight, Management, and Economic Stability Act” or “PROMESA.” PROMESA establishes a Financial Oversight and Management Board (the “Oversight Board”), “a process for restructuring debt, and expedited procedures for approving critical infrastructure projects.” The Oversight Board will consist of seven members appointed by the President to oversee the island’s government and help restructure its debt in federal court, in a process similar to bankruptcy, and oversee the island’s finances. It allows the Oversight Board to negotiate with investors and decide what they would recover from the roughly \$70 billion they lent the island. In addition, the Oversight Board “oversee[s] the development of budgets and fiscal plans for Puerto Rico’s instrumentalities and government. The board may issue subpoenas, certify voluntary agreements between creditors and debtors, seek judicial enforcement of its authority, and impose penalties.”

Other responsibilities of the Oversight Board include: “approving the governor’s fiscal plan; approving annual budgets; enforcing budgets and ordering any necessary spending reductions; and reviewing, laws, contracts, rules, regulations, or executive orders for compliance with the fiscal plan.” The Oversight Board will act as the representative of the debtor, the Commonwealth. Moreover, the “establishment of the [Oversight Board] operates as an automatic stay of creditor actions to enforce claims against the government of Puerto Rico.” In other words, under PROMESA, investors may not sue Puerto Rico while the Oversight Board does its work, and all the island’s creditors could face a loss despite recent lobbying from Wall Street interest groups.

The success of PROMESA will depend largely on who is named to the seven-member oversight board.

On August 24, 2016, President Obama appointed the following members to the board:

- Arthur Gonzalez, senior fellow at New York University’s school of Law and former Chief Judge of the U.S. Bankruptcy Court for the Southern District of New York
- Carlos Garcia, former president of Puerto Rico’ Government Development Bank and Chief Executive officer of BayBoston Managers, LLC
- Andrew Biggs, resident scholar at the American

Program: “The Future of Puerto Rico”
AIRA's Annual Advanced Restructuring and Plan of Reorganization
Conference in New York (“NY POR”)

By: Sonia Colon, Esq.
Ferraiuoli, LLC

Enterprise Institute

- David Skeel, University of Pennsylvania law professor
- Jose Carrion III, former chairman of the boards of the Puerto Rico government’s State Insurance Fund and Automobile Accident Compensation Administration.
- Jose Ramon Gonzalez, president and chief executive officer of the Federal Home Loan Bank of New York
- Ana Matosantos, served as California’s budget director from 2009 to 2013

The president appointed the members of the Board from lists provided by congressional leaders from both parties. In making the appointments, President Obama stated that “[w]ith a broad range of skills and experiences, these officials have the breadth and depth of knowledge that is needed to tackle this complex challenge and put the future of the Puerto Rican first”.

On September 30, 2016, the Board held its first meeting to elect a chairman and to address other organizational matters. The members of the Board elected José B. Carrión as the chairperson at the meeting. The Board also requested from the Governor of Puerto Rico a fiscal plan as required by the Act, and addressed other organizational matters, such as:

- Adoption of the Board’s bylaws
- Initial designation of covered entities under the Act
- Request of a Fiscal Plan and other information from the Governor of Puerto Rico
- Establish a process for the search of the Board’s executive director and certain key personnel
- Other administrative matters

On October 14, 2016, the Board held its second meeting. At the second meeting, the Board noted that it expects to appoint its executive director by mid-January 2017. The Act also provides for the appointment of a revitalization coordinator. The staff may include private citizens, employees of the federal government or employees of the Commonwealth’s government. The executive director and staff of the Board may be appointed and paid without regard to any provision of the laws of the Commonwealth or the federal government governing appointments and salaries, or procurement laws.

Promesa and Chapter 9

PROMESA is not Chapter 9 bankruptcy. Its proponents state that Chapter 9 of the Bankruptcy Code governs

Program: “The Future of Puerto Rico”
AIRA's Annual Advanced Restructuring and Plan of Reorganization
Conference in New York (“NY POR”)
By: Sonia Colon, Esq.
Ferraiuoli, LLC

adjustments of debt for municipalities and instrumentalities of sovereign states with Tenth-Amendment protections, not territories such as Puerto Rico. Under Chapter 9, creditors are afforded only limited protections while local governments retain complete control over their finances and have the exclusive authority to propose plans to adjust their own debt. Under PROMESA, the Oversight Board – mandated to achieve fiscal responsibility and access to capital markets for the island – must facilitate consensual negotiations with creditors, require Puerto Rico to balance its budgets and, produce audited financial statements. Only if the Commonwealth and its creditors fail to reach a consensual deal, and after balanced budgets and audited financials, may the Board vote – with a supermajority of five out of seven members – to authorize the courts to oversee an orderly restructuring process. Even then, the Oversight Board retains the sole authority to propose plans to adjust the Commonwealth’s debt, which can only be confirmed by a court if they are in the best interest of creditors.

PROMESA treats all creditors fairly by upholding both the U.S. Constitution and the Commonwealth’s Constitution. The Oversight Board will honor creditor contracts, protecting the integrity of existing lawful priorities, classes, and liens. PROMESA also includes built-in protections ensuring states can never use this as a precedent, debunking claims this act will cause “market contagion” or legal precedent.

Prospects

“Puerto Rico bonds are already trading with the expectation that they won’t be repaid on time and in full. General obligations maturing in 2035, one of the most frequently traded securities, are currently being exchanged at an average 65.6 cents on the dollar to yield 12.9 percent,” data compiled by Bloomberg show. That price has tumbled from 93 cents in March 2014, when they were first sold to investors.

The Commonwealth’s fiscal crisis has been escalating since last June, when Governor García Padilla said the administration couldn’t afford to repay \$70 billion of debt left by years of borrowing to cover budget shortfalls as the economy contracted and residents left at record pace for the U.S. mainland. Accordingly, PROMESA has the best potential in bringing economic stability to the Commonwealth.

The anticipated restructuring will have to balance the government’s obligations to bondholders against those to

Program: “The Future of Puerto Rico”
AIRA's Annual Advanced Restructuring and Plan of Reorganization
Conference in New York (“NY POR”)
By: Sonia Colon, Esq.
Ferraiuoli, LLC

public workers and retirees. Puerto Rico and its agencies owe bondholders \$70 billion and the island’s three retirement systems have an unfunded liability of about \$43 billion. Hedge funds holding the commonwealth’s general-obligation bonds filed a lawsuit in July against Garcia Padilla, claiming the administration is re-directing cash in violation of its constitution.

The federally appointed control board will oversee the commonwealth’s budget and any debt reduction, which can now be enforced by a court, similar to a municipal bankruptcy. The board will designate a chair within 30 days of the panel’s formation, according to the law. The federal legislation doesn’t specify how to prioritize its many bonds --- which are backed by various revenues and legal protections --- and it requires that any fiscal plan “provide adequate funding for public pension systems.”

The key aspects of PROMESA are as follows:

Automatic stay upon enactment. PROMESA imposes an automatic stay on all litigation against Puerto Rico and its instrumentalities, as well as any other judicial or administrative actions or proceedings to enforce or collect claims against the government. This stay, which is unique in its breadth and scope, will remain in effect until February 15, 2017 and can be extended for an additional 75 days by the Oversight Board that PROMESA creates to oversee the Puerto Rican economy, or for 60 days by the US District Court for Puerto Rico.

Oversight board.

Adjustment of debts.

Economic recovery measures.