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Puerto Rico's Public Debts: Accumulation and Restructuring

May 10, 2021

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R46788

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SUMMARY

R46788

May 10, 2021

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Puerto Rico's Public Debts: Accumulation and Restructuring

Puerto Rico's public debts totaled just over $70 billion when the Puerto Rico Oversight, Management, and Economic Stability Act (P.L. 114-187; PROMESA) became law on June 30, 2016. Most of those debts are now in the midst of perhaps the largest restructuring of public debt in U.S. history. By way of comparison, the City of Detroit had about $18 billion in debt when it entered bankruptcy in 2013. Puerto Rico's debt restructuring could also become one of the most expensive ever, with professional fees projected to exceed $1 billion. The precarity of Puerto Rico's fiscal troubles became widely known in mid-2013. The restructuring of Puerto Rico's public debts could inform future federal responses to fiscal strains faced by some state and local governments.

PROMESA created two paths for debt restructuring and established a Financial Oversight and Management Board (FOMB; Oversight Board). Title III established a debt restructuring process that draws on the Bankruptcy Code. Title VI set up a debt restructuring process similar to some sovereign debt procedures. U.S. District Court Judge Laura Taylor Swain was chosen to preside over Title III cases. PROMESA conditioned the Oversight Board's termination on Puerto Rico's ability to access "short-term and long-term credit markets at reasonable interest rates." Restructuring of the island's debts is a likely prerequisite to that access. The Oversight Board, after delays due to Hurricanes Irma and María in September 2017, led efforts to restructure the island's public debts through litigation and negotiations with the Puerto Rican government, hedge funds, bond insurers, and others.

Puerto Rico's public debts fall into four categories: general obligation (GO) bonds and other debt payable through the main Treasury accounts of the Commonwealth of Puerto Rico (CPR); sales-tax-backed debt known by its Spanish acronym COFINA and other revenue-backed debt; debt of public corporations such as the Puerto Rico Electric Power Authority (PREPA); and debt issued by local county-like governments (*municipios*) and other smaller entities. In February 2019, a federal district court judge confirmed the plan to restructure COFINA debt. Bonds with a par value of $17.6 billion were then exchanged for $12 billion in new bonds. After several postponements in proceedings to restructure debts of the island's central government, in early February 2021 the Oversight Board announced an agreement with "certain bondholders" to restructure GO and related debts. The Board filed the corresponding amended plan with the Title III court on March 8, 2021. The following day, the Board filing suggested an agreement with pension bondholders was near. Implementation of plans requires confirmation by the Title III court.

This report outlines the accumulation of the island's public debts and how they are being restructured. Puerto Rico has faced a series of fiscal challenges since its postwar economic development strategy of industrialization faltered in the early 1970s, including acute budget crises in 2006-2007 and 2013-2016. The island's lack of access to a means to restructure its debts led to PROMESA's enactment. This report focuses on the largest parts of the island's public debt. For brevity's sake, it discusses restructuring of debts issued by PREPA, the Highways and Transportation Authority (HTA), and smaller public corporations only in passing. The Puerto Rico Aqueduct and Sewer Authority's (PRASA's) relatively stronger finances have kept it from having to restructure its bonds.

Hedge funds, which generally tolerate more financial risk than many traditional investors, have played prominent roles in Puerto Rico's debt restructuring. As default risks on Puerto Rican public debt became evident, many mutual funds reduced their holdings, allowing some hedge funds to increase theirs. In spring 2020, some accused hedge funds of trading on private information obtained through confidential Title III negotiations. In June 2020, Judge Swain required parties to disclose more about their holdings. Once those disclosures were made, some called for investigations of alleged trading on nonpublic information obtained in debt negotiations. Legislation was introduced during the 116th Congress (e.g., H.R. 6975, H.R. 683, S. 1675) to amend PROMESA in ways that could affect debt restructuring processes. On February 24, 2021, the House passed H.R. 1192, which would mandate certain disclosures by professionals working on the island's debt restructuring. A companion bill (S. 375) was introduced in the Senate. This report's Appendices include a more detailed listing of Puerto Rico's pre-PROMESA public debts, an analysis of the evolution of bond prices and trading volumes during the restructuring process, a chronology of selected events, and a glossary of abbreviations in English and Spanish.

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Introduction

Puerto Rico's public debts, which totaled just over $70 billion when the Puerto Rico Oversight, Management, and Economic Stability Act (P.L. 114-187; PROMESA) became law on June 30, 2016, are now in the midst of one of the largest restructurings of public debt in U.S. history. Puerto Rico's fiscal troubles fell under national scrutiny during summer 2013, after the City of Detroit's bankruptcy filing reminded investors that municipal bonds are not risk free, and after the financial press noted the precarious state of Puerto Rico's public finances.[1] Beyond the consequences for the island, likely to last decades, the restructuring of Puerto Rico's public debts could inform future federal responses to fiscal strains faced by some state and local governments.[2]

PROMESA, among other provisions, created two paths for debt restructuring: one that draws on the Bankruptcy Code and another that is similar to some sovereign debt procedures. It also established a Financial Oversight and Management Board (FOMB; Oversight Board) and empowered it to represent the Puerto Rican government in those debt restructuring processes. Those processes have included extensive litigation and negotiations with the Puerto Rican government, hedge funds, bond insurers, and other creditors. Destruction caused by Hurricanes Irma and María in September 2017, gubernatorial turnover, and the complexity of litigation have delayed debt restructuring.

PROMESA conditions the Oversight Board's termination on Puerto Rico's ability to access "short-term and long-term credit markets at reasonable interest rates."[3] Completing the process of restructuring the island's debts into a fiscally sustainable form is a likely prerequisite to that access.

The City of Detroit, by way of comparison, had about $18 billion in debt when it entered bankruptcy in 2013.[4] Puerto Rico's public debts, which totaled over $70 billion before including unfunded pension liabilities, are about four times larger than that sum. Puerto Rico could also become one of the most expensive restructurings ever, with professional fees that might exceed $1.4 billion.[5]

Disputes over the relative priority of general obligation (GO) debt claims and claims of sales-and-use-tax-backed debt were a central point of contention in the debt restructuring process. The Oversight Board decided to first restructure the sales tax-backed bonds—known as COFINA bonds after their Spanish acronym.[6] In August 2018, the Board reached an agreement with COFINA bondholders on a split of sales tax revenues between COFINA debt service and Puerto

[1] Andrew Bary, "Troubling Winds: Puerto Rico's Huge Debt Could Overwhelm Attempts to Revive its Economy," *Barron's*, August 26, 2013.

[2] For instance, one bankruptcy lawyer stated that Puerto Rico's debt restructuring process would "almost certainly shape future municipal restructurings." David R. Doyle, "The Puerto Rico 'Bankruptcy': a Cheat Sheet," American Bankruptcy Institute, https://www.abi.org/feed-item/the-puerto-rico-%E2%80%9Cbankruptcy%E2%80%9D-a-cheat-sheet.

[3] PROMESA §209 also requires implementation of modified accrual accounting standards and balanced budgets.

[4] Roni A. Elias, "A Lesson From Detroit: Ways to Make Municipal Bankruptcy More Rare and Less Painful," *Federal Lawyer*, May 2017, p. 70, https://www.fedbar.org/wp-content/uploads/2017/05/bankruptcy_elias-pdf-1.pdf.

[5] Christian Ramos Segarra and Rosario Fajardol, "$832 Million in Attorney Fees for Puerto Rico Bankruptcy Process," *Weekly Journal/El Vocero*, January 27, 2021, https://www.theweeklyjournal.com/business/832-million-in-attorney-fees-for-puerto-rico-bankruptcy-process/article_e6b6a3f4-6027-11eb-af4c-e796e78d7a4c.html.

[6] COFINA is the Corporación del Fondo de Interés Apremiante de Puerto Rico. **Appendix D** lists commonly used abbreviations and acronyms.

Rico's central government, the Commonwealth of Puerto Rico (CPR). That agreement became a plan that a federal district court judge confirmed on February 4, 2019, clearing the way to a restructuring of Puerto Rico's COFINA debt, which, at that time, represented nearly one-quarter of the island's outstanding public debt.[7] Bonds with a par value of $17.6 billion were then exchanged for $12 billion in new bonds.[8]

On February 23, 2021, the Oversight Board announced a revised plan agreed to by "certain bondholders" to restructure the island's GO bonds and certain other central government debts.[9] The plan, if implemented, would reduce the CPR's debt service obligations substantially, albeit by less than a plan put forth in October 2020. The Board filed a disclosure statement describing the amended plan with the Title III court on March 8, 2021.[10] Confirmation by the Title III court would be required to implement that plan, as well as other plans currently being negotiated.

This report outlines the accumulation of Puerto Rico's debt and the restructuring of the island's public debt through processes established by PROMESA. Puerto Rico's postwar economic development strategy of industrialization, as noted below, faltered after the 1973 energy crisis. Acute fiscal crises in 2006-2007 and 2013-2016 resulted in debt levels that could neither be sustained nor addressed through the Bankruptcy Code, which led to PROMESA's enactment.

This report focuses on the largest portions of the island's public debt. For brevity's sake, it omits discussion of pensions and the restructuring of public corporations, such as the Puerto Rico Electric Power Authority (PREPA), the Highways and Transportation Authority (HTA), and smaller entities. Also, the Puerto Rico Aqueduct and Sewer Authority's (PRASA's) somewhat stronger financial position has enabled it to avoid the need to seek a restructuring of its bonds.[11]

The report's Appendices include a summary of the structure of Puerto Rico's pre-restructuring public debts, an analysis of the evolution of prices and trading volumes of selected bonds during the restructuring process, a chronology of selected events, and a glossary of abbreviations in English and Spanish.

The Long Build-Up to Puerto Rico's Debt Crisis

Over the past few decades, Puerto Rico's government has struggled to collect sufficient revenues to cover outlays, which led to rising public debt levels and growing unfunded pension liabilities.[12]

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[7] Laura Taylor Swain, U.S. District Judge, "Memorandum of Opinion and Order Approving Settlement Between Commonwealth of Puerto Rico and Puerto Rico Sales Tax Financing Corporation," February 4, 2019, at https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=OTAzMDUx&id2=0.

[8] Robert Slavin, "COFINA Swaps Out Bonds in Biggest U.S. Muni Restructuring," *Bond Buyer*, February 12, 2019.

[9] Oversight Board, "Oversight Board Reaches Agreement in Principle on Debt: Creditors Holding About $7 Billion of General Obligation and Public Building Authority Bonds Committed; Mediation Continues to Gain Support Across Broad Spectrum of Creditors," press release, February 10, 2021, https://drive.google.com/file/d/149MrGro7s_q6W5tc8QoxLpwRo8NArnYR/view. Also see Oversight Board, "New Debt Agreement Opens Path to Exit From Bankruptcy," press release, February 23, 2021, https://drive.google.com/file/d/1go1HKPzYdtGFVFSfEotCgGDW7THhtn0j/view.

[10] In re: CPR, Oversight Board, *Second Amended Title III Joint Plan Of Adjustment of the Commonwealth of Puerto Rico, et al.*, March 8, 2021, https://drive.google.com/file/d/1IP-znS391lEFMcg35u6flHfcndndyxec/view.

[11] The federal government agreed to reduce debt service on Clean Water State Revolving Fund Programs, the Drinking Water State Revolving Fund Programs, and the U.S. Department of Agriculture's Rural Development (RD) Program. See PRASA, *2020 Fiscal Plan*, June 29, 2020, pp. 3-60, 3-61, https://www.aafaf.pr.gov/wp-content/uploads/2020-Fiscal-Plan-for-PRASA-as-Certified-by-FOMB-on-June-29-2020.pdf.

[12] For more information, see CRS Report R44095, *Puerto Rico's Current Fiscal Challenges*, by D. Andrew Austin.

Postwar Development Strategy Made Puerto Rico a Model

From the onset of World War II in 1939 until the 1973 energy crisis, Puerto Rico had been put forth as a model for economic development through industrialization supported by generous tax incentives.[13] That energy crisis, along with broader changes in the global economy including heightened trade competition from middle-income countries, brought Puerto Rico's postwar era of rapid economic progress to an end.[14]

During the 20th century, Puerto Rico closed much of the gap with the mainland in per capita income, literacy, and health status.[15] Nonetheless, by the 1970s Puerto Rico was still far poorer, in terms of median household income, than the poorest mainland state. Since then, that income gap has narrowed more slowly.[16] Despite the economic slowdown in the 1970s, public debt levels remained nearly steady before increasing in the mid-1980s, as shown in **Figure 1**. By 2014, the island's public debt reached a level roughly equivalent to its gross national product (GNP).[17]

Public corporations, which provide electricity, water, transportation, and other publicly provided services, accounted for much of that accumulation of debt. Puerto Rico's central government, whose budgets were considered separate from its public corporations, kept revenues and outlays roughly in balance until 2000, when outlays began to consistently outpace revenues.[18]

The 2006 Budgetary Crisis

In 2006, the Puerto Rican legislature and then-Governor Aníbal Acevedo Vilá reached an impasse on a budget and how to address looming fiscal challenges. By late 2006, after credit rating agencies downgraded the island's GO bonds nearly to junk status, island officials and their financial advisors soon came to view bonds backed by sales tax revenues as one way to manage fiscal challenges.

Tax-Backed COFINA Bonds Provided Stop-Gap Financing

Seeking to pay off old debts incurred without a clear means of repayment, the island's legislature and governor enacted measures in the second half of 2006 that set up a securitization of a new

[13] Terrence Farrell, "Arthur Lewis and the Case for Caribbean Industrialisation," *Social and Economic Studies*, vol. 29, no. 4 (December 1980), pp. 52-75, http://www.jstor.org/stable/27861908. According to one recent analysis, "real [gross domestic product] GDP per capita increased at a rate of 5.3 percent between 1950 and 1974." John Devereux, "Arrested Development? Puerto Rico in an American Century," *Journal of Economic History*, vol. 79, no. 3 (September 2019), pp. 708-735.

[14] See CRS Report R44095, *Puerto Rico's Current Fiscal Challenges*, by D. Andrew Austin. Congressional clients may request a longer memorandum version.

[15] Brian Marein, "Economic Development in Puerto Rico after US Annexation: Anthropometric Evidence," *Economics & Human Biology*, vol. 38, August 2020.

[16] The 1990 Census found Puerto Rico's median household income was 44% of Mississippi's and 30% of the U.S. estimate. The 2014-2018 American Community Survey found Puerto Rico's median household income was 46% of Mississippi's and 33% of the U.S. estimate.

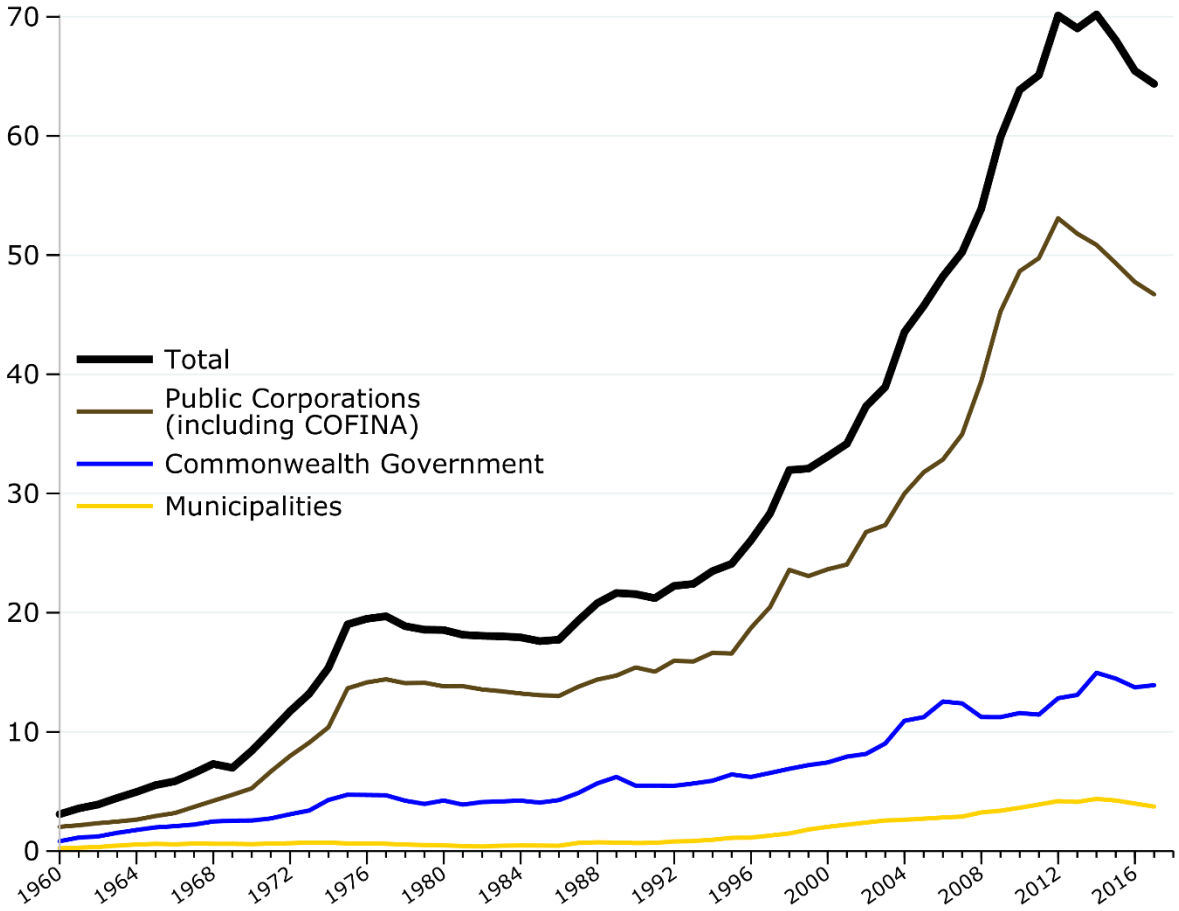
[17] Government Development Bank (GDB), *Commonwealth Quarterly Financial Report*, July 17, 2014, pp. 41-42, http://www.gdb-pur.com/documents/CommonwealthQuarterlyReport71714.pdf; and Commonwealth of Puerto Rico, *Consolidated Annual Financial Report for FY2013*, note 22, pp. 230-231, http://www.hacienda.gobierno.pr/downloads/pdf/cafr/FINANCIAL_REPORT_2013.pdf. GNP, which measures the island's total income, is typically used to measure the Puerto Rican economy because gross domestic product (GDP) is distorted by the tax avoidance strategies of multinational corporations with Puerto Rican subsidiaries.

[18] Carlos A. Colon de Armas, "La Constitución de Puerto Rico y su Requisito de un Presupuesto Balanceado," *Revista Jurídica Universidad de Puerto Rico*, vol. 85, no. 3 (2016), pp. 819-832, esp. Table 2.

5.5% sales and use tax, which replaced an excise tax.[19] The tax-backed bonds were able to obtain a high credit rating, and thus could be issued with a lower yield, reducing debt service costs to the Puerto Rican government.

Figure 1. Puerto Rico's Public Debt, 1960-2017

In billions of constant (FY2017) dollars



Source: *Statistical Appendix (Apéndice Estadístico),* various years; available at https://web.archive.org/web/20160831062749/http://www.jp.gobierno.pr/Portal_JP/Default.aspx?tabid=184.

Notes: Data represent gross public debt of Puerto Rico as of June 30 of each year, provided by the Government Development Bank of Puerto Rico. Figures for 1989 and 2014 were preliminary estimates. HTA and the University of Puerto Rico are included in the Commonwealth Government subtotal. The U.S. GDP price index is used to adjust levels for inflation. Recent *Apéndices Estadístico* omit debt data.

COFINA was established as a public corporation controlled by the Government Development Bank (GDB) to issue bonds backed by half of the proceeds of the new tax, which were divided between senior bonds carrying stronger investor protections and junior (subordinate) bonds.[20]

[20] COFINA (*Corporación del Fondo de Interés Apremiante*), known in English as the Puerto Rico Sales Tax Financing Corporation, was established by Act 91-2006, enacted May 13, 2006, http://www.lexjuris.com/lexlex/leyes2006/lexl2006091.htm; Act 117-2006, enacted July 4, 2006 (established sales and use tax); Act 291-2006, enacted December

COFINA provided funds to the Puerto Rican government and helped service its debts, but its proceeds were not tied to infrastructure projects. Instead, funds covered past debts and continuing operating budget deficits—a process termed "scoop and toss."[21] The legal status of COFINA and its relation to fiscal provisions in the Puerto Rican Constitution later became a central point of contention in debt restructuring litigation and negotiations, as subsequent sections will discuss.

As the Great Recession of 2007-2009 strained Puerto Rico's economy and public finances, more COFINA bonds were issued. Those bonds were viewed as a more favorable financing option because they carried better credit ratings than CPR GO debt and thus could be issued with a lower yield. The last COFINA bonds were issued in 2011.[22] From 2009 through 2011, former Oversight Board member Carlos García held senior posts in GDB, including serving as its president. From 2001 through 2006, García worked at Banco Santander, which helped place Puerto Rico's pension bonds and which accumulated large holdings of COFINA bonds.[23]

Experiences with Pension Obligation Bonds

The Great Recession and ongoing budgetary pressures also affected Puerto Rico's three public pension systems, which had been severely underfunded. Unfunded obligations of Puerto Rico's public pension systems were estimated at over $40 billion in 2016. Many beneficiaries of Puerto Rico's public pensions were ineligible for the federal Social Security program, leaving them dependent on systems with few remaining assets and uncertain financial prospects.

In 2006, Merrill Lynch advisors suggested that the Puerto Rico Employee Retirement System (ERS) and Merrill Lynch issue at least $7 billion in pension obligation bonds (POBs). Merrill Lynch was unable to place those bonds with investors because the bonds were ineligible for a federal tax exemption.

Other jurisdictions have issued POBs in the hope that returns on investments funded by bond proceeds would cover principal and interest payments plus the forgone investment earnings that could have been made using contributions pledged to back the bonds—an approach known as an arbitrage strategy.[24] That strategy might conceivably reduce unfunded pension liabilities were investment yields sufficiently high, if fees and other costs were low, and if bond proceeds were not diverted to cover other liabilities. Low yields or losses would expand pension liabilities.

In 2008, UBS (Union Bank of Switzerland)—which had also advised island officials on the structure of the bonds—underwrote three rounds of POBs. UBS's own proprietary funds—largely closed-end mutual funds marketed to Puerto Rico residents—bought 41% of the first POB issue, 89% of the second issue, and 38% of the third. Santander and Banco Popular, two of the largest banks in Puerto Rico, apparently bought nearly all of the remaining bonds in the second issue.[25]

26, 2006. Kobre & Kim LLP, *Final Investigative Report*, August 20, 2018, https://drive.google.com/file/d/19-lauVo3w9MPS03xYVe0SWhQin-Q6FEf/view. Part VI of that report presents an analysis of COFINA debt. GDB's board acted as COFINA's board. Act 56-2007 (pp. 3-4) granted COFINA the same legal privileges as GDB.

[21] Mike Cherney, "Borrowing Maneuver Catches Flak: 'Scoop and Toss' Involves Selling New Debt to Pay Off Existing Bonds," *Wall Street Journal*, December 2, 2013.

[22] Kobre & Kim LLP, *Final Investigative Report*, August 20, 2018, pp. 179-188.

[23] Santander Asset Management, "First Puerto Rico Tax Exempt Fund (Class A)," March 31, 2016, http://periodismoinvestigativo.com/wp-content/uploads//2016/12/TE-1Q2016.pdf.

[24] See Kobre & Kim, *Final Investigative Report*, August 20, 2018, Part VII.

[25] Craig McCann and Edward O'Neal, "UBS Succumbed to Conflicts and Purchased $1.7 Billion of Employee Retirement System Bonds into its Puerto Rican Municipal Bond Funds in 2008," Securities Litigation & Consulting Group blog, November 6, 2014, http://blog.slcg.com/2014/11/ubs-succumbed-to-conflicts-and.html.

The Puerto Rico POBs incurred substantial losses and raised serious questions regarding the judgement of ERS board members, the island government's financial advisors, and investment banks involved in implementing the bond sales. A 2010 analysis of the ERS POBs' issuance by financial analysis firm Conway MacKenzie was sharply critical of responsible officials.[26] The underlying bonds' poor performance and the use of leverage resulted in substantial losses for retail investors who held those UBS mutual funds.[27] A Puerto Rico subsidiary of UBS agreed to pay $34 million to settle claims regarding marketing of its closed-end bond funds with the U.S. Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA) in September 2015. One UBS financial advisor pleaded guilty to criminal fraud charges in November 2018.[28]

Bonds and Municipal Finance

State and local governments borrow to finance schools, streets, sewers, and other public infrastructure projects, or to support certain private projects, as well as to close short-term gaps between public revenues and outlays. U.S. state and local borrowing totaled over $3 trillion in mid-2020.[29] Municipal securities, such as bonds and notes, are generally exempt from federal taxes. Most states exempt their own securities from tax, though fewer exempt those of other states. Bonds issued by Puerto Rico, with some exceptions, offer a triple exemption from taxes—that is, exempt from federal, state, and local taxes—that made them attractive to municipal mutual fund managers and to high-income households.[30]

Municipal securities offered on the U.S. mainland are subject to SEC regulation, though securities issued by investment companies based in U.S. territories are not covered by the 1940 Investment Company Act (ICA; P.L. 76-768).[31]

Municipal—or muni—securities mostly fall into two broad categories. General obligation (GO) bonds are typically backed by a government's pledge of "full faith and credit," backed by the power to tax. Revenue bonds, often issued by public utilities, public corporations, or semi-independent authorities, can be backed by specific cash flows from a project or source—such as sales of water or electric power, sewer charges, or highway tolls—or by a broadly applied tax. Revenue bonds, while tied to narrower income streams than GO debt, can qualify for certain investor protections.[32]

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[26] Conway Mackenzie, *Review of the Events and Decisions That Have Led to the Current Financial Crisis of the Employees Retirement System of the Government of Puerto Rico*, October 2010, http://www.slcg.com/pdf/blog/13409.pdf.

