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Notes from the Puerto Rico Oversight (Not Control) Board 34th Pileggi Lecture

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NOTES FROM THE PUERTO RICO OVERSIGHT (NOT CONTROL) BOARD
34TH PILEGGI LECTURE

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PREFACE

Like other bankruptcy scholars, I am drawn to financial crises, wherever they occur. When Puerto Rico's distress deepened and the island passed its own municipal bankruptcy law back in 2014, I did what comes naturally, shifting my gaze to the Caribbean. I wrote op-eds, an amicus brief, and a short white paper, and I started research for a law review article, in each case telling courts and Congress how they should respond to the looming financial catastrophe.[1] *I was bold and confident, as law professors so often are. Sweeping proposals come easy when you know you won't be one of the people making decisions and wrestling with real world compromises.*[2] *Then suddenly, I was.*

After Congress enacted the Puerto Rico Oversight, Management, and Economic Stability Act, or PROMESA,[3] *I found myself in the midst of an intensive vetting process that landed me on the seven-member Financial Oversight and Management Board for Puerto Rico on August 31, 2016. I had been plucked from the comfortable confines of academia and thrust into the middle of Puerto Rico's economic crisis. I soon discovered a reality that is obvious to everyone other than a scholar: actually making decisions that have an enormous impact on the lives of ordinary men and women is a lot harder than talking about them. Fortunately, the other Board members had decades of practical experience, including stints leading the Government Development Bank in Puerto Rico, acting as California's state budget director, working in the*

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* S. Samuel Arsht Professor of Corporate Law, University of Pennsylvania. I am grateful to Breana Barker, Colleen Degnan, Bruce Grohsgal, Paul Regan, and Zachary J. Schnapp for helpful comments and assistance, and to the Pileggi family for their hospitality.

[1] *See, e.g.,* David Skeel, *Fixing Puerto Rico's Debt Mess*, WALL ST. J., Jan. 5, 2016 (advocating a bankruptcy framework for Puerto Rico); Brief Amici Curia of Clayton P. Gillette & David A. Skeel, Jr.,

Puerto Rico v. Franklin Cal. Tax-Free Tr., (2016) (Nos. 15-233, 15-255) (urging the Supreme Court to uphold the Recovery Act of 2014); Clayton P. Gillette & David A. Skeel, Jr., *A Two-Step Plan for Puerto Rico* 6, 12 (Univ. of Pa. Inst. for L. and Econ., Working Paper No. 16-3, 2016) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2728466 (calling for Congress to enact restructuring provisions and a control board).

[2] The impracticality of scholarly writing has often been pointed out, most famously by Judge Harry Edwards. Harry T. Edwards, *The Growing Disjunction Between Legal Education and the Legal Profession*, 91 MICH. L. REV. 34, 35 (1992).

[3] Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA), Public Law 114-187, 130 Stat. 549 (2016) (codified at 48 U.S.C. § 2101 (2016)).

Social Security Administration, running an insurance company, and serving as a federal judge.[4] *My colleagues were and are a remarkable team.*

This essay, which begins where an earlier essay concluded,[5] *chronicles the Board's efforts to help restore "fiscal responsibility and access to the capital markets" for Puerto Rico, as PROMESA instructs us to do.*[6] *I begin with a brief sketch of the depth of Puerto Rico's economic distress, which had plagued Puerto Rico for a decade when Hurricanes Irma and Maria hit in 2017, and of the principal responsibilities vested in the Oversight Board by PROMESA. I then survey the major decisions the Oversight Board has made—or in some cases, unsuccessfully tried to make—and the challenges that remain as the current Board members near the end of our three-year term.*

Needless to say, the Oversight Board is only one of many participants in Puerto Rico's recovery effort. The Governor, Puerto Rico lawmakers, disaster relief workers, ordinary citizens, and others have taken sometimes heroic measures to alleviate the distress. I focus on the Oversight Board because it is the participant I know best. I will be objective where I can and candid where I can't.

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[4] *See* Press Release, *President Obama Announces the Appointment of Seven Individuals to the Financial Oversight and Management Board for Puerto Rico* (Aug. 31, 2016), https://obamawhitehouse.archives.gov/the-press-office/2016/08/31/president-obama-announces-appointment-seven-individuals-financial (describing each of the Board members).

[5] David Skeel, *Reflections on Two Years of P.R.O.M.E.S.A.*, 87 REVISTA JURIDICA UNIV. P.R. 862 (2018).

[6] 48 U.S.C. § 2141 (b)(1) (2016).

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I. PUERTO RICO'S DISTRESS: JUNE 30, 2016

By June 30, 2016, when PROMESA was passed, Puerto Rico was in its tenth year of recession.[7] The crisis cannot be attributed to any single factor, but a workable shorthand is that from 1996 to 2006 Congress phased out a tax break that had lured pharmaceutical companies and other light manufacturing to Puerto Rico, and Puerto Rico's lawmakers borrowed money rather than decreased spending to fill the gap.[8] Puerto Rico ended up with more than $70 billion in debt and more than $50 billion of unfunded pension benefits—almost twice its annual GNP.[9]

The distress is not limited to unsustainable debt; only 40% of Puerto Ricans participate in the formal economy, as compared to roughly 62% in the U.S. as a whole.[10] Moreover, about 30% of those who do participate in Puerto Rico's formal economy work for the government.[11] The rate of participation in the private workforce is thus considerably lower.

Poverty also is devastatingly widespread in Puerto Rico. In the U.S. as a whole, roughly 13% of the population lives in poverty (which obviously is way too high).[12] But this is nothing by comparison to Puerto Rico, where the poverty rate is 43.5%.[13]

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[7] Eshe Nelson, *Puerto Rico's eye-popping economic situation, in charts,* QUARTZ (Sept. 30, 2017), https://qz.com/1091341/puerto-ricos-eye-popping-economic-situation-in-charts/.

