# REFLECTIONS ON TWO YEARS OF P.R.O.M.E.S.A.

ARTICLE

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TWO GENERATIONS AGO, NEW DEALER AND FORMER PUERTO RICO GOVERNOR Rexford Tugwell wrote a memoir about his time in Puerto Rico entitled *The Stricken Land*.[1] Although the title seemed inapt for many of the years after the memoir was published—in the 1950s and 1960s, the vibrant economy prompted talk of a "Puerto Rico miracle"[2]—it has begun to seem fitting again more recently. Puerto Rico has experienced financial distress for over a decade, and then-governor Alejandro García Padilla declared the island unable to pay its debts in 2015.[3] In 2017, Puerto Rico was pummeled by two major hurricanes, only days apart. A large percentage of Puerto Ricans spent months without electricity.

In the midst of this distress, after Puerto Rico's default and before the hurricanes, the U.S. Congress enacted the Puerto Rico Oversight, Management, and Economic Stability Act, known as P.R.O.M.E.S.A.[4] P.R.O.M.E.S.A. responded to Puerto Rico's crisis by, among other things, creating an oversight board vested

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1 REXFORD TUGWELL, THE STRICKEN LAND: THE STORY OF PUERTO RICO (1946).

2 Reinerio Hernández-Márquez, *The Puerto Rican Industrial Policy Debate of 1940-1947: The Limits of Dependent Colonial Growth*, 3 BERKELEY PLAN. J. 76 (1986) (noting that economists called the economy a "miracle").

3 *See, e.g.,* Michael Corkery, *Puerto Rico Faces its Creditors in Early Debt Resolution Talks*, N.Y. TIMES, July 14, 2015, at B1 (describing meeting with creditors two weeks after the announcement).

4 Puerto Rico Oversight, Management, and Economic Stability Act (P.R.O.M.E.S.A.), Public Law 114-187, 130 Stat. 549 (2016) (codified at 48 U.S.C. § 2101 (2016)).

with the authority to certify multi-year fiscal plans for the island and its municipal entities and providing a bankruptcy-like framework for restructuring their debt.

Although P.R.O.M.E.S.A. was controversial from the beginning, its enactment was an unlikely achievement. At a time of extreme political polarization in Washington, Democrats and Republicans worked together to draft the legislation; it was approved by large bipartisan majorities in both the House and the Senate, then promptly signed into law by President Obama.

In August 2016, six others and I were appointed to three-year terms as members of the initial oversight board.[5] By this time, I had been studying, teaching and writing about bankruptcy and financial distress for longer than I care to remember, pursuing a calling that dates back to my second year of law school. I never imagined that I would be asked to put my scholarly expertise to practical use in any context, much less a crisis as urgent and important as Puerto Rico's financial distress.

This Essay, which I am honored to have been invited to write for *Revista Jurídica*, draws both on my scholarly and on my personal experience. I will begin in a scholarly mode, by exploring the question of where P.R.O.M.E.S.A. came from. P.R.O.M.E.S.A.'s core provisions are, I will argue, the product of two historical patterns that have emerged in responses to the financial distress of public entities in the United States. The first dates back to the 1970s crisis in New York City, while the second is much more recent. If P.R.O.M.E.S.A. had been enacted prior to either of these developments, its provisions would have looked very different.

After exploring P.R.O.M.E.S.A.'s origins, I will venture a more personal account of the decisions the oversight board has made during our first two years of existence. Our first year of activity came before Hurricanes Irma and María, and the second in the hurricanes' awful aftermath. Like the recovery generally, we still are far from having completed the task we were given. I will conclude by addressing the criticisms we have faced—some from the left and others from the right—and by offering my own view on how the success or failure of the Board should be assessed.

## I. HOW WE GOT HERE

Legislative responses to financial distress in the United States are never created from scratch. They always come from somewhere—most often from the last somewhat analogous crisis. Although America's bankruptcy laws have been radically revised on several occasions, each version has been based at least in part on its predecessors.[6] When Congress enacted new resolution rules for systemically

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5 The Financial Oversight and Management Board for Puerto Rico is often referred to as the F.O.M.B., its initials in English. I will use "oversight board" or "Board" to reduce the use of acronyms. The other members of the board are José Carrión (chair), Andrew Biggs, Carlos García, Arthur González, José González and Ana Matosantos.

6 I have discussed the origins and evolution of U.S. bankruptcy law at length elsewhere. DAVID A. SKEEL, JR., DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA (2001).

important financial institutions after the 2008 crisis, it borrowed liberally from the existing bank resolution rules.[7]

Although P.R.O.M.E.S.A. follows this pattern, it is distinctive in bringing together not just one, but two sets of historical developments: (1) the use of oversight boards when public entities fall into financial distress, (2) and the more recent use of municipal bankruptcy to restructure the debts of large cities.

*A. The Rise of Oversight Boards*

The watershed moment for oversight boards was New York City's crisis in 1974 and 1975. In the midst of the crisis, state and local decision makers created a sequence of three different crisis boards. A group of New York City financial leaders responded first, forming the Financial Community Liaison group in 1974 with the blessing of Mayor Abe Beam.[8] In early 1975, the state legislature established the Municipal Assistance Corporation (hereinafter, "M.A.C."), which was authorized to issue new bonds secured by New York's sales tax and securities fees.[9] The state legislature then created yet another board, the Emergency Financial Control Board (hereinafter, "E.F.C.B."). The E.F.C.B. was given the authority to put a three year budget in place for New York City, to approve or veto any new borrowing and to oversee all of the city's revenues.[10]

The E.F.C.B. was the board that proved effective. Although the Financial Community Liaison Group included major figures in New York finance, the absence of any formal authority rendered the group largely impotent.[11] The shortcomings of the M.A.C. were a reflection of the depth of the city's financial crisis: investors were reluctant to buy new New York City bonds, even with the promise of sales tax and securities fees to assure repayment. The E.F.C.B., by contrast, had the power to directly address New York City's financial predicament. In the words of Dick Ravitch, a veteran of this and subsequent New York financial crises, the "elected officials who approved the city's budgets [had become] far more concerned about allocating spending among various constituencies and interest groups than they were with the question of whether the expenditures were matched by recurring revenues."[12] The E.F.C.B. was not beholden to either the public employee unions or the banks that underwrote New York City's debt. The

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**7** *See, e.g.*, Randall D. Guynn, *Are Bailouts Inevitable?*, 29 YALE J. ON REG. 121, 145 (2012) (noting that "the OLA [the Orderly Liquidation Authority, which includes the resolution provisions of the Dodd-Frank Act] was modeled on the bank receivership provisions of the FDI Act").

**8** *See, e.g.*, ROBERT W. BAILEY, THE CRISIS REGIME: THE MAC, THE EFCB, AND THE POLITICAL IMPACT OF THE NEW YORK CITY FINANCIAL CRISIS 19-20 (1984).

**9** *Id.* at 23-36.

**10** *Id.* at 36-43.

**11** Bailey attributes its limitations to the absence of explicit authority and its "narrowness of political base." *Id.* at 23.