[27] Craig McCann, Edward O'Neal, and Susan Song, "UBS and Santander's Role in Underwriting Employee Retirement System Bonds," Securities Litigation & Consulting Group blog, May 16, 2017, http://blog.slcg.com/2017/05/ubs-and-santanders-role-in-underwriting.html. See also Nick Brown, "Puerto Rico's Other Crisis: Impoverished Pensions," Reuters, April 7, 2016, https://www.reuters.com/investigates/special-report/usa-puertorico-pensions/. Also see David Evans, "How UBS Spread the Pain of Puerto Rico's Debt Crisis to Clients," Bloomberg, September 22, 2015, https://www.bloomberg.com/news/articles/2015-09-22/how-ubs-spread-the-pain-of-puerto-rico-s-debt-crisis-to-clients.

[28] U.S. Department of Justice, "Former Registered Financial Advisor Pleads Guilty to Bank Fraud," press release, November 16, 2019, https://www.justice.gov/opa/pr/former-registered-financial-advisor-pleads-guilty-bank-fraud-role-scheme-fraudulently-obtain. Also see Kate McCormick, "Former UBS Insider Says Banks Fueled Economic Crisis in Puerto Rico," May 1, 2018, *PBS Frontline*, https://www.pbs.org/wgbh/frontline/article/former-ubs-insider-says-banks-fueled-economic-crisis-in-puerto-rico/.

[29] Federal Reserve System Board of Governors, "State and Local Governments; Debt Securities and Loans; Liability, Level [SLGSDODNS]," https://fred.stlouisfed.org/series/SLGSDODNS.

[30] The exemption was included in the 1917 Jones Act (P.L. 64-368) and is codified as 48 U.S.C. §745. Employee Retirement System (ERS) bonds, for example, did not qualify for certain mainland tax exemptions. See Kobre & Kim LLP, *Final Investigative Report*, August 20, 2018, https://drive.google.com/file/d/19-lauVo3w9MPS03xYVe0SWhQin-Q6FEf/view, p. 338.

[31] P.L. 115-174 §506, enacted in May 2018, set a three-year phaseout period for that exemption, which the SEC can extend for another three years.

[32] James E. Spiotto, "The History and Justification for Timely Payment of Statutory Liens and Pledged Special Revenues Bond Financing in a Chapter 9 Municipal Debt Adjustment Proceeding: Is a Model State Law Necessary or

Default rates for muni securities historically have been well below rates for corporate debt, although municipal default rates have risen in the past two decades. The credit rating agency Moody's found that over a 10-year period (2008-2017) almost 10% of corporate issuances defaulted, but less than 0.5% of municipal issuances did.[33] Major defaults in recent decades include a mismanaged nuclear power project in Washington State, Orange County in Southern California, and the City of Detroit.[34] Arkansas was in default in the 1930s, and several states and the Territory of Florida defaulted or repudiated debts in the 19th century.[35]

2013-2015: Fiscal Pressures Intensify

The island's fiscal condition began to raise widespread concerns in financial markets and among policymakers in mid-2013, after Detroit filed for municipal bankruptcy and a business magazine criticized Puerto Rico's fiscal condition.[36] Then-Governor Alejandro García Padilla, who was inaugurated in January 2013, hired a team of debt restructuring advisors in early 2014.[37]

Ratings on the island's public debt—which had reached a level roughly equivalent to the island's gross national product (GNP)[38]—were downgraded in February 2014.[39] Following enactment of a local bankruptcy law, another round of downgrades put several of the debt ratings for the island's public corporations below investment grade. Ratings for COFINA and GO bonds were also downgraded.[40] The downgrades and the state of Puerto Rico's public finances ended the island's access to capital markets.[41]

Required?" *Municipal Finance Journal*, vol. 39(4), winter 2019, pp. 47-97.

[33] Moody's, *U.S. Municipal Bond Defaults and Recoveries 1970-2017*, July 31, 2018. Excerpt available at https://www.treasurer.ca.gov/cdiac/seminars/2019/20190212/day2/6.pdf.

[34] Michael Johnston, "The Biggest Municipal Bond Disasters Of All Time," MunicipalBonds.com, https://www.municipalbonds.com/news/the-biggest-municipal-bond-disasters-of-all-time/.

[35] William A. Scott, *Repudiation of State Debts in the United States*, (New York: Crowley, 1893), p. 276. Those states were Alabama, Arkansas, Florida, Georgia, Louisiana, Mississippi, North Carolina, South Carolina, Tennessee, and Virginia. Also see William B. English, "Understanding the Costs of Sovereign Default: American State Debts in the 1840s," *American Economic Review*, vol. 86, no. 1 (March 1996), pp. 259-275.

[36] Andrew Bary, "Troubling Winds: Puerto Rico's Huge Debt Could Overwhelm Attempts to Revive its Economy," *Barron's*, August 26, 2013.

[37] Mark Tannenbaum and Martin Z. Braun, "Puerto Rico GDB Hires Millstein Unit as Financial Adviser," Bloomberg, March 6, 2014, http://www.bloomberg.com/news/articles/2014-03-05/puerto-rico-gdb-hires-millstein-affiliate-as-financial-adviser. Also see Emily Glazer and Mike Cherney, "Puerto Rico Finance Arm Hires Restructuring Lawyers: Government Development Bank for Puerto Rico Hires Cleary Gottlieb Steen & Hamilton," *Wall Street Journal*, April 7, 2014.

[38] GDB, *Commonwealth Quarterly Financial Report*, July 17, 2014, pp. 41-42, http://www.gdb-pur.com/documents/CommonwealthQuarterlyReport71714.pdf. GNP, which measures the value of output created within a given jurisdiction, is considered a more accurate indicator of Puerto Rico's level of economic activity than gross domestic product (GDP), which in Puerto Rico is strongly influenced by transactions of multinational corporations that often have a tenuous connection to the island's economy.

[39] Commonwealth of Puerto Rico, *Consolidated Annual Financial Report for FY2013*, note 22, pp. 230-231, http://www.hacienda.gobierno.pr/downloads/pdf/cafr/FINANCIAL_REPORT_2013.pdf.

[40] *Ley para el Cumplimiento con las Deudas y para la Recuperación de las Corporaciones Públicas de Puerto Rico* (Ley 71 de 2014; Act 71-2014; Law Pursuant to the Debts and for the Recovery of the Public Corporations of Puerto Rico). The law is also called the "Recovery Act" or the "Local Bankruptcy Law" ("*Ley de Quiebra Criolla*").

[41] See Moody's Investor's Service, "Puerto Rico's Debt Restructuring Law Raises Default Risk for Public Corporations and the Commonwealth," July 3, 2013. Also see Kobre & Kim LLP, *Final Investigative Report*, August 20, 2018, https://drive.google.com/file/d/19-lauVo3w9MPS03xYVe0SWhQin-Q6FEf/view, pp. 189-190; and CRS Report R44095, *Puerto Rico's Current Fiscal Challenges*, by D. Andrew Austin, *Puerto Rico's Current Fiscal Challenges*, by D. Andrew Austin.

Last GO Bonds Sold Directly to Hedge Funds in March 2014

Lacking access to normal channels of municipal finance, the island's government issued $3.5 billion in GO bonds to a syndicate of hedge funds in March 2014—a month after the credit ratings on the island's GO bonds had been downgraded to junk status.[42] The bonds carried an 8.6% yield, well above usual rates in the municipal finance market.[43] The 2014 GO bonds were issued with a provision that New York State law would govern disputes, then viewed as a significant investor protection. Moreover, the Puerto Rico Constitution sets debt service as a top priority, before other public outlays.

About $900 million of the bond proceeds went to pay off bank loans, including to banks involved in underwriting the issue.[44] SEC staff reportedly recommended actions against bankers involved in the deal, including former GDB head Jorge Irizarry, who later led a coalition said to represent local junior COFINA bondholders.[45] The SEC declined to pursue those charges.[46] Investment funds Paulson & Company, Och-Ziff Capital,[47] Fir Tree Partners, Perry Capital, and Brigade Capital reportedly each bought more than $100 million of the issue.[48]

After the 2014 GO issuance, hedge funds expanded their involvement in Puerto Rico, both in purchases of bonds as well as contact with officials and policymakers. The ratings agency Fitch, according to reports, found that some 60 hedge funds held about $16 billion of Puerto Rico's

[42] "Fitch Cuts Puerto Rico's Debt to Junk," *New York Times*, February 11, 2014, https://dealbook.nytimes.com/2014/02/11/fitch-cuts-puerto-ricos-debt-to-junk/. Downgrades were triggered by warnings that the Government Development Bank faced liquidity challenges.

[43] The Series A bonds—CPR's sole bond issuance in 2014—offered at 93¢ on the dollar, carry an 8% coupon rate, implying an initial yield of 8.6%. The average yield for Bond Buyer 20-Bond GO Index for 2014 was 4.25%. See WM Financial Strategies, "Rates Over Time," November 2020, http://www.munibondadvisor.com/market.htm. The bond's official statement warned the "Commonwealth may be unable to honor its obligation to pay debt service on the Bonds," GDB, 2014A GO Bond Official Statement, March 11, 2014, https://web.archive.org/web/20160317092340/http://www.gdbpr.com/investors_resources/documents/CommonwealthPRGO2014SeriesA-FinalOS.PDF.

[44] Laura Sullivan, "How Puerto Rico's Debt Created A Perfect Storm Before The Storm," NPR/Frontline, May 2, 2018, https://www.npr.org/2018/05/02/607032585/how-puerto-ricos-debt-created-a-perfect-storm-before-the-storm.

[45] Martin Z. Braun, "SEC Probes Barclays, Morgan Stanley Bankers Over Puerto Rico," Bloomberg, June 28, 2017, https://www.bloomberg.com/news/articles/2017-06-28/sec-probes-barclays-morgan-stanley-bankers-on-puerto-rico-bonds. Also see Robert Slavin, "Morgan Stanley Hires Former GDB President to Attract Puerto Rico Business," *Bond Buyer*, April 30, 2013. Irizarry later headed the *Bonistas del Patio* group, which played a role in the COFINA restructuring.

[46] Carlos A. Otero, "Concluye sin Acusaciones Pesquisa de la SEC," [SEC Investigation Concludes without Charges], *El Vocero*, April 9, 2018, p. 5, https://issuu.com/vocero.com/docs/v04092018__1_/4.

[47] Och-Ziff changed its name to Sculptor Capital in 2019, two weeks before a deferred prosecution agreement with the U.S. Department of Justice related to trade in conflict diamonds and minerals expired. See Sculptor Capital, "Och-Ziff Capital Management Changes Name to Sculptor Capital Management," press release, September 12, 2019, https://www.globenewswire.com/news-release/2019/09/12/1914643/0/en/Och-Ziff-Capital-Management-Changes-Name-to-Sculptor-Capital-Management.html. Also see U.S. v. Och-Ziff, *Deferred Prosecution Agreement*, September 26, 2016, https://www.justice.gov/criminal-fraud/file/900261/download.

[48] Joel Cintrón Arbasetti, "Vulture Funds have Puerto Rico Cornered," Center for Investigative Journalism, April 9, 2015, https://periodismoinvestigativo.com/2015/04/vulture-funds-have-puerto-rico-cornered/.

public debt, about 22% of the total amount, by fall 2014.[49] In addition, the investment bank Goldman Sachs's holdings of Puerto Rican debt increased to a reported $1.3 billion in 2014.[50]

Federal Courts Strike Down Local Bankruptcy Law

The Puerto Rican government lost access to Chapter 9 of the U.S. Bankruptcy Code, which governs the adjustment of municipal debts, in 1984.[51] Lacking that access and with major public corporations facing severe liquidity challenges, island policymakers sought to create a path to restructuring debts through local laws. In particular, the deterioration of PREPA's finances and operations became evident in spring 2014.[52] In August 2014, PREPA, unable to afford fuel, signed a restructuring support agreement (RSA) with its creditors, which included appointment of an outside chief restructuring officer.[53]

In June 2014, Puerto Rico enacted a local bankruptcy law, which heightened concerns of default risks.[54] The hedge fund Blue Mountain Capital Management, along with the Oppenheimer and Franklin mutual fund groups, challenged the law.[55] Other hedge funds reportedly supported the law, which would enhance CPR's ability to pay GO debt by allowing cramdowns of public corporations' debt.[56] The Supreme Court struck down the local bankruptcy law,[57] holding that, although the Bankruptcy Code prevents municipalities in Puerto Rico from seeking relief under

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[49] Michael Corkery, "Let Us Help You, Hedge Funds Tell Puerto Rico," *New York Times*, September 12, 2014, https://dealbook.nytimes.com/2014/09/12/puerto-rico-finds-it-has-new-friends-in-hedge-funds/. Also see Joel Cintrón Arbasetti and Carla Minet, "Out in the Open, Hedge Funds in Puerto Rico," Center for Investigative Journalism, July 14, 2015, https://periodismoinvestigativo.com/2015/07/out-in-the-open-hedge-funds-in-puerto-rico/.

[50] Brian Chappatta, "Puerto Rico's 10% Yields Prove Too Tempting for Goldman to Skip," Bloomberg Business, May 26, 2015.

[51] P.L. 98-353 amended the Bankruptcy Code to exclude Puerto Rico from the definition of "State" for "the purpose of defining who may be a debtor under chapter 9," which removed Puerto Rico's access to Chapter 9. See Jon Greenberg, "Mystery: Strom Thurmond, Puerto Rico and Bankruptcy Protection," PolitiFact, April 27, 2016, https://www.politifact.com/factchecks/2016/apr/27/john-oliver/mystery-strom-thurmond-puerto-rico-and-bankruptcy-/. The late Judge Torruella, an expert on U.S.-Puerto Rico relations, stated in a concurrence that "there is no legislative record on which to rely for determining Congress's reasons behind the 1984 Amendments. A tracing of its travels through the halls of Congress sheds less light than a piece of coal on a moonless night regarding the reason for its enactment." Franklin Cal. Tax-Free Tr. v. Puerto Rico, 805 F.3d 322, 349 (1st Cir. 2015) (Torruella, J., concurring in the judgment), *aff'd*, Puerto Rico v. Franklin Cal. Tax-Free Tr., 136 S. Ct. 1938 (2016).

[52] In June 2014, Municipal Market Analytics (MMA) reported that "PREPA's reality is that it is operating deep in the red, with antiquated technology, high costs and declining sales." See Testimony of Robert Donahue, MMA Managing Director, in U.S. Congress, House Committee on the Judiciary, Subcommittee on Regulatory Reform, Commercial And Antitrust Law, *H.R. 870*, 114th Cong., 1st sess., February 26, 2015, p. 28, https://www.jonesday.com/files/upload/robert-donahue-testimony.pdf.

[53] For details, see CRS Report R44095, *Puerto Rico's Current Fiscal Challenges*, by D. Andrew Austin.

[54] *Ley para el Cumplimiento con las Deudas y para la Recuperación de las Corporaciones Públicas de Puerto Rico* (Ley 71 de 2014; Act 71; Law Pursuant to the Debts and for the Recovery of the Public Corporations of Puerto Rico). The law was also called the "Recovery Act" or the "Local Bankruptcy Law" ("*Ley de Quiebra Criolla*"). See also Moody's Investor's Service, "Puerto Rico's Debt Restructuring Law Raises Default Risk for Public Corporations and the Commonwealth," July 3, 2013.

[55] Carlos F. Ugalde, "Puerto Rico's Municipal Debt Crisis: A Two-Front Battle?" *Fordham Urban Law Journal*, March 17, 2015, https://news.law.fordham.edu/fulj/2015/03/17/puerto-ricos-municipal-debt-crisis-a-two-front-battle/.

[56] Michael Cembalest, "Passage to Puerto Rico," J.P. Morgan, Eye on the Market, July 11, 2016, https://www.jpmorgan.com/directdoc/passagetopuertorico.pdf. A cramdown is a reduction or restructuring of debts through a legal procedure that supersedes prior contractual requirements.

[57] Puerto Rico v. Franklin Cal. Tax-Free Tr., 136 S. Ct. 1938 (2016). Also see Stephen J. Lubben, "Puerto Rico and the Bankruptcy Clause," *American Bankruptcy Law Journal*, vol. 88, no. 4 (fall 2014), pp. 553-578 (at p. 573).

Chapter 9, the code nonetheless preempted Puerto Rico's Recovery Act, and thus barred the CPR from enacting its own municipal bankruptcy scheme to restructure debt.[58]

Governor García Padilla Calls Debt "Unpayable," Declares Fiscal Emergency

Then-Governor García Padilla called Puerto Rico's public debts "unpayable" at the end of June 2015.[59] In the following year, the governor took a series of actions to conserve the government's liquidity in the face of mounting fiscal pressures. At the beginning of August 2015, three small public bond issues were in default.[60] At the end of November 2015, Governor Padilla signed an executive order authorizing a clawback of balances and revenues from transportation and infrastructure entities.[61] In April 2016, he signed into law Act 21-2016, which declared that a debt service moratorium could be invoked to preserve funding for essential public services.[62] As Puerto Rico's defaults widened, Congress considered measures to address the island's fiscal crisis, which culminated in PROMESA's enactment.

On June 29, 2016—two days before a $780 million GO debt service payment was due—Governor Padilla suspended payments on GO and Commonwealth-guaranteed bonds, leading to the first defaults on CPR debt.[63] The following day, June 30, 2016, PROMESA was signed into law by President Obama to address Puerto Rico's debts and finances. Before describing provisions of PROMESA, the next section analyzes the structure of Puerto Rico's debt stack.

Predefault Structure of Puerto Rico's Public Debts

Puerto Rico's fiscal crisis and its accumulations of debt are intertwined with the structure of its public sector. This section surveys Puerto Rico's public debts and briefly discusses how they were accumulated. The Puerto Rican government includes a central government—the Commonwealth of Puerto Rico (CPR)—as well as some 50 public corporations.[64] These public corporations have a wide range of responsibilities, including providing electricity, water and sewer service, social services, health care, and maintenance of ports and parks. The island's

[58] See 136 S. Ct. at 1942. Chapter 9 of the Bankruptcy Code defines a municipality as a "political subdivision or public agency or instrumentality of a State." Cf. 11 U.S.C. §101(40). The Bankruptcy Code thus covers a wider set of public entities than the term municipalities usually connotes. In Puerto Rico, municipalities (*municipios*) resemble county governments on the mainland.

[59] Mensaje del Gobernador Alejandro García Padilla Sobre Situación Fiscal de Puerto Rico (Governor Alejandro García Padilla's Message on the Fiscal Situation of Puerto Rico), June 29, 2015, https://www.elnuevodia.com/noticias/politica/nota/mensajedelgobernadoralejandrogarciapadillasobresituacionfiscaldepuertorico-2066574/.

[60] Puerto Rico Standard & Poors, "Rating on Three Puerto Rico PFC Series Lowered to 'D' On Non-Payment," RatingsDirect, August 3, 2015, http://www.gdb-pur.com/investors_resources/documents/SP-RatingsDirectNews-Aug-03-2015.pdf. How clawback funds were used is unclear. See Luis J. Valentín Ortiz, "Light Shed on Clawed-Back Funds," *Caribbean Business*, August 24, 2016, https://caribbeanbusiness.com/light-shed-on-clawed-back-funds/.

[61] Gov. Alejandro García Padilla, Executive Order 2015-46, November 30, 2015, https://estado.pr.gov/es/ordenes-ejecutivas/.

[62] Puerto Rico Emergency Moratorium and Financial Rehabilitation Act, Act 21-2016, http://www.lexjuris.com/lexlex/Leyes2016/lexl2016021.htm.

[63] Gov. Alejandro García Padilla, Executive Order 2016-30, June 29, 2016, https://www.estado.pr.gov/es/ordenes-ejecutivas/. For the July 1, 2016, GO debt service payment, see Act 21-2016 at p. 53. Some other sources cite other amounts for that payment.

[64] Oficina de Gerencia y Presupuesto (Puerto Rico Office of Management and Budget; OGP), *Organigrama* (Organization Chart), March 2, 2017, http://ogp.pr.gov/SobreOGP/Pages/organigrama.aspx. That version depicted 128 government entities. Former Governor Ricardo Rosselló Nevares (2017-2019) consolidated some smaller public corporations into central government departments.

public debt, issued by 18 distinct public entities, presents an unusually complex debt structure. Transfers and cross-subsidies among different public agencies and corporations, often routed through the former Government Development Bank, added to that complexity.[65]

Government Development Bank as Fiscal Agent and Financial Advisor

The GDB—the CPR's former fiscal agent and financial advisor to each governor's administration—had a central role in Puerto Rico's debt crisis. In postwar decades, it supported the island's industrialization strategy and served a mix of public and private clients. A GDB head in 2015 described its role as "really a combination of things that the Treasury, the New York Fed and a development bank like the Inter-American Development Bank do."[66] In particular, the GDB controlled debt issuance and negotiated with investment banks. The GDB defaulted on bond payments in May 2016. In 2017, the newly formed Fiscal Agency and Financial Advisory Authority (FAFAA) assumed most of GDB's functions.[67]

Categories of Public Debt

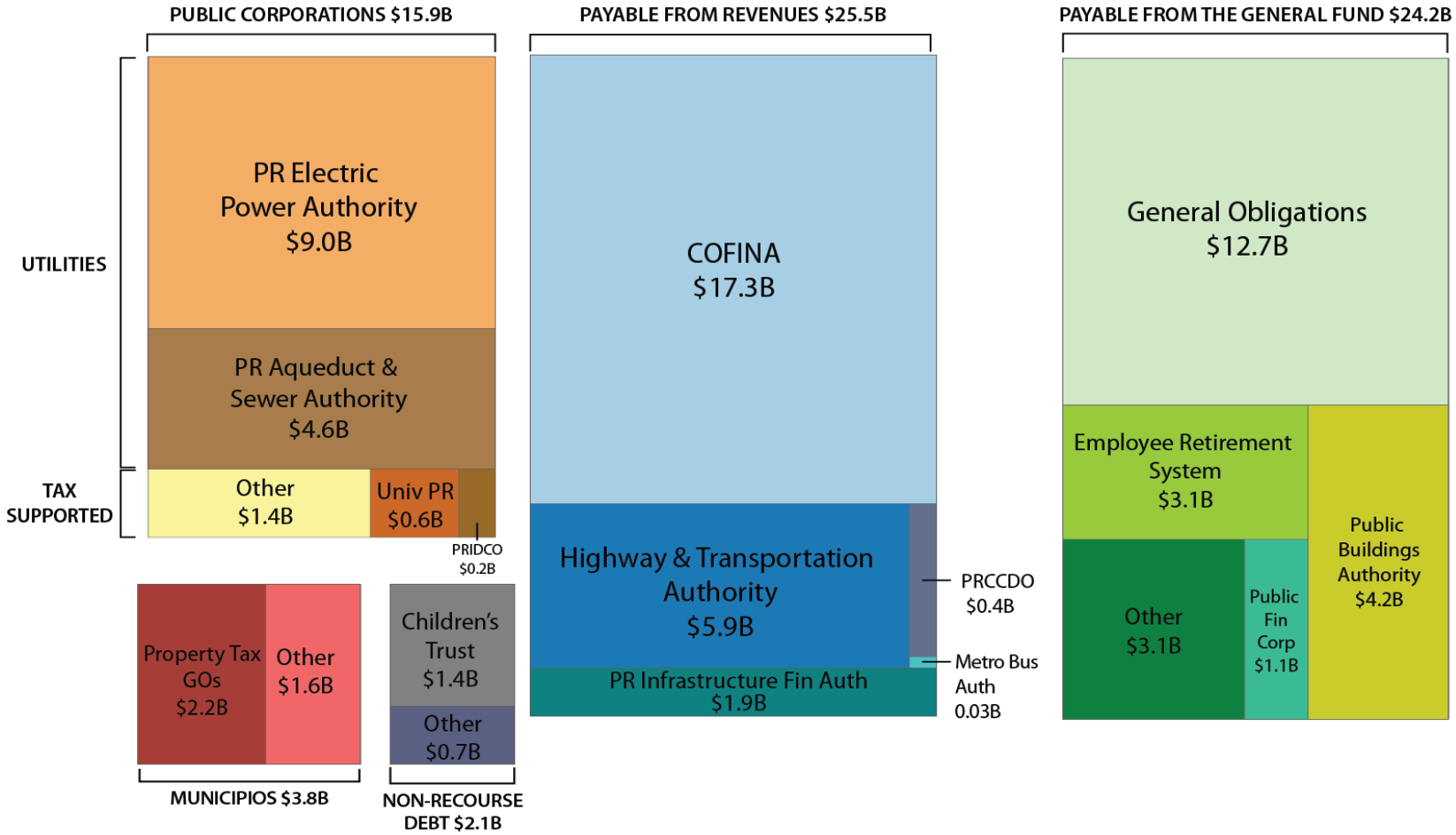
Restructuring Puerto Rico's finances has involved complex disputes among bondholders invested in different types of Puerto Rico's public debt. This section outlines the structure of the island's public debts. Since Puerto Rico lost access to credit markets in late 2014, its current debt structure has been largely unchanged, aside from the runoff of short-term notes, the 2018 wind-down of the GDB, and the 2019 restructuring of sales-tax-backed COFINA bonds (COFINA—an acronym for the *Corporación del Fondo de Interés Apremiante*—is also known as the Puerto Rico Sales Tax Financing Corporation). **Figure 2** and **Table A-1** show debt levels as of the end of July 2016.

[65] For example, a disclosure for the March 2014 NY Law GO bond issue stated (p. II-74) "GDB, however, has provided financing in the past and may continue to provide financing to governmental entities that do not have sufficient independent resources to cover their operating expenses, to the extent permitted by law." CPR, 2014A GO Bond *Official Statement*, March 14, 2020, https://emma.msrb.org/ER892398-ER588507-ER990528.pdf.