[8] *See, e.g.,* Diane Lourdes Dick, *U.S. Tax Imperialism in Puerto Rico*, 65 AM U. L. REV. 1, 76–78 (2015) (describing repeal of section 936).

[9] *See, e.g.,* FIN. OVERSIGHT AND MGMT. BD. FOR P.R., *New Fiscal Plan for Puerto Rico*, 13 (Oct. 23, 2018), https://drive.google.com/file/d/17ca0ALe7vpYn0jEzTz3RfykpsFSM0ujK/view (hereinafter *New Fiscal Plan*).

[10] *See, e.g.*, Jose B. Carrión & Andrew G. Biggs, *Don't blame Puerto Rico's poor economy on hurricanes*, WASH. POST (Dec. 17 2018), https://www.washingtonpost.com/opinions/dont-blame-puerto-ricos-poor-economy-on-hurricanes/2018/12/17/206a5734-f181-11e8-9240-e8028a62c722_story.html?utm_term=.b246ec610713.

[11] *See, e.g.*, COMMONWEALTH OF P.R., DEPT. OF LABOR AND HUMAN RES., *Puerto Rico Economic Analysis Report 2015-2016* at 20 (stating government is 25.6% of non-farm employment, with education and health services listed separately).

[12] *See, e.g.*, KAYLA FONTENOT, JESSICA SEMEGA & MELISSA KOLLAR, *Income and Poverty in the United States: 2017*, U.S. CENSUS BUREAU (Sept. 2018), https://www.census.gov/content/dam/Census/library/publications/2018/demo/p60-263.pdf.

[13] *See, e.g.*, DATA USA: PUERTO RICO & UNITED STATES, https://datausa.io/profile/geo/puerto-rico/?compare=united-states (last visited Mar. 26, 2019) (comparing Puerto Rico and the U.S. as a whole).

Given these statistics, and the fact that all is needed to take up residence in Orlando or New York is a one-way plane ticket, it is not surprising that so many Puerto Ricans are leaving Puerto Rico. Puerto Rico has lost 10% of its population since 2007, and our demographer predicts 10% more will leave in the next five years.[14] These departures include many critically important doctors and nurses, as well as a disproportionate percentage of the younger Puerto Ricans that the island needs to provide the foundation for the next generation.[15]

People who haven't followed these developments closely often assume the crisis was caused by Hurricanes Irma and Maria in September 2017. This isn't the case at all. The hurricanes smashed into an island that already was in deep distress, magnifying the misery.

II. THE OVERSIGHT BOARD'S POWERS AND RESPONSIBILITIES

Under PROMESA, Congress gave the Oversight Board two major tasks, certifying a fiscal plan and restructuring Puerto Rico's debt. Nearly everything we do flows from one or both of these responsibilities.[16]

Start with the fiscal plan. The fiscal plan is the key lever PROMESA intends for the Oversight Board to use to spur governance reform in Puerto Rico.[17] It is premised on the view that large public entities like cities, states, or territories that fall into deep financial distress invariably suffer from dysfunctional governance.[18] If the ordinary political processes were working smoothly, the city, state, or territory could adjust its revenues or expenses, and manage the crisis.

The fiscal plan is created through an iterative process with the Governor of Puerto Rico.[19] Once the Oversight Board establishes a schedule for the fiscal plan process, the Governor is given an opportunity to propose a fiscal plan.[20] After the Governor submits his proposed plan,

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[14] *See, e.g.*, *New Fiscal Plan*, *supra* note 9, at 7.

[15] Susan Milligan, *The Skilled Worker Exodus*, U.S. NEWS & WORLD REPORT (May 11, 2018, 6:00 AM), https://www.usnews.com/news/the-report/articles/2018-05-11/skilled-workers-are-leaving-puerto-rico-in-droves.

[16] For a more detailed description of these roles, see Skeel, *supra* note 5, at 870–74.

[17] *Id.* at 871.

[18] *Id.* at 865.

[19] *Id.* at 872.

[20] *Id.* at 871.

the Oversight Board determines whether the plan meets a set of 14 requirements in PROMESA.[21] The plan must provide for estimates of revenues and expenses, for instance, eliminate structural deficits, and develop a debt sustainability analysis.[22] If the Board determines the proposed fiscal plan does not satisfy PROMESA, we issue a "violation" letter, and if there is time, invite the Governor to submit a revised plan.[23] In the end, we either certify the Governor's fiscal plan or we certify our own fiscal plan.

Once the fiscal plan is certified, it serves as the touchstone for all of Puerto Rico's finances. If Puerto Rico passes a budget that is inconsistent with the fiscal plan, we can make reductions to eliminate the inconsistency.[24] We also have the authority to disallow contracts and executive orders that violate the fiscal plan.[25] To protect the fiscal plan and the reforms it calls for, PROMESA forbids courts from even considering challenges to the Board's certification decisions.[26]

The Board's other major responsibility is restructuring Puerto Rico's debt. The legislation provides two different restructuring mechanisms. The simpler of the two is in Title VI of PROMESA.[27] For those who are familiar with sovereign debt, Title VI is a lot like the collective action provisions used in international finance. If a sufficient majority of the creditors in each class of bonds votes to approve a restructuring, Title VI makes the restructuring binding on all bondholders, including the dissenters.[28] It does not, however, have any of the other features of a traditional bankruptcy law, such as a stay on collection or the power to avoid preferential transfers.