**12** RICHARD RAVITCH, SO MUCH TO DO: A FULL LIFE OF BUSINESS, POLITICS, AND CONFRONTING FISCAL CRISES 79 (2014).

E.F.C.B.'s independence from New York City's interest group politics and the powerful tools it was given by the state legislature enabled it to begin to rein in the city's unsustainable spending.[13]

New York's emergence from its crisis seems to have validated oversight boards as a response to large-scale municipal crises. When other major cities, including Philadelphia, Washington, D.C. and Miami, fell into financial distress in the 1990s, Congress and the states responded by putting oversight boards in place. The Washington D.C. oversight board is especially relevant to Puerto Rico, because both boards were created by Congress and because the Washington D.C. legislation served as the template for Puerto Rico's oversight board.[14]

D.C.'s Control Board was breathed into life by Congress in 1995, after Washington had begun accruing substantial budget deficits.[15] Treasury Secretary Robert Rubin "was scared to death of [D.C. Mayor] Marion Barry having the blank check drawn on the Treasury," and encouraged the creation of the Control Board as an alternative to an open-ended federal bailout.[16] Congress vested enormous authority in the new board. The Control Board could approve or disapprove District budgets, had veto power over any borrowing by the District and could invalidate any local legislation inconsistent with the District's budget. The Control Board legislation also created a Chief Financial Officer who had control of all of the District's revenues. During the six years of the Control Board's existence—it ended in 2001, after D.C. had four consecutive balanced budgets—Congress expanded the Board's powers several times, authorizing the Control Board to veto even emergency District legislation and giving it management control over four city agencies and nine major departments of D.C. government.[17]

Public perception of oversight boards typically has followed a similar trajectory. At the outset, they are denounced as undemocratic and are highly unpopular. Shortly after the D.C. board was established, city workers protested by blocking the Control Board's office with garbage trucks during the morning rush hour.[18] During the Board's first meeting, protestors shouted "free D.C." throughout the meeting, which was brought to an end by a bomb threat.[19] In Detroit, the appointment of emergency manager Kevyn Orr was attacked as a takeover of Detroit by

**13** *See* BAILEY, *supra* note 8, at 41-43.

**14** *See, e.g.*, *In re* Financial Oversight and Management Board for Puerto Rico, 583 B.R. 626, 633-34 (D.P.R. 2017) (comparing the powers of the Puerto Rico and D.C. boards). The Philadelphia board apparently was, in turn, the template for the D.C. board. *See, e.g.*, DEBORAH I. KOBES, OUT OF CONTROL? LOCAL DEMOCRACY FAILURE AND FISCAL CONTROL BOARDS 202 (2009) (unpublished dissertation, Massachusetts Institute of Technology), *available at* https://dspace.mit.edu/handle/1721.1/55132.

**15** District of Columbia Financial Responsibility and Management Assistance Act of 1995, Pub. L. No. 104-8, 109 Stat. 97 (1995).

**16** KOBES, *supra* note 14, at 195 (citations omitted).

**17** For discussion, see *id.*, at 206-07.

**18** *Id.* at 238.

**19** *Id.* at 239.

unsympathetic state officials. Orr faced repeated protests and needed twenty-four hour a day security.[20]

In each case, the initial hostility later gave way to acceptance and in some cases enthusiastic endorsement. After resolutely opposing D.C.'s Control Board, Mayor Marion Barry developed a working relationship with the Board and later said that the Board had been essential to D.C.'s recovery.[21] Anthony Williams, the Chief Financial Officer put in place by the Board, was later elected mayor of the District. Orr's reputation underwent a similar transformation. He is now viewed by many in Detroit and elsewhere as a hero.[22]

The initial reception of Puerto Rico's oversight board was similar to its predecessors. As with Washington D.C. and Detroit, protests greeted the board's early public meetings, and the board was criticized as undemocratic and, in Puerto Rico's case, colonial.[23] Unlike with its predecessors, there is not yet any evidence of a shift in perceptions, either in opinion polls or in the press.

### *B. The Discovery of Chapter 9*

The second stream that fed the P.R.O.M.E.S.A. legislation was the increasing use of bankruptcy to resolve the municipal distress of substantial cities. As recently as a decade ago, bankruptcy was not part of the tool-kit for addressing large scale public financial distress. Now it is.

According to the conventional wisdom, Chapter 9 of the Bankruptcy Code—the provisions governing municipal bankruptcy—was designed for sewer and water districts and the like, but could not handle the more complex problems of a distressed city government.[24] If a large city filed for bankruptcy, the thinking went, the results would be catastrophic: services would be disrupted and the city would lose its ability to borrow in the capital markets, perhaps forever. This made the

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**20** *See, e.g.,* Eric D. Lawrence, *Protestors decry Detroit's emergency financial manager,* USA TODAY.COM (March 23, 2013), https://www.usatoday.com/story/news/nation/2013/03/23/detroit-emergency-manager-protests/2013977/; Katie Rucke, *Leaked Emails Show Detroit's Emergency Manager Gets Luxury Treatment,* MINT PRESS NEWS (June 22, 2013) (criticizing the elaborateness of Orr's security detail) https://staging.mintpressnews.com/leaked-emails-detroits-unelected-austerity-manager-lives-lavishly/164102/.

**21** *See* KOBES, *supra* note 14, at 231 (describing Barry's growing cooperation with the board as mayor).

**22** *See, e.g.*, NATHAN BOMEY, DETROIT RESURRECTED: TO BANKRUPTCY AND BACK (2016).

**23** *See, e.g.*, Luis J. Valentín Ortiz, *Salsa, Rum and the Fiscal Board*, CARIBBEAN BUS. (Oct. 6, 2016) (describing protests of the first public meeting), http://caribbeanbusiness.com/salsa-rum-and-the-fiscal-board/. The criticism was not *universal*; in early opinion polls, most respondents in Puerto Rico expressed support for the oversight board. *See, e.g., PROMESA Board Meets to Discuss Governor's Turnaround Plan*, PUERTO RICO REPORT (Oct. 16 2016) (reporting that 69% of respondents in October 2016 *El Nuevo Dia* poll supported the Board, but also noting that many respondents indicated limited familiarity with the Board), https://www.puertoricoreport.com/promesa-board-meets-discuss-governors-turnaround-plan/#.WyUmyUgvzD4.

**24** For a sophisticated recent version of the conventional wisdom, see Adam J. Levitin, *Bankrupt Politics and the Politics of Bankruptcy*, 97 CORNELL L. REV. 1399 (2012).

*threat* of bankruptcy quite useful to spur lawmakers or interest groups into action. Bankruptcy itself, however, was not viewed as useful at all.

Underfunded pensions epitomized the limitations of municipal bankruptcy. The staggering burden of legacy pension obligations has become the principal source of financial distress for many cities and states.[25] Yet two insuperable obstacles seemed to rule out bankruptcy as a potential response. The first was political. Because public employees are such a powerful and well-connected interest group, it was thought, a mayor or city council that tried to use bankruptcy to adjust the city's pensions would be committing political suicide. The political consequences of filing for bankruptcy were simply too dire. The second obstacle was legal. Even if the city's elected officials were willing to file for bankruptcy, despite the political impediments, many thought that a city could not legally alter its pension obligations even in bankruptcy. After all, the reasoning went, state constitutions often include provisions protecting pension obligations.

At the outset of the decade, both obstacles started to crumble. The erosion began in a small Rhode Island town called Central Falls. In 2011, Central Falls was in deep financial distress. It was clear both that Central Falls had no other choice than to file for bankruptcy and that the town would need to restructure its pension commitments, which were seriously underfunded and by far the town's largest financial obligation. Central Falls did file for bankruptcy and it made major adjustments to its pension obligations, cutting them roughly in half.[26] The state of Rhode Island later passed legislation replacing a portion of the lost benefits, thus reducing the hardship for Central Falls' pension beneficiaries, but the pensions were significantly restructured.

The Central Falls bankruptcy filing signaled that the political barriers to adjusting pensions in bankruptcy were not insurmountable if a city had no other choice. Central Falls did not, however, address the second, legal obstacle to restructuring pensions in bankruptcy. Central Falls' pension beneficiaries ultimately agreed to the restructuring of their pensions. As a result, the bankruptcy judge did not need to rule on the question whether pensions can be restructured if one or more pension beneficiaries object. The legal barrier was still in place.

Then came Detroit. When Detroit filed for bankruptcy in 2013, it was clear that the Motor City needed to restructure all of its major debt obligations, including its pensions. Shortly after his appointment and before filing for bankruptcy, Kevyn Orr, Detroit's Emergency Manager, estimated that Detroit's pensions were underfunded by $3.5 billion.[27] He signaled that Detroit's pension obligations

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**25** *See, e.g.*, REPORT OF THE STATE BUDGET CRISIS TASK FORCE (Jan. 2014), *available at* https://www.volckeralliance.org/sites/default/files/attachments/state_budget_crisis_task_force.pdf (analyzing pension crisis and other state budget problems).

**26** *See, e.g.*, Jess Bidgood, *Plan to End Bankruptcy in Rhode Island Gains Approval*, N.Y. TIMES, (Sep. 7, 2012), at A21.

