

COMMENT

PUERTO RICAN DEBT LEGISLATION: IS THE TERRITORY BETTER OFF RESTRUCTURING MUNICIPAL DEBT UNDER PROMESA?

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I. Introduction.....	87
II. Background.....	88
A. Puerto Rico v. Franklin California Tax-Free Trust Ensured Puerto Riva Had No Where to Turn but Congress.....	88
B. How Puerto Rico Became Buried in a Mountain of Debt.....	90
III. Key Differences Between Chapter 9 and PROMESA.....	93
A. The Oversight Board.....	94
B. Creditor Collective Action.....	96
C. Capturing all of Puerto Rico’s Debt.....	101
IV. Conclusion.....	102

I. INTRODUCTION

In 1984, and without explanation, Congress stripped Puerto Rico of its access to Chapter 9 of the Bankruptcy Code,¹ titled Adjustment of Debts of a Municipality. Thirty-two years later and seventy-two billion dollars in debt,² the territory of Puerto Rico needs relief.

In February of 2015, a simple, one-page bill was introduced in Congress to reinstate Puerto Rico’s access to Chapter 9.³ This bill would have affected two-thirds of Puerto Rico’s debt by affording its municipalities the same opportunity to utilize bankruptcy as all the other U.S. States’ municipalities have; however, the bill was not passed.⁴ Instead, sixteen months later, Congress enacted the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA), paving the way for a robust bill that goes beyond Chapter 9.⁵

This comment begins by discussing the Supreme Court decision of June of 2016 that eliminated Puerto Rico’s ability to create its own legislation to address its debt problem. It also describes the many underlying factors that contributed to Puerto Rico’s enormous debt. This assessment is followed by a discussion of three key differences between PROMESA and Chapter 9. After weighing the advantages and disadvantages of the key differences, the comment concludes that Puerto Rico fairs better by restructuring municipal debt under PROMESA than it would have been under Chapter 9.

¹ Puerto Rico v. Franklin California Tax-Free Trust, 579 U.S. ___, 136 S.Ct. 1938, 1940 (2016).

² D. ANDREW AUSTIN, CONG. RESEARCH SERV., R44095, PUERTO RICO’S CURRENT FISCAL CHALLENGES 12 (Apr. 11, 2016).

³ *All Bill Information (Except Text) for H.R.870–Puerto Rico Chapter 9 Uniformity Act of 2015*, CONGRESS.GOV, <https://www.congress.gov/bill/114th-congress/house-bill/870/all-info> (last visited Aug. 6, 2017).

⁴ *Id.* (claiming the latest action on H.R. 870 was referral to a subcommittee on Mar. 16, 2015).

⁵ *S.2328–PROMESA*, CONGRESS.GOV, <https://www.congress.gov/bill/114th-congress/senate-bill/2328> (last visited Aug. 6, 2017) (noting the bill became public law on Jun. 30, 2016).

II. BACKGROUND

A. Puerto Rico v. Franklin California Tax-Free Trust Ensured Puerto Rico Had No Where to Turn but Congress

In 2014, the territory of Puerto Rico enacted the Puerto Rico Public Corporation Debt Enforcement and Recovery Act (the “Recovery Act”).⁶ This was the island’s response to its position between a rock and a hard place: the territory’s corporations were under a mountain of debt but could not utilize Chapter 9 of the Federal Bankruptcy Code (the “Code”). Nevertheless, this was not always the case. Up until 1984, Puerto Rico could utilize Chapter 9,⁷ but in that year the definition of “State” was revised to include Puerto Rico for all purposes “except for the purpose of defining who may be a debtor under Chapter 9.”⁸ Why the definition was updated to include this language is unknown:

The only comment on excluding Puerto Rico from Chapter 9 came from Professor Frank Kennedy, former Executive Director of the Commission on Bankruptcy Laws, who said: “I do not understand why the municipal corporations of Puerto Rico are denied by the proposed definition of ‘State’ of the right to seek relief under Chapter 9.”⁹

With this seemingly minor adjustment, Puerto Rico was disallowed the ability to use Chapter 9. It’s important to note, however, that having access to Chapter 9 is not synonymous with the ability to declare bankruptcy. A state’s access to Chapter 9 does not mean the state can declare bankruptcy. What Chapter 9 involves is that the state can permit any of its municipalities or corporations to declare bankruptcy: “An entity may be a debtor under Chapter 9 of [the Bankruptcy Code] if and only if such entity . . . is a municipality . . . [and] is specifically authorized . . . to be a debtor . . . by State law”¹⁰ Bankruptcy is a very useful tool that can be beneficial for all parties involved because it brings order to an otherwise disorderly situation. When a municipality stops paying its debt, each creditor that was not paid can sue individually. In fact, there is a so-called race to the courthouse because each creditor wants his or her judgment first. In this way, an individual creditor can make the insolvent municipality pay its debt before other creditors. Bankruptcy can bring order to this process by staying all litigation against the municipality, getting all the creditors involved in the same proceeding, and having a federal bankruptcy judge oversee a restructuring process.¹¹ The judge determines how much the debtor can pay back, who should be paid back first, and how much each creditor should be paid back.¹² As Professor Pottow summarized before Congress:

[A]llow me to sing the praises of Chapter 9 Chapter 9 —like chapter 11— allows collective resolution of a municipal debtor’s financial distress. In the absence of a collective forum, value-destroying fights with individual creditors will consume what

⁶ *Franklin California Tax-Free Trust*, 136 S.Ct. at 1942–43 (2016).

⁷ *Id.* at 1951–1952 n.1.

⁸ *Id.* at 1940 (quoting 11 U.S.C. § 101(52) (2015)).

⁹ *Id.* at 1954 n.2 (quoting *Bankruptcy Improvements Act, Hearing on S. 333 et al. Before the Senate Comm. on the Judiciary*, 98th Cong., 1st Sess. 326 (1983)).

¹⁰ 11 U.S.C. § 109(c) (2015).

¹¹ *Chapter 9–Bankruptcy Basics*, USCOURTS.GOV, <http://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-9-bankruptcy-basics> (last visited Aug. 6, 2017).

¹² *Id.*

little assets there are for repayment. The orderly resolution of debt in the U.S. chapter 11 bankruptcy system is world-renown and increasingly emulated.¹³

After it became clear that Puerto Rico's corporations could not pay their debt or utilize Chapter 9, the territorial government decided to enact the Recovery Act.¹⁴ The Recovery Act was Puerto Rico's own version of Chapter 9 bankruptcy.¹⁵ It provided the territory's public corporations (e.g., the power, sewer, and transportation authorities) with an avenue to restructure their crushing debt. Soon after its enactment, the Recovery Act was challenged by bondholders who would have been affected by it.

The bondholders alleged, and the Supreme Court agreed, that Puerto Rico's Recovery Act was pre-empted by section 903(1) of the Federal Bankruptcy Code,¹⁶ which states: "[A] law prescribing a method of composition of indebtedness of such municipality may not bind any creditor that does not consent to such composition"¹⁷ That is, *states* may not enact their own bankruptcy laws because that right was reserved to Congress in the Constitution¹⁸ and Congress forbids states from doing so in section 903(1) of the Code.¹⁹ This remains true despite the fact that Puerto Rico is a territory —not a state— because the Code includes within its definition of state "the District of Columbia and Puerto Rico, except for the purpose of defining who may be a debtor under Chapter 9 of this title."²⁰ However, even though Puerto Rico *is* considered a state for the purposes of prohibiting it to enact its own bankruptcy laws, Puerto Rico *is not* a state "for the purpose of defining who may be a debtor under Chapter 9 of this title."²¹ And, as previously mentioned, a municipality must be granted access to Chapter 9 by the laws of the state in which it resides. In sum, to preclude Puerto Rico from enacting its own bankruptcy laws, it *is* a state; to preclude Puerto Rico from utilizing Chapter 9, it *is not* a state. This was the Supreme Court's holding in *Franklin California Tax-Free Trust*²² and is why Puerto Rico, under a mountain of debt, could only turn to Congress for relief.