A far more comprehensive restructuring framework can be found in Title III of PROMESA. Title III borrows many of the key provisions of Chapter 9—the municipal restructuring laws that Detroit, Stockton,

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[21] The requirements are set forth in PROMESA, 48 U.S.C. § 2141(b)(1) (2016).
[22] *Id.*
[23] 48 U.S.C. § 2141(b)(3)(B) (2016).
[24] 48 U.S.C. § 2143(d) (2016).
[25] 48 U.S.C. § 2144(b) (2016).
[26] 48 U.S.C. §2126(e) (2016).
[27] In concept and effect, at least, Title VI is simple. The details are oddly complex, in part because it introduces terms (such as "Administrative Supervisor" and "Qualifying Modification") that do not appear elsewhere in PROMESA. 48 U.S.C. § 2231(a)(1) & (a)(13) (2016).
[28] 48 U.S.C § 2231(m)(1) (2016).

California, and other cities have used to restructure their debt.[29] It looks and acts like a bankruptcy law, although Congress went to great lengths to avoid calling Title III bankruptcy. It is bankruptcy-like, imposing a stay on collection and incorporating many of the other key features of U.S. bankruptcy law.

The most dramatic innovation of Title III is its scope. Not only can Puerto Rico's municipal entities invoke Title III, as with municipal bankruptcy; Title III also is available to Puerto Rico itself. Prior to PROMESA, Puerto Rico did not have any bankruptcy option, since its municipalities are excluded from municipal bankruptcy and the Supreme Court struck down a restructuring law Puerto Rico enacted to fill the gap.[30] PROMESA more than remedied this problem by giving the Oversight Board the authority to file Title III proceedings not only for Puerto Rico's municipal entities, but also for Puerto Rico itself.

PROMESA thus gave the Board two really big tools: the authority both to certify a fiscal plan that would serve as a blue print for Puerto Rico's finances, and to file bankruptcy-like Title III proceedings on behalf of Puerto Rico or its municipalities.

III. THE PROGRESS TO DATE

When the seven of us were appointed on August 31, 2016, we didn't know each other, we had no advisors or staff, and we had no idea what Puerto Rico's revenues and expenses were. For the next six months, we and our advisors scrambled to determine Puerto Rico's revenues and expenses as precisely as we could, so that we could certify the fiscal plan

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[29] Section 301(a) (codified at 48 U.S.C. § 2161(a) (2016)) incorporates numerous bankruptcy provisions, many from Chapter 9 and Chapter 11. For an overview of Detroit, Michigan's and Stockton, California's municipal restructuring laws, see generally Nick Brown, *Chapter 9 bankruptcy puts Detroit in driver's seat of its restructuring,* REUTERS (Jul. 18, 2013, 8:30 PM), https://www.reuters.com/article/us-usa-detroit-chapter9/chapter-9-bankruptcy-puts-detroit-in-drivers-seat-of-its-restructuring-idUSBRE96I01A20130719; *see also* Hilary Russ, *Analysis: Stockton, California new paradigm for struggling cities,* REUTERS (Jul. 1, 2012, 8:06 AM) https://www.reuters.com/article/us-stockton-bankruptcy-filing/analysis-stockton-california-new-paradigm-for-struggling-cities-idUSBRE86007T20120701.

[30] *See* Puerto Rico v. Franklin Cal. Tax-Free Tr., 136 S. Ct. 1938, 1946–49 (2016).

that would serve as the basis for Puerto Rico's budgets and the restructuring of its debt.[31]

One of the great blessings of the President's and Congressional leaders' choice of Board members was—and is—that we have a wide range of expertise. Several Board members are bankers, one was a state budget director, one is a pension expert, one runs an insurance company, and two of us are bankruptcy experts.[32] This enabled us to specialize to some extent, devoting particular attention to our areas of expertise.

By early 2017, we made significant progress and had gone back and forth with Governor Rosselló and his administration on the terms of the first multi-year fiscal plan.[33] After a flurry of last-minute negotiations, we reached agreement on the Commonwealth fiscal plan. We certified the plan, together with two "amendments," on March 13, 2017, and certified the plans for other public entities as well.[34] On May 3, 2017, two days after a stay on creditor collection efforts expired, we put the Commonwealth of Puerto Rico into Title III.[35] Two months later, we filed a Title III proceeding for PREPA, the electricity company.[36] Our mantra throughout the process was "once and done," and at the time, it seemed possible this could be achieved.[37]

Then hurricanes Irma and Maria hit. Even those who were not on the island can get some idea how awful the hurricanes were from photos of the destruction. Although the mountains in the east usually deflect hurricanes off to the south or north, Hurricane Maria smashed straight through, pummeling the entire island. According to some estimates, the hurricane inflicted more than $100 billion of damage on Puerto Rico.[38]

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[31] The events in this paragraph and the next three are described more fully in Skeel, *supra* note 5, at 874–80. A succinct summary is provided here for context.

[32] Carlos Garcia and Jose González were each heads of the Government Development Bank and are bankers; Ana Matosantos was California's budget director; Andrew Biggs is a pension expert; José Carrión runs an insurance company; and Arthur González (a former bankruptcy judge) and I are bankruptcy specialists. *See* Press Release, *supra* note 4.

[33] Skeel, *supra* note 5, at 881.

[34] *Id.* at 875.

[35] *Id.* at 873.

[36] *Id.* at 876.

[37] *Id.* at 874.

[38] *See* Jorge L. Ortiz, *Hurricane Maria's economic impact on Puerto Rico: At least $43 billion, possibly as high as $159 billion*, USA TODAY (Dec. 4, 2018, 8:02 PM) https://www.usatoday.com/story/news/2018/12/04/hurricane-maria-economic-impact-puerto-rico/2209231002/.