**27** *See, e.g.,* Randy Kennedy et al., *Foundations Aim to Save Pensions in Detroit Crisis*, N.Y. TIMES (Jan. 13, 2014), https://www.nytimes.com/2014/01/14/us/300-million-pledged-to-save-detroits-art-collection.html.

would need to be adjusted both for existing and for new employees. Detroit's public employee unions challenged Detroit's bankruptcy filing, insisting that the intended pension restructuring was illegal and some of Detroit's pension beneficiaries later voted against Detroit's proposed plan of adjustment. The bankruptcy judge was directly confronted with the legal question whether the pensions could be adjusted. In his ruling declaring Detroit eligible for bankruptcy, the Detroit bankruptcy judge concluded the pensions could indeed be restructured, notwithstanding Michigan's constitutional protections.[28]

After the Detroit ruling, the judge in the bankruptcy of Stockton, California reached the same conclusion. Unlike Detroit, however, Stockton ultimately decided not to restructure the pensions.[29] As of now, then, two bankruptcy judges have concluded—one directly, one in dicta—that public entities can restructure their pension obligations in bankruptcy. Because the appellate courts have not yet addressed this question, it is worth asking whether the Detroit and Stockton judges were right. In my view, they were.

It is important to begin by pointing out that only the unfunded portion of the pensions is generally at issue. If a city promised its pension beneficiaries $1000, and it had set aside $700 to pay the obligations, the beneficiaries would have a constitutionally protected property right to the $700 that had been set aside. Only the unfunded portion—$300 in this example—could be adjusted.

With Detroit, the most obvious argument that the city could not restructure even the unfunded portion of its pensions was based on a 1963 amendment to the Michigan constitution. According to the amendment, "[t]he accrued pension benefits of each pension plan . . . shall be a contractual obligation thereof which shall not be diminished or impaired."[30] This provision seemed to forbid adjustments, at least of accrued benefits. But the amendment was not designed with restructuring in mind. The drafters were trying to address a different problem—a problem with the legal status of pension promises.[31] Pension promises have traditionally been treated as "gratuities" for legal purposes, which meant that the city or state could withdraw the promised benefit at any time if it changed its mind. The drafters of the constitutional amendment sought to put pensions on a firmer legal footing by ensuring they had the same contractual status as other obligations. They were not attempting to determine whether pension obligations could be restructured if a city was incapable of paying them.

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**28** *In re* City of Detroit, Mich., 504 B.R. 97, 150-54 (Bankr. E.D. Mich. 2013). The bankruptcy judge confirmed this holding in his opinion approving Detroit's plan of adjustment. *In re* City of Detroit, Mich., 524 B.R. 147, 181 (Bankr. E.D. Mich. 2014).

**29** Stockton did significantly restructure its employees' healthcare benefits.

**30** MICH. CONST. art. IX, § 24.

**31** For further discussion, see David Skeel, *The Meaning of Detroit*, NAT'L AFFAIRS 3, 10 (Winter 2015); David A. Skeel Jr., *Can Pensions be Restructured in (Detroit's) Municipal Bankruptcy* 5-6 (Federalist Society White Paper, Oct. 2013).

Even if Michigan's constitutional provision were designed to prevent a restructuring, it would be overridden by the Supremacy Clause of the U.S. Constitution.[32] Because bankruptcy law is federal, it prevails over a conflicting state law. Federal law prevails even over a state constitutional provision.

The second argument is an attack not just on pension restructuring, but on municipal bankruptcy as a whole. According to this argument, municipal bankruptcy violates one or both of two provisions in the U.S. Constitution.[33] It either encroaches on state sovereignty, thus violating the Tenth Amendment, or violates the Contracts Clause, which prohibits a state from interfering with existing contracts.[34] Because the Contracts Clause only prevents states from impairing contracts, not Congress, this objection characterizes Congress as using its bankruptcy authority to aid and abet an impairment of contracts by states and their municipalities.

In my view, these are not silly arguments. In fact, the U.S. Supreme Court struck down the first municipal bankruptcy law on these grounds in 1936,[35] before upholding a similar law two years later.[36] But the municipal bankruptcy law protects states' sovereignty by, among other things, requiring the state to consent to a municipality's bankruptcy filing, permitting only voluntary filings and precluding the court from interfering with political or governmental powers. Contrary to the Contracts Clause argument, the power to restructure a municipality's obligations emanates from Congress, not the state. In view of these facts, the Detroit judge seems right to have concluded that municipal bankruptcy is fully constitutional.

A final objection is based on a provision of Chapter 9 itself. A bankruptcy court is prohibited from approving a city's restructuring plan if the plan would require the city to take steps that are "prohibited by law."[37] Since Michigan law prohibits the impairment of accrued pension benefits, the argument goes, a plan of adjustment that restructured pensions would be invalid because pension adjustments are prohibited by law. Construing the provision in this way would set Chapter 9 at war with itself. All—or nearly all—of the contracts that a municipality restructures in bankruptcy are contracts the municipality could not restructure outside of bankruptcy, due to the Contracts Clause in the U.S. and state constitutions. The "prohibited by law" provision cannot have been designed to render municipal

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**32** *Id.* U.S. CONST. art VI.

**33** *See, e.g.*, Skeel, *The Meaning of Detroit*, *supra* note 31, at 11.

**34** *Id.* U.S. CONST. art I, § 10.

**35** Ashton v. Cameron County Dist., 298 U.S. 513 (1936).

**36** United States v. Bekins, 304 U.S. 27 (1938).

**37** 11 U.S.C. § 943(b)(4) (2012).

bankruptcy useless and it has not be construed in this way.[38] The Detroit court held that the provision applies to a municipality's obligations after they have been restructured, not to the restructuring itself.[39] Chapter 9 permits a restructuring, but once the municipality emerges from bankruptcy it cannot be violating the law.

Much as with pension obligations, the recent municipal bankruptcy cases also open up space to significantly restructure a distressed city's bond debt. Prior to Detroit, many in the municipal bond markets believed that general obligation bonds—that is, bonds supported by the "full faith and credit" of the city that issued them—could not be restructured in bankruptcy.[40] According to this logic, revenue bonds are partially protected in bankruptcy, because their repayment is secured to the extent of the revenue stream pledged to them; general obligation bonds are entirely protected because of the generally held view that a city would be obligated to raise revenues or cut expenses to the extent necessary to service its debts.[41] The Detroit case revealed the fallacy in this reasoning. If a general obligation bond is not collateralized in any way, as usually is the case, it is simply an unsecured obligation. It is subject to restructuring, just as the unsecured obligations of a corporation are in Chapter 11.

Prior to the enactment of P.R.O.M.E.S.A., oversight boards had been used to address the distress of significant cities for more than forty years. The use of municipal bankruptcy was far more recent, but it was rapidly coming of age. Each of these trends figured prominently in the provisions Congress included in P.R.O.M.E.S.A.

## II. P.R.O.M.E.S.A. and the Oversight Board So Far

P.R.O.M.E.S.A. breathed the oversight board into being and gave us two major sources of authority: the power to certify fiscal plans for Puerto Rico and its municipal entities, and the power to restructure Puerto Rico's debt. Not coincidentally, each source of authority corresponds to one of the historical trends. Yet each also has features that are unique to P.R.O.M.E.S.A. After describing the two pillars of the oversight board's mandate, I will briefly chronicle our efforts before and after Puerto Rico was ravaged by Hurricanes Irma and Maria in September 2017.

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**38** *See In re* Sanitary & Improv. Dist. #7, 98 B.R. 970, 974 (Bankr. D. Neb. 1989) (stating that "[t]o create a federal statute based upon the theory that federal intervention was necessary to permit adjustment of a municipality's debts and then to prohibit the municipality from adjusting such debts is not, to the point of view of this Court, a logical or necessary result.")

**39** *In re* City of Detroit, Mich., 524 B.R. 147, 211-12 (Bankr. E.D. Mich. 2014).

**40** For discussion of this misperception and illustrative citations, see David A. Skeel, Jr., *What is a Lien? Lessons from Municipal Bankruptcy*, 2015 U. ILL. L. REV. 675, 684-85.