Puerto Rico's legal situation vis-à-vis municipal bankruptcy seems unjust, especially considering that Puerto Ricans are American citizens and that the 1984 amendment disallowing them access to Chapter 9 was made without comment or explanation. However, this unjustness is tolerated due to Congress's plenary power over territories.

Article IV of the Constitution states: "The Congress shall have Power to dispose of and make all needful Rules and Regulations respecting the Territory or other Property belonging to

¹³ *Puerto Rico Chapter 9 Uniformity Act of 2015: H.R. 870 Before the H. Comm. on the Judiciary*, 114th Cong. 21 (2015) (Prepared statement of John A. E. Pottow, Esq., Professor of Law, University of Michigan Law School).

¹⁴ *Franklin California Tax-Free Trust*, 136 S.Ct. at 1942-43 ("Puerto Rico responded to the fiscal crisis by enacting the [Recovery Act] in 2014").

¹⁵ See *id.* at 1943 ("Chapter 3 of the Recovery Act, on the other hand, mirrors Chapters 9 and 11 of the Federal Bankruptcy Code by creating a court-supervised restructuring process intended to offer the best solution for the broadest group of creditors.").

¹⁶ *Id.* at 1943.

¹⁷ 11 U.S.C. § 903(1) (2015).

¹⁸ *Franklin California Tax-Free Trust*, 136 S.Ct. at 1944 (Through U.S. CONST. art. I, § 8, cl. 4, "[t]he Constitution empowers Congress to establish 'uniform Laws on the subject of Bankruptcies throughout the United States.'").

¹⁹ *Id.* at 1945 ("Congress enacted a provision expressly pre-empting state municipal bankruptcy laws." *Id.*).

²⁰ 11 U.S.C. § 101(52) (2015).

²¹ *Id.*

²² *Franklin California Tax-Free Trust*, 136 S.Ct. at 1942 ("[T]he Code prevents Puerto Rico from authorizing its municipalities to seek Chapter 9 relief. Without that authorization, Puerto Rico's municipalities cannot qualify as Chapter 9 debtors. § 109(c)(2). But Puerto Rico remains a 'State' for other purposes related to Chapter 9, including that chapter's pre-emption provision. That provision bars Puerto Rico from enacting its own municipal bankruptcy scheme to restructure the debt of its insolvent public utilities companies." *Id.*).

the United States”²³ The Supreme Court, in the first quarter of the twentieth century, held that Congress’s power over territories was plenary; this ultimate power was only limited by the most fundamental constitutional protections for the people of Puerto Rico.²⁴ Thus, regardless of the inequity in (1) stripping Puerto Rico of its access to Chapter 9 without explanation or debate, and (2) prohibiting Puerto Rico from enacting its own bankruptcy laws, Congress is acting within its plenary powers. However, the islanders have a different name for Congress’s incredible authority: colonialism.

B. How Puerto Rico Became Buried in a Mountain of Debt

Puerto Rico’s importance was heightened during the late 1950’s due to the Cold War and Fidel Castro’s overthrow of its neighbor, Cuba.²⁵ At that time the world was being divided among communist and democratic lines. The U.S.’s decision to:

[E]nable Puerto Ricans to develop a local Constitution was intended to provide credibility to the United States in its struggle with the Communist Bloc, and to win the hearts of third world countries in the United Nations

. . . . U.S. lawmakers envisioned using Puerto Rico as a financial bridge that could facilitate the United States’ economic interests in Latin America.²⁶

Suffice to say, during the Cold War, Puerto Rico was of particular importance to the U.S.

Puerto Rico prospered as a manufacturing hub until the mid-1970’s because it served as a cheap labor base within the U.S.²⁷ Since Puerto Rico was within the U.S., its products were not subject to tariffs as they were brought to the mainland.²⁸ However, when the free trade policies of the 1970’s began reducing tariffs, Puerto Rico was no longer the cheapest labor market.²⁹ Since companies could import products more cheaply, they began moving to third world countries with labor rates more attractive than Puerto Rico’s.³⁰ Also in the 1970’s, the federal government applied its minimum wage to Puerto Rico,³¹ which increased labor costs and made the territory an even less appealing place for manufacturers.³²

²³ U.S. CONST. art. IV, § 3, cl. 2 (“The Congress shall have Power to dispose of and make all needful Rules and Regulations respecting the Territory or other Property belonging to the United States; and nothing in this Constitution shall be so construed as to Prejudice any Claims of the United States, or of any particular State.” *Id.*).

²⁴ Juan R. Torruella, *Outstanding Constitutional and International Law Issues Raised by the United States-Puerto Rico Relationship*, 100 MINN. L. REV. HEADNOTES 79 (2016) (“Pursuant to this theory, the inhabitants of Puerto Rico, as denizens of an ‘unincorporated territory,’ were to be denied all but the most fundamental constitutional protections and Congress was granted almost unlimited plenary powers.” *Id.*).

²⁵ See Larry Rohter, *Puerto Rico Fighting to Keep Its Tax Breaks for Businesses*, N.Y. TIMES (May 10, 1993), <http://www.nytimes.com/1993/05/10/business/puerto-rico-fighting-to-keep-its-tax-breaks-for-businesses.html?pagewanted=all> (“During the cold war, a tax-incentive program was the principal instrument used by Washington to build Puerto Rico as a free-market, democratic alternative to Cuba.” *Id.*) (last visited Aug. 6, 2017).

²⁶ Charles R. Venator-Santiago, *Cold War Civil Rights: The Puerto Rican Dimension*, 42 CAL. W. INT’L. L. J. 423, 432-33 (2011).

²⁷ Barry P. Bosworth, *Speech at an Inter-American Dialogue Event: Debt and Politics in Puerto Rico*, C-SPAN (Jun. 1, 2016), <https://www.c-span.org/video/?410433-1/interamerican-dialogue-hosts-discussion-puerto-ricos-debt> (discussing the sentence’s proposition at 8m 08s).

²⁸ *Id.* (discussing the sentence’s proposition at 8m 20s).

²⁹ *Id.* (discussing the sentence’s proposition at 8m 29s).

³⁰ *Id.* (discussing the sentence’s proposition at 8m 46s).

³¹ Jack Salmon, *How the Minimum Wage Helped Wreck Puerto Rico’s Economy*, FOUNDATION FOR ECONOMIC EDUCATION (April 16, 2016), <https://fee.org/articles/how-the-minimum-wage-helped-wreck-puerto-ricos-economy/>.

³² Bosworth, *supra* note 27 (discussing the sentence’s proposition at 9m 27s) (last visited Aug. 6, 2017).

