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Congress Approves Measures to Return Puerto Rico to Financial Stability

In a last ditch effort to save the Commonwealth of Puerto Rico (the *"Commonwealth"* or *"Puerto Rico"*) from an imminent freefall into insolvency without a clear path to stabilize, Congress has approved the Puerto Rico Oversight, Management, and Economic Stability Act (*"PROMESA"*).[1] President Obama is expected to sign the measure into law by July 1, 2016. Puerto Rico owes its bondholders a $1.9 billion debt payment on July 1 that by all accounts it cannot make, and the passage of PROMESA provides the Commonwealth with breathing room to restructure its debts without the immediate threat of creditor lawsuits due to its inability to pay its debts when due.

In addition to certain provisions aimed to aid the Commonwealth in creating economic opportunities for its residents, PROMESA contains three main components. First, the bill establishes a seven-member Financial Oversight and Management Board (the *"Oversight Board"*) with broad powers to oversee and guide the Commonwealth to fiscal stability. Secondly, the bill incorporates certain provisions from the U.S. Bankruptcy Code (the *"Bankruptcy Code"*) to establish a process similar to the municipal bankruptcy provisions of the Bankruptcy Code (Chapter 9) to permit the Commonwealth to adjust its debts. Finally, PROMESA includes provisions encouraging and permitting consensual restructuring agreements among creditors.

Importantly, although PROMESA, itself, would not in reality prevent the Commonwealth's default on July 1, the bill imposes a short-term stay on all litigation and all similar out-of-court actions or proceedings against Puerto Rico and its instrumentalities to collect on the Commonwealth's debts. Additionally, if the Commonwealth were to enter a bankruptcy-like restructuring process that is authorized by PROMESA, the automatic stay provisions of the Bankruptcy Code would apply to stay any action to collect a debt against the Commonwealth.

The Independent Oversight Board

PROMESA's oversight of the Commonwealth is not just supervision but real control over the Commonwealth's finances. The Oversight Board is unaffiliated with the Commonwealth and has been provided necessary tools as a part of PROMESA to provide structure and guidance to Puerto Rico's government.

For Instance, the seven-member Oversight Board must approve a fiscal plan for the Commonwealth, approve all budgets, and approve all debt issuances by the Commonwealth. In essence, any major financial decision by the Commonwealth must be approved by the Oversight Board. The duties of the Oversight Board are similar to those held by oversight boards and emergency managers previously appointed by various States to help restructure their distressed municipalities.[2]

Once the Oversight Board has been appointed, PROMESA requires that it consult with the Governor of Puerto Rico to establish a schedule for the Commonwealth to deliver a five-year fiscal plan to the Oversight Board for approval. The plan itself must contain a roadmap establishing how the Commonwealth will achieve fiscal responsibility and gain access to the capital markets. If the Oversight Board does not approve a plan, it is required to provide the Commonwealth with recommendations and revisions that would make the plan approvable. If the Governor is thereafter unable to meet the requirements set by the Oversight Board, the Oversight Board, itself, may devise its own plan for the Commonwealth. Regardless of whether fiscal plan comes from the Commonwealth or the Oversight Board, tough decisions and cuts will be required in order to place Puerto Rico on a path to fiscal stability.

In addition to its role in helping to establish a path to stability for the Commonwealth, the Oversight Board must also approve all yearly budgets devised by the Commonwealth. As with the fiscal plan, the Oversight Board may reject a budget and provide the Commonwealth with directives in order to approve a budget. If the Governor fails to comply, the Oversight Board is required to craft the Commonwealth's budget. As an added measure, PROMESA requires regular reporting by the Commonwealth to the Oversight Board with respect to its compliance with the existing budget.

Additionally, the Oversight Board is permitted, in its sole discretion, to subject any territorial instrumentality, such as Puerto Rico's public corporations, to the requirements contained in PROMESA. It is likely that the Oversight Board will elect to place a number of Puerto Rico's public corporations, including the Puerto Rico Electric Power Authority, under its control. Thus, the Oversight Board is permitted to take a holistic approach to restructuring the Commonwealth, and to bring within its jurisdiction those public corporations of the Commonwealth that are also suffering extreme financial distress.

Debt Adjustment

In addition to its oversight mechanisms, the Oversight Board is permitted to authorize the Commonwealth or any of its public corporations to file a petition similar to a Chapter 9 bankruptcy petition with the U.S. District Court for the District of Puerto Rico (the "*District Court*") if five members of the Oversight Board agree that certain conditions exist and the Commonwealth has met certain milestones, including implementing its fiscal plan.

PROMESA's judicial debt adjustment process incorporates many provisions of the Bankruptcy Code, including the automatic stay provisions and the protections included in the municipal bankruptcy provisions for holders of debt secured by a pledge of special revenues. This process is meant to provide a means similar to Chapter 9 of the Bankruptcy Code (the municipal bankruptcy provisions) for the Commonwealth, or applicable instrumentality, to adjust its debts. Pursuant to this process, and similar to Chapter 9, the District Court would be required to approve a plan of adjustment submitted by the Commonwealth or applicable instrumentality. Importantly, throughout the process, the Oversight Board would serve as the Commonwealth's representative, and would file the Commonwealth's petition, plan of adjustment or any other filings with the District Court.

Creditor Collective Action

In addition to authorizing a bankruptcy-like restructuring process, PROMESA establishes a voluntary process in which Puerto Rico and its creditors may work together to restructure the Commonwealth's debts. Pursuant to the bill, the Oversight Board is required to divide the Commonwealth's creditors into separate pools based upon the nature of the debt. Each pool would then be permitted to vote on a so-called "Qualifying Modification" to the debt that it is owed, which would become binding if supported by a two-third majority of outstanding principal in the pool. The District Court has the power to order any dissenting creditors to accept the Qualifying Modification as well.

Going Forward

Although it remains to be seen whether Puerto Rico will be successful in restructuring its debt, PROMESA provides guidance, structure, and breathing room to permit Puerto Rico to make the difficult decisions required to return to a path of fiscal stability. If the oversight mechanisms in the States, such as Michigan's emergency manager provisions, provisions under Pennsylvania law, and Congress's oversight over Washington, D.C. when it entered a sustained period of fiscal instability, are any indication, Puerto Rico could receive the guidance, and judicial help, necessary to help it make the difficult decisions required to become fiscally stable.

For More Information

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1 H.R. 5278 (approved by the U.S. House of Representatives on June 9, 3016); S. 2328 (approved by the U.S. Senate on June 29, 2016).

2 For a detailed discussion of these provisions, see Municipalities in Distress? How States and Investors Deal with Local Government Financial Emergencies (2d ed. forthcoming). Copies of this forthcoming edition of the book will be available from Chapman and Cutler LLP.

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