**41** *Id.*

### *A. P.R.O.M.E.S.A.'s Two Pillars: Fiscal Plans and Restructuring*

The touchstone for the oversight board's budgetary authority is the requirement that we certify fiscal plans for Puerto Rico and any "covered" municipal entities—that is, entities the board has designated as subject to P.R.O.M.E.S.A.'s requirements.[42] Under P.R.O.M.E.S.A., each fiscal plan must cover at least the next five years. It also must seek to "restore fiscal responsibility and access to the capital markets," and satisfy a list of fourteen different requirements, from "provid[ing] for estimates of revenues and expenditures" to "respect[ing] the relative lawful priorities or lawful liens."[43]

P.R.O.M.E.S.A. also specifies the process by which the fiscal plan is produced. The Governor of Puerto Rico submits a proposed fiscal plan, on a schedule determined by the oversight board.[44] The oversight board determines whether the plan satisfies the requirements of P.R.O.M.E.S.A. If it does not, the Board issues a notice of violation to the Governor.[45] The Governor then submits a revised fiscal plan to the Board.[46] After this iterative process, the Board either certifies the Governor's fiscal plan, certifies a joint Governor-Board plan, or—if the plan is not P.R.O.M.E.S.A.-compliant—it proceeds to certify its own fiscal plan.[47]

The fiscal plan is an extraordinarily important document. It is not immutable—it can be revised and recertified to reflect changed circumstances—but every annual budget is required to conform to the fiscal plan currently in effect.[48] If it does not, the Board is instructed to issue a notice of violation; if the Governor does not correct the deficiency the Board can (and must) develop its own "revised compliant budget."[49] The Board also is given the authority to prevent enforcement of proposed contracts or regulations that are inconsistent the fiscal plan.[50] Moreover, the federal district court is deprived of subject matter jurisdiction over any litigant's challenges to certified fiscal plans or budgets.[51]

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**42** Puerto Rico Oversight, Management, and Economic Stability Act, 48 U.S.C. § 2141(a) (2016) (providing for fiscal plans); *id.* § 2141(b) (requirements apply to "territorial government or covered territorial instrumentality.")

**43** *Id.* § 2141(b)(1).

**44** *Id.* § 2141(a) ("the Oversight Board shall deliver a notice to the Governor providing a schedule for the . . . Fiscal Plans.")

**45** *Id.* § 2141(c)(3)(B)(i) (notice of violation).

**46** *Id.* § 2141(d)(1) (instructing Governor to submit revised plan).

**47** *Id.* § 2141(e)(1) (approval of Governor's plan); *id.* § 2141(e)(2) (oversight board's plan); *id.* § 2141(e) (joint plan).

**48** *Id.* § 2142(c)(1) (stating that "the Oversight Board shall determine in its sole discretion whether each proposed Budget is compliant with the applicable Fiscal Plan.")

**49** *Id.* § 2142(d)(1)(B) (notice of violation); *id.* § 2142(e)(3) (Board's own budget).

**50** The Board also has oversight authority over any new issuance of debt. This authority applies whether or not a fiscal plan is in place.

**51** 48 U.S.C. § 2126(e).

A principal template for P.R.O.M.E.S.A.'s fiscal provisions was the D.C. Control Board statute from the 1990s.[52] The iterative fiscal plan process, and the requirement of a multi-year fiscal plan, echo the D.C. precedent.[53] In some respects, the Puerto Rico oversight board has even more authority than the D.C. board;[54] but in several respects, the Puerto Rico Board's authority is not as broad as the D.C. Board. The D.C. statute provided for the appointment of a new Chief Financial Officer who had authority over the District's revenues and answered primarily to the Control Board.[55] As a result of subsequent legislation, the D.C. board also had control over much of the D.C. government.[56] Since we do not have these additional powers, the fiscal plan is even more central to the Puerto Rico board's authority than it was in Washington, D.C.[57]

The second major source of authority is the power to initiate a restructuring on behalf of Puerto Rico or one of its municipal entities. P.R.O.M.E.S.A. provides two separate restructuring frameworks, one known as Title VI and the other as Title III—based, in each case, on the part of P.R.O.M.E.S.A. where the provisions appear.[58] Title VI, the simpler option, is similar to the collective action provisions that are used to restructure sovereign debt.[59] It applies only to bonds, as very broadly defined,[60] and permits the bonds to be restructured if sufficient majorities of each type of bonds vote in favor. Title VI is purely consensual—there is no mechanism for requiring a class of bonds to accept a restructuring if the class votes no—and it does not have many of the features that bankruptcy or a bankruptcy-like process includes, such as the automatic stay.

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**52** District of Columbia Financial Responsibility and Management Assistance Act of 1995, Pub. L. No. 104-8, § 201, 109 Stat. 97 (1995) (establishing financial plan requirements); *Id.* § 202 (defining process for submission and approval of financial plans and budgets).

**53** There were a variety of differences; the District of Columbia plan (called a "financial plan") was for the current year and the next three years, rather than a minimum of five years as with P.R.O.M.E.S.A., and it was subject to a somewhat different list of requirements.

**54** Perhaps most importantly, P.R.O.M.E.S.A. authorizes the Board to initiate bankruptcy-like restructuring proceedings, as discussed below. P.R.O.M.E.S.A. also repeatedly gives authority to the oversight board in its "sole discretion." *See, e.g.,* 48 U.S.C. § 2141(c)(3) (fiscal plan certification decisions are in the Board's sole discretion).

**55** Pub. L. No. 104-8, § 302, 109 Stat. 97. The Chief Financial Officer who was appointed, Anthony Williams, proved so successful that he was later elected mayor.

**56** *See* District of Columbia Financial Responsibility and Management Assistance Act of 1995, Pub. L. No. 104-8, 109 Stat. 97 (1995).

**57** *In re* Financial Oversight and Management Board for Puerto Rico, 583 B.R. 626, 633-34 (D.P.R. 2017).

**58** Title VI is sections 601-602 of P.R.O.M.E.S.A., and Title III is sections 301-317 of P.R.O.M.E.S.A. Pub. L. No. 114-187, §§ 301-317, 601-602, 130 Stat. 549 (2016). U.S. bankruptcy law uses a similar labeling strategy. Chapter 9—the municipal bankruptcy chapter—consists of sections 901-946. United States Bankruptcy Code, 11 U.S.C. §§ 901-946. Chapter 11—reorganization—consists of sections 1101-1174 of 11 U.S.C. §§ 1101-1174.

**59** 48 U.S.C. §§ 2231-2232.

**60** *Id.* § 2104(2) (defining "Bond").

Title III is very similar to bankruptcy.[61] If the drafters had the D.C. Control Board statute in front of them as they designed P.R.O.M.E.S.A.'s fiscal plan provisions, their eyes were on Chapter 9 when they constructed Title III. As with Chapter 9, Title III provides only for voluntary filings; creditors cannot file an involuntary case.[62] In each context, an automatic stay prohibiting creditors from continuing to pursue non-bankruptcy collection efforts goes into effect as soon as the debtor files.[63] The debtor then negotiates with its creditors over the terms of a plan of adjustment. After the plan and a disclosure statement are approved, the plan is submitted to each class of creditors for a vote.[64] The plan can be approved consensually, if each class of creditors vote yes, or non-consensually, if one or more classes vote no and the requirements for a nonconsensual plan are satisfied.[65]

Title III's most important innovation is the fact that it covers not just Puerto Rico municipalities, but Puerto Rico itself. Unlike Chapter 9, which applies to municipal entities within a state but not to the state, Title III includes the larger entity, Puerto Rico.[66] The expanded scope appears to reflect a conclusion by the drafters that restructuring the Puerto Rico's municipal debt might not be sufficient to address Puerto Rico's financial distress.

The inclusion of Puerto Rico itself within the ambit of Title III may explain, or partially explain, the puzzling absence of any reference to "bankruptcy" in P.R.O.M.E.S.A.[67] By avoiding the term "bankruptcy," and relying on its authority under the Territories Clause of the Constitution, rather than the Bankruptcy Clause, lawmakers may have sought to reassure state bankruptcy critics that P.R.O.M.E.S.A. is not intended to lay a foundation for state bankruptcy. Title III is unique to Puerto Rico and potentially other U.S. territories.