In 1976, Congress added section 936 to the Internal Revenue Code, which was intended to establish Puerto Rico as “a free-market, democratic alternative to Cuba.”³³ Section 936 gave manufacturers a federal income tax credit for (1) producing products within Puerto Rico and selling them abroad, and (2) for investing their profits in Puerto Rico.³⁴ This led Puerto Rico to accumulate large amounts of U.S. investment capital, which “provided key support to bank liquidity from the late 1970s to the late 1990s”³⁵

By the early 1990’s, the cold war era was over and the Clinton administration wanted to reduce the deficit.³⁶ In 1996, Congress passed legislation that eliminated Section 936 over a period of ten years, completely phasing it out by 2006.³⁷

Before the credit was repealed, U.S. corporations’ possessions claiming tax credits comprised most of Puerto Rico’s manufacturing sector and employed many Puerto Ricans. With the repeal of § 936, the largest employers left the island, taking jobs and corporate tax dollars with them Manufacturing has declined by two thirds since the repeal.³⁸

In addition to the economic damage done by corporations and manufacturers leaving the island, the Puerto Ricans themselves have been leaving.³⁹ Puerto Ricans are U.S. citizens at birth and can migrate to the mainland if they so choose. Between 2000 and 2015, the island’s population decreased by 334,000, or nine-percent.⁴⁰ Forty-percent of Puerto Ricans who to the mainland do so because the economic opportunities are greater than on the island.⁴¹ This decrease in population is a decrease in the Commonwealth’s tax base and is another contributor to Puerto Rico’s economic decline over the past decade.

Over the same period of time that the corporations and people were leaving, Puerto Rico began amassing an incredible public debt. Between 1960 and 2000, the Commonwealth’s debt grew from three billion to thirty billion dollars (adjusted for inflation).⁴² That is, it took forty years to increase its debt by twenty-seven billion. However, from 2000 to 2015 —while the Section 936 tax credit was expiring, citizens were moving to the mainland and the Great Recession was setting in— Puerto Rico increased its debt from thirty billion to seventy billion dollars.⁴³

This blatant debt growth begs the question: Why did investors continue lending money to Puerto Rico? Presumably for two reasons: Puerto Rico’s bonds have significant tax breaks and Puerto Rico’s financial data was unclear. Puerto Rican municipal bonds are a particularly attractive investment because of their triple tax-exempt status.⁴⁴ As Timiraos explains, “unlike

³³ Rohter, *supra* note 25.

³⁴ Diane Lourdes Dick, *U.S. Tax Imperialism in Puerto Rico*, 65 AM. U. L. REV. 1 (2015).

³⁵ *Id.* at 74 (quoting Fed. Res. Bank of N.Y., *Report on the Competitiveness of Puerto Rico's Economy* 15 (2012)).

³⁶ Rohter, *supra* note 25.

³⁷ Dick, *supra* note 34, at 76.

³⁸ Hannah Geller, *Reforming Municipal Bankruptcy: Lessons from Puerto Rico*, 7 U.P.R. BUS. L.J. 152, 166–167 (2015).

³⁹ Jens Manuel Krogstad, *Historic population losses continue across Puerto Rico*, PEWRESEARCH.ORG (March 24, 2016), <http://www.pewresearch.org/fact-tank/2016/3/24/historic-population-losses-continue-across-puerto-rico/> (last visited Aug. 6, 2017).

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² AUSTIN, *supra* note 2, at 12–14.

⁴³ *Id.*

⁴⁴ Nick Timiraos, *Puerto Rico's Debt Crisis in Seven Questions*, WALL ST. J. (Apr. 13, 2016), <http://blogs.wsj.com/economics/2016/04/13/puerto-ricos-debt-crisis-in-seven-questions/> (last visited Aug. 6, 2017).

other municipal bonds, Puerto Rican debt is exempt from local, state, and federal taxes, which made them an attractive investment during an era of low yields.”⁴⁵ For example, a California investor’s interest earned on out-of-state municipal bonds is subject to California personal income tax.⁴⁶ Only in-state, Californian municipal bonds would enjoy triple tax exemption⁴⁷ and, of course, Puerto Rican municipal bonds. Thus, generally speaking, anyone who would like to earn tax free investment income in the municipal bond market may either invest in his or her home state or invest in Puerto Rico.

Another likely reason lenders continued to lend, was their misunderstanding of the true picture of Puerto Rico’s finances. Anne Krueger, a Senior Research Professor of International Economics at Johns Hopkins, performed a study for the Government Development Bank of Puerto Rico. In it, she wrote:

[Puerto Rico’s] published quarterly figures are too narrow in scope to provide an accurate picture, while the [Consolidated Annual Fiscal Report’s] consolidated accounts appear with a long lag and are difficult to interpret. Analysts should not have to engage in jujitsu with the data in order to figure out the fiscal deficit Better statistics are not a luxury. Without them the Commonwealth is flying blind and market uncertainty about underlying developments is reflected in the risk premium on government debt.⁴⁸

This lack of timely, clear, and reliable data made it difficult for investors to foresee how serious the debt crisis had become. Additionally, the Great Recession hit in 2007 and 2008, making the economic picture even blurrier. With these two occurrences skewing the true picture of Puerto Rico’s finances, it’s no wonder investors didn’t see Puerto Rico’s debt crisis coming.

Another reason that investors continued pouring money into Puerto Rico was because, as of 1984, the territory was incapable of declaring bankruptcy. Following Congress’ law denying Chapter 9 access to the territory of Puerto Rico, “millions of individuals nationwide invested billions of dollars in reliance on that law.”⁴⁹ Though this reasoning was used to argue against reinstating Puerto Rico’s access to Chapter 9, its foundation can be attacked:

Some might worry that [reinstating Puerto Rico’s access to Chapter 9 and allowing it to apply retroactively] to pre-existing debts is somehow unfair or even unconstitutional to the holders of that debt. This concern is mistaken [The Nation’s previous bankruptcy law] generally applied to pre-existing debts when enacted, and the Supreme Court confirmed the permissibility of Congress exercising its power under the Bankruptcy Clause in this manner This of course makes sense because Congress has authority under the Constitution’s Bankruptcy Clause to adjust debts . . . putting all on notice that their contractual rights are always subject to adjustment by the Congress . . .

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⁴⁵ *Id.*

⁴⁶ Franchise Tax Board, *Taxing municipal bond interest in California*, FTB.CA.GOV, https://www.ftb.ca.gov/Archive/Professionals/Taxnews/1106/1106_9.shtml (last visited Nov. 11, 2016).

⁴⁷ Morgan Stanley, *California Tax Report*, MORGANSTANLEYFA.COM (Rev. Jan., 2013), <http://www.morganstanleyfa.com/public/projectfiles/b5ca6d9c-fdc8-4956-8154-9035fd8cbbce.pdf>.

⁴⁸ ANNE O. KRUEGER ET AL., PUERTO RICO – A WAY FORWARD 22-23 (2015), <http://www.bgfpr.com/documents/PuertoRicoAWayForward.pdf>.

⁴⁹ *Puerto Rico Chapter 9 Uniformity Act of 2015: H.R. 870 Before the H. Comm. on the Judiciary*, 114th Cong. 88 (2015) (written testimony of Thomas Moers Mayer, Esq., Partner and Co-Chair, Corporate Restructuring and Bankruptcy Group, Kramer Levin Naftalis and Frankel, LLP) [hereinafter, *Chapter 9 Hearing*].

⁵⁰ *Id.* at 20 (Prepared statement of John A. E. Pottow, Esq., Professor of Law, University of Michigan Law School).

However, the original argument that people relied on Puerto Rico's inability to file bankruptcy has pragmatic strength. It seems that an average investor is likelier to know simply that Puerto Rico's municipalities can't declare bankruptcy, not that Congress has the constitutional powers to change this ability at any time.