[66] Mary Williams Walsh and Michael Corkery, "Behind Puerto Rico's Woes, a Broadly Powerful Development Bank," *New York Times*, November 29, 2015; and Arturo C. Porzecanski, "The Government Development Bank: At the Heart of Puerto Rico's Financial Crisis," American University working paper, September 18, 2014, http://auapps.american.edu/aporzeca/www/The%20GDB%20at%20the%20Heart%20of%20Puerto%20Ricos%20Financial%20Crisis.pdf.

[67] Enabling Act of the Fiscal Agency and Financial Advisory Authority, Act 2 of 2017, January 18, 2017, https://www.aafaf.pr.gov/wp-content/uploads/a-002-2017-1.pdf.

Figure 2. Puerto Rico's Public Debt as of July 31, 2016, in $Billions



Source: CRS calculations based on *Commonwealth Statement*, December 18, 2016, https://web.archive.org/web/20170101045953/http://bgfpr.com/documents/CommonwealthofPuertoRicoFinancialInfoFY201612-18-16.pdf.

Notes: Some items may not sum to totals due to rounding. This figure excludes debt of the Government Development Bank to minimize double counting. See source document for other important notes and caveats.

Unfunded obligations of Puerto Rico's pension systems, which were estimated at $49 billion as of June 2015, are not included.[68] Puerto Rico's public debt, after adjustments to avoid double-counting, totaled $68.7 billion at the end of July 2016.[69]

These debts can be divided by the source of funds used to repay them,[70] namely

1. the Commonwealth's General Fund;
2. the sales & use tax or other specific revenue sources;
3. public corporations' revenues;
4. other debts, including local governments (*municipios*) and nonrecourse debt.[71]

By July 2016, the category of debt repaid through the General Fund included $12.7 billion in GO debt backed by the good faith, credit, and taxing power of the Commonwealth, as well as $4.2 billion in Public Building Authority debt, most of which carried a CPR guarantee. Another $25.5 billion of Puerto Rico's public sector debt was payable from selected tax receipts, including $17.3 billion in COFINA bonds. An additional $11.5 billion was payable through Commonwealth appropriations. Outstanding bonds for the island's largest public corporations, PREPA ($9.0 billion) and PRASA ($4.6 billion), are mostly repaid through utility charges.

Public Debt and the Puerto Rico Constitution

The Puerto Rican Constitution's provisions related to budgets and debt have played a central role in the process of restructuring the island's public debts.[72] Puerto Rico treated public corporations as legally separate from the island's central government,[73] although in practice governors largely have controlled them indirectly via appointments of those corporations' boards.[74] Debts of most public corporations were also considered as separate from debts of the central (CPR) government.

Five key fiscal policy clauses in the Puerto Rico Constitution are

- a **balanced budget requirement** that appropriations (*asignaciones aprobadas*) not exceed available resources (*los recursos disponibles*) (Article VI, Section 8);

[68] GDB, *Commonwealth Statement*, December 18, 2016, p. 222, https://web.archive.org/web/20170101045953/http://bgfpr.com/documents/CommonwealthofPuertoRicoFinancialInfoFY201612-18-16.pdf.

[69] Ibid. Also see **Table A-1**.

[70] For a detailed discussion of different categories of public debts, see GDB, *Commonwealth Statement*, December 18, 2016, pp. 172-208.

[71] The Children's Fund, which comprises most of the nonrecourse debt, stems from settlements of 1990s tobacco suits. Archived CRS Report RL30058, *Tobacco Master Settlement Agreement (1998): Overview, Implementation by States, and Congressional Issues*, by C. Stephen Redhead, is available to congressional clients upon request.

[72] The English version of the Puerto Rico Constitution is available at https://web.archive.org/web/20130302224519/http://www.oslpr.org/english/PDF/The%20Constitution%20of%20the%20Commonwealth%20of%20Puerto%20Rico.pdf.

[73] For instance, the law (Act 83 of 1941; 22 L.P.R.A. §193) creating PREPA's predecessor states that "debts, obligations, contracts, bonds, notes, promissory notes, receipts, expenses, accounts, funds, companies and property of the Authority, its officers, agents or employees, should be understood to be of the said governmentally controlled corporation and not of the central government."

[74] Geoff G. Burrows, "The New Deal in Puerto Rico: Public Works, Public Health, and the Puerto Rico Reconstruction Administration, 1935-1955," City University of New York (CUNY) dissertation, 2014, https://academicworks.cuny.edu/gc_etds/315.

- a **priority for payment of interest and principal for securities backed by the "full faith and credit"** of the Puerto Rico government in the case of a budgetary shortfall (Article VI, Section 8);
- a "**clawback**" provision, mandating the reapplication of revenues to debt service of full faith and credit pledges (Article VI Section 2);
- a **prohibition on issuance of new GO debt** if average debt service costs over the two preceding fiscal years equaled or exceeded 15% of the average of total revenues for those two years (Article VI Section 2);[75]
- a **30-year limit on GO bond maturities**, except for housing bonds, which were permitted maturities of up to 40 years (Article VI, Section 2).

The stringency of those provisions, however, was loosened in several ways. A 1974 Puerto Rico Attorney General's opinion held that bond proceeds counted as "available resources," thus relaxing the balanced budget requirement.[76] The 15% limit and the 30-year maturity limit were considered to apply only to central government GO debt, not to so-called "extraconstitutional" debt of public corporations and COFINA. The GDB, by serving as a conduit for transferring resources between the central government and other public entities, also weakened the effective distinction between "constitutional" and "extraconstitutional" debt.[77] Moreover, some have contested whether some post-2012 debt issues conformed to the 15% limit, as well as the reach of clawback measures used to bolster resources for payment of GO debt. Interpretations of those constitutional limits have shaped much of the island's public finance policy as well as PROMESA Title III litigation, which later sections describe.[78]

PROMESA Enacted in 2016 to Address the Crisis

PROMESA (P.L. 114-187), as noted above, established two debt adjustment processes and a Financial Oversight and Management Board for Puerto Rico, among other provisions.[79] Title II of PROMESA endowed the FOMB with wide authorities, while the governor and legislature of Puerto Rico retained substantial control over public priorities, within the constraints of Board-certified fiscal plans and other PROMESA provisions.

[75] This limit was interpreted as "15% of the average annual revenues raised under the provisions of Commonwealth legislation and deposited into the treasury (… 'internal revenues') in the two fiscal years preceding the fiscal year of such proposed issuance. Internal revenues consist principally of income taxes, sales and use taxes (other than those assigned to COFINA) and excise taxes." GDB, *Commonwealth Statement*, December 18, 2016, p. 177.

[76] P.R. Op. Sec. Just. 1974-15, 1974 WL 326062 (P.R. Atty. Gen.). Also see Carlos Colón De Armas, "La Constitución de Puerto Rico y Su Requisito de un Presupuesto Balanceado," [Puerto Rico's Constitution and its Balanced Budget Requirement], *Law Review of the University of Puerto Rico*, vol. 85, no. 3 (2016), pp. 819-832; and Sergio M. Marxuach, "The Endgame: An Analysis of Puerto Rico's Debt Structure and the Arguments in Favor of Chapter 9," Center for a New Economy working paper, November 30, 2015, http://bit.ly/2aBM7X3.

[77] Arturo C. Porzecanski, "The Government Development Bank: At the Heart of Puerto Rico's Financial Crisis," American University working paper, September 18, 2014, http://auapps.american.edu/aporzeca/www/The%20GDB%20at%20the%20Heart%20of%20Puerto%20Ricos%20Financial%20Crisis.pdf.

[78] For instance, see "Restructuring COFINA and GO Bonds."

[79] See CRS Report R44532, *The Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA; H.R. 5278, S. 2328)*, coordinated by D. Andrew Austin.

Oversight Board Appointments and Organization

The Oversight Board plays a central role in the restructuring process. At the end of August 2016, President Obama appointed six members from nomination lists compiled by congressional leaders and a seventh of his own choosing.[80] The Puerto Rico governor was empowered to appoint a nonvoting representative to the Board. The Board chose José B. Carrión, an island insurance broker, as chair.[81]

Litigation questioning the Board's compliance with the U.S. Constitution's Appointments Clause delayed the renomination or replacement of the original members, whose three-year terms expired in August 2019. The Supreme Court rejected those challenges in June 2020, clearing the way for new nominations and appointments.[82]

The Oversight Board chooses which instrumentalities will be "covered."[83] The Board can require the CPR government and covered instrumentalities to submit fiscal plans and budgets, which are subject to Board approval. In September 2016, the Oversight Board listed the CPR government as a covered territory and 62 public corporations and other entities as covered instrumentalities.[84] The Board also represents covered entities in debt restructuring processes set up by PROMESA.

PROMESA Established Two Paths to Restructure Debt

PROMESA's Title III establishes a debt restructuring process that draws on Chapters 9 and 11 of the U.S. Bankruptcy Code.[85] Title VI establishes a debt restructuring process for voluntary collective action agreements, similar to procedures used in some sovereign debt negotiations. Chief Justice John Roberts selected U.S. District Court Judge Laura Taylor Swain to oversee PROMESA Title III processes in proceedings in San Juan and New York.

Chapter 9 of the U.S. Bankruptcy Code[86] and Debt Restructuring under PROMESA Title III

Congress first enacted a municipal bankruptcy law during the Great Depression of the 1930s to allow local governments to reorganize their debts under the supervision of a federal court.[87] State governments cannot file

[80] White House, "President Obama Announces the Appointment of Seven Individuals to the Financial Oversight and Management Board for Puerto Rico," press release, August 31, 2016, https://obamawhitehouse.archives.gov/the-press-office/2016/08/31/president-obama-announces-appointment-seven-individuals-financial.

[81] Mr. Carrión's relatives have served in various leadership roles in Banco Popular, the island's largest bank. Guillermo A. Baralt, *Tradition into the Future: The First Century of the Banco Popular de Puerto Rico: 1893-1993* (San Juan: Banco Popular, 1993). José Carrión was brother-in-law of Pedro Pierluisi Urrutia, Resident Commissioner at the time.

[82] Financial Oversight and Management Bd. for Puerto Rico v. Aurelius Investment, LLC, 590 U. S. ___ (2020), https://www.supremecourt.gov/opinions/19pdf/18-1334_8m58.pdf.

[83] PROMESA §101(d)(1).

[84] Oversight Board, "Covered Entities List," November 18, 2016, https://drive.google.com/file/d/1D37UiofV0T5s1Q4J54vs3xX_ArGF9532/view.

[85] See the appendix of CRS Report R44532, *The Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA; H.R. 5278, S. 2328)*, coordinated by D. Andrew Austin, for a listing of Bankruptcy Code provisions incorporated into Title III.

[86] See CRS Report R45137, *Bankruptcy Basics: A Primer*, by Kevin M. Lewis; and CRS Legal Sidebar LSB10116, *When the City Goes Broke: Pensions, Retirees, and Municipal Bankruptcies*, by Kevin M. Lewis.

[87] U.S. Courts, "Chapter 9—Bankruptcy Basics," https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-9-bankruptcy-basics. Also see Michael W. McConnell and Randal C. Picker, "When Cities Go Broke: a Conceptual Introduction to Municipal Bankruptcy," *University of Chicago Law Review*, vol. 60(2), spring 1993, pp.

for bankruptcy, but may allow—or bar—their municipalities to seek protection from creditors under provisions of Chapter 9 of the Bankruptcy Code. The code defines "municipality" as a "political subdivision or public agency or instrumentality of a State," which includes not only towns and cities, but also school districts, utility districts, and public authorities responsible for roads, bridges, water, sewers, and other publicly provided services.[88]

A municipality may only receive Chapter 9 protections if several conditions are met: its state government approves; it is insolvent; it wishes to implement a "plan of adjustment"; and it negotiates with creditors in good faith or demonstrates such negotiations are impracticable.[89] A municipality's petition stays creditors from taking action to collect debts, within certain limits and subject to certain challenges. A bankruptcy court, however, cannot control a municipality's regular operations, with some narrow exceptions.[90] A municipality's final plan of adjustment, typically the result of negotiations with creditor groups, is subject to a federal judge's confirmation.

The PROMESA Title III process largely follows procedures of Chapter 9 of the Bankruptcy Code, although it adds some requirements and omits others.[91] First, Title III uses the terms "covered territory"—meaning Puerto Rico—and "covered territorial instrumentalities" rather than "municipality." Second, Title III, unlike Chapter 9, does not require insolvency as a prerequisite to seeking protection from creditors. Other differences are that the Oversight Board decides which public entities are *covered territorial instrumentalities*, chooses whether they can seek debt relief, and represents those entities through the Title III process.[92] PROMESA requires formulation and certification of *Fiscal Plans* for covered entities,[93] which are necessarily integrated with debt restructuring plans. Filing a Title III relief petition triggers an initial stay of litigation, although creditors may challenge the petition afterward.[94]

Major Title III cases have involved multiple issuers of debt because those entities' fiscal relations were entwined, which has complicated negotiations with creditor representatives. The Oversight Board has, with the approval of the Title III court, used its authority to appoint agents to represent interests of bondholders and other creditors.[95] The court also appointed a mediation team headed by Judge Barbara Houser to oversee negotiations.[96] A plan support agreement (PSA) outlines terms of negotiations and may be modified as additional parties sign on or as terms shift.

The Oversight Board is charged with proposing a *plan of adjustment* to implement negotiated terms of the restructuring. That plan may involve proposals to modify Puerto Rican laws, regulations, and fiscal plans. The Puerto Rican government and legislature retain broad powers to control public operations aside from other PROMESA strictures.[97] Obtaining legislative or regulatory changes consistent with the plan of adjustment is one prerequisite of court confirmation of the plan.[98]

425-495.

[88] 11 U.S.C. §101(40).

[89] That condition also may be met by reaching agreement with creditors holding a majority of claims in each affected class, or if the municipality reasonably believes a creditor may try to obtain a preferential transfer. 11 U.S.C. §109(c)(5).

[90] 11 U.S.C. §904.

[91] For a list of provisions referenced in PROMESA Title III, see Appendix B of CRS Report R44532, *The Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA; H.R. 5278, S. 2328)*, coordinated by D. Andrew Austin.

[92] PROMESA §§206, 304, 312, 315; 48 U.S.C. §§2146, 2164, 2172, 2175.

[93] PROMESA §201; 48 U.S.C. §2141.

[94] PROMESA §304; 48 U.S.C. §2164.

[95] PROMESA §104; 48 U.S.C. §2124. Also see Stipulation and Order Approving Procedure to Resolve Commonwealth-COFINA Dispute, In re CPR, case 17-03283-LTS, August 10, 2017, https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=NzAwNDI5&id2=0.

[96] In re: CPR, case 17-03283-LTS, *Order Appointing Mediation Team*, June 23, 2017, https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=NjU3Njgy&id2=0. The team was appointed under terms of 11 U.S.C. §105. Barbara Houser had been chief bankruptcy judge of the U.S. Bankruptcy Court for the Northern District of Texas.

[97] PROMESA §§303, 314; 48 U.S.C. §§2163, 2174.

[98] PROMESA §314; 48 U.S.C. §2174(b)(5).

The Oversight Board, as agent of the debtor, must file a *disclosure statement* for a plan of adjustment to inform creditors.[99] If the Title III court holds that the disclosure statement is adequate, creditors vote on the plan of adjustment. Creditors holding the same or similar types of debt or claims are divided into classes, as specified in the plan of adjustment. Creditors within classes whose claims would be impaired by the plan vote to approve or reject it. Approval of at least one class of impaired creditors is required. Other requirements for confirmation by the Title III court include that the plan was proposed in good faith, that it is feasible and in the best interests of creditors, and that it conforms to a Board-certified fiscal plan.[100] After approval, creditors are compensated according to the plan, in cash, in new bonds, or in other ways, equal to payment in full, nothing, or some intermediate amount.

Restructuring COFINA and GO Bonds

Disputes over the legal and constitutional foundation for tax-backed bonds and for certain other bonds have played a central role in Puerto Rico's debt restructuring, even before PROMESA's enactment. In particular, controversies over the relative priority of GO debt claims and claims of sales-and-use-tax-backed COFINA debt split investor groups.

Some suspected that issuing COFINA bonds sidestepped a limitation on debt issuance in the Puerto Rico Constitution, an accusation denied by others.[101] COFINA bonds were sold as "extraconstitutional" debt, meaning that bond proceeds and tax revenues supporting debt service were not to be considered as "available resources" to the CPR. Bond documents asserted that COFINA proceeds were therefore protected from "clawback," that is, the invocation of a provision of the Puerto Rican Constitution prioritizing payment of GO debt service.[102] While the Puerto Rican government obtained opinions from mainland law firms and the Puerto Rican Attorney General that COFINA funds would not be subject to clawback, at least one mainland law firm partner expressed doubt that a court would bar clawback of COFINA funds—an opinion not shared with investors.[103] In 2009, bond filings began to note, in general terms, the potential legal risks presented by COFINA's structure.[104]

Some major mutual funds, which had bought Puerto Rico securities at par when issued before the island's fiscal challenges became evident, sharply reduced their holdings of the island's public debt in late 2013 and 2014, prompting sharp drops in bond prices.[105] A significant portion of those sales were to hedge funds with a stronger appetite for complex debt restructuring processes.[106]

Many GO bondholders believed that restructuring the island's public corporations' debts or clawing back COFINA revenues could help the government meet GO bond obligations,

[99] PROMESA §§301, 310; 11 U.S.C. §1125.

[100] PROMESA §314; 48 U.S.C. §2174(b); 11 U.S.C. §1129.

[101] William Isaac, "Banks Have Huge Stake in Outcome of Puerto Rico Crisis," *American Banker*, November 5, 2015, https://www.americanbanker.com/opinion/banks-have-huge-stake-in-outcome-of-puerto-rico-crisis. The 2018 Kobre & Kim report claimed the GDB sought to compute the 15% debt limitation appropriately.

[102] Official Statement, "Puerto Rico Sales Tax Financing Corporation Sales Tax Revenue Bonds, Series 2007B," July 23, 2007, https://emma.msrb.org/MS261958-MS237266-MD462937.pdf.

[103] Kobre & Kim LLP, *Final Investigative Report*, August 20, 2018, https://drive.google.com/file/d/19-lauVo3w9MPS03xYVe0SWhQin-Q6FEf/view, pp. 160-161, 164-165, 174-175.

[104] Ibid., pp. 187-188.

[105] *Bond Buyer*, "Oppenheimer, Franklin Cut Puerto Rico Debt Holdings Amid Rally," September 12, 2018.

[106] Matt Wirz, Andrew Scurria, and Heather Gillers, "Bond Funds Dump Puerto Rico: Investor Exodus from Puerto Rico Built Speed in October," *Wall Street Journal*, October 25, 2017, https://www.wsj.com/articles/bond-funds-dump-puerto-rico-1508929380.

prompting contention with COFINA bondholder groups.[107] Conflicts also emerged between senior COFINA bondholders, which included several mainland financial institutions and hedge funds, and junior COFINA bondholders, who tended to be individual residents of Puerto Rico.[108]

Much of the COFINA-GO litigation included coalitions of major bondholders, such as the Ad Hoc Group of Puerto Rico GO Bondholders, the COFINA Senior Bondholders Coalition, and the *Bonistas del Patio*, a group claiming to represent island-based junior COFINA bondholders.[109] Three bond insurers (Ambac, National Public Finance, and Assured Guaranty), also known as monolines, also participated actively in negotiations and litigation.[110] These groups played a role in congressional deliberations that led to PROMESA's enactment.

The constitutional fiscal provisions became more salient as the prospect of a default of Puerto Rico's government loomed, triggering heightened tensions among bondholders. In July 2016, a group of GO bondholders sued then-Governor García Padilla to demand a clawback of COFINA-pledged revenues. In April 2017, a federal appeals court held that PROMESA stay provisions applied.[111] That suit and other litigation, however, convinced the Oversight Board that the GO-COFINA dispute needed to be resolved through the PROMESA Title III process.[112]

New Governor Inaugurated in January 2017

In January 2017, Governor Ricardo Rosselló Nevares succeeded Governor García Padilla, who did not seek reelection.[113] The new governor took steps to restructure the island government, including setting up FAFAA,[114] which took over financial management roles from the GDB. Rothschild & Co. were brought in to replace previous restructuring advisors.[115] The new governor abandoned the PREPA RSA and revamped PREPA's governance by letting the chief restructuring officer's contract lapse and replacing the PREPA board appointed in 2017 with his own

[107] Michael Cembalist, "Passage to Puerto Rico," J.P. Morgan, Eye on the Market, July 11, 2016, https://www.jpmorgan.com/directdoc/passagetopuertorico.pdf.

[108] Joanisabel González, "COFINA Bondholders Head to Boston," *El Nuevo Día*, March 16, 2017, https://www.elnuevodia.com/english/english/nota/cofinabondholdersheadtoboston-2301236/.

[109] Joel Cintrón Arbasetti and Carla Minet, "Old Colleagues Gather in a Group that Requires Puerto Rico to Pay the Debt," Center for Investigative Journalism, October 24, 2017, http://periodismoinvestigativo.com/2017/10/old-colleagues-gather-in-a-group-that-requires-puerto-rico-to-pay-the-debt/. Joel Cintrón Arbasetti and Carla Minet, "Map of the Players and their Positions in the Puerto Rico Debt Game," Center for Investigative Journalism, July 23, 2015, http://periodismoinvestigativo.com/2015/07/map-of-the-players-and-their-positions-in-the-puerto-rico-debt-game/.

[110] Heather Gillers, "Bond Insurers Prepare for the Worst in Puerto Rico," *Wall Street Journal*, June 30, 2016.

[111] Order and Opinion, Lex Claims, LLC, et al. v. Garcia-Padilla, et al, case 17-1241, April 4, 2017, media.ca1.uscourts.gov/pdf.opinions/17-1241P-01A.pdf.

[112] Jaresko Declaration, In re: COFINA, p. 10, January 12, 2019, https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=OTAxNzgz&id2=0.

[113] His father, Pedro Rosselló González, served as governor of Puerto Rico from 1993 until 2001. Former Governor García Padilla supports maintaining Puerto Rico's current status. Former Governor Rosselló Nevares and current Governor Pedro Pierluisi Urrutia advocate statehood for Puerto Rico. Divergent views on Puerto Rico's political status have traditionally distinguished the island's political parties in the postwar era.

[114] Act 2 of 2017, January 18, 2017, and Oversight Board, "Covered Entities List," November 18, 2016, https://drive.google.com/file/d/1D37UiofV0T5s1Q4J54vs3xX_ArGF9532/view.

[115] Eric Platt, "Rothschild to Advise Puerto Rico on $69bn Debt Restructuring," *Financial Times*, January 18, 2017, https://www.ft.com/content/b00acb45-341b-3501-888a-4685fc9ee4e6.

appointees.[116] Rosselló Nevares also disbanded a commission set up by his predecessor to audit the island's public debts.[117]

Oversight Board Files PROMESA Title III Petitions in May 2017

PROMESA required the Oversight Board to take several steps to restructure debts. In an initial step, as noted above, the Board listed the CPR and the bulk of the island's public corporations as covered instrumentalities under terms of PROMESA.[118] That designation required the governor to draft fiscal plans for the CPR and covered instrumentalities, whether or not the instrumentalities' debts were to be restructured. Fiscal plans and budgets are subject to certification by the Board, which can impose its own plan if the governor's draft is deemed inadequate.

Where the Board viewed debt restructuring as necessary, the next step was to petition a federal district court to initiate PROMESA Title III proceedings. The subsequent steps that put the GO-COFINA dispute into the Title III court followed in rapid succession in late April and early May 2017. Puerto Rico enacted a measure to claw back COFINA funds to the general fund,[119] triggering a default declaration on COFINA bonds on May 4, 2017.[120] A day before, on May 3, 2017, the FOMB filed a petition to restructure CPR's obligations under Title III of PROMESA.[121] On May 5, 2017, the Board then filed a Title III petition for COFINA,[122] and on May 21, 2017, it filed a petition for HTA.[123] The Board also initiated a Title III process for PREPA on July 2, 2017, and thus rejected the previous RSA framework.[124]

The Board also used PROMESA Title VI, which sets out a different procedure, to settle debts and operations of the GDB. The Board approved the GDB's restructuring petition in July 2017, and the bank was dissolved in November 2018.[125] Most of its functions, as noted above, were taken over by the FAFAA.

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[116] The PREPA RSA of November 2015 specified that the Puerto Rican governor choose a board of three members from a list "of at least 10 candidates prepared by a recognized firm in the field of search for executive candidates, according to objective criteria that take into account professional and educational backgrounds." See GDB, Restructuring Support Agreement, November 2, 2015, p. 98, at http://www.gdb-pur.com/investors_resources/documents/PREPA-RSA-RestructuringSupportAgreement-FullyExecuted.pdf. Rosselló's 2016 campaign treasurer was appointed chair of the PREPA board. See Javier Balmaceda, "Puerto Rico's PREPA Privatization: A Sale Too Private," *Forbes*, April 3, 2018, https://www.forbes.com/sites/debtwire/2018/04/03/puerto-ricos-prepa-privatization-a-sale-too-private/?sh=4a5358a27490.

[117] Gloria Ruiz Kuilan, "Rosselló Elimina la Comisión para la Auditoría de la Deuda," *El Nuevo Día*, April 19, 2017, https://www.elnuevodia.com/noticias/politica/notas/rossello-elimina-la-comision-para-la-auditoria-de-la-deuda/. See further discussion in the section "An Audit of Puerto Rico's Public Debt."

[118] PROMESA §101(d)(1)(A).

[119] Fiscal Plan Compliance Act, Act 26-2017, April 29, 2017.

[120] Robert Slavin, "COFINA Trustee Declares Default; Seniors Call for End of Subordinate Payments," *Bond Buyer*, May 10, 2017. Also see Bank of New York Mellon, letter to COFINA Trustees, May 4, 2017, https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=NjIwMzQ1&id2=0.

[121] Financial Oversight and Management Board (FOMB), *Petition for Relief on Behalf of the Commonwealth of Puerto Rico*, May 3, 2017, https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=NjE3NjAy&id2=0.