Whatever the logic, P.R.O.M.E.S.A.'s restructuring provisions are powerful tools for addressing Puerto Rico's financial distress. The oversight board administers Title VI proceedings and is the one that files a Title III case, serves as the representative of the debtor, and files the plan of adjustment. Title III is distinct from Chapter 9 in that imposes a confirmation standard that requires that any

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**61** *Id.* §§ 2161-2177.

**62** 11 U.S.C. § 901(a) (incorporating 11 U.S.C. § 301 of the Bankruptcy Code (voluntary filings) but not 11 U.S.C. § 303 (involuntary filings)); 48 U.S.C. § 2164(a) (commencement of voluntary case).

**63** 11 U.S.C. § 901(a) (incorporating 11 U.S.C. § 362 of the Bankruptcy Code); 48 U.S.C. § 2161 (incorporating 11 U.S.C. § 362 of the Bankruptcy Code)).

**64** 11 U.S.C. § 901(a) (incorporating 11 U.S.C. § 1125 and parts of 11 U.S.C. § 1126, which govern disclosure statements and voting in Chapter 11); 48 U.S.C. § 2161 (same)).

**65** 11 U.S.C. 901(a) (incorporating parts of 11 U.S.C. § 1129(a) and (b), which govern consensual and nonconsensual reorganization in Chapter 11); 48 U.S.C. § 2161 (same)).

**66** 48 U.S.C. § 2162(1)(A) (permitting filing by "a territory that . . . has had an Oversight Board established for it.").

**67** On the other hand, the omission also reflects a historical pattern: Congress has long used distinct labels for the restructuring of a public entity's debt. Chapter 9 is called "Adjustment of Debts of a Municipality," and creditor votes on a *plan of adjustment*, rather than a *reorganization plan* as in corporate bankruptcy. 11 U.S.C. § 941 (2012) (providing for the filing of "a plan for the adjustment of the debtor's debts.")

plan of adjustment conform to the then certified Fiscal Plan. Thus, the board's powers to set forth Puerto Rico's future fiscal path are inextricably linked to, and designed to be consistent with, the debt restructuring framework.

### *B. Act One: Pre-Maria*

When the seven members of the oversight board were appointed on August 31, 2016, we were on our own. We had no staff or advisors. I knew one of the other board members, and had once met another, but did not know the others.[68] Most of the other board members were in a similar position. The seven of us were on the phone constantly, dealing with matters large and small. We selected a chairman, José Carrión, and began our search for advisors, hiring a strategic consultant and New York and Puerto Rico law firms in the first few months.

The overriding objective of the first year was to certify fiscal plans for the Commonwealth, Puerto Rico Electric Power Authority (hereinafter, "P.R.E.P.A."), the Puerto Rico Aqueduct and Sewer Authority (hereinafter, "P.R.A.S.A."), the Government Development Bank, the University of Puerto Rico and several other municipal entities. Our mantra was "once and done." We referred to this principle repeatedly, both in private conversations and public meetings. "Once and done" meant we would avoid half measures that would require that additional adjustments be made in the future. We would insist on a fiscal plan and debt restructuring that did everything necessary to restore fiscal balance and access to capital markets, as P.R.O.M.E.S.A. requires, and would create the conditions for economic growth.

The most obvious obstacle, both for then-governor Alejandro García Padilla and for the oversight board, was that no one really knew what Puerto Rico's revenues and expenditures were. The Puerto Rico Legislature passed a balanced budget each year, but the budget relied on accounting gimmicks such as delayed payments to vendors, under-funding of pension contributions, borrowing to fund current expenses, and overestimation of expected revenues. The most recent audited financial statements dated back to fiscal year 2014.[69]

Much of the oversight board's energy in late 2016 and early 2017 was devoted to establishing a credible "baseline scenario" of revenues and expenses. Based initially on the information received from the García Padilla administration, our advisors would calculate as precisely as they could the likely revenues and expenses for the ten year period to be covered in the fiscal plan. To determine the baseline scenario, we would consider only revenues that could be expected to materialize and which did not require new legislative action from Congress.

Our conclusion that speculative revenues should not be included created an impasse with governor García Padilla. A key issue was federal funding for Puerto

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**68** I knew Judge Arthur González from bankruptcy circles and had met Andrew Biggs.

**69** Melba Acosta Febos, *La reestructuración de la deuda como respuesta a la crisis fiscal de Puerto Rico y la recuperación luego del huracan María*, 87 REV. JUR. UPR 821 (2018).

Rico's Medicaid and Medicare expenses. Puerto Rico receives considerably less reimbursement for these expenses than states do; in 2011, Congress gave Puerto Rico $6.4 billion in additional funding for fiscal years 2011-2019 to make up for some of the difference. The extra funds were rapidly being used up, and were expected to zero out as early as the first quarter of fiscal year 2018 (Summer 2017).[70] We concluded that it was not appropriate to assume that Congress would provide additional funding, since it was not clear Congress would. Because governor García Padilla's proposed fiscal plan assumed major new healthcare funding and other uncertain funding, we issued a notice of violation.[71]

In January, 2017, governor Rosselló assumed office, after having won the election in November. On January 18, 2017, we sent governor Rosselló a letter outlining the baseline scenario we had developed and the size of the adjustments that we believed needed to be made to bring Puerto Rico's finances into fiscal balance.[72] Under the baseline scenario—before taking measures to increase revenues and decrease expenses—we projected annual deficits of $7 billion per year for the ten years of the plan.[73] To close the gap, we concluded that the Puerto Rico's government would need to increase tax revenues by $1.5 billion annually by fiscal year 2019 and undertake significant structural and fiscal reforms, including steps to right-size the government (savings of $1.5 billion annually by fiscal year 2019) and to reduce higher education, healthcare and pension costs.[74]

Given the magnitude of the gap, and the breadth of the sacrifice that would be required under the "once and done" approach, it seemed unlikely that we and governor Rosselló's administration would reach agreement over the terms of a certifiable fiscal plan. But we did. After a flurry of last minute negotiations that culminated the night before the public meeting at which the fiscal plan would be certified, we agreed to certify a document consisting of the Governor's fiscal plan, modified by two amendments drafted by the oversight board.[75]

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**70** *See, e.g.*, DEP'T OF HEALTH AND HUMAN SERV., ASPE DATA POINT, NEARLY 900,000 PUERTO RICANS MAY LOSE HEALTH COVERAGE WHEN MEDICAID FUNDS RUN OUT (Jan. 12, 2017), *available at* https://aspe.hhs.gov/system/files/pdf/255461/PuertoRicoEnrollment_DataPoint.pdf.

**71** Letter from José B. Carrión III, Chair, Financial Oversight and Management Board for Puerto Rico, to Alejandro García Padilla, Governor of Puerto Rico (Nov. 23, 2016). The proposed fiscal plan also assumed that a key portion of Puerto Rico's tax revenues—so called Act 154 revenues—would not decline despite significant risk that they would.

**72** Letter from José B. Carrión III, Chair, Financial Oversight and Management Board for Puerto Rico, to Ricardo A. Rosselló Nevares, Governor of Puerto Rico (Jan. 18, 2017) [hereinafter, "January 18, 2017 F.O.M.B. letter."]

**73** *Id.* at 1.

**74** *Id.* at 4-6.

**75** *See* Financial Oversight and Management Board for Puerto Rico, Minutes of Fifth Meeting of the Board (Mar. 13, 2017). Fiscal plans for the Government Development Bank ("G.D.B."), the Puerto Rico Highways & Transportation Authority ("H.T.A."), the Puerto Rico Aqueduct and Sewer Authority ("P.R.A.S.A.") and the Puerto Rico Electric Power Authority ("P.R.E.P.A.") were certified at the Board's seventh meeting the following month. *See* Financial Oversight and Management Board for Puerto Rico, Minutes of Seventh Meeting of the Board (April 28, 2017).