Lastly, investors continued to pour money into Puerto Rico because its government started selling secured bonds. In 2007, Puerto Rico reached its debt ceiling and could borrow no more.⁵¹ To get around this, the government began selling bonds secured by sales tax by pledging sales tax revenues to payback these new bonds.⁵² One can imagine how displeased the old lenders would be since a great source of revenue —sales tax— was being pledged to new lenders. Ten years later, this has created a tremendous issue for the courts. Puerto Rico's constitution claims that those who lend directly to the island's government —those who buy general obligation bonds— will be paid back first.⁵³ However, those lenders who have securitized debt —those whose loans are backed by sales-tax revenue— have a property interest that likely cannot be disrupted by the courts without triggering the Takings Clause of the Constitution.⁵⁴ In July of 2016, fund managers holding general obligation bonds “sued Governor Alejandro García Padilla in [the] U.S. District Court in San Juan to stop the administration from transferring funds away from bondholders.”⁵⁵ This litigation still looms and, on October 24, 2016, the sales-tax bondholders requested that it be temporarily halted as Puerto Rico works to restructure its debt.⁵⁶

The underlying reasons for Puerto Rico's incredible debt are numerous and spread throughout the public and private sectors. The federal government, territorial government, and creditors all share blame for allowing Puerto Rico's debt to achieve such a level. Had this situation arisen within a state, rather than a territory, the solution would be clear: have the state's municipalities file for Chapter 9 bankruptcy. Nevertheless, this was not an option for Puerto Rico. Instead, Congress passed an entirely new law —the Puerto Rico Oversight, Management, and Economic Stability Act— to remedy this debilitating situation. We now consider the main differences between Chapter 9 and PROMESA to ultimately determine whether Puerto Rico has benefited from the new legislation.

III. KEY DIFFERENCES BETWEEN CHAPTER 9 AND PROMESA

The simplest way Congress could have granted Puerto Rico relief would have been to reinstate its access to Chapter 9. In fact, a modest one-page bill was introduced in Congress which would have achieved this goal.⁵⁷ Had it passed, Puerto Rico would have been on the same

⁵¹ Michelle Kaske, *Hedge Funds Face Off Over Puerto*, BLOOMBERG LAW (Nov. 3, 2016), <https://www.bloomberglaw.com/s/news/66d09c6f196026f22f8f165e3f835717/document/OGISLQ6VDKHT?headlineOnly=false&highlight=Puerto+and+Rico+and+debt>. (last visited Aug. 6, 2017).

⁵² *Id.*

⁵³ Michelle Kaske, *Hedge Funds Holding Puerto Rico GOs Sue Over Sales-Tax Bonds*, BLOOMBERG.COM (Oct. 7, 2016), <http://www.bloomberg.com/news/articles/2016-10-07/hedge-funds-holding-puerto-rico-gos-sue-over-sales-tax-bonds> (“Puerto Rico's constitution states its general obligations must be repaid before other expenses. A portion of the island's sales-tax revenue is dedicated to repaying bonds, called Cofinas by their Spanish acronym.” *Id.*) (last visited Aug. 6, 2017).

⁵⁴ *Chapter 9 Hearing*, *supra* note 49, at 20 (Prepared statement of John A. E. Pottow, Esq., Professor of Law, University of Michigan Law School) (“Secured creditors hold liens on collateral, and so one could argue that the Bankruptcy Code's invalidation of those property rights might implicate the Taking Clause. I say ‘might’ because the issue has never been definitively resolved by the Supreme Court . . .”).

⁵⁵ Kaske, *supra* note 53.

⁵⁶ Kaske, *supra* note 51.

⁵⁷ CONGRESS, *supra* note 3.

playing field as all other states in terms of municipal bankruptcy. However, the bill did not pass; instead, Congress chose to enact an entirely new law known as PROMESA. The remainder of this comment explores the key differences between Chapter 9 and PROMESA to determine which is better for Puerto Rico.

A. The Oversight Board

Undoubtedly, the most controversial component of PROMESA is its implementation of an oversight board with broad powers to control the spending of Puerto Rico. A federal oversight board is well beyond the bounds of Chapter 9 because of constitutional concerns over state sovereignty.⁵⁸ A federal bankruptcy judge controlling a municipality's spending is akin to the federal government directing a state government's municipality on how to spend its tax dollars.⁵⁹ This goes too far and would not be allowed under current judicial precedent,⁶⁰ but these concerns don't apply when dealing with a territory like Puerto Rico.

The PROMESA oversight board is comprised of seven members, all appointed by the President, and has the authority to reject budgets approved by the Puerto Rican legislature.⁶¹ Why is this oversight board so controversial? The true controversy lies not in the mere existence of a board, but Puerto Rico's inability to influence it.

Oversight boards are not novel; consider Detroit's recent bankruptcy. In July of 2013, "Detroit filed for Chapter 9 protection . . . with an estimated \$18–\$20 billion in debt."⁶² The following year, the state legislature passed the Michigan Financial Review Commission Act of 2014 in which a commission was created to "[r]eview, modify, and approve proposed and amended operational budgets of [Detroit]."⁶³ In fact, "[a] proposed budget or budget amendment does not take effect unless approved by the commission."⁶⁴ However, there was little, if any, controversy surrounding the implementation of this oversight board.⁶⁵

The Michigan commission was made up of nine members: the state treasurer; the director of the department of technology, management, and budget; three experts appointed by the governor; one expert recommended by the senate majority leader; one expert recommended by the speaker of the house of representatives; Detroit's mayor; and Detroit's City Council President.⁶⁶ Thus, only two of the nine members had to be from Detroit's local government: the mayor and the City Council President. Five of the nine members had to be experts, but did not

⁵⁸ Clayton P. Gillette & David A. Skeel, Jr., *Governance Reform and the Judicial Role in Municipal Bankruptcy*, 125 YALE L.J. 1150, 1166 n.54 (2016) (quoting *In re N.Y.C. Off-Track Betting Corp.*, 434 B.R. 131, 140 (Bankr. S.D.N.Y. 2010) ("[Section 904 of the Bankruptcy Code] codifies the Tenth Amendment's general prohibition on a bankruptcy court's power to interfere with a state entity." *Id.*)).

⁵⁹ USCOURTS, *supra* note 11.

⁶⁰ Gillette & Skeel, *supra* note 58, and accompanying text.

⁶¹ D. ANDREW AUSTIN, CONG. RESEARCH SERV., R44532, THE PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT I (Jul. 1, 2016) ("PROMESA would establish an Oversight Board with broad powers of budgetary and financial control over Puerto Rico." *Id.*).

⁶² Peter Saunders, *Detroit After Bankruptcy*, FORBES (Apr. 24, 2016), <https://www.forbes.com/sites/petesauanders1/2016/04/24/detroit-after-bankruptcy/#6ecclfec63d7> (last visited Aug. 6, 2017).

⁶³ Mich. Comp. Laws Ann. § 141.1637(c) (2014).

⁶⁴ *Id.*

⁶⁵ Only one quasi-critical news report was discovered regarding the Michigan Financial Review Commission. See, e.g., Chastity Pratt Dawsey, *Is Detroit's financial oversight board too big to succeed?*, MLIVE.COM (Jul. 10, 2014), http://www.mlive.com/politics/index.ssf/2014/07/is_detroits_financial_oversigh.html (last visited Aug. 6, 2017).

⁶⁶ Mich. Comp. Laws Ann. § 141.1635 (2014).

have to be tied to Detroit in any way. However, there were few, if any, protests, even though Detroit's autonomy was being eroded by unelected appointees from Lansing, ninety miles away.