[122] FOMB, *Petition for Relief on Behalf of COFINA*, May 5, 2018, https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=NjE3ODQx&id2=0.

[123] FOMB, *Petition for Relief on Behalf of HTA*, May 21, 2017, https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=NjIzMjkw&id2=0.

[124] FOMB, *Petition for Relief on Behalf of PREPA*, July 2, 2017, https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=NzA4NjU1&id2=0.

[125] In re: GDB, *Findings of Fact, Conclusions of Law, and Order*, November 7, 2018, https://document.epiq11.com/

Judge Swain then directed the Oversight Board to resolve disputes among GO and COFINA creditors through confidential mediation overseen by a senior bankruptcy judge. On August 10, 2017, Judge Swain appointed the Unsecured Creditors Committee (UCC) to represent Commonwealth interests and Bettina Whyte to represent COFINA interests.[126] Negotiations were surrounded by a cascade of litigation by various interested parties.[127]

Hurricanes Irma and María Hit Puerto Rico in September 2017

Two Category 5 hurricanes soon stalled progress in those negotiations. In September 2017, Hurricane Irma skirted the northern edge of Puerto Rico, and two weeks later, Hurricane María passed over the whole island, leaving major damage in its wake.[128] The hurricanes affected the debt restructuring process in several ways. First, the island's electrical grid was disabled, which crippled many water and sewer facilities, as well as most manufacturing facilities and transportation systems. Health, housing, and incomes also were affected. Second, the disaster responses commanded the attention of public officials and others. The hurricanes' damage to public infrastructure, including the island's electrical grid, and to private businesses, including most manufacturing facilities, prompted the Oversight Board to revise the Commonwealth's fiscal plan to reflect reduced economic activity and tax revenues. The Board anticipated that federal disaster recovery funding—which it estimated would total $82 billion—would enhance the ability to repay creditors in future years.[129] Much of that funding, however, has been slow in coming.[130]

Settling the COFINA/GO Dispute

The COFINA Senior Bondholders Coalition, a coalition of hedge funds and investment groups, played a central role in negotiations that led to a settlement of the COFINA/GO dispute over payment priority. The coalition controlled about a third of outstanding senior COFINA debt and substantial amounts of COFINA subordinate (junior) bonds. In June 2015, the coalition retained the law firm Quinn Emanuel and lead counsel Susheel Kirpalani.[131]

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document/getdocumentbycode/?docId=3427095&projectCode=PR4&source=DM.

[126] Stipulation and Order Approving Procedure to Resolve Commonwealth-COFINA Dispute, In re FOMB as Representative of Commonwealth of Puerto Rico, case 17-03283-LTS, August 10, 2017, https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=NzAwNDI5&id2=0. Bettina Whyte was managing director and senior advisor at Alvarez & Marsal, a New York financial advisory firm.

[127] At this writing in February 2021, the Commonwealth Title III docket contained over 15,800 filings—a rough indicator of the complexity of the case.

[128] John P. Cangialosi, Andrew S. Latto, and Robbie Berg, "Tropical Cyclone Report: Hurricane Irma," National Hurricane Center, AL112017, June 30, 2018, https://www.nhc.noaa.gov/data/tcr/AL112017_Irma.pdf; and Richard J. Pasch, Andrew B. Penny, and Robbie Berg, "Tropical Cyclone Report: Hurricane Maria," National Hurricane Center, February 14, 2019, AL152017, https://www.nhc.noaa.gov/data/tcr/AL152017_Maria.pdf.

[129] Oversight Board, *Commonwealth Revised Fiscal Plan*, October 23, 2018, p. 17, https://drive.google.com/file/d/17ca0ALe7vpYn0jEzTz3RfykpsFSM0ujK/view.

[130] See CRS Report R46609, *The Status of Puerto Rico's Recovery and Ongoing Challenges Following Hurricanes Irma and María: FEMA, SBA, and HUD Assistance*, coordinated by Elizabeth M. Webster.

[131] Second Supplemental Verified Statement of the Senior COFINA Bondholders' Coalition Pursuant to Federal Rule of Bankruptcy Procedure 2019, case 17-03283-LTS, docket #1552, October 26, 2017. Also see Michelle Bocanegra, "MVP: Quinn Emanuel's Susheel Kirpalani," Law360, November 30, 2018, https://www.law360.com/articles/1094205/mvp-quinn-emanuel-s-susheel-kirpalani. In that interview, UCC lead counsel Luc Despins is described as a mentor.

After selling off about half of their COFINA junior bonds after Hurricane María hit, the coalition increased its holdings of those bonds from $709 million in October 2017 to $2.222 billion at the end of October 2018, as shown in **Figure 3**.[132] Over that interval—October 2017 to October 2018—the price of COFINA senior bonds rose from about 35% to over 80% of par, and junior bonds rose from about 10% of par to about 50% of par.

On May 14, 2018, the COFINA Senior Bondholders Coalition proposed a framework to settle the GO/COFINA dispute,[133] which the Oversight Board reportedly rejected as offering the CPR no "meaningful debt relief."[134] Further negotiations led to an agreement in principle, announced on June 5, 2018, that would allocate 53.65% of the Pledged Sales Tax Base Amount—set at 5.5% of the 10.5% Sales & Use Tax—to COFINA.[135] Judge Swain, according to media reports, viewed the draft agreement favorably, as it could sidestep calls to rule on the validity of COFINA's legal structure under the Puerto Rico Constitution.[136]

Under the proposed framework, existing COFINA bonds would be exchanged for new securities designed to reduce debt service obligations over the next decade, but carrying stronger investor protections. Certain COFINA creditors were to collect about $1.2 billion held in escrow.[137] The reduction in COFINA claims allowed the CPR government a greater share of sales and use tax revenues, which, in principle, would benefit GO bondholders. Island taxpayers also appear to have benefited from a reduction of certain tax rates enacted in December 2018.[138]

[132] See the corresponding 7th verified statement, November 16, 2018, https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=ODk5ODcw&id2=0.

[133] BusinessWire, "COFINA Senior Bondholders Coalition Discloses Participation in Constructive Settlement Discussions to Help Resolve Puerto Rico's Debt Crisis," May 14, 2018, https://www.businesswire.com/news/home/20180514005558/en/.

[134] Eva Lloréns Vélez, "GO-COFINA Bondholder Sides Head for Shootout," *Caribbean Business*, July 13, 2018, https://caribbeanbusiness.com/go-cofina-bondholder-sides-head-for-shootout/.

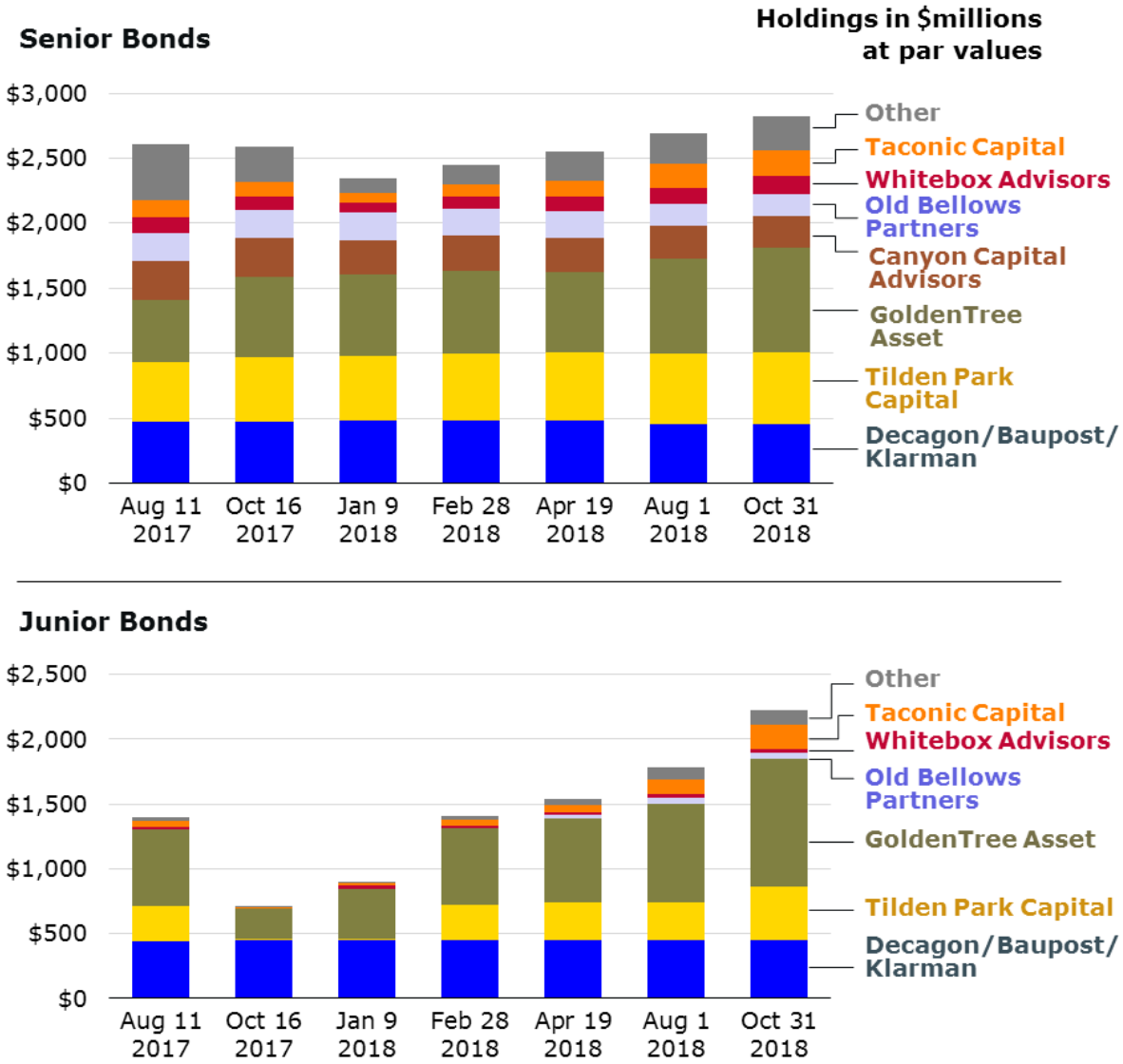
[135] Michelle Kaske, "Puerto Rico's Sales-Tax Bonds Soar on Optimism About Deal," Bloomberg News, June 8, 2018, https://www.bloomberg.com/news/articles/2018-06-08/puerto-rico-cofina-investors-get-half-sales-tax-in-proposed-deal.

[136] Eva Lloréns Vélez, "GO-COFINA Bondholder Sides Head for Shootout," *Caribbean Business*, July 13, 2018.

[137] Puerto Rico Fiscal Agency and Financial Advisory Authority (FAFAA), COFINA Fiscal Plan, p. 5, September 7, 2018, http://www.aafaf.pr.gov/assets/cofina-fiscal-plan-090718.pdf.

[138] Act 257-2018, enacted December 18, 2018. See Price Waterhouse Coopers, "Puerto Rico Adopts Significant Amendments to its Income Tax Code," January 2019, https://www.pwc.com/us/en/services/tax/library/insights/puerto-rico-significant-amendments-to-income-tax-code.html.

Figure 3. COFINA Holdings of Senior COFINA Bondholders Coalition



Source: CRS calculations using Rule 2019 filings on the COFINA docket.

Notes: Baupost, headed by Seth Klarman, controls the investment vehicles named Decagon Holdings. See David Dayen, "We Can Finally Identify One of the Largest Holders of Puerto Rican Debt," Intercept, October 3, 2017, https://theintercept.com/2017/10/03/we-can-finally-identify-one-of-the-largest-holders-of-puerto-rican-debt/.

The Oversight Board announced a deal with major COFINA creditors in August 2018.[139] Once the Puerto Rican government enacted conforming legislation,[140] the Oversight Board certified a revised COFINA fiscal plan.[141] On October 18, 2018, the Board filed a disclosure statement that

[139] FOMB, "Oversight Board Reaches Deal with COFINA Bondholders: Proposed COFINA Bondholders Agreement to Save Puerto Rico over $17 Billion," August 8, 2018, https://drive.google.com/file/d/ 1xGS5aCydodTTGhhCtk3OhHLFD6I_Qnny/view.

[140] Act 241 of 2018, November 15, 2018, http://www.lexjuris.com/lexlex/Leyes2018/lexl2018241a.htm.

[141] FOMB, *Unanimous Written Consent Certifying COFINA's Fiscal Plan*, October 19, 2018, https://drive.google.com/

detailed the proposed restructuring of COFINA debt.[142] On November 27, 2018, the Title III court approved[143] a revised disclosure statement,[144] clearing the way for a vote among classes of COFINA bondholders for approval.[145] The UCC, representing the interests of Commonwealth creditors, conditionally approved the agreement in early November 2018 after having complained about the settlement.[146]

Many junior COFINA bondholders contended the settlement was unfair. Some alleged that key Senior COFINA Bondholders Coalition members had purchased enough junior bonds to attain a decisive position in settlement negotiations, to the advantage of senior COFINA bondholders and the detriment of junior COFINA bondholders.[147] Small investors also complained about $332 million in consummation costs awarded to major investors involved in negotiations.[148] Several small COFINA bondholder suits were dismissed by the Title III court. The U.S. Court of Appeals for the First Circuit upheld those dismissals on February 8, 2021.[149] In a separate case, that court upheld on March 2, 2021, the dismissal of claims of Puerto Rico credit unions—called *cooperativas*—who contended they were pressured to buy COFINA junior bonds.[150]

Oversight Board, Title III Court Move to Wrap Up COFINA Restructuring

Arthur González, a member of the FOMB, argued that the proposed COFINA agreement was a prudent compromise, which avoided litigation that could end with a judgement that

> would either find that COFINA and its bondholders own the island's sales tax revenues, which would sharply reduce the funds available for other constituencies, or that the Commonwealth has the right to claw them back. A loss for the Commonwealth would be a particularly devastating setback, costing the local government billions of dollars in reduced debt and recouped revenue over the coming decades.[151]

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file/d/1KL0LsMGXtOaNPJ8YPKMpJCCs37uKZT9C/view.

[142] FOMB, *Disclosure Statement for the Title III Plan of Adjustment of the Debts of Puerto Rico Sales Tax Financing Corporation*, Case No. 17-BK-3284 (LTS), October 18, 2018, https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=ODk3NzAy&id2=0. Bankruptcy Code §1125 incorporated into PROMESA (§301(a)) required the Oversight Board to file a disclosure statement ahead of voting by creditors to accept or reject the plan.

[143] In re CPR and In re COFINA, Order Approving Disclosure Statement, https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=OTAwMTE5&id2=0.

[144] FOMB, *Disclosure Statement for the Amended Title III Plan of Adjustment of the Debts of Puerto Rico Sales Tax Financing Corporation*, Case No. 17-BK-3284 (LTS), November 16, 2018, https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=ODk5NzQw&id2=0. In re CPR and In re COFINA, Disclosure Statement for the Second Amended Title III Plan of Adjustment, November 26, 2018, https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=OTAwMDAw&id2=0.

[145] A memorandum, which congressional clients may request, describes the structure of the new COFINA bond issue.

[146] Robert Slavin, "COFINA Deal Takes Step Forward with Proposed Settlement," *Bond Buyer*, November 6, 2018.

[147] Eva Lloréns Vélez, "'Bonistas' Tout COFINA Deal Impact on Local Capital," *Caribbean Business*, October 22, 2018, https://caribbeanbusiness.com/bonistas-tout-cofina-deal-impact-on-local-capital/.

[148] A list of the Consummation Cost Parties is presented as Term Sheet Exhibit B (p. 367) of the second amended disclosure statement of November 26, 2018. The Consummation Cost provision is at pp. 362-364.

[149] For a summary of a hearing on four related appeals contesting the COFINA settlement, see Robert Slavin, "COFINA $17.6B Deal Attacked in Appeals Court," *Bond Buyer*, August 3, 2020. One of the judges who heard arguments in August 2020, Juan R. Torruella, died in October 2020. Pinto-Lugo et al. v. CPR, *Judgement* and *Opinion*, case 19-1181, U.S. Court of Appeals for the 1st Circuit, February 8, 2021, http://media.ca1.uscourts.gov/pdf.opinions/19-1181P-01A.pdf.

[150] Cooperativa de Ahorro y Credito v. Oversight Board, *Judgement* and *Opinion*, case 19-1391, U.S. Court of Appeals for the 1st Circuit, March 2, 2021, http://media.ca1.uscourts.gov/pdf.opinions/19-1391P-01A.pdf.

[151] Arthur J. González, "Lawful Restructuring Compromises Are Key to Puerto Rico's Future," Morning Consult,

Natalie Jaresko, executive director of the Oversight Board, stated in a court filing that the

> alternative to the Plan is protracted litigation . . . which could lead to an all-or-nothing recovery for holders of either Commonwealth claims or COFINA's Existing Securities.[152]

Court Approves Restructuring and Bond Exchange in February 2019

On February 4, 2019, as noted above, Judge Swain approved the COFINA settlement and confirmed its restructuring plan,[153] marking one of the largest municipal bond restructurings in U.S. history and thus resolving the GO-COFINA dispute.[154] On February 12, 2019, old COFINA debt with a par value of $17.6 billion was exchanged for $12 billion in new COFINA bonds, which were divided into several current-interest-bearing bonds (CIBs; i.e., normal bonds) and capital appreciation bonds (CABs), for which balloon payments would be due in future decades, the last ones ending in 2058.[155]

Concerns over COFINA Settlement and Ethical Conflicts

Some investment firms reported significant gains from holdings of Puerto Rican public debt and in particular, COFINA bonds.[156] A group of hedge funds, which acquired COFINA bonds at distressed prices and then spearheaded creditor negotiations, reportedly made "hundreds of millions of dollars" in profits.[157] Some smaller-scale bondholders complained that the exchange was mishandled and that their interests were not protected in negotiations, from which they were excluded.[158] For instance, rounding protocols, according to some, disadvantaged investors with

November 20, 2018, https://morningconsult.com/opinions/lawful-restructuring-compromises-are-key-to-puerto-ricos-future/. González had served as chief judge of the U.S. Bankruptcy Court for the Southern District of New York.

[152] Jaresko Declaration, In re: COFINA, §§9, 67, January 12, 2019, https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=OTAxNzgz&id2=0.

[153] Memorandum Opinion and Order Approving Settlement between Commonwealth of Puerto Rico and Puerto Rico Sales Tax Financing Corporation, U.S. District Court for the District of Puerto Rico, Case 17-03283, February 4, 2019, https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=OTAzMDUx&id2=0.

[154] The confirmation involved one filing on the Commonwealth of Puerto Rico (CPR) docket (17-03283) and two filings in the COFINA docket (17-03284). On the CPR docket, see Memorandum Opinion and Order Approving Settlement between Commonwealth of Puerto Rico and Puerto Rico Sales Tax Financing Corporation, U.S. District Court for the District of Puerto Rico, Case 17-03283, February 4, 2019, https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=OTAzMDUx&id2=0. On the COFINA docket, two filings on February 4, 2019, were superseded by amended documents filed the next day. See Amended Order and Judgment Confirming the 3rd Amended Title III Plan Of Adjustment of Puerto Rico Sales Tax Financing Corporation, U.S. District Court for the District of Puerto Rico, February 5, 2019, https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=OTAzMjM4&id2=0. Also see Amended Memorandum of Findings of Fact and Conclusions of Law, U.S. District Court for the District of Puerto Rico, February 5, 2019, https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=OTAzMjI0&id2=0.

[155] Robert Slavin, "COFINA Swaps Out Bonds in Biggest U.S. Muni Restructuring," *Bond Buyer*, February 12, 2019. Seven sets of CABs mature in years ranging from 2024 through 2051. The largest balloon payments are scheduled for 2046 ($1.1 billion) and 2051 ($640 million).

[156] Michelle Celarier, "Puerto Rican Bonds Power Hedge Fund Whitebox Advisors' 2018 Gains: The Bonds Were a Bright Spot for Whitebox and Other Hedge Funds in an Otherwise Dismal Year," *Institutional Investor*, January 29, 2019. Also see Michelle Celarier, "Tilden Park is Having a Big Year: Josh Birnbaum's Firm is Up Double Digits on the Back of a Deal for its Puerto Rico Bonds," *Institutional Investor*, November 29, 2018, https://www.institutionalinvestor.com/article/b1c1175xfxk6t1/Tilden-Park-is-Having-a-Big-Year.

[157] Andrew Scurria, "Hedge Funds Bask in Puerto Rico Bond Deal: Bondholders Offering Debt Relief in $18 Billion Renegotiation Gain Substantial Profits," *Wall Street Journal*, February 9, 2019, https://www.wsj.com/articles/hedge-funds-bask-in-puerto-rico-bond-deal-11549713600. In court filings, the group calls itself the Senior COFINA Bondholders Coalition.

[158] Peter Hein, Response to Request by FOMB, In re COFINA, June 4, 2019, https://cases.primeclerk.com/puertorico/

smaller holdings and advantaged those who held major positions.[159] Judge Swain dismissed objections that small holders were excluded from mediation, stating that individual investors were not prevented "from advocating their positions and seeking to participate in negotiations," that investors were "welcome to reach out to the mediation team," and that investors could object to proposals resulting from mediation and other negotiations.[160]

Some contend that links among the Whitebox investment fund, a member of the Senior COFINA Bondholders Coalition; the Compass funds; and McKinsey, the main consultant to the Oversight Board, posed conflicts of interest that were not properly disclosed.[161] The Board commissioned a review that asserted that McKinsey's investments posed no conflict, although they "could create the appearance of a potential conflict."[162] The following day, McKinsey paid $15 million to settle claims that it failed to disclose conflicts of interest in 14 other bankruptcy cases.[163]

Board Pivots GO Restructuring in 2019

The resolution—apart from certain appeals—of the COFINA restructuring cleared a path to address restructuring of GO bonds and debts of other entities closely tied to the island government, such as the Employee Retirement System (ERS) and the Public Building Authority (PBA). The PBA constructs buildings that are leased to agencies of the island government.

On January 14, 2019, the Oversight Board, in conjunction with its special claims committee and the UCC, challenged the validity of $6 billion (at par value) of GO bonds issued after 2011—referred to as "late vintage GO"—such as the $3.5 billion 2014 issue placed with hedge funds, allegedly issued in violation of a constitutional debt limitation.[164] In May 2019, the Oversight Board and the UCC filed over 250 avoidance action suits[165] and sued bankers involved in the

Home-DownloadPDF?id1=OTEzMzcw&id2=0.

[159] Michelle Kaske, "Puerto Rico Bondholders Fume for Being Shortchanged in Swap," Bloomberg, February 22, 2019, https://www.bloomberg.com/news/articles/2019-02-22/puerto-rico-investors-fume-as-debt-swap-leaves-some-shortchanged.

[160] In re: CPR, Omnibus hearing, March 4, 2020, pp. 213-214, https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=OTYwMTE1&id2=0.

[161] Michelle Celarier, "The Story McKinsey Didn't Want Written," *Institutional Investor*, July 8, 2019, https://www.institutionalinvestor.com/article/b1g5zjdcr97k2y/The-Story-McKinsey-Didn-t-Want-Written. See **Figure 3** for a summary of Whitebox holdings of COFINA bonds. Also see Mary Williams Walsh, "McKinsey Advises Puerto Rico on Debt. It May Profit on the Outcome," *New York Times*, September 26, 2018.

[162] In re: CPR, Informative Motion Regarding Publication and Filing of Final Investigative Report: McKinsey & Co., February 18, 2019, https://drive.google.com/file/d/1avv872k0XNonEiN9x0UzNUCUYDtYkqOd/view?usp=drivesdk.

[163] In re: Westmoreland et al., *Mediated Settlement Term Sheet between the U.S. Trustee Program and the McKinsey Entities*, U.S. Bankruptcy Court, Southern District of Texas, Houston Division, February 19, 2019, https://www.justice.gov/opa/press-release/file/1133251/download. Also see Peter Wells, "McKinsey Agrees to $15M Settlement over Bankruptcy Disclosures," *Financial Times*, February 19, 2019.

[164] Urgent Motion of the FOMB, Case 17-BK-3283 (LTS), January 14, 2019, https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=OTAyMjAz&id2=0. The motion alleged that after 2012, issuance of GO bonds violated the Puerto Rico's Constitution's Article VI Section 2 requirement that average debt service in the past two years not exceed 15% of revenues. The motion also contended that the guaranteed debt of the Public Building Authority (PBA) and the PBA leases to CPR agencies constituted a scheme to avoid the 15% limit. Those claims were pulled back after negotiations with creditors.

[165] Abner Dennis, "Puerto Rico's Debt Battles: The Oversight Board Goes on a Suing Spree," Little Sis webpage, June 5, 2019, https://news.littlesis.org/2019/06/05/puerto-ricos-debt-battles-the-oversight-board-goes-on-a-suing-spree/. The Board acted through a Special Claims Committee. See "Commonwealth of Puerto Rico Avoidance Actions," https://cases.primeclerk.com/puertoricoavoidanceactions/Home-Index.

2014 GO bond issue.[166] Avoidance actions allow a trustee to challenge transactions involving debtors before the filing of a bankruptcy petition.[167]

The Board did not explain why it chose to challenge GO bonds backed by a constitutional guarantee, but did not challenge the legal and constitutional basis of COFINA bonds. One investment analyst concluded "[t]he tacit support [by U.S. District Court Judge Swain] for the securitized structure represented by COFINA should be a welcome development for a municipal market that has been transitioning away from full faith and credit GO pledges and toward dedicated revenue pledges with perfected liens."[168] A coalition of bond insurers and bondholders filed a motion defending the validity of the GO bonds on March 21, 2019.[169]

2020: Oversight Board, Hedge Funds Negotiate Over GO Bonds

On May 31, 2019, after negotiations with creditors, the Oversight Board announced a Plan Support Agreement (PSA) for GO bonds and debt issued by ERS and PBA. The PSA was supported by the Lawful Constitutional Debt Coalition (LCDC); some other hedge funds, including some members of the COFINA Senior Bondholders Coalition; and some retiree and labor groups.[170]

The Oversight Board released an amended PSA on February 9, 2020, claiming to have the backing of holders of $10 billion in GO and Public Building Authority bonds,[171] followed by a draft disclosure statement on February 28, 2020.[172] The Oversight Board claimed that holders of 58% of outstanding GO and PBA debt had signed onto the PSA.[173] The new PSA offered slightly better terms for holders of GO and guaranteed debt, but worse terms for junior bonds.[174] Future debt service would fall from levels that fluctuate around $3 billion to $1.5 billion per year.