During this same period of time, we also were negotiating with creditors of, among others, the Commonwealth and P.R.E.P.A., over the terms of potential restructuring. As of the moment of its enactment, P.R.O.M.E.S.A. provided a six month stay on creditor litigation and other creditor efforts to collect what they are owed, and authorized us to extend the stay for another seventy-five days.[76] The stay was essential, preventing the complete chaos that would have ensued if creditor collection activity had not been restrained. But the stay came to an end on May 1, 2017. The only way to retain the stay would be to file Title III petitions.

On May 2, governor Rosselló sent letters to the oversight board asking us to file a Title III case for the Commonwealth and several other entities.[77] Faced with the prospect of dozens of creditor lawsuits, we filed for Title III the next day.

P.R.E.P.A. was not one of the early Title III filings. Prior to the enactment of P.R.O.M.E.S.A., P.R.E.P.A. and many of its creditors had negotiated the terms of a potential Restructuring Support Agreement (hereinafter, "R.S.A."). Under the proposed R.S.A., as amended multiple times by the creditors and P.R.E.P.A. before the Board voted on it, some of P.R.E.P.A.'s bond creditors would agree to a fifteen percent restructuring of their debt, and the debt would essentially be converted into fully secured claims supported by a "transition charge" on electricity revenues. If we initiated a Title VI proceeding for the R.S.A., P.R.O.M.E.S.A. provided a streamlined process for its approval. The seven of us wrestled for weeks over the question whether to approve the R.S.A. and to initiate Title VI. Although the R.S.A. clearly would be very generous to creditors, and had been negotiated at a time when P.R.E.P.A. did not have access to bankruptcy or other restructuring provisions, some board members thought it would be manageable and would help stabilize the troubled, unreliable utility; they feared that P.R.E.P.A. could not survive a privatization or other transformative transaction. Others believed that transformation was essential and that the terms of the R.S.A. would make transformation impossible. In the end, the board voted to reject the R.S.A. by a 4-3 vote.[78] The board filed a Title III case for P.R.E.P.A. on July 2, 2017.

As the first anniversary of our appointment arrived, we had made extensive use of the tools provided by P.R.O.M.E.S.A. We also had been sharply criticized by nearly everyone. Many Puerto Ricans and economists such as Nobel Prize winner Joseph Stiglitz argued that our economic projections were far too optimistic,

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**76** Puerto Rico Oversight, Management, and Economic Stability Act, 48 U.S.C. § 2194(d)(1)(B) (2016).

**77** Letter from Ricardo Rosselló Nevares, Governor, to José B. Carrión III, Chair, Financial Oversight and Management Board for Puerto Rico (May 2 2017). Governor Rosselló pointed out, among other things, that "good-faith efforts to reach a consensual restructuring . . . [had] not demonstrated sufficient progress so as to achieve a sustainable level of debt under the Fiscal Plan." *Id.*

**78** The P.R.E.P.A. vote was the Board's first non-unanimous vote. The four of us who voted not to initiate a Title VI process for P.R.E.P.A. wrote a column explaining our reasoning. Andrew Biggs, Arthur J. González, Ana J. Matosantos & David Skeel, *Privatize Puerto Rico's Power*, WALL ST. J. (June 29, 2017), https://www.wsj.com/articles/privatize-puerto-ricos-power-1498776904.

and that the cuts called for in Puerto Rico's fiscal plan would magnify the economic crisis in Puerto Rico, leading to a deep depression.[79] Creditors criticized the fiscal plan in the opposite terms. They insisted that the economic assumptions of the fiscal plan were unduly pessimistic and that the fiscal plan provided too little money for repayment of creditors.[80]

No one enjoys being criticized, but we all understood this to be part of our job. The role of an oversight board is to make decisions that are difficult for others to make—and where necessary, to be the bad guy. We assumed the next step would be to make sure the fiscal plan was fully implemented, to see if the projections proved to be accurate (and if not, to adjust the fiscal plan) and to develop the terms of plans of adjustment in the Title III cases.

Then the hurricanes hit.

### C. *Act Two: Post-Maria*

Those of us who were not on island when Hurricane Maria pummeled Puerto Rico probably cannot fully understand what it was like. A friend of mine says it sounded like an airplane roaring to life, over and over, for twelve hours. The entire island lost power and a large percentage of Puerto Ricans would be without power for months (some still are). A new report estimates that the hurricanes may have caused more than 4000 deaths, many because access to medical treatment was cut off.[81]

One of the first actions the oversight board took was to withdraw a motion we had filed in the Title III case in a dispute over furloughs with governor Rosselló.[82] One of the amendments to the fiscal plan required the Governor to implement furloughs (essentially, salary reductions) for public employees if he was not able to achieve sufficient savings through other governmental reforms. When the savings proved insufficient, the Governor had taken the position that the furlough amendment was a recommendation, not a requirement, and he refused to implement it. Given the island-wide suffering caused by the hurricanes, furloughs no longer made sense and we withdrew our motion to compel implementation.

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**79** *See, e.g.*, Joseph Stiglitz & Martin Guzman, *From Bad to Worse for Puerto Rico*, PROJECT SYNDICATE (Feb. 28, 2017) (criticizing the projections used for the initial fiscal plan), https://www.project-syndicate.org/commentary/puerto-rico-debt-plan-deep-depression-by-joseph-e--stiglitz-and-martin-guzman-2017-02?barrier=accesspaylog.

**80** *See, e.g.,* Assured Guaranty Corp. et al. v. Commonwealth of Puerto Rico, et al., Adv. Proc. No. 17-125-LTS (2017 D.P.R.) (*In re* Financial Oversight and Management Board for Puerto Rico as representative of the Commonwealth of Puerto Rico) (alleging that the fiscal plan was illegal and unconstitutional).

**81** Nishant Kishore et al., *Mortality in Puerto Rico after Hurricane Maria*, NEW ENG. J. MED. (May 29, 2018), *available at* https://www.nejm.org/doi/full/10.1056/NEJMsa1803972.

**82** *See, e.g.,* Alex Wolf, *Puerto Rico Board Withdraws Bid to Force Furloughs*, LAW360 (Oct. 4, 2017), *available at* https://www.law360.com/articles/971463/puerto-rico-board-withdraws-bid-to-force-furloughs.

We also offered our support to governor Rosselló as he met with lawmakers in Washington to ask for generous disaster relief from Congress. Governor Rosselló has made numerous visits to Washington to inform lawmakers of the extent of the destruction caused by the hurricanes and the progress of the recovery.

One issue on which we found ourselves in conflict with the Rosselló administration was P.R.E.P.A. Even before the hurricane, P.R.E.P.A. was fragile and highly unreliable. The people of Puerto Rico faced frequent, unpredictable blackouts. We concluded that P.R.E.P.A.'s governance could be streamlined and improved, and its response to the hurricane enhanced, if a chief transformation officer (hereinafter, "C.T.O.") were put in place to centralize internal decision making and to serve as a focal point for the desperately needed transformation of P.R.E.P.A. We filed a motion in the Title III case asking for approval of our C.T.O., P.R.E.P.A. and the Governor opposed the motion.[83] They acknowledged that P.R.O.M.E.S.A. gave us extensive authority, but argued we did not have the power to "take over" the electricity company. Much to our disappointment, Judge Swain agreed with P.R.E.P.A. and the government. She pointed out that our request for a C.T.O. was not based on the fiscal plan, or on the government's violation of a fiscal plan or budget, and emphasized that the Board's powers are not unlimited.[84] She admonished the Board and the government to work together.

As we and governor Rosselló's administration began work on new fiscal plans—fiscal plan 2.0, we called them—the oversight board had significantly more capacity than we had a year earlier. In Spring 2017, before the hurricanes, we had hired an executive director, Natalie Jaresko. Earlier this decade, as Minister of Finance of Ukraine, Natalie had managed the successful restructuring of Ukraine's debt, and had also run a private equity fund in Ukraine. In addition to the excellent staff we already had, Natalie hired new staff, significantly enhancing our internal expertise. We also still had the outside advisors we had depended on in the initial fiscal plan and Title III process. The oversight board was no longer a startup.