Even Puerto Rico attempted to implement its own control board under the now defunct Puerto Rico Public Corporation Debt Enforcement and Recovery Act.⁶⁷ This act would have created a three-person oversight board for each public debtor, each of whom would be appointed by the Governor.⁶⁸ However, no more than one of the three members could have been a resident of Puerto Rico, meaning that the remaining two must be experts from outside the territory.⁶⁹ Therefore, even Puerto Rico's self-enacted oversight board would have included a majority of members from beyond its borders.

Therefore, why is the federal oversight board under PROMESA so controversial? Since oversight boards are common in municipal bankruptcy cases, the controversy cannot be simply from the mere presence of a board. Instead, the controversy must stem from Puerto Rico's inability to influence the board. In Michigan, thirty-nine percent of the state's voters are in the Detroit Tri-County area.⁷⁰ Even though the state instituted a financial commission to oversee Detroit during its bankruptcy, the people of Detroit maintained significant influence over the state government via their ability to vote in state elections. This was an implicit check on the financial commission's broad powers. Under the Recovery Act in Puerto Rico, the three-person oversight committee could only make recommendations to the territorial government on how to deal with a municipality refusing to follow its restructuring plan.⁷¹ Therefore, the citizens of Detroit gave up some autonomy, but could still influence the board by voting in state elections, and the citizens of Puerto Rico did not give up any autonomy.

Under PROMESA, "[t]he Oversight Board shall consist of seven members appointed by the President"⁷² Though the President appoints the seven members, he may only appoint one at his sole discretion; his remaining appointees must be from recommendations received by several congressional leaders.⁷³ "The Governor [of Puerto Rico] . . . shall be an ex officio member of the Oversight Board *without voting rights*."⁷⁴ Thus, unlike the Michigan commission that included Detroit's mayor and City Council President, PROMESA does not require that any voting members of the oversight board have any current ties to Puerto Rico. Though this ensures the board's objectivity, it also significantly reduces the ability of Puerto Ricans to exert political pressure on the board.

On August 31, 2016, President Obama named the seven members of the board: a conservative think-tanker, an insurance broker, two bankers, a former federal bankruptcy judge, a former director of the California Department of Finance, and an Ivy League corporate law

⁶⁷ *Puerto Rico v. Franklin California Tax-Free Trust*, 136 S. Ct. 1938, 1946 (Jun. 13, 2016) (holding Puerto Rico's Recovery Act preempted by the Bankruptcy Code).

⁶⁸ 2014 P.R. Laws Act No. 71 § 203 [hereinafter, Recovery Act].

⁶⁹ Recovery Act § 101(42) ("[O]versight commission' means a body composed of three (3) independent experts appointed by the Governor under chapter 2 of this Act, not more than one (1) of whom may be a resident of the Commonwealth at the time of appointment." *Id.*).

⁷⁰ Mich. Dept. of Tech., Mgmt., and Budget, *Population Density in Michigan: 2010*, MICHIGAN.GOV (Mar. 22, 2011), https://www.michigan.gov/documents/cgi/cgi_census_map_popdens_tract_10_347989_7.pdf; U.S. Bureau of the Census, *Mich. Population by Cnty.*, SENATE.MICHIGAN.GOV (May 18, 2017), <http://www.senate.michigan.gov/sfa/economics/MichiganPopulationByCounty.PDF>.

⁷¹ Recovery Act § 203 ("If the oversight commission... finds that an eligible obligor has failed to meet an interim performance target... the oversight commission shall issue a noncompliance finding... explaining the reasons for such noncompliance and making recommendations for curing such noncompliance." *Id.*).

⁷² 48 U.S.C. § 2121 (2016).

⁷³ *Id.*

⁷⁴ *Id.* (emphasis added).

professor.⁷⁵ Four of these seven members are native Puerto Ricans,⁷⁶ one of which maintains an office in Puerto Rico.⁷⁷ Undoubtedly, this majority of Puerto Rican natives were meant to “soothe anxiety on the island.”⁷⁸ Nevertheless, their presence is no guarantee that the three and one-half million American citizens living within Puerto Rico will have any influence over the board or its decisions. Their only direct line to the board will be through a governor who holds a non-voting position.

If Puerto Rico had been given access to Chapter 9, it’s likely that they would have instituted its own control boards with *non-Puerto Ricans* to oversee municipalities.⁷⁹ Under PROMESA, the federal government instituted a control board that includes *a majority of Puerto Ricans* to oversee all of the territory. In this light, PROMESA’s oversight board does not seem to be a far cry from what Puerto Rico would have experienced had it been given access to Chapter 9. The key difference between the two is that Puerto Rican politicians cannot veto what the PROMESA oversight board does,⁸⁰ but this is not necessarily a bad thing. Mismanagement of Puerto Rico finances—for example, circumventing the debt ceiling and failing to publish accurate data—is a main contributor to its current economic crisis. If Puerto Rico maintains control over its finances, it is liable to be locked out of capital markets, which, in turn, would be a devastating proposition for the Puerto Rican people.⁸¹ By handing over fiscal responsibility to unelected officials, Puerto Rico’s reputation should increase, thereby restoring creditors’ confidence, and reducing the rates that such creditors are willing to lend to Puerto Rico.⁸²

So, regarding the oversight board, is Puerto Rico better off under PROMESA than it would have been under Chapter 9? The answer is yes: if you want an omelet, then you must crack a few eggs. In this case, the eggs being cracked are Puerto Ricans’ ability to elect officials to control the territory’s spending; and the omelet will be long-term fiscal health and access to capital markets.

B. Creditor Collective Action

Another controversial portion of PROMESA that differs from Chapter 9 is its Title VI, Creditor Collective Action. This title retroactively inserts collective action clauses (CAC) into all the contracts between Puerto Rico and its creditors. CACs allow a majority of holders of a particular bond to agree to restructure the issuer’s debt—even if a minority of those

⁷⁵ Office of the Press Secretary, The White House, *President Obama Announces the Appointment of Seven Individuals to the Financial Oversight and Management Board for Puerto Rico* (Aug. 31, 2016), <https://www.whitehouse.gov/the-press-office/2016/08/31/president-obama-announces-appointment-seven-individuals-financial> (last visited Aug. 6, 2017).

⁷⁶ *Id.*

⁷⁷ Hub International CLC, *Firm Overview*, CLC INSURANCE PR, http://www.clcinsurancepr.com/firm_overview.html (last visited Aug. 6, 2017).

⁷⁸ Steven Mufson, *White House names seven to Puerto Rico oversight board*, WASH. POST (Aug. 31, 2016), https://www.washingtonpost.com/business/economy/white-house-names-seven-to-puerto-rico-oversight-board/2016/08/31/9cee9376-6f8b-11e6-9705-23e51a2f424d_story.html (last visited Aug. 6, 2017).

⁷⁹ This assessment is supported by the control boards presented in the Recovery Act. See Recovery Act § 203.

⁸⁰ Recovery Act § 203 (providing the oversight commission power to simply write noncompliance notices and curative recommendations).

⁸¹ See Bill Cooper, *Keeping the Promise of PROMESA: Next Steps for Puerto Rico*, YOUTUBE (Sep. 27, 2016), https://youtu.be/qZ2JKpeI8po?list=PLEMqhsjmFr7yJ_B2xjEPrOIYYkK8uw083 (claiming the purpose of PROMESA is to impose fiscal responsibility to allow Puerto Rico to get back into the capital markets, at 6m 35s) (last visited Aug. 6, 2017).