Thousands of houses were demolished, and electricity was not restored to some parts of the island until the following spring, many months later. For a long time the death toll was listed as 64; we now know a more accurate number would be at least 2,000, and possibly 3,000 or more.[39]

Given the destruction caused by the hurricanes, and its dire implications for Puerto Rico's already troubled economy, we obviously had to throw out our original fiscal plan and start over on a new plan that took account of Puerto Rico's new realities. In the months after the hurricanes, we negotiated intensively with Governor Rosselló and his advisors over the terms of a new fiscal plan. We had an excellent working relationship on the whole. In the end, we reached agreement on nearly everything, with two major exceptions.

The first exception was pensions. We believe it's essential that there be modest cuts to Puerto Rico's pensions. Given the depth of the crisis, every constituency needs to share in the sacrifice Puerto Rico must bear to restore fiscal balance once again. For pensions, our current fiscal plan states that a "10% average reduction in pensions is appropriate and necessary."[40] Moreover, the court might be reluctant to confirm a restructuring plan that made significant cuts to other creditors, but left the pensions entirely intact. The pension shortfall is enormous with more than $50 billion in liabilities and almost no assets.[41] A proposal to leave these obligations untouched would "unfairly discriminate" against creditors whose claims were subject to restructuring.[42] To put Puerto Rico's pensions on a more stable footing, they need to be shifted from a defined benefit plan to defined contribution. This has already commenced with the largest of the pensions, and will be done with the other pensions as well.[43] To assure that the pension adjustments do not harm the most

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[39] *See* Ray Sanchez, *How Puerto Rico's death toll climbed from 64 to 2,975 in Hurricane Maria*, CNN.COM (Aug. 29, 2018, 2:59 PM), https://www.cnn.com/2018/08/29/us/puerto-rico-growing-death-toll/index.html.

[40] *New Fiscal Plan*, *supra* note 9, at 123. As this essay goes to press, the Board is on the verge of certifying a new five year fiscal plan. The new fiscal plan is not likely to differ dramatically from the current plan, but there will be significant adjustments in some areas.

[41] *Id.*

[42] The prohibition of unfair discrimination, which can be found in section 1129(b)(1) (incorporated in Title III under section 301(a)), precludes a plan from giving significantly better treatment to one class of unsecured creditors than to another class. In the Detroit bankruptcy, the court applied a subjective test in construing the requirement. *In re* City of Detroit, 524 B.R. 147, 255-57 (Bankr. E.D. Mich. 2014).

[43] The Employees' Retirement System has 245,000 beneficiaries and ceased defined benefit accruals starting in 2013. The Teachers' Retirement System and Judicial Retirement

vulnerable workers, our fiscal plan uses a means test: the cuts will only affect retirees with the most generous benefits; those whose total retirement benefits are below the poverty level will be fully protected.[44]

The second exception was labor law reform. Puerto Rico's labor laws provide lavish benefits and substantial protection from workers being laid off.[45] The benefits are a boon for current employees, who are understandably reluctant to trim them, but the cost to employers discourages businesses from hiring new employees.[46] Puerto Rico's labor regulation is radically out of line with labor rules in the fifty states, forty-nine of which provide for at-will employment.[47] Our economist projected that reforming Puerto Rico's laws, and making them more like the rules elsewhere in the U.S., would add 1% of growth a year to Puerto Rico's economy, or roughly $42 billion over the next 30 years.[48]

Unlike with pension restructuring, which we can achieve through the Title III process, the Board does not have the power to enact legislation. Since the principal labor benefits are ensconced in Puerto Rico law, they can be changed only by Governor Rosselló and Puerto Rico lawmakers.[49] In June, 2018, there was a brief period when significant labor reform seemed possible. By offering to let Governor Rosselló invest several billion dollars of the expected growth in the people of Puerto Rico, we were able to persuade him to support repeal of Law 80, where the principal protections are housed. After intense debate in Puerto Rico's House and Senate, the reforms were killed.[50] "Unfortunately," as our most recent fiscal plan put it, "there was no political will to enact the labor reform proposal outlined in the April 19, 2018 version of the New Fiscal

System, which have not yet made a full transition, have 80,000 and 860 beneficiaries, respectively. *New Fiscal Plan*, *supra* note 9, at 119–23.

[44] *Id.* at 123 (stating no cuts to beneficiaries whose benefits are below the poverty level).

[45] *Id.* at 43.

[46] *Id.*

[47] *Id.*

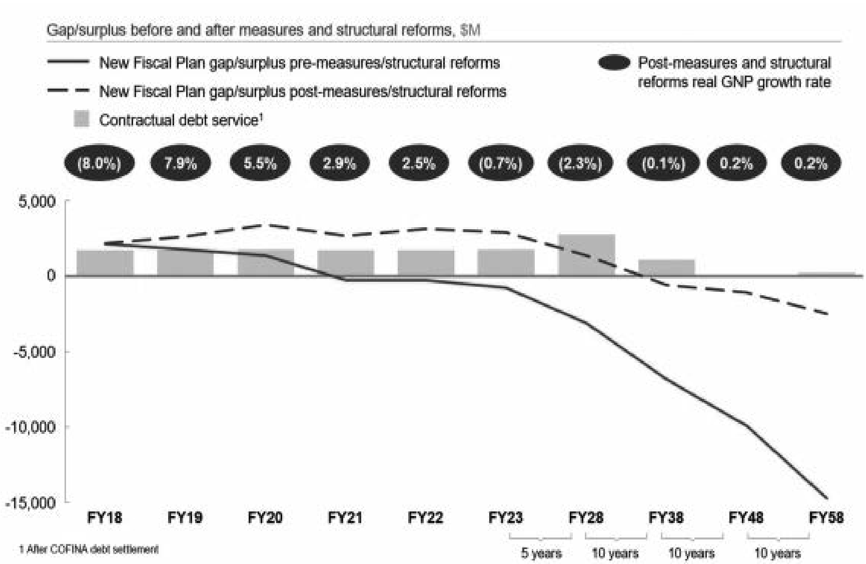
[48] *Id.* at 46.