In contrast to the wrap-up of the COFINA case, the GO bond case has been delayed by a series of obstacles. On March 27, 2020, the Title III court, at the request of the Oversight Board, suspended consideration of the adequacy of the disclosure statement covering the proposed restructuring of GO, PBA, and ERS debt due to the effects of the Coronavirus Disease 2019

[166] In Re: CPR, Complaint, May 5, 2019, https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=OTExMTY2&id2=0.

[167] John D. Ayer, Michael Bernstein, and Jonathan Friedland, "Overview of Avoidance Actions," *American Bankruptcy Institute Journal*, March 2004.

[168] Axios Advisors Managing Partner Triet Nguyen quoted in Robert Slavin, "COFINA Money Likely to Flow Soon," *Bond Buyer*, February 5, 2019.

[169] Robert Slavin, "Puerto Rico Investors Move to Defend Legality of Bonds," *Bond Buyer*, March 21, 2019; PBA Funds', Assured's, And QTCB Noteholder Group's Rule 12(C) Motion for Judgment on the Pleadings, Case 18-00149-LTS, March 21, 2019, https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=OTA3NDEx&id2=0.

[170] LCDC comprises Aristeia Capital, Farmstead Capital, FCO Advisors, GoldenTree, Marble Ridge Capital, Monarch Alternative Capital, Taconic Capital, and Whitebox Advisors. See Oversight Board, *Amended Disclosure Statement*, February 9, 2019, p. 11, https://drive.google.com/file/d/1_JApEw_dGRQCpgAVo0SaffZrVuap6WqQ/view. Golden Tree, Taconic, and Whitebox were major members of the Senior COFINA Bondholders Coalition.

[171] Oversight Board, *Plan Support Agreement*, February 9, 2019, p. 8.

[172] Oversight Board, *Disclosure Statement for the Amended Title III Joint Plan of Adjustment of the CPR, et al.*, February 28, 2020, https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=OTQ0OTAy&id2=0.

[173] In re: CPR, Omnibus hearing, March 4, 2020, p. 18, https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=OTYwMTE1&id2=0.

[174] Brad W. Setser, "What Exactly is in the New Agreement Between Puerto Rico's Board and its Creditors?" Council on Foreign Relations Blog Post, February 11, 2020, https://www.cfr.org/blog/what-exactly-new-agreement-between-puerto-ricos-board-and-its-creditors.

(COVID-19) pandemic.[175] The Board has filed regular status reports on its activities relevant to that case and on effects of the pandemic.[176] The Board, in its December 2020 report, stated that negotiations continue, but declined to offer details due to confidentiality restrictions.

Accusations of Insider Trading in the GO Restructuring Process

On February 25, 2020, the Title III Court received allegations of insider trading by coalitions of hedge funds involved in GO restructuring mediation and negotiations. On the same date, the UCC called for more specific disclosures of holdings by participants in the GO mediation. For instance, previous disclosure filings reported aggregate holdings that combined GO debt with a full faith and credit pledge and PBA bonds that carried a CPR guarantee, distinctions that potentially translated into different treatment in restructuring plans. On June 8, 2020, Judge Swain ordered that creditor disclosures fully conform to Federal Rule of Bankruptcy Procedure 2019(b) standards.[177]

One analysis of changes in mediation participants' holdings as reported in amended disclosure filings asserted that LCDC members had increased holdings of GO bonds issued after 2011—referred to as late vintage GO bonds—while in an overlapping time period the LCDC and the Oversight Board had sought to invalidate the late vintage bonds.[178] That analysis also pointed to bond price changes that appeared to coincide with confidential mediation sessions in mid-January 2020. Hedge funds and other institutional investors denied that their members had either traded during restricted periods or traded on nonpublic information.[179]

Calls for Investigations of Alleged Insider Trading

In June 2020, Oversight Board Executive Director Natalie Jaresko testified that she was aware of insider trading allegations, but considered those a matter for law enforcement.[180] On August 5, 2020, five House Members sent a letter to the New York State Attorney General requesting an investigation into possible violations of that state's Martin Act, which covers a broad range of

[175] In re: CPR, *Order*, March 27, 2020, https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=OTQ5Nzg0&id2=0.

[176] Oversight Board, *Status Report*, May 1, 2020, https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=OTU3MjM0&id2=0. Also see Oversight Board, *Status Report*, December 4, 2020, https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=OTk2MDI5&id2=0.

[177] *Order Further Amending Case Management Procedures*, U.S. District Court for the District of Puerto Rico, Case 17 BK 3283-LTS, June 8, 2020, https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=OTU5OTU2&id2=0.

[178] Abner Dennis, "21 Vulture Funds Stalking Puerto Rico's Central Government: Legal Challenges, Investments, Insider Trading," Public Accountability Initiative webpage, August 5, 2020, https://public-accountability.org/report/the-21-vulture-funds-stalking-puerto-ricos-central-government-legal-challenges-investments-insider-trading/.

[179] Robert Slavin, "Puerto Rico Board, Investment Funds Reject Court Investigation of Insider Trading," *Bond Buyer*, October 15, 2020. Also see *Reply of LCDC*, In re: CPR, October 15, 2020, https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=OTg1NzM2&id2=0. Trading of securities by an insider while in possession of material nonpublic information may constitute insider trading barred by federal securities law. See Cindy A. Schipani and H. Nejat Seyhun, "Defining 'Material, Nonpublic': What Should Constitute Illegal Insider Information?" *Fordham Journal of Corporate & Financial Law*, vol. XXI, 2016, pp. 327-378.

[180] Testimony of Oversight Board Executive Director Natalie Jaresko, in U.S. Congress, House Committee on Natural Resources, *PROMESA Implementation During the Coronavirus Pandemic*, 116th Cong., 2nd sess., June 11, 2020, Serial 116–35, p. 97.

securities dealings.[181] Resident Commissioner Jenniffer González asked the U.S. Securities and Exchange Commission to consider whether securities laws were violated.

On October 5, 2020, House Committee on Natural Resources Chair Raúl Grijalva and other Members sent the Oversight Board a letter requesting an investigation into those allegations.[182] On the same day, a bond insurer, National Public Finance, asked the Title III Court to investigate insider trading and related allegations.[183] Both requests were declined. The Oversight Board demurred on an investigation, but pledged to contact the U.S. Department of Justice, explaining that

> given the investigative resources available to Department and its expertise in investigating the conduct at issue, the Oversight Board believes the Department is better suited than the Oversight Board to evaluate the evidence and to determine whether federal laws have been violated. This approach will also avoid saddling the Commonwealth with a potentially expansive and expensive investigation.[184]

Judge Swain declined bond insurer National Public Finance's motion to direct the U.S. Trustee or another entity to conduct an investigation, writing that "neither PROMESA nor any provision of the Bankruptcy Code that is incorporated into Title III explicitly authorizes this Court to initiate an independent investigation along the lines of the investigation sought by National in its Motion."[185] Moreover, Judge Swain found that "National ha[d] not proffered evidence sufficient to support a reasonable inference that any participant in the Mediation has traded on inside information to the detriment of counterparties or the bond market, much less to the detriment of the Title III and Mediation processes."

Restructuring on Hold in 2020

The final resolution to the Title III case for GO bonds and related debts was in limbo for much of 2020 for several reasons. First, the COVID-19 pandemic, as elsewhere, has disrupted normal operations and cast in doubt previous projections of Puerto Rico's economic and fiscal future. A series of earthquakes hit the southwest of Puerto Rico in early 2020, further disrupting operations.

Second, allegations that hedge funds involved in negotiations had traded bonds using nonpublic information prompted Judge Swain to order more detailed disclosures, which in turn has prompted further litigation. Third, former Resident Commissioner Pedro Pierluisi Urrutia was inaugurated as governor in January 2021. Changes in the governor's office have typically led to major staffing changes in island agencies and public corporations.[186] Fourth, some of the original Oversight Board members have stepped down and the process of appointing new members or

[181] N.Y. Gen. Bus. Law §§352, 352-c.

[182] Letter of Chair Grijalva to Oversight Board Executive Director Natalie Jaresko, October 21, 2020, https://naturalresources.house.gov/download/grijalva-house-letter-to-fomb-on-insider-trading-investigation-october-21-2020.

[183] National Public Finance Guarantee, *Motion*, In re: CPR, October 5, 2020, https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=OTg1NzM2&id2=0.

[184] Oversight Board, letter to Chairman Raul Grijalva, October 27, 2020, https://drive.google.com/file/d/10mffHf-R-VOUfATYZtRSWOO1GqZWDMQC/view.

[185] In re: CPR, *Order*, October 28, 2020, https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=OTg2Mjgz&id2=0.

[186] José Alvarado Vega, "Pierluisi, Delgado Win Puerto Rico Primaries," *Caribbean Business*, August 17, 2020, https://caribbeanbusiness.com/pierluisi-delgado-win-puerto-rico-primaries/. Pierluisi also worked as a consultant to the Oversight Board after his term as Resident Commissioner.

extending appointments of current members remains unfinished. Until the reappointment process had concluded, the Board's composition and priorities were unclear. Fifth, the pace of disaster recovery funding, which was expected to bolster the island's economy—and thus its ability to service debts—in the medium term has been slow and uncertain.[187] The Biden Administration has released some of those recovery funds.[188]

The Oversight Board discussed proposals to revise the plan of adjustment to reflect effects of the COVID-19 pandemic on the island economy at its October 30, 2020, public meeting. A newly appointed member, Justin Peterson, left the online meeting, blocking a vote to modify the plan.[189]

Oversight Board Announces Revised GO PSA in February 2021

On October 29, 2020, Judge Swain ordered the Oversight Board to present "an informative motion presenting a term sheet disclosing the material economic and structural features of an amended plan of adjustment that the Oversight Board intends to propose for confirmation" by February 10, 2021, which would cover GO debt, as well as debts of the Public Building Authority.[190] On that date, the Oversight Board announced that it had reached an agreement in principle with several major bondholders. Two weeks later it released the proposed amended plan support agreement (PSA), which it filed with the Title III court on March 8, 2021.[191] **Table 1** compares terms of the February 2021 PSA with those of a plan discussed by the Oversight Board in October 2020.

Although the total recovery value of the newly proposed GO settlement is higher than the plan outlined by the Board in October 2020,[192] it would be well below that of the plan of adjustment filed in February 2020 ($15.2 billion) or the creditors' counterproposal of August 2020 ($15.3 billion), in part reflecting effects of the COVID-19 pandemic.[193]

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[187] See CRS Report R46609, *The Status of Puerto Rico's Recovery and Ongoing Challenges Following Hurricanes Irma and María: FEMA, SBA, and HUD Assistance*, coordinated by Elizabeth M. Webster.

[188] José A. Delgado Robles, "White House Approves $3.7 Billion to Repair PRASA: With the Newly Approved Funds, the Federal Government has Promised More than $67.7 Billion for the Island's Recovery and Reconstruction, However, Only a Third of the Money has Arrived," *El Nuevo Día*, January 6, 2021, https://www.elnuevodia.com/english/news/story/white-house-approves-37-billion-to-repair-prasa/.

[189] Robert Slavin, "Puerto Rico Board Member Exercises Exit Veto," *Bond Buyer*, October 30, 2020. Peterson is managing director of the DCI Group, which had worked on behalf of GO bondholders during Governor García Padilla's term in office (2013-3017). José A. Delgado Robles and Joanisabel González, "Donald Trump Picks Justin Peterson as New Oversight Board Member: The President Announces his Intention to Appoint a Partner of a Controversial Firm Representing Bondholders," *El Nuevo Día*, October 8, 2020, https://www.elnuevodia.com/english/news/story/donald-trump-picks-justin-peterson-as-new-oversight-board-member/.

[190] In re: CPR, Order on Joint Motion of PSA Creditors, October 29, 2020, https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=OTg2NDIy&id2=0.

[191] In re: CPR, Oversight Board, *Second Amended Title III Joint Plan Of Adjustment of the Commonwealth of Puerto Rico, et al.*, March 8, 2021, https://drive.google.com/file/d/1IP-znS391lEFMcg35u6flHfcndndyxec/view. Also see Oversight Board, "Oversight Board Reaches Agreement in Principle on Debt: Creditors Holding About $7 Billion of General Obligation and Public Building Authority Bonds Committed; Mediation Continues to Gain Support Across Broad Spectrum of Creditors," press release, February 10, 2021, https://drive.google.com/file/d/149MrGro7s_q6W5tc8QoxLpwRo8NArnYR/view. Also see Oversight Board, *Amended Plan Support Agreement*, February 23, 2021, https://drive.google.com/file/d/15zWXi83c0EOI8Pzw2uS_lYGgxRbugBsV/view.

[192] Espacios Abiertos, "Nueva Propuesta del Pago de la Deuda Deja a Puerto Rico sin Dinero en Efectivo en Ocho Años [New proposal for debt service would leave Puerto Rico without cash in eight years]," press release, February 10, 2021, https://espaciosabiertos.org/nueva-propuesta-del-pago-de-la-deuda-deja-a-puerto-rico-sin-dinero-en-efectivo-en-ocho-anos/.

[193] See Oversight Board, *Plan of Adjustment Discussion*, p. 53, October 30, 2020, https://drive.google.com/file/d/1UDwg3-wMpsRhUdDbkpGS-wuZsoWte38d/view.

Table 1. Comparison of February 2021 PSA and October 2020 Board Proposal

Dollar amounts in millions

Item	February 2021 PSA	October 2020 PSA	Difference
Cash GO	$7,024[a]	$5,984	$1,040
Cash PBA	$1,073	[b]	—
Annual fixed payment GO & COFINA Sr	$1,150	$1,050	$100
Time period	25 years	20 years	5 years
GO bond issue	$6,683	$4,980	$1,703
Capital Appreciation Bond issue	$730; rises to $1066	$0	$730
Annual Maximum on CVI	from $200 to $400	$50	from $150 to $350
Cumulative Maximum on CVI	$3,500	$1,000	$2,500
Time period for CVI	22 years	20 years	2 years

Source: CRS analysis of CPR PSAs, Espacios Abiertos, Oversight Board, *Plan of Adjustment Discussion*, pp. 51-57, October 30, 2020, https://drive.google.com/file/d/1UDwg3-wMpsRhUdDbkpGS-wuZsoWte38d/view.

Notes: CAB capital appreciation bonds are no-coupon bonds with balloon payments near maturity. Contingent valuation instruments (CVIs) pay creditors more if economic growth exceeds fiscal plan baseline projections.

a. Includes potential $350 million contingent on revenues above benchmarks.

b. PBA terms not included in October Board proposal.

If terms of the most recent PSA were implemented, existing bonds covered by the agreement would be exchanged for cash, new GO bonds, capital appreciation bonds (with interest only payable in future years), and contingent valuation instruments (CVIs) that would pay creditors extra amounts if the island's economic growth exceeded Oversight Board projections. The mix of new assets received would differ for each old bond, with estimated recovery rates ranging from 67.7% for the 2014 GO bond to 80.3% for pre-2011 PBA bonds, excluding CVI payments.[194] Those recovery rates are well above what market prices indicate were expected recovery rates for much of the period of the debt restructuring, as a later section discusses.

The Oversight Board chairman claimed the proposed plan aimed at consensual agreement; that it reflected harm to the island from hurricanes, the COVID-19 pandemic, and other natural disasters; that it was a fair deal for creditors; and that it would be a "once and done deal."[195] The plan also includes reductions of 2%-3% in some pension payments above certain thresholds, which the Board contends would protect most pensioners from those reductions.[196] Pension reductions, creditor concerns, and macroeconomic uncertainties, among other considerations, may spur opposition to the Board's plan.[197]

[194] Robert Slavin, "Puerto Rico Reaches Deal with Debt Holders with 14% Less Repayment," *Bond Buyer*, February 23, 2021.

[195] David Skeel, "Oversight Board: Right Deal for Puerto Rico Rests on Four Principles," *Bond Buyer*, February 8, 2021.

[196] Oversight Board, *Lowering Puerto Rico's Debt to Sustainable Levels: Plan Support Agreement with Bondholders*, February 26, 2021, p. 6, https://drive.google.com/file/d/1wTLXvJRu2GI38DRcpOWuVHX2OvTwvAVo/view.

[197] Robert Slavin, "Puerto Rico Debt Restructuring Faces Several Obstacles," *Bond Buyer*, March 5, 2021.

Governor Pedro Pierluisi was quoted as stating that the agreement was a "step forward," although he vowed to oppose any plan that would result in reductions in public pension payments to retirees.[198] On April 12, 2021, the Oversight Board announced an agreement in principle with two bond insurers, Assured Guaranty and National Public Finance Guarantee.[199] A plan support agreement was announced on May 5, 2021, which removes one hurdle to implementation of the CPR PSA. The agreement involves treatment of the CPR clawback of revenues from certain public corporations.[200]

Market Perspectives on Debt Restructuring

Trends in bond prices provide a window on investors' views of the restructuring process and proposals as they proceed through the events described in previous sections. **Figure 4** shows bond prices as a percentage of par from 2013 through 2020 for selected issues of GO bonds; COFINA bonds; and bonds of the three largest Puerto Rican public corporations: PREPA, PRASA, and HTA.

Bond prices, according to finance theory, reveal market expectations of the probability of default and recovery rates—that is, the value of what bondholders would receive after default and restructuring.[201] Once the prospect of default became a certainty, bond prices then reflected market expectations of recovery rates. **Appendix B** presents data on bond prices and trading volumes for a narrower time period. **Appendix C** lists key dates with links to key documents.

Bond prices have changed dramatically over the course of the debt restructuring process.[202] Many Puerto Rican bonds traded above par before mid-2013. All of these bond prices fell sharply in 2013, reacting to the Detroit bankruptcy filing and a business press article on Puerto Rico's fiscal distress.[203] The introduction of a local bankruptcy measure in June 2014 and the announcement by Puerto Rico's governor a year later that the island's debts were "unpayable" also pushed bond prices down.

[198] Justine Coleman, "Puerto Rico Debt Restructure Plan Threatens Public Pensions," *The Hill*, March 9, 2021, https://thehill.com/homenews/state-watch/542318-puerto-rico-debt-restructure-plan-threatens-public-pensions.

[199] Oversight Board, "Agreement in Principle Summary: HTA, CCDA, and Clawback Claims," April 12, 2021, https://drive.google.com/file/d/1ZOE9M4oqBlFNyhgrbFpN71NW8b6-f4Pa/view.

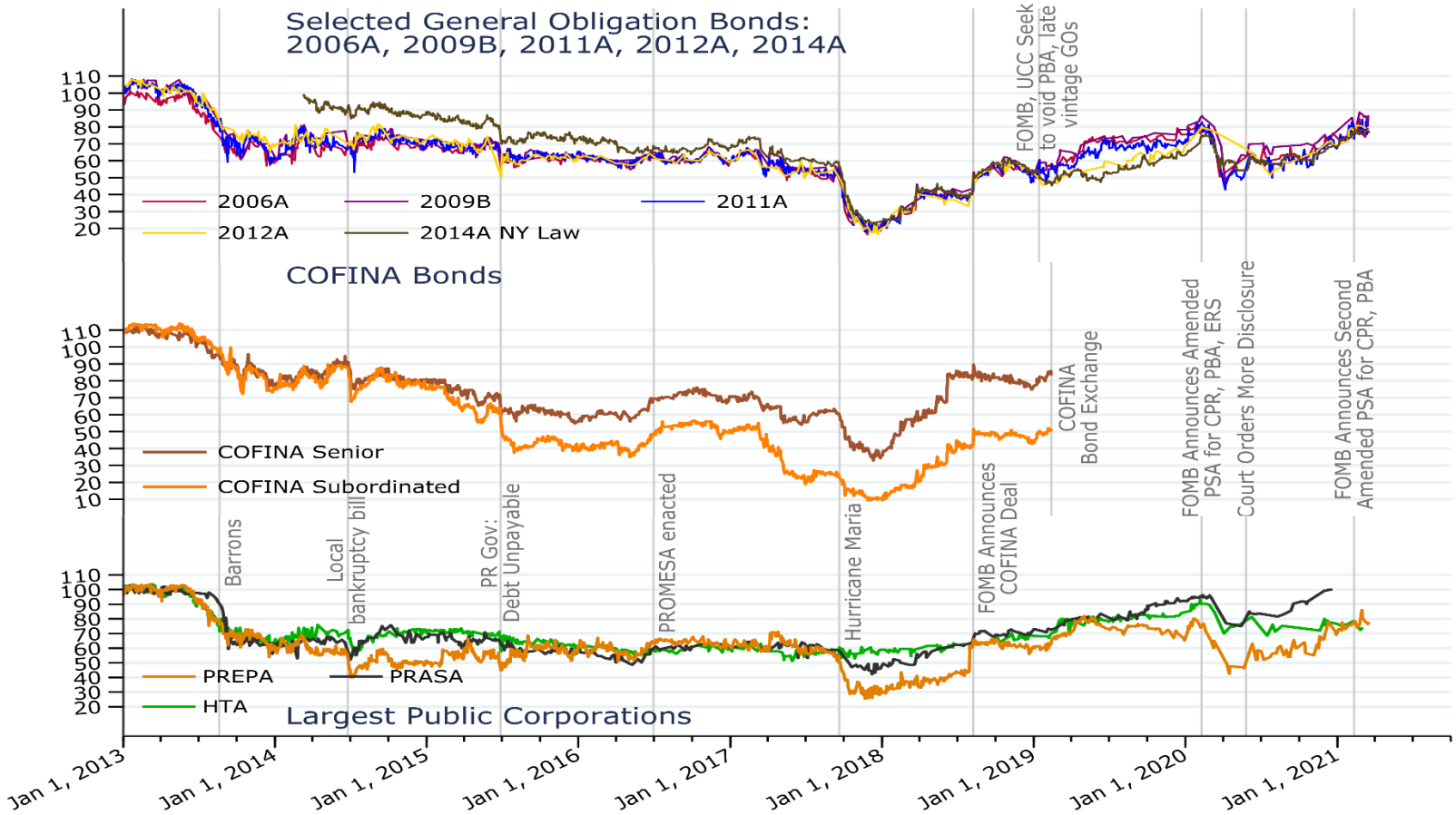
[200] Oversight Board, "Oversight Board Completes Agreement with Assured Guaranty and National Public Finance Guarantee Corp.: Settles Asserted Clawback Claims Against the Commonwealth and Establishes Framework for a HTA Title III Plan of Adjustment," press release, May 5, 2021, https://drive.google.com/file/d/1HKvFLiAG5Wv3c3xrkGakvnC0sqI_f8Y-/view. The plan support agreement is available at https://drive.google.com/file/d/1BqBUrjTk_xjtg1wEhOdnv3ul4WfUorld/view.

[201] A risk-neutral investor would calculate a bond's value as (1-α)*(present value of principal and interest payments) + α*(recovery value), where α is the probability of default. Given that default on the bulk of Puerto Rico's debt was highly likely or certain by mid-2015, bond prices would then directly reflect market expectations of recovery rates. Holders of some bonds backed by dedicated revenue streams have argued that default on those bonds was not inevitable, although such arguments gained no traction in the Title III court.

[202] More specific allegations of insider trading are discussed in a previous section.

[203] Andrew Bary, "Troubling Winds: Puerto Rico's Huge Debt Could Overwhelm Attempts to Revive its Economy," *Barron's*, August 26, 2013.

Figure 4. Price Trends for Selected Puerto Rico Bonds



Source: CRS calculations based on the Municipal Securities Rulemaking Board EMMA site: https://emma.msrb.org/.

Notes: All prices quoted as percentage of par value. CUSIPS (codes used to identify issuers and financial securities) are 2006A (74514LHN0), 2009B (74514LVW4), 2011A GO (74514LYW1), 2012A (74514LA98), 2014A NY Law GO (74514LE86), PREPA (74526QVX7), PRASA (745160QF1), HTA (745181K97), COFINA Subordinated (74529JHN8), and COFINA Senior (74529JNX9). The first vertical grey line indicates the release of the August 2013 *Barron's* article; the second is the introduction of a local bankruptcy measure. COFINA bonds were exchanged for new bonds on February 12, 2019. Values interpolated between trade dates.

Not all categories of debt moved to the same extent. For instance, COFINA subordinate bond prices reacted more sharply to events of 2015 than GO bond prices, although they recovered more ground than other bonds in the lead-up to the enactment of PROMESA at the end of June 2016. The COFINA default in May 2017 depressed senior and especially subordinate COFINA bonds.

The devastation left by Hurricanes Irma and María in September 2017 severely depressed almost all Puerto Rico bond prices.[204] GO bonds then traded at a quarter of par or less, while COFINA subordinates briefly traded at about 10% of par. Prices began to recover in 2018, with the February enactment of the Balanced Budget Act of 2018 (BBA 2018; P.L. 115-123), which appropriated disaster relief funds for Puerto Rico and other affected areas. Prices also responded to Oversight Board proposals in April 2018 that combined calls for fiscal austerity with relatively optimistic macroeconomic forecasts.

In January 2018, the Oversight Board called for invalidating late vintage GO issues, causing the older GOs to trade at a premium to the 2014 issue. The 2014 GO issue had traded above older GO issues until Hurricane María, reflecting the New York law provision. Some of the allegations of insider trading—discussed in "Accusations of Insider Trading in the GO Restructuring Process," above—center on divergences between earlier and late vintage GO bonds. Those differences narrowed after the Oversight Board announced an Amended Plan Support Agreement for the CPR, ERS, and PBA in February 2020.