⁸² See *id.* and accompanying text.

bondholders do not consent.⁸³ Thus, CACs are meant to eliminate hold-outs, which has become a troublesome issue over the past several decades.⁸⁴ CACs began appearing as part of sovereign debt agreements in England in the 1870's, but were not adopted in the U.S. until the early 2000's.⁸⁵ They are important for sovereign bonds because “unlike corporate debtors, sovereigns do not have the option of filing for bankruptcy.”⁸⁶ Therefore, sovereigns must create this collective action process as part of their bond contracts if they hope to have any chance at future restructuring of their debts.

Under PROMESA, the oversight board will divide the bondholders into pools according to their “relative priority or security arrangements.”⁸⁷ Then the bond issuer or bondholder may propose a modification of the bond,⁸⁸ which becomes qualified so long as (1) the issuer consults with all of the bondholders in the pool, (2) the modification treats all the bondholders the same, and (3) the modification is approved by the oversight board.⁸⁹ Once it is qualified, the modification will be voted on by the bondholders, which is the first step in making the modification binding.⁹⁰ If (a) at least half of the bondholders vote, and (b) the bondholders holding two-thirds of the principle amount vote affirmatively,⁹¹ the modification passes its first hurdle to becoming binding. Next, the oversight board must approve the modification;⁹² and lastly, the district court must enter an order that the requirements of Title VI have been satisfied.⁹³ At this point, the modification becomes binding on all of the bondholders—even those who voted against it.⁹⁴

This is peculiar because “Title VI of [PROMESA] contains a mechanism for retroactively changing contract rights of bondholders”⁹⁵ Chapter 9 of the Bankruptcy Code and Title III of PROMESA provide similar mechanisms, but these processes are overseen by a federal judge. The Creditor Collective Action under PROMESA takes place almost entirely outside of the courtroom. The only judicial involvement is the final order from the district judge. In said final order, the judge, instead of certifying that the modification is reasonable—in the best interest of the creditors—and feasible,⁹⁶ it merely states that Title VI has been followed.⁹⁷ In other words,

⁸³ Antonio J. Pietrantonì, *Collective Action Clauses for Puerto Rican Bonds: Borrowing Costs, Practical Considerations and Lessons from Sovereign Debt*, 84 REV. JUR. U.P.R. 1195, 1199–1200 (2015).

⁸⁴ Intl. Monetary Fund, *Strengthening the Contractual Framework to Address Collective Action Problems in Sovereign Debt Restructuring* 15 (Sept. 2, 2014) (“In light of the evolution of the sovereign debt market over the past 30 years, there has been a growing awareness that ‘collective action’ problems may undermine the sovereign debt restructuring process.” *Id.*).

⁸⁵ Pietrantonì, *supra* note 83, at 1205 (“It was not until after Mexico included a C.A.C. in a bond issued in the spring of 2003 that sovereign bonds under New York Law began to embrace them.” *Id.*).

⁸⁶ David A. Skeel, Jr., *Can Majority Voting Provisions Do It All?*, 52 EMORY L.J. 417, 418 (2003).

⁸⁷ 48 U.S.C. § 2231(d)(3)(A) (2016).

⁸⁸ *Id.* at § 2231(i).

⁸⁹ *Id.* at § 2231(g)(1).

⁹⁰ *Id.* at § 2231(m)(1)(A).

⁹¹ *Id.* at § 2231(j).

⁹² *Id.* at § 2231(m)(1)(B).

⁹³ 48 U.S.C. § 2231(m)(1)(D) (2016).

⁹⁴ *Id.* at § 2231(m)(2).

⁹⁵ *Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA): Discussion Draft Before the H. Comm. on Natural Resources*, 114th Cong. 44 (2016) (statement of Susheel Kirpalani, Partner, Quinn Emanuel Urquhart & Sullivan).

⁹⁶ 11 U.S.C. § 943(b) (2015).

⁹⁷ 48 U.S.C. § 2231(n)(3) (“The district court shall nullify a Modification and any effects on the rights of the holders of Bonds resulting from such Modification if and only if the district court determines that such Modification is manifestly inconsistent with this section.”).

Congress has enabled private parties (i.e., bondholders) to bind together and vote to retroactively affect the contractual rights of other private parties.

Contract rights are normally considered property under the Takings Clause of the constitution.⁹⁸ When Congress' interference with those rights is its legislation's intended purpose (rather than an ancillary byproduct), the *Penn Central* test is used to determine if the legislation constitutes a taking.⁹⁹ This test comes from a 1978 Supreme Court case, *Penn Central Transp. Co. v. New York City*,¹⁰⁰ which established several factors for the court to consider: "(1) the economic impact of the government action on the property owner; (2) the degree of interference with the property owner's investment-backed expectations; and (3) the 'character' of the government action."¹⁰¹ Considering the economic impact of the government action means the court must measure the change in "fair market value caused by the regulatory imposition."¹⁰² Considering the owner's investment-backed expectations means the creditor must "demonstrate that they bought their property in reliance on a state of affairs that did not include the challenged regulatory regime"¹⁰³ Finally, considering the character of the government action means "a court must balance the liberty interest of the private property owner against the government's need to protect the public interest through the imposition of the restraint."¹⁰⁴

If a dissenting bondholder whose contractual rights were modified as a result of a creditor collective action alleges a government taking, he or she will first have to show that Title VI constitutes a direct interference with a property right rather than an ancillary one. After this, the bondholding plaintiff will have to show a detrimental change in the fair market value of the bond as a result of the collective action. The fact that the fair market value must be considered, rather than the face value is paramount because Puerto Rican municipal bonds are being traded at approximately sixty to seventy cents on the dollar.¹⁰⁵ Thus, a suing bondholder will have to show that his contract has been impaired more than thirty-percent to forty-percent of the face value of the bond.

Another hurdle for a dissenting and litigating bondholder will be to show that he or she purchased the bond in reliance that it would not be adjusted by legislation. Bondholders have several significant arguments to make regarding this factor. First, Puerto Rico was specifically exempted from Chapter 9 protection in 1984. Second, Puerto Rico's constitution guarantees that general obligations bonds will be paid back before all other bonds.¹⁰⁶ Consequently, a potential bond purchaser likely concluded that Puerto Rico will have no recourse but to pay back the bond. Furthermore, specifically for general obligation bonds, a holder likely thought that if all else fails, his or her bonds will be paid back. However, this argument would only apply to a

⁹⁸ ROBERT MELTZ, CONG. RESEARCH SERV., R42635, WHEN CONGRESSIONAL LEGISLATION INTERFERES WITH EXISTING CONTRACTS: LEGAL ISSUES 13-14 (Aug. 20, 2012).

⁹⁹ *Id.* at 15.

¹⁰⁰ *Id.* at 15, n.102 ("The test was announced by the Supreme Court in *Penn Central Transp. Co. v. New York City*, 438 U.S. 104 (1978)." *Id.*).

¹⁰¹ *Id.* at 15.

¹⁰² 26 AM. JUR. 2D *Eminent Domain* § 14 (2016).

¹⁰³ *Id.*

¹⁰⁴ *Id.*

¹⁰⁵ Michelle Kaske, *Most Dreaded Provision of Puerto Rico Law Seen Spurring Pact*, BLOOMBERG (Oct. 28, 2016), <http://www.bloomberg.com/news/articles/2016-10-28/most-dreaded-provision-of-puerto-rico-law-seen-spurring-pact> ("Not everyone is as optimistic. Prepa debt is trading below the potential 85-cents on the dollar recovery rate. Bonds maturing in 2040 with a 5.25 percent coupon changed hands Thursday at an average price of 67.9 cents, according to data compiled by Bloomberg." *Id.*) (last visited Aug. 6, 2017).