A major new complexity was incorporating the massive amount of anticipated disaster relief from the federal government into the new fiscal plan. Congress has passed several disaster relief bills, each of which included funding for Puerto Rico, and it is possible that more relief will be forthcoming.[85] It is difficult to determine precisely how much aid Puerto Rico will receive, because most of the funds are distributed by the Federal Emergency Management Agency and other agencies on

**83** Urgent Motion of Financial Oversight and Management Board for Puerto Rico for Entry of Order Confirming Appointment and Authority of Chief Transformation Officer, *In re* Financial and Management Board for Puerto Rico, Docket No. 361, Case No. 17-04-780 (D.P.R) (Oct. 26, 2017); Opposition of AAFAF, On Behalf of Governor Ricardo Rosselló, to the Oversight Board's Urgent Motion for an Order Confirming Appointment of a Chief Transformation Officer, *In re* Financial and Management Board for Puerto Rico, Docket No. 381, Case No. 17-04-780 (D.P.R. (Nov. 13, 2017).

**84** *In re* Financial Oversight and Management Board for Puerto Rico, 583 B.R. 626 (D.P.R. 2017).

**85** *See, e.g.*, Patricia Mazzei, *What Puerto Rico Is, and Isn't Getting in Disaster Relief*, N.Y. TIMES (Feb. 9, 2018), at A20 (describing the disaster relief aid approved by Congress since September, 2017).

a discretionary basis. The number we used in the fiscal plan—$54.5 billion—reflected the amount of aid Puerto Rico is likely to receive under existing legislation.[86]

Another major complication was migration from the island. Even before the hurricanes, Puerto Rico's population was declining. The destruction caused by the hurricanes, and the months of delay before electricity was finally restored in many areas, left many Puerto Ricans feeling they needed to leave the island. Departure is as simple as a flight to Miami or New York, especially for those who have family or friends on the mainland. A massive migration would sharply reduce Puerto Rico's tax revenues in the coming years; an exodus of medical professionals could magnify Puerto Rico's healthcare crisis. These possibilities and other uncertainties needed to be taken into account in the revised fiscal plan.[87]

In the midst of discussions on the new fiscal plans, governor Rosselló announced that he intended to transform P.R.E.P.A. through a privatization process.[88] The Governor proposed that an outside manager be brought in to run P.R.E.P.A.'s transmission and distribution system pursuant to a long term contract, and to privatize much or all of P.R.E.P.A.'s generation. P.R.E.P.A. currently relies heavily on oil to generate electricity; privatization would significantly change the generation mix, to rely much more on renewable sources of electricity such as solar energy. We strongly endorsed the Governor's privatization plan. Affordable, reliable electricity is essential both to the future of P.R.E.P.A. itself and to creating the economic growth Puerto Rico needs. Like the Governor, we believe some form of privatization is the best way to achieve it.

We worked closely with the Governor and his administration on the new fiscal plans, meeting in person on multiple occasions. In the end, we were unable to reach complete agreement on the Puerto Rico or P.R.E.P.A. fiscal plans, due to our belief that significant labor reform and an adjustment to Puerto Rico's pensions are essential to achieving fiscal balance and future economic growth, and to the Governor's opposition to these measures. We therefore certified our own fiscal plans for these entities.[89] Even here, a large majority of the provisions in the fiscal

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**86** FINANCIAL OVERSIGHT AND MANAGEMENT BOARD FOR PUERTO RICO, *New Fiscal Plan for Puerto Rico: Restoring Growth and Prosperity* 11 (May 30, 2018) (hereinafter, *New Fiscal Plan for Puerto Rico)*. The fiscal plan also projects $8 billion in private insurance funds, for a total of $62 billion of disaster relief. *Id.*

**87** For discussion and one estimate of migration since the hurricanes, see Martin Echenique & Luis Melgar, *Mapping Puerto Rico's Hurricane Migration with Mobile Phone Data*, CITYLAB (May 11, 2018), *available at* https://www.citylab.com/environment/2018/05/watch-puerto-ricos-hurricane-migration-via-mobile-phone-data/559889/.

**88** *See, e.g.,* Scott Neuman, *Puerto Rico's Governor Announces Plan to Privatize Island's Troubled Electric Utility*, NPR (Jan. 23, 2018), *available at* https://www.npr.org/sections/thetwo-way/2018/01/23/579875991/puerto-ricos-governor-announces-plan-to-privatize-island-s-troubled-electric-uti.

**89** We certified the Commonwealth, P.R.E.P.A. and P.R.A.S.A. fiscal plans on April 19, 2018, and the GDB, the University of Puerto Rico, the Public Corporation for the Supervision and Insurance of Coplans came from the Governor's fiscal plans. And the Governor has subsequently agreed to pursue legislation implementing some of the key labor reforms—such as a shift to at will employment—in return for our agreement to allow some of the savings from the reform to be used for investment in the people of Puerto Rico.[90] These reforms need to be enacted legislatively, a step that is still uncertain as of this writing.

With the new fiscal plans in place, the next step will be proposing plans of adjustment in the Title III cases. Mediation with creditors has been underway for months under the guidance of a team of mediators led by Judge Barbara Houser.[91] There also have been numerous litigated issues in the Title III cases. We are hopeful we can propose plans of adjustment for the Commonwealth and P.R.E.P.A. by early 2019, though we cannot yet tell if that is realistic.

## III. How Should Our Decision Making be Assessed?

Our decision making thus far has managed to draw sharp criticism from both the left and the right. Working my way from left to right, I will briefly comment on some of the most frequent criticisms in the discussion that follows. I then will consider how—in my view—the success or failure of the Board should be assessed.

Critics from the left have condemned the oversight board as a colonialist imposition on Puerto Rico, have described it as a collection agent for creditors and have argued that the spending reductions and governmental reforms we have called for will be catastrophic for the economy.

Although the "colonialist" label is politically freighted, the general point that the oversight board has undemocratic qualities is hard to deny. We were not democratically elected and the authority we have been given temporarily reduces the authority of Puerto Rico's elected officials. Advocates of oversight boards argue that this can be a virtue, so long as the board is temporary, since the board is not subject to the same pressures as elected officials, such as the need to be responsive to powerful interest groups. In Puerto Rico's case, the temporary suspension of fiscal self-governance was imposed by Congress in return for very strong debt restructuring powers that, absent P.R.O.M.E.S.A., Puerto Rico did not have access to. But I acknowledge there is a cost to the imposition of an oversight board. My hope is that our decisions will prove to be good ones and that the intrusion of the Board will one day be viewed as having been beneficial.

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operatives of Puerto Rico (COSSEC, by its Spanish acronym), and the Puerto Rico Highways & Transportation Authority plans on April 20, 2018. We certified a slightly revised fiscal plan for the Commonwealth on May 30, 2018. *New Fiscal Plan for Puerto Rico*, *supra* note 86.

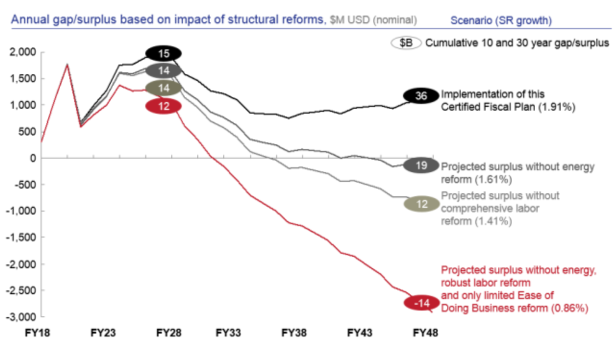
**90** *New Fiscal Plan for Puerto Rico, supra* note 86. Our economist calculates that the labor reforms, if enacted will enhance Puerto Rico's economy by nearly a percent (.80%) every year. *Id.* at 3.

**91** Because the mediation is subject to strict confidentiality constraints, I have omitted discussion of any details.

The second complaint—that the corrective measures required by the fiscal plan will prove too stringent[92]—also needs to be taken seriously.[93] Our economist and our other experts believe that the adjustments will not prove harmful. Based on the best estimates we have of the many relevant variables, we believe that the Puerto Rico economy will return to positive growth by 2022 if the fiscal plan is fully implemented. But the fiscal plan is based on a series of judgment calls.[94] We cannot rule out the possibility that they will prove to be wrong. If the projections do prove mistaken, however, or other important variables change, we can and will amend the fiscal plan.