The relationship between bond prices and estimated recovery rates in the consummated COFINA plan and recent proposals for restructuring GO and related debts has attracted some attention. Several activists assert that the marked recovery of bond prices after some of those prices reached extremely low levels in fall 2017 implies that investors took advantage of island residents. The recovery of those prices, per se, need not imply any misbehavior on the part of investors, but could reflect a transfer of bond holdings to investors and funds more willing to tolerate risk, or less adverse to litigation, or better informed about long-term prospects.

The shift in holdings from smaller bondholders to hedge funds acting within coalitions may also play a role. Hedge funds, some contend, can serve to mitigate collection action challenges to enforcing creditor interests facing dispersed investors.[205]

What Can Puerto Rico Afford to Pay?

A "once and done deal," as the Oversight Board chair put it, would require a manageable future debt service burden. Capacity to service public debt depends on growth in the tax base—largely proxied by growth of the island's economy—as well as the efficiency of tax administration and the willingness to keep tax rates in proportion to expenditures. In other terms, debt service capacity rests on a government's ability to run primary surpluses; that is, having receipts running sufficiently above non-debt-service outlays to meet debt service obligations. For each component of debt service capacity—economic growth, tax administration, willingness to tax, and fiscal constraint—reasons for both optimism and concern may exist.

[204] PRASA, the water and sewer authority, was the exception, reflecting its comparatively stronger finances.

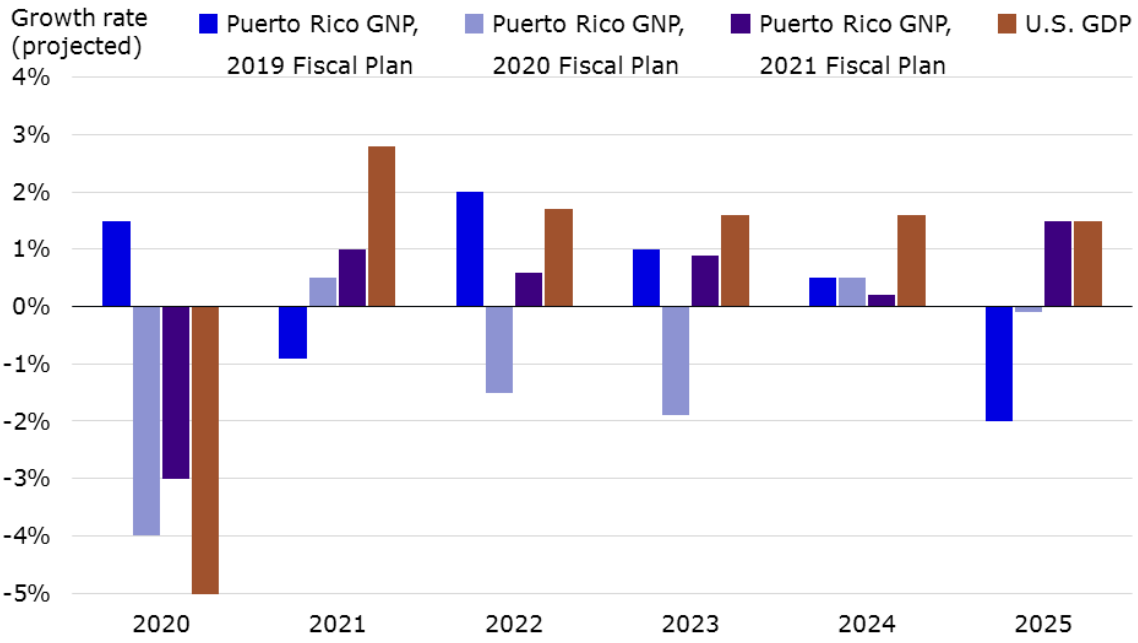
[205] Marcel Kahan and Edward Rock, "Hedge Fund Activism in the Enforcement of Bondholder Rights," *Northwestern University Law Review*, vol. 103, no. 1 (winter 2009), pp. 281-322. Those enhanced capacities to enforce bond covenants, the authors note, may impair interests of issuers. Some COFINA creditors argued that actions of hedge funds impaired their interests, but were unable to persuade courts to intervene.

Puerto Rico's Economy Expected to Shrink

In recent decades economic growth in Puerto Rico has been uneven, if not stagnant.[206] Recovery from the 2017 Hurricanes Irma and María has been slow. Earthquakes in late 2019 and early 2020, along with the COVID-19 pandemic, also hindered economic activity. The island's economy, according to April 2021 Oversight Board estimates, shrank by 3.0% in 2020.[207]

The Board projects negligible economic growth over the next five years, as shown in **Figure 5**.[208] The 2021 CPR Fiscal Plan projects somewhat more growth than plans from recent past years. Growth projections that adjust for income increases due to federal COVID-19 relief measures show stronger growth in 2021 (3.8%) and 2022 (1.5%), but weaker growth for later years. Puerto Rico's projected economic growth trajectory, according to Oversight Board projections, will be well below growth rates expected for the U.S. economy for the years 2021-2024, although it would nearly match the projected U.S. growth rate in 2025.

Figure 5. Projected Puerto Rican and U.S. Economic Growth Rates, 2020-2025



Source: Oversight Board, *Fiscal Plan Macroeconomic Overview and Fiscal Plan*, August 18, 2020; and Oversight Board, *Certified 2021 Fiscal Plan*, April 23, 2021.

Notes: Puerto Rico projections use GNP, which avoids distortions in GDP measures related to tax avoidance strategies of multinational firms with Puerto Rican subsidiaries. Puerto Rican growth rates are for the CPR fiscal year, which starts on July 1.

[206] See CRS Report R44095, *Puerto Rico's Current Fiscal Challenges*, by D. Andrew Austin.

[207] Oversight Board, *Certified Fiscal Plan for Puerto Rico*, April 23, 2021, ch. 4, https://drive.google.com/file/d/1reetKnfKsa1uR-A0u9l3FM6PfGamHCrx/view. Growth is measured for fiscal years of the Puerto Rican government, which start on July 1. Economic growth is measured using gross national product, which avoids distortions due to profit shifting.

[208] Testimony of Oversight Board Executive Director Natalie Jaresko, in U.S. Congress, House Natural Resources Committee, 116th Cong., 2nd sess., hearing, *PROMESA Implementation During the Coronavirus Pandemic*, June 11, 2020, p. 10, https://www.govinfo.gov/content/pkg/CHRG-116hhrg40637/pdf/CHRG-116hhrg40637.pdf.

The 2021 CPR Fiscal Plan anticipates that Puerto Rico will receive $110 billion in federal funds over the coming decade, although mainland firms or contractors would receive some of that amount. Federal and private disaster assistance is estimated to drop from $8.1 billion in 2019 to $2.3 billion in 2020, and to rise in following years as Community Development Block Grant Disaster Recovery (CDBG-DR), Federal Emergency Management Agency (FEMA) permanent public assistance, and certain other federal program funds are disbursed.[209]

The island's shrinking population, due to continuing net outmigration to the mainland and low birth rates, also affects its growth prospects.[210] The U.S. Census Bureau estimates that the island's population fell from 3.73 million in 2010 to 3.16 million in 2020, a decrease of 15%.[211] The Oversight Board projects that its population will decline to 2.76 million by 2026.[212]

The FOMB has been optimistic that structural reforms, such as changes in the island's labor laws to encourage higher labor participation rates and to loosen employment law restrictions and protections, would accelerate economic growth.[213]

Some economists have viewed Oversight Board projections of Puerto Rico's growth prospects and its capacity to service debt as overly optimistic[214] and note that fiscal austerity could restrain economic growth enough to outweigh gains from proposed structural and labor market reforms.[215] Although low labor participation rates have been a persistent issue in Puerto Rico,[216] recent IMF research suggests projections of faster economic growth through structural changes are often unfulfilled.[217]

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[209] Oversight Board, *Certified Fiscal Plan for Puerto Rico*, April 23, 2021, ch. 4, exhibits 12, 13, 14, pp. 31-39, https://drive.google.com/file/d/1reetKnfKsa1uR-A0u9l3FM6PfGamHCrx/view. Also see Sergio M. Marxuach, "Federal Funds Anchor New Fiscal Plan," Center for a New Economy blog, April 29, 2021, https://grupocne.org/2021/04/29/federal-funds-anchor-new-fiscal-plan/.

[210] Jennifer Hinojosa and Edwin Meléndez, *Puerto Rican Exodus: One Year Since Hurricane Maria*, Hunter College Center for Puerto Rican Studies, issue brief RB2018-05, September 2018, https://centropr.hunter.cuny.edu/sites/default/files/RB2018-05_SEPT2018%20%281%29.pdf.

[211] U.S. Census Bureau, *Puerto Rico Municipios Population Totals: 2010-2020*, April 30, 2021, https://www.census.gov/programs-surveys/popest/technical-documentation/research/evaluation-estimates/2020-evaluation-estimates/2010s-total-puerto-rico-municipios.html.

[212] Oversight Board, *Certified Fiscal Plan for Puerto Rico*, April 23, 2021, ch. 4, exhibit 17, p. 42, https://drive.google.com/file/d/1reetKnfKsa1uR-A0u9l3FM6PfGamHCrx/view.

[213] FOMB letter to Members of Congress, November 14, 2018, https://drive.google.com/file/d/10BKVqq_YhKNT_-tGAEaphk1QhDiy3mSX/view.

[214] Pablo Gluzmann and Martin Guzman, *Puerto Rico's Debt Dilemma*, Espacios Abiertos working paper, May 2019, http://espaciosabiertos.org/wp-content/uploads/Puerto-Ricos-Debt-Dilemma-Final-Report-May-2019.pdf; and Omaya Sosa Pascual and Luis Valentín Ortiz, "Fantasy of the Fiscal Plan for Puerto Rico," Center for Investigative Journalism, February 20, 2018, https://periodismoinvestigativo.com/2018/02/the-fantasy-of-the-fiscal-plan-for-puerto-rico/.

[215] Pablo A. Gluzmann, Martin M. Guzman, and Joseph E. Stiglitz, *An Analysis of Puerto Rico's Debt Relief Needs to Restore Debt Sustainability*, National Bureau of Economic Research, working paper no. 25256, November 2018, http://www.nber.org/papers/w25256. Also see Brad W. Setser, "Could Maria's Legacy Be a New Debt Trap for Puerto Rico?" Council on Foreign Relations blog post, November 13, 2018, https://www.cfr.org/blog/could-marias-legacy-be-new-debt-trap-puerto-rico.

[216] María E. Enchautegui and Richard B. Freeman, "Why Don't More Puerto Rican Men Work?: The Rich Uncle (Sam) Hypothesis," in Susan M. Collins, Barry P. Bosworth, and Miguel A. Soto-Class, eds., *The Economy of Puerto Rico: Restoring Growth* (Brookings: Washington, DC, 2006).

[217] Kevin Greenidge, Meredith A. McIntyre, and Hanlei Yun, *Structural Reform and Growth: What Really Matters: Evidence from the Caribbean*, International Monetary Fund, working paper 16/82, April 7, 2016, https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Structural-Reform-and-Growth-What-Really-Matters-Evidence-from-the-Caribbean-43855. Those authors find that, among Caribbean countries, structural reforms only appear in the long term and depend on investments in institutional quality that support the maintenance of reform efforts. The IMF chief

Effects of the 2017 hurricanes, the 2020 earthquakes, and the COVID-19 pandemic all complicate the island's fiscal prospects. Despite the catastrophic damage endured by the island, Executive Director Jaresko stated that federal disaster recovery funds and insurance proceeds would promote economic growth and raise tax collections, which would increase Puerto Rico's ability to repay its debt,[218] in particular through the rebuilding of the island's electric grid and generating fleet, in part to be supported through Community Development Block Grant disaster recovery funds. Federal outlays on permanent disaster recovery projects had been slow relative to mainland standards, although the Biden Administration has lifted holds on those funds.[219] Restructuring of Puerto Rico's energy sector, however, is subject to substantial implementation, operational, and financial risks.[220]

Contingent valuation instruments (CVIs) added into the amended plan of adjustment proposed by the Oversight Board in February 2021, if implemented, would provide creditors with additional payments if Puerto Rico's economy grew faster than the Board's projections.

Revenue Growth and Tax Policy

Recent tax collections have exceeded projections. CPR-source revenue rose from $10.1 billion in FY2018 to a projected $12.3 billion in FY2019. Federal-source income also rose by $3.6 billion between those years.[221] Revenues for the last half of calendar 2020 were stronger than expected.[222]

Other concerns persist. Recent changes in federal tax laws regarding treatment of intellectual property and corporate taxation could present challenges to Puerto Rico's economic development strategies, which historically have relied heavily on advantageous tax treatment of corporate

economist said "it was strongly felt that if you have sufficiently flexible labour markets and product markets, labour and capital will move freely to wherever you have the highest wages or the highest returns. But the truth is that doesn't happen very easily, especially when you're talking about labour mobility." Martin Sandbu, "Gita Gopinath: 'Fiscal Policy Plays an Essential Role in Recovery,'" *Financial Times*, November 19, 2020.

[218] "The fiscal stimulus from the Federal disaster recovery funds and the insurance proceeds has the impact of increased economic growth that translates into more tax revenues for the Commonwealth. While no Federal monies are being used to pay debt, the Commonwealth's new reality is that the Government will collect more revenue during the period of the Fiscal Plan." Testimony of Executive Director Natalie Jaresko, in U.S. Congress, House Committee on Natural Resources, Oversight Hearing on PROMESA, 116th Cong., 1st sess., May 2, 2019, written response to Rep. Horsford's question 13, Ser. 116-14, https://www.govinfo.gov/content/pkg/CHRG-116hhrg36258/html/CHRG-116hhrg36258.htm.

[219] U.S. Department of Housing and Urban Development (HUD), "HUD Accelerates Access to Puerto Rico Disaster Relief Funds: Department Removes Onerous Restrictions that Limited Island's Access to Funds, Obligates $8.2 Billion in Federal Mitigation Funding," press release 21-066, April 19, 2021, https://www.hud.gov/press/press_releases_media_advisories/HUD_No_21_066. Also see HUD Office of the Inspector General, *Review of HUD's Disbursement of Grant Funds Appropriated for Disaster Recovery and Mitigation Activities in Puerto Rico*, report 2019SU008945I, April 20, 2021, https://www.hudoig.gov/reports-publications/investigation-summary/review-huds-disbursement-grant-funds-appropriated.

[220] See CRS Report R45023, *Repair or Rebuild: Options for Electric Power in Puerto Rico*, by Richard J. Campbell, Corrie E. Clark, and D. Andrew Austin.

[221] Puerto Rico Planning Board, Statistical Appendix to the FY2019 Economic Report of the Governor (Apéndice Estadístico del Informe Económico a la Gobernador), May 2020, Table 27, http://jp.pr.gov/Econom%C3%ADa/Ap%C3%AAndice.

[222] Robert Slavin, "Puerto Rico Revenues Coming in Well Ahead of Projections," *Bond Buyer*, February 18, 2021.

income.[223] Those tax incentives have led some to term Puerto Rico a tax haven.[224] In July 2019, Puerto Rico enacted a law that consolidated many of its tax incentives.[225] The Oversight Board has expressed concerns about how the CPR has awarded tax credits and incentives.[226] The Puerto Rico Treasury Department has promised to tighten controls on tax fraud.[227]

About one-fifth of the CPR's revenue stems from Act 154 taxes on transactions between multinational corporation subsidiaries based in Puerto Rico and the mainland, which often can be credited against federal tax liabilities. In September 2019, then-Treasury Secretary Mnuchin had pushed to phase out Act 154 taxes.[228]

Comparison with Heavily Indebted States

A comparison with per capita debt levels of state governments is one benchmark of Puerto Rico's capacity to repay debt. Puerto Rico's post-restructuring public debts—if recent plans and proposals go through—would leave it with per capita debt burdens somewhat above the most highly indebted state governments. Puerto Rico's per capita income levels, however, are well below those of mainland states.[229] The Oversight Board, in a presentation outlining its March 2021 restructuring plan, contends that those proposals would significantly reduce Puerto Rico's public debt in comparison to the most heavily indebted mainland states.[230]

Issues for Congress

Puerto Rico's debt restructuring processes may present policy issues concerning not only the island, its debts, and its creditors, but also municipal finance markets more broadly. Congress therefore might consider legislative and oversight initiatives focused not only on Puerto Rico, but also on the wider municipal securities market.

As Puerto Rico's public debt comprises about 2% of overall municipal debt, the consequences of debt restructurings will affect or have affected a significant number of investors. Many investors

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[223] Manuel Madrid, "How the Tax Cut Sacks Puerto Rico," *American Prospect*, June 28, 2018, http://prospect.org/article/how-tax-cut-sacks-puerto-rico. Also see Francisco Luis, "Acts 20 & 22 Interplay With New U.S. Tax Reform," *Caribbean Business*, February 8, 2018.

[224] Abner Dennis, "A Tax Haven Called Puerto Rico," Little Sis, February 19, 2020, https://news.littlesis.org/2020/02/19/a-tax-haven-called-puerto-rico/. Also see Jesse Barron, "How Puerto Rico Became the Newest Tax Haven for the Super Rich," *GQ*, September 18, 2018, https://www.gq.com/story/how-puerto-rico-became-tax-haven-for-super-rich. Also see Testimony of Miriam J. Ramirez, former Puerto Rico Senator, in U.S. Congress, House Committee on Natural Resources, Subcommittee on Indian, Insular and Alaska Native Affairs, *Examining Procedures Regarding Puerto Rico's Political Status and Economic Outlook*, Oversight hearing, 114th Cong., 1st sess., June 24, 2015, Ser. 114-13, https://www.govinfo.gov/content/pkg/CHRG-114hhrg95300/html/CHRG-114hhrg95300.htm.

[225] Act 60 of 2019, July 1, 2019, http://www.lexjuris.com/lexlex/Leyes2019/lexl2019060.htm.

[226] Oversight Board, letter to Treasury Secretary Teresita Fuentes Marimón and Secretary for Economic Development and Commerce Manuel Laboy River, October 31, 2018, ahttps://drive.google.com/file/d/1HWNVx0Ce6gkH4Ijy2YJfbbKtttz7MrvR/view.

[227] Robert Slavin, "Puerto Rico Treasury Announces Crackdown on Tax Fraud," *Bond Buyer*, February 22, 2021.

[228] Robert Slavin, "Puerto Rico Will Lose Federal Tax Credits that Support 18% of Revenue," *Bond Buyer*, September 12, 2019.

[229] Brad Setser, "Is Puerto Rico Back on a Path Toward Debt Sustainability?" Council on Foreign Relations blog post, September 30, 2019, https://www.cfr.org/blog/puerto-rico-back-path-toward-debt-sustainability. Setser was a U.S. Treasury official involved in discussions leading up to enactment of PROMESA.

[230] Oversight Board, "Lowering Puerto Rico's Debt to Sustainable Levels: Plan Support Agreement with Bondholders," February 26, 2021, p. 5, https://drive.google.com/file/d/1wTLXvJRu2GI38DRcpOWuVHX2OvTwvAVo/view.

held Puerto Rican public debt through mutual funds, which generally bought bonds near or at par when issued, and then were left with realized losses after those funds sold off those holdings.[231] Judicial decisions in Puerto Rico cases could shape case law, thus affecting the future disposition of mainland municipal debtors.

In the case of Puerto Rico, issues with federal tax exemptions, alleged violations of securities laws, and the interpretation of provisions of the Bankruptcy Code incorporated into PROMESA Titles III and VI may provide lessons for policymakers.

More generally, many have complained that the restructuring process has taken too long to complete.[232] Moreover, the costs of litigation, which the Oversight Board has called "extraordinarily expensive," have been higher than expected.[233] Costs of the Oversight Board's operations and litigation are borne by island taxpayers and residents.[234]

Federalism and Municipal Debt Markets

The federal government has three main instruments to shape municipal bond markets: tax policies, securities laws, and bankruptcy laws. Requirements for exemptions from federal income taxation play a fundamental role in municipal finance because marketing bonds without that exemption is more difficult.[235] Securities laws that mandate disclosure requirements help investors make informed choices so that financial resources and risk-bearing can be allocated in an efficient way.

The federal government, to a large extent, has exercised light oversight of municipal bond markets, which provide state and local governments with lower-cost access to capital to build roads, schools, public buildings, and water and sewer systems, among other ends, as well as to help manage cash flows to match revenues and outlays.[236] This reflects a division of responsibilities between the federal government and states, which have the flexibility to accommodate policies to local conditions. Congress, however, has greater authority to oversee territories through its Article IV powers.

Great Depression-era securities laws were not considered to apply to municipal securities until the early 1970s, when questionable practices by some municipal finance specialty firms and New York City's fiscal crisis prompted federal responses.[237] The Securities Acts Amendments of 1975 (P.L. 94-29) extended the reach of federal regulations to the municipal securities market, established the Municipal Securities Rulemaking Board (MSRB), and imposed certain antifraud provisions.[238] The act also included a provision known as the Tower Amendment that barred the

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[231] John Dizard, "'Bottom-Feeding' Hedge Funds are Big Winners on Puerto Rico Bonds," *Financial Times*, November 9, 2018.

[232] Robert Slavin, "Puerto Rico Bond Negotiations Slog Toward Seventh Year," *Bond Buyer*, January 25, 2021.

[233] Oversight Board, letter to congressional leaders, March 12, 2018, https://drive.google.com/file/d/17oP8ppSHFN9YbprGMkjTscVmnH_cDoo3/view?usp=drivesdk.

[234] PROMESA §107, 48 U.S.C. § 2127.

[235] Harvey Galper, Kim Rueben, Richard Auxier, and Amanda Eng, "Municipal Debt: What Does it Buy and Who Benefits?" *National Tax Journal*, December 2014, vol. 67(4), pp. 901-924, https://www.urban.org/sites/default/files/publication/33631/109047-municipal-debt-what-does-it-buy-and-who-benefits-.pdf.

[236] Government Accountability Office, *Factors Contributing to the Debt Crisis and Potential Federal Actions to Address Them*, GAO-18-387, pp. 38-40, May 9, 2018, https://www.gao.gov/products/GAO-18-387.

[237] National Federation of Municipal Analysts, *White Paper on Federal Securities Law Relating to Municipal Securities*, March 2008, https://www.nfma.org/assets/documents/DG.WP.securities_law_0803.doc.pdf.

[238] *Report of the Senate Committee on Banking, Housing and Urban Affairs to Accompany S.249*, S.Rept. No. 94-75,

MSRB and SEC from requiring that municipal issuers file pre-sale financial statements.[239] Some have questioned those limits on federal regulation of municipal finance,[240] although others point to more active federal enforcement of disclosure violations.[241]

A 2012 SEC report included some legislative proposals for enhancing disclosure in the municipal bond market, although it did not call for removing Tower Amendment restrictions.[242] A 2020 SEC advisory panel discussed various means to improve the timeliness and usefulness of disclosures, although some warned of imposing new disclosure requirements that would burden small public issuers.[243] H.R. 4476, introduced September 24, 2019, during the 116th Congress, would have set data standards for financial disclosure, although it would not have imposed new disclosure standards.

The scale of Puerto Rico's debt restructuring could conceivably lead to other modifications of municipal finance practice. Federal bankruptcy law, which during the Great Depression was extended to cover instrumentalities of state governments such as cities and public authorities, also plays a role in how municipal bond contracts are structured and how investors and creditors share risks. Past municipal bond defaults have affected how municipal bond markets operate. New York City's financial crisis in the mid-1970s led to stronger investor disclosure requirements, and the early 1980s defaults of the Washington Public Power Supply System (WPPSS) led to the expansion of bond insurance.[244] In general, however, municipal defaults have been much less frequent than corporate or individual defaults.[245]

Congress controls tax policy and the tax treatment of municipal securities more directly. Modifications of the federal tax treatment of municipal securities could lead to significant changes in government finance because of the importance that tax advantages play in marketing those securities. For instance, in 2006, Merrill Lynch advisors suggested that ERS and Merrill Lynch issue at least $7 billion in pension obligation bonds (POBs). Because those bonds were ineligible for federal tax exemptions, Merrill Lynch was unable to place those bonds. UBS then sold less than half that amount, as noted above, largely purchased through its own proprietary accounts.[246] Had a larger amount of bonds been issued, the island government's finances would

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94th Cong., 1st sess., p. 41 (1975). Also see Jon R. Tandler, "Municipal Antifraud Liability Under the Federal Securities Laws upon Issuance of Tax-Exempt Industrial Development Bonds," *Journal of Urban & Contemporary Law*, vol. 24, January 1993, pp. 193-212, https://openscholarship.wustl.edu/law_urbanlaw/vol24/iss1/7. Some contended that prior to the 1975 act, municipal securities issuers had been subject to the antifraud provisions of the federal securities laws.

[239] 15 U.S.C. §78o–4(d). John Tower was then a Senator from Texas.

[240] U.S. Securities and Exchange Commissioner Elisse B. Walter, A. A. Sommer, Jr. Corporate, Securities and Financial Law Lecture, October 28, 2009, https://www.sec.gov/news/speech/2009/spch102809ebw.htm. Also see Sarah Wynn, "Ex-SEC Chair Elisse Walter: Not Enough Progress on Muni Disclosure," *Bond Buyer*, February 24, 2020.

[241] Maggie Guidotti, "Seeking 'the SEC's Full Protection': A Critique of the New Frontier in Municipal Securities Enforcement," *University of Chicago Law Review*, vol. 82(4), 2015, pp. 2045-2118, http://www.jstor.org/stable/43655479.

[242] Securities and Exchange Commission, *Report on the Municipal Securities Market*, July 31, 2012, https://www.sec.gov/news/studies/2012/munireport073112.pdf.

[243] SEC, Fixed Income Market Structure Advisory Committee meeting, February 10, 2020, pp. 132-183, https://www.sec.gov/spotlight/fixed-income-advisory-committee/fimsac-021020-transcript.pdf.