¹⁰⁶ Kaske, *supra* note 51 ("Puerto Rico's constitution states that general obligations must be repaid before other expenses...").

bondholder that purchased the bond before having a reason to suspect Puerto Rico would be able to pay back its debt without legislative intervention. Such a bond holder would probably have to be holding a bond that predated Puerto Rico's investment rating slide, which began at the end of 2011 when Moody's downgraded Puerto Rican bonds.¹⁰⁷ After that, it would be hard for a purchaser to claim innocent ignorance.

Lastly, the bondholder who dissents from credit creditor collective action under Title VI and sues under the Takings Clause will have to show that his or her liberty interest is more important than the common good. This will be a difficult burden for a dissenting bondholder to overcome. Following the *Penn Central* test, "a 'taking' may more readily be found when the interference with property can be characterized as a physical invasion by the government . . . than when interference arises from some public program adjusting the benefits and burdens of economic life to promote the common good."¹⁰⁸ Thus, a bondholder will have several significant hurdles to overcome before getting a court to rule that either the Title VI is unconstitutional or that the Government should compensate the bondholder for the decrease in the value of his contract due fellow bondholders exercising Title VI.

Under Supreme Court precedent, it seems that only those bonds with securitized interests would likely overcome all of these hurdles. In *Louisville Joint Stock Land Bank v. Radford*,¹⁰⁹ the Supreme Court determined that a congressional act, which modified a mortgagee's (i.e., creditor) contractual rights against the mortgagor (i.e., borrower), violated the Takings Clause.¹¹⁰ The challenged legislation allowed bankrupt farmers to retain possession of their farms for five years (for a reasonable rent fixed by the court) and allowed the farmers to purchase their property at any time for an appraised amount.¹¹¹ The act, therefore, stripped the mortgagee's "right to retain the lien until the indebtedness thereby secured is paid . . . [and] to assure having the mortgaged property devoted primarily to the satisfaction of the debt"¹¹² Thus, the Supreme Court long ago established that the bankruptcy proceedings are subject to, and limited by, the Takings Clause of the Fifth Amendment.¹¹³ This is especially true when discussing securitized debt.

Puerto Rico's sales tax financing corporation (COFINA) has issued approximately fifteen billion dollars in secured debt.¹¹⁴ As noted by Marxuach, "[b]onds issued by COFINA are secured by Act 91-2006, as amended [], which allocates a portion of the Commonwealth sales and use tax to pay debt service on the bonds issued by COFINA."¹¹⁵ Under Title VI of PROMESA, the oversight board could group COFINA bondholders together into a *secured* pool and allow them to vote on restructuring their debt. However, if a minority of COFINA bondholders dissent, their secured interest can be impaired by a two-thirds majority of

¹⁰⁷ Gov't Dev. Bank of P.R., *Commonwealth of P.R. Moody's Historical Rating*, http://www.gdbpr.com/investors_resources/commonwealth.html (last visited Aug. 6, 2016).

¹⁰⁸ *Cienega Gardens v. United States*, 331 F.3d 1319, 1338 (Fed. Cir. 2003) (quoting *Penn Cent. Transp. Co. v. City of N.Y.*, 438 U.S. 104, 124 (1978)).

¹⁰⁹ *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1935).

¹¹⁰ Ann K. Wooster, Annotation, *What Constitutes Taking of Property Requiring Compensation Under Takings Clause of Fifth Amendment to United States Constitution—Supreme Court Cases* 10 A.L.R. FED. 2d 231, § 30 (2006).

¹¹¹ *Id.*

¹¹² *Id.*

¹¹³ Julia Patterson Forrester, *Bankruptcy Takings*, 51 FLA. L. REV. 851, 868 (1999).

¹¹⁴ Sergio M. Marxuach, Center for a New Economy, *The Endgame: An Analysis of Puerto Rico's Debt Structure and Arguments in Favor of Enacting a Comprehensive Debt Restructuring Mechanism for Puerto Rico* 3 (Apr. 28, 2016).

¹¹⁵ *Id.* at 6.

bondholders without their consent. This process would seemingly violate the Supreme Court precedent established in *Radford*.¹¹⁶

Presumably to avoid such constitutional issues, Congress included in Title VI a provision that allows bondholders of a secured pool who dissent from a creditor collective action to either (1) retain the lien securing their bond or (2) receive a deferred cash payment or substitute collateral in the amount of their bond.¹¹⁷ This provision will have the effect of making creditor collective actions non-existent for secured bondholders. The entire point of allowing a two-thirds majority vote to bind the entire pool is to eliminate holdouts. This provision, though necessary to avoid violating the Takings Clause, effectively gives holdouts a reward: those who dissent from a collective action retain the ability to be paid in full. As noted by Kirpalani during his statement before the House Committee on Natural Resources, “the ability to bind holdouts if they engage in brinkmanship is the only way to get everyone to the table and have any hope of a voluntary agreement.”¹¹⁸ Thus, Title VI effectively applies to unsecured debt, but not secured debt because a secured creditor can simply retain his or her lien and wait for payment in full.

Regarding the creditor collective action, is Puerto Rico better off under PROMESA than it would have been under Chapter 9? No. Chapter 9 provides for bondholders to bind holdouts with a two-thirds vote, but it must be done as part of a federal court proceeding.¹¹⁹ This means that the federal bankruptcy judge, with a fifteen-year appointment, can reject the plan if it is too hard on the municipality’s people. As criticized by Professor David Skeel, a member of the PROMESA oversight board, the federal bankruptcy judge handling Detroit’s adjustment plan allowed general obligation bondholders to take a sixty-percent cut, but pensioners to only take a forty-percent cut—even though they were of the same priority.¹²⁰ Professor Skeel suggests that to pass Chapter 9’s fairness test, the plan simply had to satisfy the judge’s consciousness. However, under Title VI of PROMESA, the federal judge does not get to decide if the qualified modification is fair.¹²¹ This decision is made by the oversight board¹²²—political appointees with a limited guarantee of continued employment.

It comes down to from where the bondholder-creditors will get a better deal from at the expense of the debtors: the oversight board or a federal bankruptcy judge. A federal bankruptcy judge is not beholden to anyone and may be sympathetic to the Puerto Rican people, thereby permitting bigger cuts for hedge funds than pension funds. The oversight board, on the other hand, is a group of appointees with three year terms who may be removed for cause.¹²³ Billion-dollar bond fund managers would likely have an easier time persuading the oversight board than they would persuading a federal judge. Conversely, the Puerto Rican people would likely have an easier time persuading a federal judge than they would the oversight board—after all, Puerto Ricans only have a non-voting member in Congress and aren’t counted in federal elections. Thus, the Creditor Collective Action clause is probably not positive for the Puerto Rican people. It

¹¹⁶ Wooster, *supra* note 110, at § 30.

¹¹⁷ 48 U.S.C. § 2231(m)(1)(C) (2016).

¹¹⁸ *Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA): Discussion Draft Before the H. Comm. on Natural Resources*, 114th Cong. 41 (2016) (statement of Susheel Kirpalani, Partner, Quinn Emanuel Urquhart & Sullivan).

¹¹⁹ 11 U.S.C. § 1126(e) (2015).

¹²⁰ David A. Skeel, Jr., *Fixing Puerto Rico’s Debt Mess*, WSJ.COM (Jan. 5, 2016), <http://www.wsj.com/articles/fixing-puerto-ricos-debt-mess-1452040144> (last visited Aug. 6, 2017).