[49] To his credit, Governor Rosselló and Puerto Rico lawmakers did enact legislation reducing the number of paid vacation days for public employees to fifteen, which is closer to mainland norms, and adjusting other public employee benefits. *Id.* at 74 (describing the effect of Act 26-2017).

[50] Carrión & Biggs, *supra* note 10 (noting the Puerto Rican legislature's rejection of a reform effort).

Plan, or to repeal Law 80 [the source of the benefits] as was required by the May 30, 2018 version of the New Fiscal Plan."[51]

The current fiscal plan—certified on October 23, 2018— takes account of this resistance to reform.[52] Thanks to an expected $82 billion of federal and private disaster aid, our projections show significant near-term surpluses. Absent the massive boost that labor reform would provide, however, the economy is likely to revert to deficits in fiscal year 2034. This trajectory can be seen in one of the key graphs in the fiscal plan, which one of the Governor's advisors refers to as a "see-saw."[53]



I've painted a bleak picture of where things are in Puerto Rico, but there have been positive developments as well. Governor Rosselló is committed to truly transforming PREPA, the electricity company, which is absolutely essential to Puerto Rico's future. We're working with the Governor to shift PREPA away from its heavy reliance on diesel oil to generate electricity, toward cheaper and cleaner generation. The Governor's goal is for PREPA to enter into a long-term concession agreement for the management of PREPA's transmission and distribution facilities, and to privatize much of the generation. This process is well underway, with an ongoing auction for the management contract and

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51 *New Fiscal Plan, supra* note 9, at 46 (emphasis removed).
52 *Id.* at 14.
53 *Id.* at 11.

strong interest from private suppliers of solar energy and other renewables.[54]

The Governor also has effected a voluntary restructuring of the Government Development Bank ("GDB") under Title VI of PROMESA. Most of GDB's functions have already been transferred to other agencies in the government, and the bank will gradually be dissolved.[55] PREPA's transformation and the wind-down of GDB reflect a shift from the state-centered approach brought to Puerto Rico by New Dealer Rexford Tugwell in the 1940s, to a more contemporary partnership between the public and private sectors.

The other major restructuring development is the confirmation of Title III's plan of adjustment for Puerto Rico's sales tax bonds—known as COFINA.[56] The plan will provide roughly $17.5 billion of savings for Puerto Rico over the next forty years, and it is an important building block for the larger and more complex Title III case of Puerto Rico as a whole.[57] Some have argued that we should have held out for even greater savings in the COFINA case, for the benefit of Puerto Rico's creditors and other stakeholders. But as my colleague Arthur González pointed out in an op-ed, there was a very real risk that the sales tax creditors would have won this litigation, and even less of the revenues would have been available for Puerto Rico's Title III case.[58]

The Board itself has also made considerable progress—and has matured—over the past three years. The Board is an unusual creature from a governance perspective. Unlike a corporate board of directors, which provides outside oversight of the corporation, the seven of us are

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[54] For a good overview of these initiatives, *see* P.R. Fiscal Agency and Fin. Advisory Auth., *A Government Perspective: Energy Policy and Regulatory Reform in Puerto Rico* (Jan. 18, 2019) (prepared for 45th PURC/World Bank International Training Program on Utility Regulation and Strategy).

[55] The Title VI restructuring and wind-down are described in GOVERNMENT OF PUERTO RICO, *Government Development Bank for Puerto Rico: New Fiscal Plan* 10–14 (Apr. 12, 2018).

[56] Fin. Oversight and Mgmt. Bd. for P.R., *Unanimous Written Consent Approving and Issuing Certifications Pursuant to Sections 104 and 206 of PROMESA for the Puerto Rico Sales Tax Financing Corporation (COFINA)*, (May 9, 2017), https://cases.primeclerk.com/puertorico/Home-DownloadPDF?id1=NjE3ODQx&id2=0

[57] *Id.*

[58] Arthur J. Gonzalez, *Lawful Restructuring Compromises Are Key to Puerto Rico's Future*, MORNING CONSULT (Nov. 20, 2019), https://morningconsult.com/opinions/lawful-restructuring-compromises-are-key-to-puerto-ricos-future/.

principals. We are like a governmental agency in this regard—and in fact, the Board was expressly created as an "entity" within the government of Puerto Rico.[59] In the beginning, the Board was little more than the seven of us and a few advisers. The Board looks quite different now. Since coming on as Executive Director in June 2017, after overseeing the restructuring of Ukraine's debt and serving as Minister of Finance, Natalie Jaresko has assembled a fine staff of more than twenty employees, nearly all of whom are Puerto Rican and live on the island.[60] Although our outside advisors continue to play an essential role, we now have significant internal capacity, including expertise on issues ranging from media outreach to accounting and the electricity industry. The Executive Director runs things on a day-to-day basis and is the principal point of contact for our advisors and for most outsiders, including Puerto Rico agency heads and lawmakers. She is not technically a member of the Board, but in practice she is in many respects, even the less pleasant ones: her name often appears on the caption with the seven of us when the Board is sued by a creditor or disgruntled Puerto Rico lawmaker.