[244] Walter (2009), op. cit. Also see Beverly Hirtle, "Growth of the Financial Guarantee Market," *Federal Reserve Bank of New York Quarterly Review*, Spring 1987, p. 18, https://fraser.stlouisfed.org/title/economic-policy-review-federal-reserve-bank-new-york-1170/spring-1987-3020/growth-financial-guarantee-market-401663.

[245] S&P Global, *2017 Annual U.S. Public Finance Default Study and Rating Transitions*, May 8, 2018.

[246] Kobre & Kim LLP, *Final Investigative Report*, August 20, 2018, https://drive.google.com/file/d/19-lauVo3w9MPS03xYVe0SWhQin-Q6FEf/view, pp. 158-159.

have been in even worse shape. Thus, lack of federal tax exemption helped constrain the extent of a strategy that an independent review concluded "was so badly structured that, rather than yielding profits, it resulted in tremendous losses that have accelerated the demise of [the] Retirement System."[247] Modifying federal tax exemption requirements or limiting the amount of certain types of bonds might restrain issues of debt that could create serious fiscal risks. Congress has also limited tax exemptions on some types of municipal bonds on other grounds.[248]

Federal Policies and Municipal Debt Structures

Federal tax and bankruptcy law help shape financial decisions of state, local, and territorial governments on how they structure their debts. For instance, constraints on issuance of private activity bonds (PABs) and on advance refundings of municipal bonds have changed the "muni" markets. Congress may consider how the different treatment of municipal bonds in federal bankruptcy law might affect how local governments approach municipal finance decisions.

In municipal finance, GO bonds are typically used to support publicly provided services and infrastructure, such as streets, schools, and other public buildings, and are backed by a jurisdiction's commitment to collect sufficient tax revenues. GO bonds, backed by the full faith and credit of a jurisdiction, have the advantage of being supported by a broad set of budgetary resources, without a specific lien on revenues. The experience of restructuring Puerto Rico's public debts could affect how future municipal finance arrangements are made.

Revenue bonds have typically been used to finance infrastructure to supply services that generate their own revenue through fees or charges, such as electric power, toll roads, water and sewers, and airports, often administered through authorities with some measure of independence from elected governments.[249] If a project or authority failed to generate revenues sufficient to cover debt service, revenue bondholders generally could not obtain support from other revenue sources, such as general tax revenues. Although revenue bonds are backed by more narrowly defined cash flows, they carry the advantage that liens could be applied to a stream of fees and charges.

In 1988, Congress enacted bankruptcy legislation that included particular protections for bondholders' interests in pledged fees and charges backing certain revenue bonds.[250] The 1988 act added Section 928 to the Bankruptcy Code, which states "special revenues acquired by the debtor after the commencement of the case shall remain subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case."[251] Without that exception, special revenues collected by a debtor would not be subject to lien.[252] Litigation

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[247] Statement of Motives, Act 116-2011, July 6, 2011, http://osl.pr/download/en/2011/A-0116-2011.pdf.

[248] See CRS Report RL31457, *Private Activity Bonds: An Introduction*, by Steven Maguire and Joseph S. Hughes.

[249] Annette Thau, *The Bond Book* (New York: McGraw-Hill, 2001), pp. 132-133.

[250] The Senate's explanation of the relevant provision of a bill enacted as P.L. 100-597 stated that "[t]o eliminate the confusion and to confirm various state laws and constitutional provisions regarding the rights of bondholders to receive revenues pledged to them in payment of their debt obligations of a municipality, a new section is provided in the Amendment to ensure that revenue bondholders receive the benefit of their bargain with the municipal issuer and that they will have unimpaired rights to the project revenues pledged to them." U.S. Congress, Senate Committee on the Judiciary, *Report to Accompany S. 1863*, 100th Cong., 2nd sess., S.Rept. 100-506, 1988, p. 12.

[251] 11 U.S.C. 928(a), applicable to Title III cases by PROMESA §301.

[252] 11 U.S.C. 552(a) states that property acquired by a debtor after a bankruptcy filing "is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case." One summary of Chapter 9 provisions concluded that "Congress made clear that revenue bondholders are entitled to receive the revenues pledged to them without any interference and on a timely basis." James E. Spiotto, *Primer on Municipal Debt Adjustment: Chapter 9*, 2012, p. 28, https://web.archive.org/web/20160206065733/http://afgi.org/resources/

regarding the restructuring of the Puerto Rico Highways and Transportation Authority (PRHTA) has raised questions about the treatment of revenue bonds and special revenues.[253] Congress could consider modifying Section 928 of the Bankruptcy Code to clarify those issues. Some have contended a clearer treatment of special revenue bonds would lower financing costs for local governments.[254]

Ultra-Long-Term and Exotic Debt

Mutual funds provide small investors with the advantages of diversification by pooling large numbers of securities. Expecting those investors, however, to monitor hundreds or thousands of issuers, some of which may employ complex securities, may be unrealistic. A 1993 SEC staff report found that larger numbers of unsophisticated individual investors were buying municipal securities and that governments had come to rely on increasingly complex structured securities and derivatives.[255] The onset of the financial crisis in mid-2007 led to the failure of exotic forms of municipal debt widely marketed to individual investors.[256] The underwriting and marketing of POBs to retail investors in Puerto Rico has raised concerns.[257]

Congress passed PROMESA, among other ends, to create a debt restructuring process that would put Puerto Rico's public finances on a sustainable basis, which could then anchor a healthier economic climate.[258] Risks due to uncertainties in future economic growth and population trends could compound potential challenges embedded in the use of COFINA CABs. Some analysts have noted that the use of financial instruments or public-private partnership agreements that provide governments with up-front proceeds may yield few benefits in later years and may shift fiscal burdens to future generations that may have benefited little from the use of those proceeds.[259]

Bankruptcy_Primer.pdf.

[253] See 1st Circuit, Opinion, Assured Guaranty Corporation v. Commonwealth of Puerto Rico, cases 18-1165 and 18-1166, p. 14, March 26, 2019, http://media.ca1.uscourts.gov/pdf.opinions/18-1165P-01A.pdf. The U.S. Supreme Court declined to review the case on January 13, 2020; see https://www.supremecourt.gov/docket/docketfiles/html/public/19-391.html. Also see Karen Pierog, "Court Ruling in Puerto Rico Bankruptcy Fans Revenue Bond Fears," Reuters, March 28, 2019, https://www.reuters.com/article/usa-puertorico-bonds/court-ruling-in-puerto-rico-bankruptcy-fans-revenue-bond-fears-idUSL1N21E1HY.

[254] James E. Spiotto, "The History and Justification for Timely Payment of Statutory Liens and Pledged Special Revenues Bond Financing in a Chapter 9 Municipal Debt Adjustment Proceeding: Is a Model State Law Necessary or Required?" *Municipal Finance Journal*, vol. 39(4), winter 2019, pp. 47-97.

[255] U.S. Securities and Exchange Commission, *Staff Report on the Municipal Securities Market*, September 1993, https://www.sec.gov/info/municipal/mr-munimarketreport1993.pdf.

[256] See CRS Report RL34672, *Auction-Rate Securities*, by D. Andrew Austin.

[257] Craig McCann, Edward O'Neal, and Susan Song, "UBS and Santander's Role in Underwriting Employee Retirement System Bonds," Securities Litigation & Consulting Group blog, May 16, 2017, http://blog.slcg.com/2017/05/ubs-and-santanders-role-in-underwriting.html. See also Nick Brown, "Puerto Rico's Other Crisis: Impoverished Pensions," Reuters, April 7, 2016, https://www.reuters.com/investigates/special-report/usa-puertorico-pensions/. Also see David Evans, "How UBS Spread the Pain of Puerto Rico's Debt Crisis to Clients," Bloomberg, September 22, 2015, https://www.bloomberg.com/news/articles/2015-09-22/how-ubs-spread-the-pain-of-puerto-rico-s-debt-crisis-to-clients.

[258] Rob Bishop and Sean Duffy, "PROMESA Promises Hope for Puerto Rico and Its Investors," *National Review*, May 22, 2016, https://www.nationalreview.com/2016/05/puerto-rico-debt-crisis-promesa-bill-positive-solution/.

[259] John Gilmour, "The Indiana Toll Road Lease as an Intergenerational Cash Transfer," *Public Administration Review*, vol. 72, no. 6 (November/December 2017), pp. 856-865.

Congress could consider changes in requirements for federal tax exemptions to encourage issuers to rely on securities that avoid exotic structures or ultra-long maturities

Bankruptcy Procedures, Disclosure, and Potential Conflicts of Interest

Congress could consider measures to protect the interests of a wider set of investors in complex bankruptcy cases, such as by strengthening or clarifying disclosure requirements. The COFINA restructuring raised concerns that hedge funds and institutional investors involved in settlement negotiations were treated more favorably than individual investors.

Congress could consider bolstering disclosure requirements for officials and professionals engaged in the debt restructuring processes established by PROMESA. The House unanimously passed H.R. 1192 (Puerto Rico Recovery Accuracy in Disclosures Act of 2021; PRRADA) on February 24, 2021, two days after it had been introduced. A companion bill was introduced in the Senate on February 23, 2021. Both bills would require professionals engaged in PROMESA Title III actions to file a disclosure statement under Section 2014(a) of the Federal Rules of Bankruptcy Procedure before being compensated. In particular, professionals would have to set forth their connections with creditors, debtors, the Oversight Board and those it has employed, and other interested parties. The bill would also require retroactive disclosures by professionals who had already been compensated. In the 116th Congress, the House passed a similar measure (H.R. 683) on December 8, 2020. A companion bill (S. 1675) had been introduced in the Senate on May 23, 2019.

Hedge funds have played a central role in Puerto Rico's debt restructuring, as well as in other complex bankruptcy cases, in which debt and other claims are increasingly treated as liquid assets.[260] Hedge funds, through the scale of their investments, may enhance market efficiency by overcoming collective action challenges facing smaller or more traditional investors, as noted above. Hedge funds and similar funds, acting either singly or in concert, however, may disadvantage other claimants.[261] Conflicts of interest may be particularly salient in bankruptcy and debt restructuring processes because major cases have involved a relatively narrow set of professionals.[262] In particular, the extensive and ongoing relationships among McKinsey—the Oversight Board's main contractor—and firms working on major bankruptcy cases have raised concerns.[263]

Stronger disclosure requirements on holdings of debt instruments and on potential conflicts of interest may help level the playing field, an issue that Congress has addressed in the past. One legal scholar argued that Congress crafted provisions of the 1934 Bankruptcy Act to curtail

[260] "Claims trading is increasingly important given the emerging role of hedge funds in Chapter 11 proceedings and the roaring controversy over their disclosure obligations under Federal Rule of Bankruptcy Procedure 2019." Henry T.C. Hu and Jay L. Westbrook, "Abolition of the Corporate Duty to Creditors," *Columbia Law Review*, vol. 107, no. 193 (October 2007), http://ssrn.com/abstract=977582.

[261] Marcel Kahan and Edward B. Rock, "Hedge Funds in Corporate Governance and Corporate Control," *Univ. of Pennsylvania Law Review*, vol. 155 (May 2007), pp. 1077-1079, http://scholarship.law.upenn.edu/faculty_scholarship/94. The authors suggest a reconsideration of Securities and Exchange Commission rule 13(d) filing requirements in the context of corporate control (cf. SEC Rule 13d-5(b)(1), 17 C.F.R. §240.13d-5(b)(1)).

[262] Lynn M. LoPucki, "The Demographics of Bankruptcy Practice," *American Bankruptcy Law Journal*, vol. 63, 1989, pp. 289-320.

[263] Michelle Celarier, "The Story McKinsey Didn't Want Written," *Institutional Investor*, July 8, 2019, https://www.institutionalinvestor.com/article/b1g5zjdcr97k2y/The-Story-McKinsey-Didn-t-Want-Written. Mary Williams Walsh, "One Man vs. McKinsey: A Billionaire Says the Consultancy Has Rigged the Bankruptcy System," *New York Times*, April 11, 2019. Also see the section "Concerns over COFINA Settlement and Ethical Conflicts."

opportunities for collusion among insiders to the disadvantage of other parties.[264] Another scholar argues that requiring investors to disclose "material rights against or affecting distressed firms, whether direct or derivative, and whether held singly or collectively, in real time, using online market portals or similar information systems" would curtail potential abuses by unregulated private investors such as hedge funds.[265] Research on other asset-trading disclosure requirements suggests that they limit insiders' excess gains.[266] According to economic theory, reducing insiders' excess gains would enhance assets' attractiveness to rational small investors.

An Audit of Puerto Rico's Public Debt

H.R. 6975, introduced on May 22, 2020, would have established a commission to audit all public debt issued by Puerto Rico since 1972.[267] The measure would also have allowed discharge of some unsecured debts, applied certain ethics requirements to the Oversight Board, provided federal funding for Board activities, and commissioned a Government Accountability Office (GAO) report on the Board's spending and activities, among other provisions.

This proposal to audit the island's public debt followed other initiatives. In July 2015, the Puerto Rico legislature enacted Act 97-2015, which, among other provisions, established a Commission for a Comprehensive Audit of Public Credit.[268] The act's preamble[269] stated

> As one of the necessary mechanisms to proceed towards a broad fiscal and financial restructuring, this Legislative Assembly recognizes as prudent and necessary the creation of an independent commission composed of members from the public sector and private citizens, drawn from diverse strategic sectors of civil society, entrusted with the responsibility to audit the totality of Puerto Rico's public debt. The commission will

[264] David A. Skeel, Jr., "Markets, Courts, and the Brave New World of Bankruptcy Theory," *Wisconsin Law Review*, 1993, p. 493, https://scholarship.law.upenn.edu/faculty_scholarship/1268. "Prior to the enactment of section 77B of the Bankruptcy Act in 1934, the fate of financially distressed firms was played out almost exclusively in state foreclosure and receivership proceedings and their federal counterparts.… The widespread perception that this system facilitated collusion sparked the decision to undertake a vast reformation of the nation's insolvency laws. Critics of the equity receivership process were particularly concerned that management and senior creditors conspired to squeeze out bondholders and other widely dispersed investors."

[265] Jonathan C. Lipson, "The Shadow Bankruptcy System," *Boston Univ. Law Review*, vol. 89(5), 2009, p. 1619, http://www.bu.edu/law/journals-archive/bulr/volume89n5/documents/LIPSON.pdf.

[266] André Betzer, Jasmin Gider, Daniel Metzger, and Erik Theissen, "Stealth Trading and Trade Reporting by Corporate Insiders," *Review of Finance*, vol. 19 no. 2 (March 2015), pp. 865-905. Also see Ruidi Huang and Yuhai Xuan, "'Trading' Political Favors: Evidence from the Impact of the STOCK Act," working paper, January 1, 2021, https://ssrn.com/abstract=2765876.

[267] The House Committee on Natural Resources held a hearing on October 22, 2019, to consider a discussion draft that included many of the provisions included in H.R. 6975. U.S. Congress, House Committee on Natural Resources, *PROMESA: Discussion Draft (Day One)*, 116th Cong., 1st sess., October 22, 2019. Discussion draft is available at http://docs.house.gov/meetings/II/II00/20191022/110103/BILLS-116pih-ToamendthePuertoRicoOversightManagementandEconomicStabilityActorPROMESAandforotherpurposes.pdf.

[268] Act 97-2015, July 1, 2015, http://www.lexjuris.com/LexLex/Leyes2015/lexl2015097.htm.

[269] Original text: *Como uno de los mecanismos necesarios para poner en marcha un proceso amplio de reestructuración fiscal y financiera, esta Asamblea Legislativa entiende prudente y necesaria la creación de una comisión independiente integrada por funcionarios del sector publico y de ciudadanos privados, provenientes de diversos sectores estrategicos en la sociedad civil, encomendada con la responsabilidad de auditar la totalidad de la deuda publica puertorriqueña. La comisión operara de manera autónoma y tendrá la autoridad necesaria para evaluar todas las transacciones gubernamentales que entienda pertinentes para las tareas que le serán encomendadas por esta Ley.*

> operate in an autonomous manner and will have the necessary authority to evaluate all government transactions pertinent to the tasks assigned by this law.

Governor Rosselló Nevares disbanded the commission after he took office in 2017.[270] Volunteer citizen efforts have attempted to continue the former commission's work, although without formal investigative powers.[271] For instance, one citizen group in January 2019 issued a report challenging the legal basis of COFINA debt.[272]

The Oversight Board commissioned an investigation of Puerto Rico's debt by the law firm Kobre & Kim, which produced a 608-page final investigative report in August 2018.[273] Although the Kobre & Kim report was extensive, some contended that key points were less than fully investigated.[274] Some of those concerns overlapped with concerns regarding gaps in the reporting of possible conflicts of interest among those involved in debt restructuring in various roles. The UCC has also sought to obtain documents and other evidence in PROMESA Title III litigation.[275] The Oversight Board, as noted above, challenged certain debts. Oversight Board Executive Director Natalie Jaresko, responding to congressional questions in an October 2019 hearing, opposed a new effort to audit Puerto Rico's public debts, which, in her view, would delay restructuring processes now underway and the resolution of PROMESA Title III litigation.[276]

A bill was introduced in the Puerto Rican Senate on February 25, 2021, that would again establish a commission to audit the island's public debts.[277] The Oversight Board contended that such a commission would duplicate work done by Kobre & Kim and suggested the Puerto Rican Senate modify the bill.[278]

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[270] Luis J. Valentín Ortiz, "Puerto Rico Debt Audit Drags on as Creditor Negotiations Heat Up: Almost Two Years After the Enactment of the Federal PROMESA Law and the Imposition of a Fiscal Control Board, Puerto Rico Still Lacks a Public Debt Audit that Shows, Without Doubt, How Much Debt was Legally Contracted," Center for Investigative Journalism, June 11, 2018, http://periodismoinvestigativo.com/2018/06/puerto-rico-debt-audit-drags-on-as-creditor-negotiations-heat-up/.

[271] *Noticel*, "Desmantelar Comisión de Auditoría de Deuda Sirve para Encubrir Ilegalidades [Dismantling the Committee to Audit the Debt Serves to Cover Up Illegal Actions]," January 27, 2017, https://www.noticel.com/junta-fiscal/ahora/credito-de-pr/economia/20170127/desmantelar-comision-de-auditoria-de-deuda-sirve-para-encubrir-ilegalidades/.

[272] Comisión Ciudadana para la Auditoría Integral del Crédito Público, *COFINA: Deuda Ilegal e Ilegitima* [COFINA: Illegal and Illegitimate Debt], January 15, 2019, https://media.noticel.com/o2com-noti-media-us-east-1/document_dev/2019/01/17/Informe%20sobre%20COFINA%20enero%202019_1547740010072_30040005_ver1.0.pdf.

[273] Kobre & Kim LLP, *Final Investigative Report*, August 20, 2018, pp. 167-168, https://drive.google.com/file/d/19-lauVo3w9MPS03xYVe0SWhQin-Q6FEf/view. Also see Arthur J. González, "Oversight Board Member: Read the PR Debt Report," *Bond Buyer*, March 4, 2021.

[274] Luis J. Valentín Ortiz, "Puerto Rico Debt Audit Drags on as Creditor Negotiations Heat Up: Almost Two Years After the Enactment of the Federal PROMESA Law and the Imposition of a Fiscal Control Board, Puerto Rico Still Lacks a Public Debt Audit that Shows, Without Doubt, How Much Debt was Legally Contracted," Center for Investigative Journalism, June 11, 2018, http://periodismoinvestigativo.com/2018/06/puerto-rico-debt-audit-drags-on-as-creditor-negotiations-heat-up/.

[275] Ibid.

[276] Testimony of Natalie Jaresko, Executive Director of the Oversight Board, in U.S. Congress, House Committee on Natural Resources, *Proposed Amendments to the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA)*, hearings, 116th Cong., 1st sess., October 22, 2019, http://naturalresources.house.gov/download/ms-natalie-jaresko-testimony-fc-leg-hrg-102219-promesa-ii-day-1.

[277] PR Senate Bill 205, https://sutra.oslpr.org/osl/esutra/MedidaReg.aspx?rid=138023.

[278] Oversight Board, letter to Puerto Rican Senator Nick Pastrana, April 9, 2021, https://drive.google.com/file/d/1HfBUZEHAzrXB5Po_pySrLSQ7wZp_mKvQ/view.

Constitutional Restraints May Be an Ineffective Substitute for Prudent Budgeting

Some economists have called for imposing constitutional restrictions on government finances, such as on outlays, revenues, or debt. The Puerto Rican Constitution, as discussed above, includes a balanced budget requirement and various constraints on public debt. Those provisions, however, did not appear to set an effective constraint on levels of indebtedness. In the 1840s, when several states had defaulted on or repudiated public debts, other states in similar fiscal straits managed to avoid default, apparently motivated by a desire to maintain good credit. Those examples might motivate federal policymakers to reassess the utility of constitutional or legal mechanisms to ensure sustainable fiscal policies relative to other ways of establishing fiscal balance. Sound fiscal policies may provide a better bulwark against default.

Appendix A. Details of Puerto Rico's Public Debt

Table A-1 presents data underlying **Figure 2**, which provides a breakdown of Puerto Rico's public debts at the end of July 2016, shortly before the PROMESA debt restructuring process commenced. One column shows indebtedness to the GDB (*GDB Loan*), which had been the Puerto Rican government's fiscal agent and advisor. Public agencies and corporations deposited funds in GDB accounts, and the GDB extended loans to some public corporations as an alternative to issuing bonds to the municipal finance market. GDB bonds are excluded from **Figure 2** to minimize double counting.

Table A-1. Puerto Rico's Public Debt As of July 31, 2016, in $ Millions

	Bonds & Private Loans	GDB Loans	Other Loans	Total Debt
Direct Good Faith & Credit: General Obligations	**12,543**	**169**	-	**12,713**
Indebtedness Payable Primarily from Commonwealth Taxes				
COFINA	17,322	-	-	17,322
Highways & Transportation Authority	4,176	1,734	-	5,910
PRIFA (Guaranteed Portion)	1,861	-	-	1,861
Puerto Rico Convention Center District Authority	386	4	-	391
Metropolitan Bus Authority	28	-	-	28
Subtotal	**23,774**	**1,738**	-	**25,512**
Indebtedness Payable Primarily from Commonwealth Appropriations				
Public Building Authority (Guaranteed Portion)	4,005	182	-	4,187
Retirement System for Employees (ERS)	3,144	-	-	3,144
Public Finance Corporation (PFC)	1,091	-	-	1,091
Other Agencies & Public Corporations	-	2,999	102	3,101
Subtotal	**8,239**	**3,181**	**102**	**11,523**
Indebtedness Payable by Tax-Supported Public Corporations				
Government Development Bank (Guaranteed	4,014	-	-	4,014
University of Puerto Rico	496	76	-	573
Puerto Rico Industrial Development Company	159	78	-	237
Port of the Americas Authority (APLA; Guaranteed)	226	2	-	227
Highways & Transportation Authority T. Moscoso	140	-	-	140
Puerto Rico Infrastructure Finance Authority	226	-	-	226
Other Agencies and Public Corporation	0	609	-	609
Subtotal	**5,262**	**765**	-	**6,027**
Indebtedness Payable by Non-Tax-Supported Public Corporations				
Puerto Rico Energy Power Authority (PREPA)	8,955	35	1	8,991
Puerto Rico Aqueduct & Sewer Authority (PRASA)	3,980	66	581	4,627
Subtotal	**12,935**	**101**	**582**	**13,618**
Municipios' Indebtedness				
General Obligations (Property Tax)	881	1,316	-	2,197
Municipal Finance Authority (Property Tax)	620	-	-	620
Sales & Use Tax	5	533	-	538
Special Obligations and Other	221	236	-	457
Subtotal	**1,726**	**2,085**	-	**3,811**

	Bonds & Private Loans	GDB Loans	Other Loans	Total Debt
Nonrecourse Indebtedness				
Children's Trust	1,442	-	-	1,442
Housing Finance Authority (HFA)	487	85	-	572
Puerto Rico Industrial Investment Corporation	103	-	-	103
Other Agencies and Public Corporations	14	0	-	14
Subtotal	**2,046**	**85**	-	**2,132**
Total	**66,526**	**8,124**	**684**	**75,334**
Exclusions to Eliminate Double Counting				
Total Indebtedness				75,334
Less: Government Development Bank Bonds				-3,766
Total "Public Sector Debt" Including COFINA Capital Appreciation Bond Accretion				71,568
Less: Capital Appreciation Bond (CAB) Accretion				-2,914
TOTAL PUBLIC SECTOR DEBT				**68,654**

Source: CRS calculations based on *Commonwealth of Puerto Rico Financial Information and Operating Data Report*, December 18, 2016, https://web.archive.org/web/20170101045953/http://bgfpr.com/documents/CommonwealthofPuertoRicoFinancialInfoFY201612-18-16.pdf.

Notes: Items might not sum to totals due to rounding. Debt of COFINA (*Corporación del Fondo de Interés Apremiante*; Puerto Rico Sales Tax Financing Corporation) was restructured in January 2019. Debt of the Government Development Bank was restructured in November 2018. AMSCA is the Spanish acronym of the Mental Health and Anti-Addiction Services Administration. See source document for other notes and caveats.

Appendix B. Price Trends and Trading Volumes for Selected Bonds

Prices of Puerto Rico's bonds have experienced wide swings since the island's fiscal precarity became more widely known in 2013. Prices reveal market views of the value of future cash flows, which in the case of Puerto Rico's public bonds will be determined in large part by the debt restructuring processes created by PROMESA.

Some in Congress have expressed concerns that some investors may have traded on nonpublic information obtained in the course of PROMESA Title III negotiations among creditors, the Oversight Board, and representatives of Puerto Rico's government. Charts shown below depict price trajectories and trading volumes for selected bonds. CRS chose specific bonds either because the U.S. Treasury had identified them as representative in materials distributed in the legislative deliberations that led to PROMESA or because they were larger issues that would likely be more liquid than smaller issues. CRS also chose bonds that would have been affected by initiatives by the Oversight Board and the UCC to invalidate certain GO and PBA bonds.