¹²¹ 48 U.S.C. § 2231(g)(1)(C) (2016).

¹²² *Id.* at § 2231(g)(1)(C).

¹²³ *Id.* at § 2121(e)(5).

gives bondholders a way to modify their debt without facing a potentially sympathetic federal judge.

C. Capturing all of Puerto Rico's Debt

Chapter 9 applies only to municipal debt. Professor Skeel explains that only “distressed municipalities can file for bankruptcy if their state permits this, as roughly half do. The states themselves do not have a bankruptcy option, however, no matter how bleak their circumstances may be.”¹²⁴ Why? In a 2013 article, Professor Skeel provided five reasons why states are not extended the right to file for bankruptcy: (1) people’s unwillingness to change the status quo; (2) protection of public employee compensation and pension; (3) bankruptcy will not fix the underlying political issues causing the debt; (4) bankruptcy would be ineffective since bond obligations make up less than ten percent of annual budget in even the most indebted states; and (5) allowing a state to file bankruptcy would reduce the federal government’s ability to impose tough fiscal reforms in return for a bailout.¹²⁵ Thus, it is not that a state bankruptcy would be unconstitutional, it is simply that the federal government hasn’t put the framework in place.

Had Resident Commissioner Pierluisi’s Puerto Rico Chapter 9 Uniformity Act (H.R. 870) been passed, it would have granted Puerto Rico the ability to allow its municipalities to file for Chapter 9 bankruptcy. Under the Bankruptcy Code, “[t]he term ‘municipality’ means political subdivision or public agency or instrumentality of a State.”¹²⁶ Political subdivisions include “counties, cities, towns, townships, villages”¹²⁷ Public agencies and state instrumentalities include “public corporations, school, fire, water/irrigation or improvement districts, and boards and authorities that own or run utilities, hospitals, housing developments, transportation systems, and other public services.”¹²⁸

As of September 30, 2015, Puerto Rico’s debt was approximately seventy-billion-dollars.¹²⁹ A little over forty-seven billion, or two-thirds of that debt, was issued by Puerto Rican municipalities.¹³⁰ On the other hand, close to twenty-three billion, or one-third, of Puerto Rico’s debt were issued by Puerto Rico itself.¹³¹ Therefore, simply giving Puerto Rico access to Chapter 9 would have only affected two-thirds of its total debt. This issue was flagged by one bondholder representative during the Puerto Rico Chapter 9 Uniformity Act’s hearing: “This bill would affect \$48 billion of bonds. Notice I said \$48 billion. The other \$25 billion . . . is held by all the funds who support this bill. They want it to apply to everybody other than them.”¹³² The point is well taken. Had Puerto Rico been given access to Chapter 9, all the municipal debt would have been on the chopping block, affecting a subset of the creditors. Creditors of the Commonwealth —e.g., creditors of general obligation bonds— would have been protected. In fact, creditors of the Commonwealth would probably have benefited from the Puerto Rico

¹²⁴ David A. Skeel, Jr., *Is Bankruptcy the Answer For Troubled Cities And States?*, 50 HOUS. L. REV. 1063, 1064 (2013).

¹²⁵ *Id.* at 1067-77.

¹²⁶ 11 U.S.C. § 101(40) (2015).

¹²⁷ 5 WILLIAM L. NORTON JR. & WILLIAM L. NORTON III, NORTON BANKR. L. & PRAC. § 90:5 (3d ed. 2016).

¹²⁸ *Id.*

¹²⁹ Marxuach, *supra* note 114, at 3.

¹³⁰ *See id.* (claiming the “Other Public Sector Debt” amounted to \$47,145 million).

¹³¹ *See id.* (claiming the “Debt Payable from General Fund” amounted to \$22,764 million).

¹³² *Puerto Rico Chapter 9 Uniformity Act of 2015: H.R. 870 Before the H. Comm. on the Judiciary*, 114th Cong. 1st Sess. 81 (2015) (Oral testimony of Thomas Moers Mayer, Esq., Partner and Co-Chair, Corporate Restructuring and Bankruptcy Group, Kramer Levin Naftalis and Frankel, LLP).

Chapter 9 Uniformity Act because, the more debt Puerto Rico could restructure elsewhere, the abler Puerto Rico would be to repay the debts it didn't structure.¹³³ Thus, simply giving Puerto Rico access to Chapter 9 would have hit municipal creditors hard and given Commonwealth creditors a windfall.

However, unlike Chapter 9, PROMESA applies to all debt held by the Commonwealth of Puerto Rico. Section 2162 establishes that a debtor may be "a territory that . . . has had an Oversight Board established for it by the United States Congress . . . or a covered territorial instrumentality . . ." ¹³⁴ Under Chapter 9, only a state can authorize a municipality to be a debtor and utilize bankruptcy.¹³⁵ Here, this power is not extended to Puerto Rico. Title I of PROMESA reserves this power to the oversight board: "[The] Oversight Board, in its sole discretion . . . may designate any territorial instrumentality as a covered territorial instrumentality that is subject to the requirements of this chapter."¹³⁶

This difference between PROMESA and Chapter 9 is incredibly important for holders of municipal or instrumentality debt, and in turn, important for the Puerto Rican people. Had Resident Commissioner Pierluisi's simple one-page bill been passed, Puerto Rico's municipalities would have shouldered the entire debt restructuring burden. This would have sent borrowing rates for just the municipalities —such as the electric power authority and gas authority— skyrocketing, while the borrowing rates for Puerto Rico remained low. Such a situation would have caused utility rates to increase and this cost would be passed on to the Puerto Rican people. At the same time and due to Puerto Rico's continued low borrowing rate, the territorial government would have been able to continue racking up debt. Under this topic, it seems that PROMESA is better for Puerto Rico and its people than simply extending Chapter 9.

IV. CONCLUSION

Though the people of Puerto Rico continue to protest PROMESA, they are likely better off than they would have been had Puerto Rico simply been given access to Chapter 9. The oversight board provides the Puerto Rican government credibility, which enables it to regain access to capital markets and to borrow at reasonable rates. Even though the people of Puerto Rico have no direct influence on the oversight board, the majority of its members are native Puerto Ricans. This provides at least an avenue of influence by way of compassion for the territory's people and situation. PROMESA, unlike Chapter 9, also corrals all of Puerto Rico's debts, providing all lenders certainty. Unfortunately, Title VI would allow bondholders to wheel and deal largely unchecked by an impartial federal judge. However, Title VI actions are overseen by the oversight board, which again, is populated by a majority of Puerto Rican natives. Furthermore, collective action clauses are relatively new in the United States and, consequently, Title VI's utility remains to be demonstrated. Puerto Rico's road ahead is austere, but it will be better navigated with PROMESA than with Chapter 9.

¹³³ University of Pennsylvania Law School, *A way forward for Puerto Rico's debt crisis*, YOUTUBE (Jun. 6, 2016), https://www.youtube.com/watch?v=SC2B3X-z0S0&index=1&list=PLEMqhsjmFr7yJ_B2xjEPrOIYYkK8uw083 (David A. Skeel, Jr. discussing the sentence's proposition at 13m15s) (last visited Aug. 6, 2017).

¹³⁴ 48 U.S.C. § 2162 (2016).

¹³⁵ 11 U.S.C. § 109(c)(2) (2016) ("An entity may be a debtor under Chapter 9 of this title if and only if such entity... is specifically authorized, in its capacity as a municipality or by name, to be a debtor under such chapter by State law . . ." *Id.*)

¹³⁶ 48 U.S.C. § 2121(d)(1)(A) (2016).