IV. THE CHALLENGES THAT HAVE EMERGED

This year is critical for the Oversight Board and for Puerto Rico. The post-Maria recovery effort is far enough along that key features, such as the extent of federal disaster relief, are slowly coming into focus. It has been nearly three years since PROMESA was enacted and Puerto Rico suspended payment on nearly all of its debt, and two years since the commencement of Puerto Rico's Title III case. Uncertainty remains, but it no longer precludes the restructuring Puerto Rico needs. For the seven current Board members, the August 31, 2019, expiration date of our three-year terms give us further incentive to complete the restructuring this year.[61]

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[59] *See* 48 U.S.C. § 2121(c)(1)(2016).

[60] PROMESA expressly provides for an Executive Director and appears to contemplate that the Executive Director function like a powerful chief of staff. 48 U.S.C. § 2123(a)(2016).

[61] Because the seven of us can remain in place until we are replaced, it is possible that some or all of us will serve beyond August 31, 2019. The Board itself will continue until Puerto Rico has "adequate access to short-term and long-term credit markets" and four consecutive fiscal years in which revenues are at least as high as expenditures, "as determined in accordance with modified accrual accounting standards." 48 U.S.C. § 2149 (1) & (2) (2016).

As we press to complete the first wave of reforms and to propose what we hope will be a "once and done" restructuring plan, the Board has encountered a variety of new challenges. Three complications are of particular note.

A. *The Limits of Our Power*

The Puerto Rico Board was modeled on the Washington D.C. control board ("DC Control Board") of the mid 1990s, which had enormous power over the Washington D.C. government.[62] The legislation that created the DC Control Board put a new Chief Financial Officer in place, with authority over all of Washington's revenues and answerable primarily to the DC Control Board.[63] In 1997, two years after the DC Control Board was created, Congress expanded its powers, giving it control of nearly every agency and department.[64] The DC Control Board had a wide range of additional powers as well.[65] We have learned, somewhat to our dismay, that the Puerto Rico Board does not have quite as much power. The DC Control Board was a true "control" board, whereas the seven of us are an oversight board—an oversight board with significant power, but an oversight board, nonetheless.

We first came face-to-face with this reality shortly after Hurricane Maria. It had quickly become clear that PREPA, the electricity company, which was deeply troubled even before the hurricanes, would not be able to restore electricity to the island for months.[66] PREPA also had entered into a large, highly controversial contract with a company called Whitefish, which appeared to have relatively little capacity and whose owners were from the Montana district of the Secretary of the Interior.[67] We proposed to bring in a Chief Transformation Officer ("CTO") to begin the process of transforming PREPA into a utility that can provide reliable,

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[62] For an excellent overview of the D.C. Control Board and its actions, see Deborah I. Kobes, *Out of Control? Local Democracy Failure and Fiscal Control Boards* 185, 186 (2009) (unpublished dissertation, Mass. Inst. of Tech.), *available at* http://hdl.handle.net/1721.1/55132.

[63] *Id.* at 205–06.

[64] *See id.* at 206–07.

[65] *Id.*

[66] Frances Robles & Patricia Mazzei, *Parts of Puerto Rico Won't Have Power for 8 Months. What's the Holdup?* N. Y. TIMES (Dec. 23, 2017), https://www.nytimes.com/2017/12/23/us/puerto-rico-power-outage.html.

[67] *See, e.g.*, Christopher Helman, *Is That $300 Million Puerto Rico Power Contract 'Whitefishgate' Or Just a Red Herring*, FORBES, Nov. 3, 2017.

affordable electricity.[68] The CTO would function very much like the chief restructuring officers appointed in many corporate reorganization cases, although with somewhat broader powers.[69] I was pretty sure we could do this.[70]

Unfortunately, I am not the judge. Judge Laura Taylor Swain denied our CTO request. After explicitly contrasting our authority to the broader powers given to the DC Control Board, she held that Puerto Rico's Oversight Board can control PREPA budgets and require approval of PREPA contracts, but we cannot take over PREPA's day-to-day operations.[71] The CTO would have operational control of PREPA and thus is beyond our authority under PROMESA, she ruled.[72] She concluded the opinion with a strong call for the Oversight Board and the Governor to work together.[73]

Last summer brought another disagreement about the scope of our authority. Perhaps emboldened by the PREPA CTO decision, Governor Rosselló argued that anything in the fiscal plan that touches in any way on policy can only ever be a recommendation.[74] It cannot bind the Governor. This time Judge Swain sided with the Board. [75] "The power bestowed on the Oversight Board" by the provision governing recommendations, she concluded, "allows the Oversight Board to make binding policy choices for the Commonwealth, notwithstanding the Governor's rejection" of the Board's choices.[76] The Board's power to impose policy is not unlimited, however.[77] It does not give us the authority to enact laws.[78] "Thus," Judge Swain concluded, "with respect to policy measures that would require the adoption of new legislation or the repeal or modification of existing

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[68] *See In re* Fin. Oversight & Mgmt. Bd. for P.R., 583 B.R. at 629.

[69] *Id.* at 630.

[70] The Governor and his advisors seem to have been confident we couldn't. Christian Sobrino, head of Puerto Rico's fiscal agency and the Governor's ex-official member on the Oversight Board, leaned over to me at a meeting a few months later and said, "You didn't seriously think you could win the CTO case, did you?"

[71] *In re* Fin. Oversight & Mgmt. Bd. for P.R., 583 B.R. at 626.

[72] *Id.* at 635–36.

[73] *Id.* at 637.

[74] *In re* Financial Oversight and Management Board for Puerto Rico, 327 F. Supp 3d 364, 370 (D.P.R. 2018), aff'd, 916 F.3d 98 (1st Cir 2019).

[75] *In re* Fin. Oversight & Mgmt. Bd. for P.R., 327 F.Supp. 3d at 372. The case is currently on appeal.

[76] *See id.* at 373.