Some 18 entities issued public debt on behalf of Puerto Rico, which added to the complexity of the island's debt structure. In addition, most bond issuances were divided into multiple subissues. Therefore, the figures below give a partial view of trading activity.[279]

The charts also show, by means of vertical lines, some key events in the restructuring processes. Those key dates, and other events, are listed in **Table C-1**, with links to related documents. Rational investors trade when they have new information, when assets' risk characteristics are perceived to have shifted, or due to liquidity needs.

COFINA Prices and Volumes

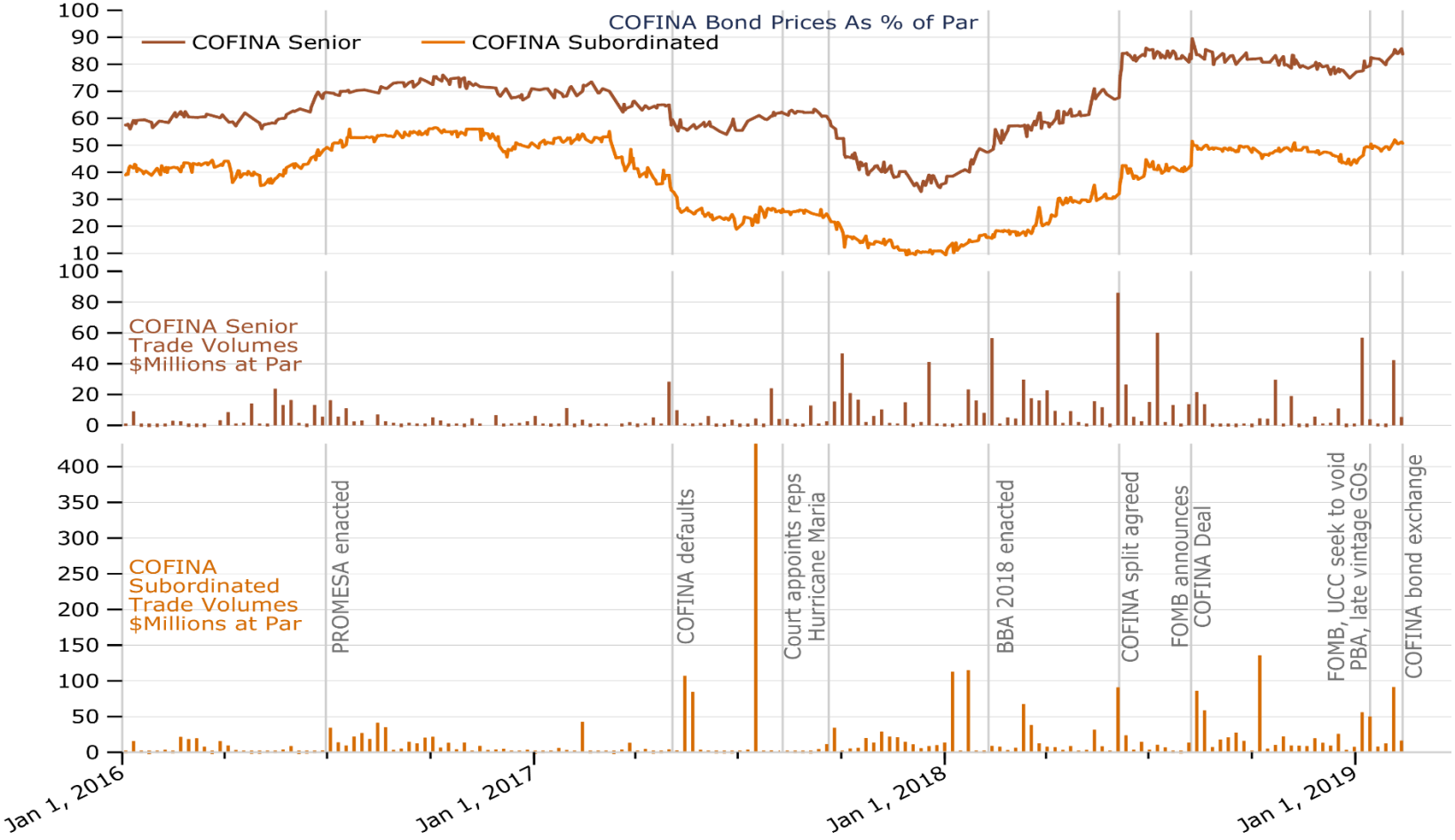
Figure B-1 shows the evolution of prices and trading volumes for senior and subordinate (junior) COFINA bonds from 2016 through February 2019, when old COFINA bonds were exchanged for new ones. Trading amounts are aggregated by week, with bars centered on Mondays.[280] Trade volumes are typically larger for junior bonds, which was a larger issue, but also may reflect strategic purchases, as described in a previous section. Other things equal, larger bond issues are more liquid and trade more frequently.

Trades in junior bonds picked up after PROMESA's enactment, but those volumes were dwarfed by some large trades after COFINA defaulted and before the Title III court appointed representatives for the debt negotiations. Prices for COFINA junior bonds fell to nearly 10% of par after Hurricane María, but both senior and junior bond prices began to recover at the end of 2017, and especially after the February 2018 passage of the Balanced Budget Act of 2018 (BBA 2018; P.L. 115-123), which provided funds for Puerto Rico. Those prices jumped sharply after an agreement on a split of COFINA revenues was announced in June 2018 and, to a lesser extent, once the Oversight Board announced details of the final COFINA deal.

[279] The Municipal Securities Rulemaking Board's EMMA site, from which data underlying those figures, is designed to limit comprehensive collection of trading data for a given issuer.

[280] Thus, a bar placed slightly ahead of an event might include trades made late in the week, rather than trading occurring ahead of the event.

Figure B-1. Trading Volumes for COFINA Bonds, 2016-2019



Source: CRS calculations based on Municipal Securities Rulemaking Board EMMA data: https://emma.msrb.org/. CUSIPs are COFINA Subordinated (74529JHN8), and COFINA Senior (74529JNX9).

Notes: Trade volume aggregated by week, centered on Mondays. See text and **Table C-1** for information on key events. Vertical scales differ. Volumes include inter-dealer transactions used to execute block trades.

GO and PBA Bond Prices and Trading Volumes

Figure B-2 shows prices and trading volumes for selected GO bonds from 2018 through 2020. **Figure B-3** shows that information for selected Public Building Authority (PBA) bonds. These charts, as noted elsewhere, provide a partial view of the price and trading of GO and PBA bonds due to the degree of fragmentation of Puerto Rico's debt structure.

From the time of their issuance until around the time that Hurricane María hit Puerto Rico, the 2014 GO bonds, issued with a provision to be governed by New York law, traded at a premium to other GO bonds. After María, that premium vanished and GO bonds traded at similar prices, just above 20% of par (as shown in **Figure 4**). During 2018, those bonds' prices rose to about 50% of par, with marked increases after enactment of the Balanced Budget Act of 2018 (P.L. 115-123) in February, the April release of Oversight Board proposals for pension reductions and other changes, and the Board's announcement of a framework for a COFINA settlement in August.[281]

GO bond prices began to diverge in January 2019, when the Oversight Board and the UCC challenged the validity of late vintage GO bonds and PBA bonds. The 2014 GO bonds began to trade at lower prices than earlier vintage GO bonds. That gap increased after GO/PBA PSA negotiations began in April 2019. Sculptor Capital, a hedge fund member of the Lawful Constitutional Debt Coalition, outlined four no-trade periods, beginning with the start of the PSA negotiations, and claimed that its trades of relevant bonds took place outside of those periods (**Table B-1**). Some large trades in 2011 GO bonds, however, took place during the first no-trade period, although whether those traders possessed nonpublic information is unclear. Many trades also occurred soon after the end of those periods. As those periods ended when previously private information became public, one would expect markets to react.

Table B-1. No-Trade Periods According to Sculptor Capital

Dates	Starting and Ending Dates of No-Trade Periods
April 22, 2019	Commencement of PSA negotiations
June 16, 2019	Oversight Board publishes PSA
October 2, 2019	Sculptor receives material nonpublic information
October 17, 2019	Financial data released by FAFAA to EMMA and Reorg Research
October 25, 2019	Sculptor receives Oversight Board proposal
February 9, 2020	Publication of amended PSA
August 15, 2020	Oversight Board circulates PSA proposal
October 1, 2020	Oversight Board announces PSA proposals

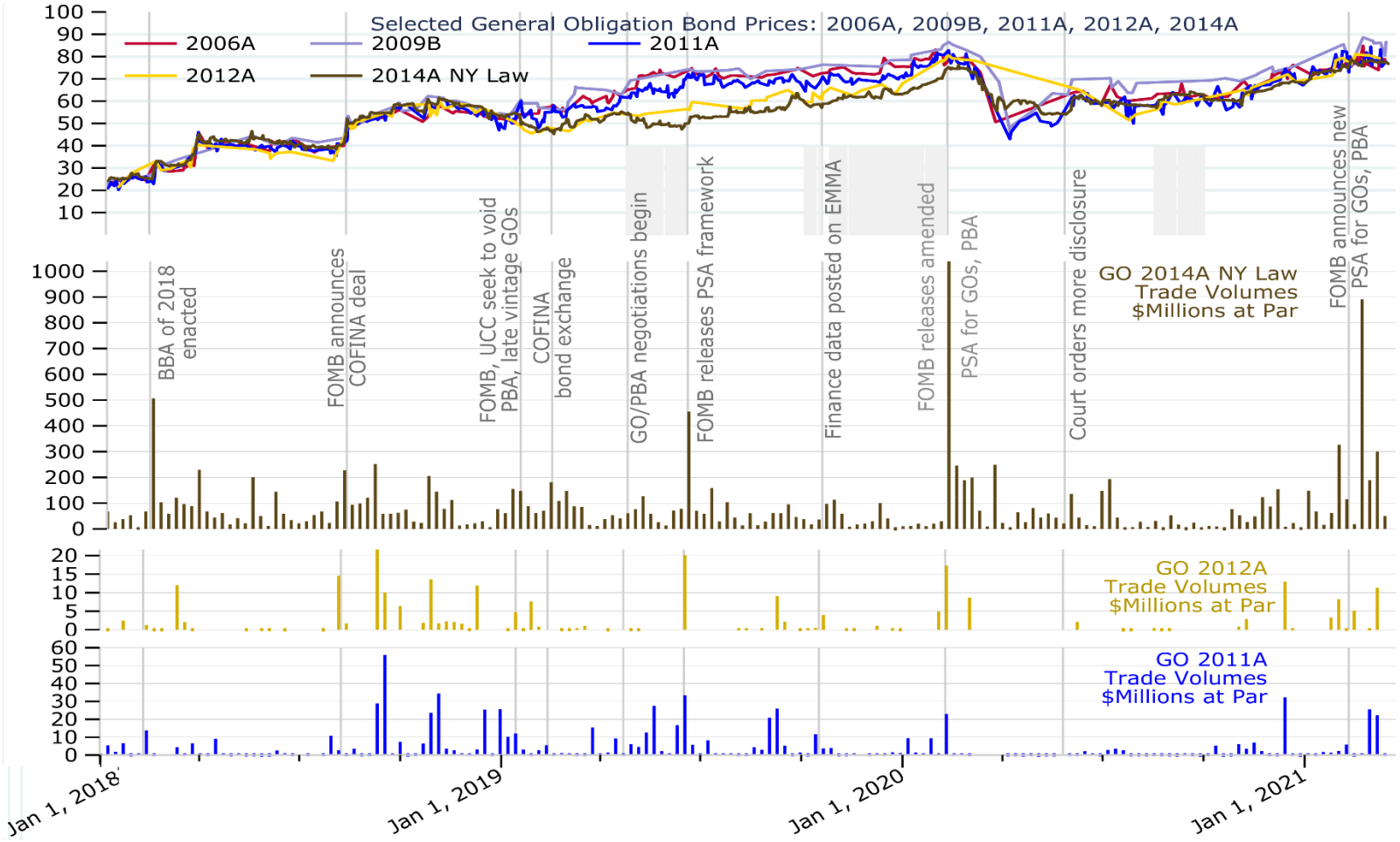
Source: In re: CPR, Informative Motion of Sculptor Capital, October 26, 2020, https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=OTg1Njc5&id2=0.

Notes: Initial date indicates when parties to negotiation may have obtained material nonpublic information. Second date notes a "cleansing event" when that information became publicly available. EMMA is the Municipal Securities Rulemaking Board's electronic data website. Reorg Research covers restructurings for investors.

GO bond spreads narrowed after the fourth no-trade period ended with the Oversight Board PSA announcement. GO and PBA bond prices dipped in spring 2020, but stabilized after May 2020, when the Title III court required detailed Rule 2019(b) disclosures.

[281] See **Table C-1** for a listing of events and links to documents.

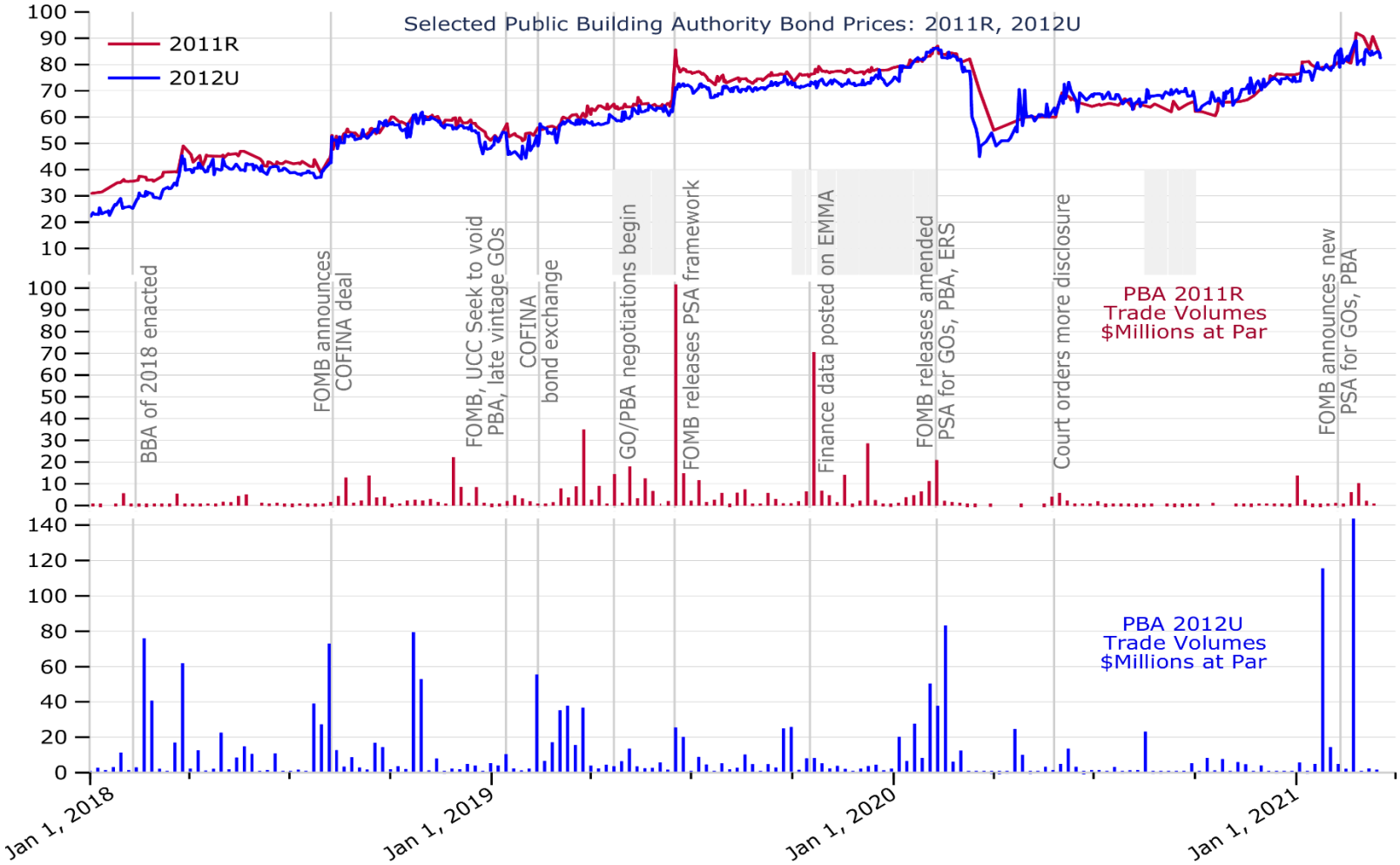
Figure B-2. Price Trends and Trading Volumes for Selected GO Bonds, 2018-2021



Source: CRS calculations based on the Municipal Securities Rulemaking Board EMMA site: https://emma.msrb.org/. CUSIPs are 2006A (74514LHN0), 2009B (74514LVW4), 2011A GO (74514LYW1), 2012A (74514LA98), and 2014A NY Law GO (74514LE86).

Notes: See text and **Table C-1** for information on key events. Trade volumes are summed by week, centered on Mondays. Vertical scales differ. Light grey areas denote no-trade periods as described by Sculptor Capital. Volumes include inter-dealer transactions used to execute block trades.

Figure B-3. Selected Puerto Rico Building Authority Bond Price Trends and Trading Volumes, 2018-2020



Source: CRS calculations based on the Municipal Securities Rulemaking Board EMMA site: https://emma.msrb.org/.

Notes: See text and **Table C-1** for information on key events. Trade volumes are summed by week, centered on Mondays. Vertical scales differ. Light grey areas denote no-trade periods as described by Sculptor Capital. Volumes include inter-dealer transactions used to execute block trades.

Appendix C. Chronology of Selected Events

Table C-1 lists many key events in the restructuring of Puerto Rico's public debts.

Table C-1. Selected Chronology of Puerto Rico's Debt Restructuring

Items are in reverse chronological order and include links to supporting documents

Date	Action
2021	
May 5, 2021	Oversight Board, and CPR announce plan support agreement with bond insurers to resolve clawback issues related to HTA and certain other public corporations
April 12, 2021	Oversight Board announces agreement in principle with bond insurers
March 8, 2021	Oversight Board announces progress in ERS negotiations; files disclosure statement for CPR and related debt with Title III court
February 23, 2021	Oversight Board releases amended PSA proposal for CPR and related debt
February 10, 2021	Title III court deadline for FOMB to present outline for CPR/ERS/PBA/etc. plan; Board asks for delay and announces an "agreement in principle"
January 6, 2021	David Skeel, Jr. and Arthur J. González reappointed to the Oversight Board
January 2, 2021	Pedro Pierluisi Urrutia inaugurated as Governor of Puerto Rico
2020	
December 14, 2020	President states intention to name Antonio Medina Comas to Oversight Board
December 8, 2020	President appoints John Nixon and Betty Rosa, reappoints Andrew Biggs to Oversight Board
October 29, 2020	Title III Court sets February 2021 date for Oversight Board to outline term sheet for amended plan
October 28, 2020	Title III Court Omnibus hearing; Judge Swain denies motion of National Public Finance Guarantee for an investigation of possible insider trading; asks Oversight Board to submit term sheet for GO and PBA restructuring by February 10, 2021.
October 21, 2020	Chairman Grijalva et al. ask Oversight Board to investigate insider trading allegations
October 15, 2020	LDCD objection to National Public Finance Guarantee motion
October 13, 2020	Ad Hoc GO Group objection to National Public Finance Guarantee motion
October 13, 2020	QTCB Group objection to National Public Finance Guarantee motion
October 9, 2020	Justin Peterson appointed to Oversight Board
October 6, 2020	David Skeel, Jr. selected as Oversight Board Chair; former Chair José Carrión III steps down
October 5, 2020	National Public Finance asks Title III Court for investigation of insider trading allegations
October 1, 2020	FOMB Announces PSA proposals for CPR and related debt
August 15, 2020	FOMB Circulates PSA proposal
August 5, 2020	Five Members of House NY Delegation send letter to NY State Attorney General
July 2, 2020	Title III Court rules against HTA, other revenue bond holders.
July 1, 2020	Oversight Board Chair José Carrión and Board Member Carlos García to step down.
June 8, 2020	Judge Swain orders compliance with Federal Rule of Bankruptcy Procedure 2019(b)
May 21, 2020	Amended PSA for CPR, PBA, ERS, etc.
May 26, 2020	Title III Court Opinion & Order Re: UCC et al. Motion 2019(b) disclosures
March 2, 2020	Correspondence alleging insider trading among GO creditors filed on CPR docket (C.Long, Feb. 25, 2020 letter)
February 28, 2020	Amended Title III Joint Plan of Adjustment of the Commonwealth of Puerto Rico

Date	Action
February 28, 2020	Disclosure Statement for Amended Title III Plan
February 25, 2020	Unsecured Creditors Committee asks for more specific Federal Rule of Bankruptcy Procedure 2019(b) disclosures; alleges suspicious trading activity by parties to GO mediation
February 9, 2020	Amended Plan Support Agreement for CPR, PBA, ERS, etc. "The PSA was signed by the holders of approximately $8 billion in claims of GO Bonds and PBA bonds. The PSA also allows each holder of GO Bonds or PBA Bonds with a face amount of such bonds in excess of one million dollars to join the PSA. Since its execution, holders of an additional $2 billion in GO Bonds or PBA Bonds have joined the PSA." Amd. Discl. Stmt. p. 8
January 16, 2020	"Apparently a deal was reached ...in mediation which was widely known among municipal bond dealers and their institutional clients" C.Long letter, Feb. 25, 2020
2019	
October 17, 2019	EMMA and Reorg Research publish financial data from AAFAF
September 27, 2019	Oversight Board commences PBA Title III case
September 27, 2019	Oversight Board proposes initial plan of adjustment for CPR, ERS, etc.
September 11, 2019	Title III Court order re: Mediation confidentiality restrictions
August 7, 2019	Wanda Vázquez Garced, the Puerto Rican Justice Minister, sworn in as Governor
August 7, 2019	Puerto Rico's Supreme Court rules succession violates PR Constitution
August 2, 2019	Gov. Ricardo Rosselló's resignation effective, replaced by Pierluisi
July 31, 2019	H Nat Resources Chairman Raúl Grijalva circulates PROMESA discussion draft
July 24, 2019	Title III Court orders stay on specified litigation
July 18, 2019	UCC files challenges to PBA bonds
June 16, 2019	Executed Plan Support Agreement
June 16, 2019	FOMB Publishes Plan Support Agreement
June 7, 2019	Plan Support Agreement ("Retiree Committee PSA")
June 7, 2019	Plan Support Agreement ("AFSCME PSA")
May 31, 2019	Oversight Board reaches agreements (Plan Support Agreement) with certain creditor groups: Retiree Committee, AFSCME, PBA & CPR GO bondholders
April 22, 2019	Commencement of GO PSA Negotiations
February 5, 2019	Plan of adjustment for COFINA confirmed by Title III Court
January 14, 2019	Oversight Board and UCC challenge validity of GO bonds issued after 2011
2018	
August 30, 2018	Board approves Plan Support Agreement for COFINA
August 20, 2018	Kobre & Kim issues commissioned review of the Government's debt
August 8, 2018	Board announces deal with senior & junior COFINA creditors, bond insurers
July 5, 2018	Gov. Ricardo Rosselló Nevares sues Oversight Board
April 18, 2018	Oversight Board releases proposed Fiscal Plans with pension reductions, labor law changes, regulatory changes
February 9, 2018	Balanced Budget Act of 2018 (BBA 2018; P.L. 115-123) enacted: provides emergency response funds
2017	
September 2017	Hurricanes Irma and María hit Puerto Rico
July 2, 2017	Oversight Board commences PREPA Title III case
May 21, 2017	Oversight Board commences HTA Title III case
May 5, 2017	Oversight Board commences COFINA Title III case

Date	Action
May 5, 2017	Oversight Board commences ERS Title III case
May 3, 2017	Oversight Board commences CPR Title III case
February 15, 2017	Original expiration date for PROMESA stay: extended 75 days

Source: Compiled by CRS.

Appendix D. Table of Common Acronyms

Table D-1. Puerto Rico Table of Common Acronyms

Acronym	Full Name	Spanish Acronym	Full Spanish Name
COFINA	Puerto Rico Sales Tax Financing Corporation	COFINA	Corporación del Fondo de Interés Apremiante de Puerto Rico
CPR	Commonwealth of Puerto Rico	ELA	Estado Libre Asociado de Puerto Rico
ERS	Puerto Rico Employees Retirement System	ASR	Administración de los Sistemas de Retiro de los Empleados del Gobierno y la Judicatura
FAFAA	Puerto Rico Fiscal Agency and Financial Advisory Authority	AAFAF	Autoridad de Asesoría Financiera y Agencia Fiscal
GDB	Government Development Bank	BGF	Banco Gubernamental de Fomento
GO	General obligation bond	—	—
LCDC	Lawful Constitutional Debt Coalition	—	—
Oversight Board, FOMB	Financial Oversight and Management Board	JSF	La Junta de Supervisión Fiscal
PBA	Puerto Rico Public Buildings Authority	AEP	Autoridad de Edificios Públicos
P3	Public-Private Partnerships Authority	AAPP	Autoridad para las Alianzas Público-Privadas
PRASA	Puerto Rico Aqueduct & Sewer Authority	AAA	Autoridad de Acueductos y Alcantarillados
PREPA	Puerto Rico Electric Power Authority	AEE	Autoridad de Energía Eléctrica
PRHTA	Puerto Rico Highways & Transportation Authority	ACT	Autoridad de Carreteras y Transportación
PROMESA	Puerto Rico Oversight, Management, and Economic Stability Act (P.L. 114-187)	—	—
PSA	Plan Support Agreement	—	—
SUT	Sales and Use Tax	IVU	Impuesto sobre Ventas y Uso
UCC	Unsecured Creditors Committee	—	—

Source: Compiled by CRS.

Note: In some cases, such as COFINA, the Spanish acronym is typically used.

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