Given the $54.5 billion and possibly more of federal funds that will be coming to the island, it may no longer seem necessary to require governmental reforms or the other adjustments in the fiscal plan. These funds will indeed make an enormous difference, and Puerto Rico is likely to have a fiscal surplus for the next several years as a result of the fiscal stimulus they will produce. But the disaster funds do not remove the need for reform. If the changes in the fiscal plan are not made, Puerto Rico's economy is likely to quickly revert to deficits again after the federal funds run out—our economist predicts a return to deficits by fiscal year 2029. The consequences of failing to restore fiscal balance are shown graphically in one of the key exhibits in the new Commonwealth fiscal plan.[95] Not only are the adjustments still necessary; we believe that now is the optimal time to make them, precisely because the influx of federal funds will soften their impact.

**ANNUAL GAP/SURPLUS BASED ON IMPACT OF STRUCTURAL REFORMS**

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**92** *See, e.g.*, Joseph Stiglitz & Martin Guzman, *From Bad to Worse for Puerto Rico*, PROJECT SYNDICATE (Feb. 28, 2017) (criticizing the projections used for the initial fiscal plan), https://www.project-syndicate.org/commentary/puerto-rico-debt-plan-deep-depression-by-joseph-e--stiglitz-and-martin-guzman-2017-02?barrier=accesspaylog.

**93** It is important to note that, although our fiscal plans can be criticized, P.R.O.M.E.S.A. precludes any legal challenge to a certified fiscal plan. Puerto Rico Oversight, Management, and Economic Stability Act, 48 U.S.C. § 2126(e) (2016).

**94** We believe structural reforms will have a significant impact on growth. Others, such as Larry Summers, are more skeptical.

**95** *New Fiscal Plan for Puerto Rico*, *supra* note 86.

The one criticism made by some on the left that is altogether inaccurate is the suggestion we are essentially collection agents for Puerto Rico's creditors.[96] Indeed, we are unaware of any creditor that agrees. Before P.R.O.M.E.S.A. was enacted, Puerto Rico and its municipalities did not have any bankruptcy or bankruptcy-like mechanism for restructuring any of their debt. Every state can authorize one or more of its municipalities to file for bankruptcy under Chapter 9 of the Bankruptcy Code; Puerto Rico cannot. Puerto Rico is defined as a state for the purposes of every provision in the bankruptcy laws except the provision authorizing municipalities to file for bankruptcy.[97] Faced with this exclusion, Puerto Rico enacted its own municipal restructuring law, the *Recovery Act*, in 2013. But the Supreme Court struck down the *Recovery Act* in 2016.[98] The Court held that, although Puerto Rico was not a state for the purposes of the provision authorizing municipalities to file for bankruptcy, it was a state with respect to another provision that forbids the states from enacting their own municipal bankruptcy laws.[99] As a result, Puerto Rico did not have access to any restructuring mechanism.

P.R.O.M.E.S.A. filled this gap. With the enactment of Title VI and Title III, Puerto Rico now has even more restructuring options than a state since these titles apply to Puerto Rico itself as well as to municipal entities in Puerto Rico. The oversight board is in the midst of using both of these tools to restructure the debt of Puerto Rico and some of its municipal entities.

Creditors and critics from the right have criticized the oversight board from the opposite direction of our liberal critics. They have insisted the adjustments in the fiscal plans are not nearly stringent enough, Puerto Rico's precise fiscal condition remains too opaque, our projections are too pessimistic and the fiscal plans imply too deep a restructuring of Puerto Rico's debt.[100]

Start with claims the fiscal plan could—and should—have been far more aggressive. This seems unlikely. Achieving fiscal balance after years of deficit spending required painful adjustments to every part of Puerto Rico's budget. The fiscal plan cut as much as we believed possible, to the point where our economist's projections suggested that further adjustments would be too much for Puerto Rico to bear and would prove counterproductive because they would prevent Puerto Rico from ending a decade of negative real growth, a failure that would prevent any sustainable recovery.

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**96** One irony in this allegation is that many of Puerto Rico's creditors are Puerto Ricans.

**97** The provision defining Puerto Rico as a state for most purposes is 11 U.S.C. § 101(52). The definition and its exclusion were added in 1984, with no explanation regarding why Puerto Rico was excluded from Chapter 9.

**98** Puerto Rico v. Franklin Cal. Tax-Free Trust, 136 S. Ct. 1938 (2016)

**99** The provision preventing states from enacting their own restructuring laws is 11 U.S.C. § 903.

**100** In a May 15, 2018 letter to the oversight board, Assured Guaranty, a substantial Puerto Rico creditor, insisted, among other things, that "the Revised Fiscal Plan suffers from flawed methodologies and assumptions that result in an artificially pessimistic projection of Puerto Rico's future revenues, economic growth, and debt capacity." Dominic J. Federico, President and Chief Executive Officer Assured Guaranty, to Members of the Oversight Board (May 15, 2018), at 2-3.

With respect to contentions that our economic projections are too pessimistic, this is possible, just as we cannot rule out the possibility our projections are too optimistic. The projections are complex, and some of the key variables are highly uncertain. But we have developed the projections as carefully as possible; we do not think they are too pessimistic.[101]

Concerns about the extent to which Puerto Rico's debt will be restructured are framed in terms both of objections to the determinations reflected in the fiscal plan and as a claim that a significant debt restructuring is incompatible with restoring market access as P.R.O.M.E.S.A. requires.[102] If creditors are not paid nearly all of what they are owed, the reasoning goes, investors will shun Puerto Rico, making it impossible for Puerto Rico to "access" the markets. Those who make this argument often consider only half of the equation, however. While future investors are indeed likely to consider the magnitude of the restructuring, they also will consider the health of Puerto Rico's balance sheet. If Puerto Rico does not restructure its debt sufficiently—and as a result is not fully on its way to fiscal balance—future investors will be reluctant to lend to Puerto Rico. New creditors and investors look at the balance sheet and want to see low debt. They do not give brownie points for having high debt because old debt has not been restructured. Indeed, one of the major reasons Puerto Rico has not had market access for the past four years is that investors concluded its existing debt was unsustainable.

The financial distress that made P.R.O.M.E.S.A. necessary can only be reversed if every constituency shares in the sacrifice. The cost of government in Puerto Rico is unsustainable and so too is the amount of Puerto Rico's debt. Both need to be brought into balance.

What about the role of the Board? How should our decision making be assessed? In my view, there are two key criteria. The first is whether the oversight board makes the hard decisions that are needed to help reverse Puerto Rico's downward spiral and put the economy in a position to grow. We are expected to make unpopular decisions that elected officials cannot easily make. P.R.O.M.E.S.A. gave us very powerful tools to help reverse Puerto Rico's decline. If we use them well, as we have tried to do, we will have fulfilled an important part of the trust that was placed in us.

The other key factor is making sure that the sacrifice is distributed fairly. If some constituencies were to bear much of the sacrifice and others bore little, the perception of unfairness would seriously impede the recovery process. This also means taking the human costs of every decision we make into account. Pensions are an example. Because the Puerto Rico's pension systems are almost completely unfunded —a deficit of more than $50 billion— we believe that they must be reformed and that there must be adjustments to the benefits. But we have carefully structured the reforms so that those with the smallest pension benefits will not

**101** As noted earlier, P.R.O.M.E.S.A. precludes challenges to the fiscal plan by withdrawing subject matter jurisdiction from the district court. 48 U.S.C. § 2126(e).

**102** Recall that P.R.O.M.E.S.A. requires the fiscal plans to "achieve fiscal responsibility and access to the capital markets." 48 U.S.C. § 2141(b).

face any cuts at all. The adjustments will only affect those who are most able to afford them. And the overall adjustment to pensions—ten percent—is smaller than the adjustments in other areas, in important part because the benefits are so essential to the livelihood of the beneficiaries, as well as to Puerto Rico's economic health.

If the oversight board makes the hard decisions that we need to make, and if we ensure that the sacrifice is distributed fairly, I believe we will have succeeded in our task. We may not ever be popular again, but we will have done our part in the resurgence of Puerto Rico.