[77] *See id.*

[78] *See id.*

Commonwealth law, the Oversight Board has only budgetary tools and negotiations to use to elicit any necessary buy-in from the elected officials and legislators."[79]

Unlike the DC Control Board or Detroit's Emergency Manager, who took control of the local government, Puerto Rico's Oversight Board must share authority with the Governor and Puerto Rico's legislature.[80] Given Puerto Rico's awkward political status in the United States—with no voting representation in Congress or vote in presidential elections—an oversight board that more fully displaced the authority of Puerto Rico's lawmakers would have magnified concerns about colonialism.[81] But the constraints on the Board's authority, which were a key part of the compromises incorporated into PROMESA, have created "an awkward power sharing arrangement," as Judge Swain put it, that is "'fraught with potential for mutual sabotage.'"[82]

B. The Downside of Essential Federal Disaster Relief

The awkwardness of our partnership with Governor Rosselló has been magnified by the rollout of federal disaster relief in the aftermath of Hurricane Maria. In one respect, we have been closely aligned with Governor Rosselló. We strongly supported the Governor's efforts to alert Washington to the extent of devastation wrought by the hurricanes and his pleas for federal help. We also shared some of his concerns about the recovery effort and whether the funding would be released in a sufficiently timely fashion. It was clear from the beginning that Puerto Rico had little hope of recovery absent generous federal aid.

Along with the flower of hope provided by the federal disaster aid, there is also, unfortunately, a dangerous weed. The flush of new funding creates the illusion of coming prosperity. The fiscal plan projects significant near-term surpluses until fiscal year 2034.[83] These near-term

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[79] *Id.* at 373.

[80] *See* Skeel, *supra* note 5, at 865; *see also Factbox-Puerto Rico vs Detroit: What's different?* REUTERS (May 3, 2017, 5:43 PM), https://www.reuters.com/article/us-puertorico-debt-bankruptcy-detroit-fa/factbox-puerto-rico-vs-detroit-whats-different-idUSKBN17Z2LT.

[81] Judge Juan Torruella is one of the best-known current critics of Puerto Rico's status. *See, e.g.*, Juan R. Torruella, *Why Puerto Rico Does Not Need Further Experimentation with its Future: A Reply to the Notion of "Territorial Federalism,"* 135 HARV. L. REV. FORUM 65 (2018).

[82] *In re* Fin. Oversight and Mgmt. Bd. for P.R., 583 B.R. at 636.

[83] *New Fiscal Plan*, *supra* note 9, at 11.

surpluses create a strong disincentive for Puerto Rico's elected officials to implement governmental reform. The reluctance is entirely understandable; the reforms are difficult and unlikely to be popular with the voters whose support an elected official depends on. With federal funding coming in, the need for reform no longer seems obvious. The problem is that the surpluses are temporary—the fiscal equivalent of a sugar high. If Puerto Rico does not reform the dysfunctional features of its governance, its economy will revert to long-term deficits when the temporary stimulus of federal disaster relief wears off.

The drafters of PROMESA cannot have envisioned these conditions. Puerto Rico was desperately low on liquidity when PROMESA's power sharing provisions were put in place. The need for liquidity was expected to give the Oversight Board leverage—it would put considerable pressure on Puerto Rico lawmakers to make the changes necessary to increase the island's revenues and decrease its expenses. But the liquidity constraints have been much weaker than expected. The stay on creditor collection that started when PROMESA was enacted,[84] and which resumed after the Board filed for Title III,[85] provided initial relief by freeing Puerto Rico from the obligation to make payments to its creditors. Since the hurricanes, Puerto Rico has begun receiving massive disaster relief aid. As a result, Puerto Rico faces much less liquidity stress than expected, as reflected (though somewhat misleadingly) by the roughly $12 billion Puerto Rico has in several thousand bank accounts as of this writing.[86] This makes it more challenging than expected to implement reform.

I do not want to overstate this challenge or to suggest no reforms are being made. Governor Rosselló has made significant reforms in some areas—most visibly, in education—and the Board retains very important

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[84] 48 U.S.C. § 2194 (2016). The Board extended the initial stay for an additional 75 days, as authorized by this section. It expired on May 1, 2017.

[85] 48 U.S.C. § 2161(a) (2016) (incorporating the automatic stay in section 362 of the Bankruptcy Code).

[86] Much of this money is likely to be restricted, and thus not directly available to the Commonwealth. The Board hired Duff & Phelps to conduct an extensive investigation of the bank accounts. Hannah Cartwright, *Duff & Phelps Appointed to Conduct a Forensic Analysis of Puerto Rico's Finances,* PASQUINES (Feb. 28, 2018), https://pasquines.us/2018/02/28/duff-phelps-appointed-conduct-forensic-analysis-puerto-ricos-finances/. Duff &Phelps completed the investigation in March, 2019. *See Fiscal board releases report detailing bank balances*, CARIBBEAN BUS., March 15, 2019, https://caribbeanbusiness.com/fiscal-board-releases-report-detailing-puerto-ricos-bank-balances/.

powers through the fiscal plan and budgetary process. But we do not have quite as much leverage as we originally assumed.

C. The Appointments Clause Challenge

The Oversight Board also faces an existential challenge. In 2017, hedge fund called Aurelius hired Ted Olson—the superlawyer who represented the Republicans in *Bush v. Gore*—to sue the Oversight Board, alleging the current members of the Board were not constitutionally appointed.[87] According to Aurelius, we should have been appointed through nomination by the President and advice and consent of the Senate, rather than through the similar yet somewhat different process permitted by PROMESA.[88] If the Board was not constitutionally appointed, we did not have the authority to file Puerto Rico's Title III case and the case should be dismissed.[89] Aurelius and another objector are betting, as the *Washington Post* recently put it, "that the overthrow of the Promesa board will enable them to demand a better payout."[90]

In the District Court, the case featured three former solicitor generals: Olson; Don Verrilli, whom we hired to defend us; and Walter Dellinger, representing Governor Rosselló, who sided with the Board (as did the United States, one of the largest groups of creditors, and Puerto Rico's retirees.)[91] The District Court concluded that the Oversight Board is a territorial body—an entity within Puerto Rico's government—and its members are Puerto Rico officers, not federal officers subject to the Appointments Clause.[92] The court therefore rejected Aurelius' challenge.[93]

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[87] Nick Brown, *Puerto Rico creditor Aurelius asks U.S. judge to throw out bankruptcy*, REUTERS (Jan. 10, 2018, 5:04 PM), https://www.reuters.com/article/us-puertorico-debt-bankruptcy/puerto-rico-creditor-aurelius-asks-u-s-judge-to-throw-out-bankruptcy-idUSKBN1EZ2UR.

[88] *Id.*

[89] *Id.*

[90] Editorial, *A man-made disaster looms over Puerto Rico*, WASH. POST (Mar. 3, 2019), https://www.washingtonpost.com/opinions/a-man-made-disaster-looms-over-puerto-rico/2019/03/03/b810c00a-3b9b-11e9-aaae-69364b2ed137_story.html?utm_term=.31ae234e65ce.

[91] *In re* Fin. Oversight & Mgmt. Bd. for P.R., Case No. 17 BK 3283-LTS, at *1–2 (D.P.R. July 13, 2018).

[92] *Id.* at *34.

[93] *Id.* at *35.

The First Circuit reversed.[94] In an opinion written by Judge Juan Torruella, the court rejected PROMESA's characterization of the Board as a Puerto Rico entity, concluding the Board members are federal officers.[95] "The Board members are, in short, more like Roman proconsuls picked in Rome to enforce Roman law and oversee territorial leaders than they are like the locally selected leaders that Rome allowed to continue exercising some authority," he wrote, in a widely quoted sentence.[96] The court then concluded that we are "principal" rather than "inferior" officers under the Appointments Clause, and "therefore should have been appointed by the President, by and with the advice and consent of the Senate."[97]

The court did not, however, invalidate the actions taken by the Board to date. Applying the de facto officer doctrine, which protects actions taken by officers who appear to have proper authority, the court held that our actions to date are fully enforceable.[98] The court also delayed implementation of its ruling for 90 days, "so as to allow the President and the Senate to validate the currently defective appointments or reconstitute the Board in accordance with the Appointments Clause."[99] The court made clear that "[d]uring the 90-day stay period, the Board may continue to operate as until now."[100]

The First Circuit decision left us two possible options for protecting the Board's authority and the restructuring process. The President and Senate could remove any doubt by going through the advice and consent process, as the opinion invites them to do. As of this writing, the President has announced his intention to nominate the seven of us, and to send our names to the Senate for possible confirmation. It is not yet clear whether or when the confirmation will take place.

The second alternative—which does not preclude the first—is appealing the First Circuit ruling to the Supreme Court. We have now taken this step, asking the Supreme Court to take certiorari and review the First Circuit decision. We also have asked for a stay of the First Circuit ruling while the Supreme Court considers the certiorari petition.

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[94] Aurelius Investment, LLC, et. al. v. Commonwealth of Puerto Rico, et. al., Case No. 18-1671, at 54 (1st Cir. Feb. 15, 2019).

[95] *Id.* at 46.

[96] *Id.* at 40.

[97] *Id.* at 49.

[98] *Id.* at 53.

[99] *Id.* at 54.

[100] *Id.*

Some have insinuated that our primary motive in responding to the First Circuit decision is self-aggrandizement—we're trying to protect our positions. The contention is somewhat odd given that the seven of us serve on the Board without pay. It also is mistaken. What matters is the authority of the Board as an entity, not whether any of us is on the Board. Only if a valid Board is in place can it certify fiscal plans and budgets that restore fiscal balance and access to the capital markets. And only a valid Board can use Title III of PROMESA to restructure Puerto Rico's debt.

Fortunately, the Board's authority is secure for at least 90 days, and thereafter if implementation of the First Circuit ruling remains on hold while the Supreme Court decides whether to take certiorari. It is uncertain whether the Court will indeed take the case, or whether it will eventually uphold PROMESA's selection process. But the arguments for both seem strong—the case raises extremely important constitutional issues, and the First Circuit decision is at odds with a long tradition of allowing flexibility with appointments in the territorial context.[101]

IV. LOOKING FORWARD

Having emphasized the current challenges, I should reiterate that there has been important progress as well. As mentioned earlier, the court has approved two major restructuring plans, one for the GDB and the other for COFINA. In addition, while Puerto Rico's finances are still far from transparent, there has been improvement here as well. The Board now requires weekly public reporting of the amount of cash in the Treasury Single Account, and monthly financial reports from Puerto Rico and related entities. The Board also has become especially vigilant about pushing for implementation of the reforms in the fiscal plan and budgets.

As the three-year term of the initial Board members winds down, we expect to propose—and hopefully see confirmed—a plan of adjustment for Puerto Rico. If PREPA's transformation stays on track, the foundation should be fully in place this year. Each of these steps is essential. Puerto Rico is still a long way from success, and I'm not quite as optimistic as I was at the outset of my own involvement, but this could be the year that

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[101] Our brief in the First Circuit chronicles the history. Brief for Appellee the Fin. Oversight and Mgmt. Bd. for P.R. and the P.R. Fiscal Agency and Fin. Advisory Auth., Aurelius Inv., LLC, et al., v. Puerto Rico, Case No. 18-1671 (Oct. 1, 2018).

the outlines of a new, more economically vibrant Puerto Rico finally start coming into focus.

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