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Final Version

24 May 2016

Hon. Robert Bishop
Chairman
United States House of Representatives
Committee on Natural Resources
1324 Longworth House Office Building
Washington, D.C. 20515

Re: H.R. 5278

Chairman Bishop:

I am writing on behalf of the Center for a New Economy ("CNE"), a Puerto Rico non-partisan, not-for-profit, independent think tank, to convey our analysis of H.R. 5278, the "Puerto Rico Oversight, Management, and Economic Stability Act", or "PROMESA".

First, I want to thank the members and the staff of the United States House of Representatives Committee on Natural Resources (the "Committee") for the amount of time, effort, and resources they have dedicated to this issue under your leadership.

The Committee has made considerable progress during the past five months in developing a legislative solution to Puerto Rico's complicated debt crisis. In our opinion, the Committee has acted in good faith and served as an honest broker in structuring a process through which a compromise solution could be reached.

We also commend the Committee for streamlining the debt restructuring process relative to prior versions of that procedure and for including new language in the bill regarding the establishment of a Congressional Task Force to Study Economic Growth in Puerto Rico and requiring the Government Accountability Office to draft a report on including Puerto Rico in the HUB Zone Program.

Notwithstanding this process and the progress it has yielded, we believe the political costs associated with the oversight part of the bill are extremely high and quite definite, while any benefits to be derived from debt restructuring are fairly uncertain and contingent on the successful implementation of a complicated, new territorial debt restructuring process, which combines principles drawn from both the U.S. Bankruptcy Code and the realm of sovereign debt restructuring.

Therefore, on balance and taking into account the totality of the circumstances, CNE cannot endorse H.R. 5278 as currently drafted. The attached document sets forth CNE's detailed assessment of H.R. 5278 and contains recommendations for its improvement. We hope it is a useful reference as you and the Committee keep working on the bill.

Finally, we look forward to continue collaborating with the Committee and with members of the House of Representatives and the Senate to improve the legislation in the coming days.

Cordially,

Sergio M. Marxuach

Policy Director
Center for a New Economy

Final Version

CENTER FOR A NEW ECONOMY
ASSESSMENT OF H.R. 5278
THE PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT
24 MAY 2016

Introduction

CNE has analyzed Puerto Rico's economic and fiscal situation for more than a decade. During that period, we have carefully surveyed and considered the socioeconomic context and the rapidly deteriorating financial position of the island, and attempted to address some of the most pressing problems. Through the publication of a series of research papers and policy briefs, we have proposed what we believe are thoughtful and actionable policy recommendations to multiple stakeholders, both within and beyond Puerto Rico. More recently, given the severity of the current situation we have engaged in advocacy and outreach efforts in Washington, D.C.

As the situation in Puerto Rico reached a critical point, CNE developed the following principles to use as benchmarks for evaluating H.R. 5278 or any other proposal regarding federal oversight of Puerto Rico's finances and the process for restructuring its unsustainable public debt. These principles are:

1. Any federally appointed oversight board has to respect existing Puerto Rican political institutions and processes.
2. The ultimate responsibility and decision-making authority regarding taxation and public expenditures must rest with Puerto Rico's democratically elected officials, who must act in accordance with transparency standards and be held publicly accountable to their constituents.
3. Any proposal to restructure Puerto Rico's debt must treat both creditors and debtors fairly and equitably and provide, *ex ante*, a clear and feasible path for actually delivering meaningful debt relief.
4. No classes of Puerto Rico debt should be excluded from the restructuring process.
5. New economic growth opportunities will not materialize by themselves even after the implementation of a comprehensive debt restructuring. Therefore, a U.S. House/Senate economic growth task force for Puerto Rico should collaborate with knowledgeable stakeholder groups in the island to develop a long-term economic growth strategy. The design of such a collaborative comprehensive strategy should include short-term measures to spark new investment activity, and medium-term proposals that help rebuild economic

institutions, strengthen public governance, and identify strategic investments in particular sectors of the Puerto Rican economy.

6. If Congress is unwilling or unable to act, then it should expressly allow Puerto Rico to legislate its own legal framework to restructure its debt.

We base our analysis of H.R. 5278 within the framework of this set of principles.

PRINCIPLE 1—RESPECT FOR EXISTING PUERTO RICAN POLITICAL INSTITUTIONS AND PROCESSES

The following sections of H.R. 5278 are some examples of federal overreach that will undermine the authority of existing Puerto Rican institutions and interfere with the political processes of the government of Puerto Rico:

- The Oversight Board is created by the federal government as an entity within the government of Puerto Rico, disregarding the Puerto Rican legal and political process to create and abolish government agencies, departments and other entities. (Section 101(c)(1))
- Furthermore, the Oversight Board's operating budget will be fully funded by the government of Puerto Rico (Section 107(b)), yet the Board will not be subject to any control or supervision either by the Governor or the Puerto Rico Legislature. (Sections 108(a)(1) and (2))
- Notwithstanding that the Oversight Board will be an entity of the Commonwealth government fully funded by the Puerto Rico Treasury, only one member is required to maintain a primary residence or have a primary place of business in Puerto Rico. (Section 101(e)(2)(B))
- Oversight Board members are also exempt from any liability claims arising out of actions taken to carry out the purposes of the Act. (Section 105)
- Section 104(i) requires the Oversight Board to issue a certification that the government of Puerto Rico or an instrumentality thereof has successfully reached a *voluntary* agreement with bondholders. It is not clear to us why a voluntary agreement, freely entered into by willing and able parties, to *reduce or restructure* part of Puerto Rico's debt would need to be certified by a federal government Oversight Board.
- Pursuant to Section 201, the Oversight Board has exclusive control to ensure comprehensive Fiscal Plans are enacted and implemented, including the authority to require the government of Puerto Rico to include in such Fiscal Plans any recommendation made by the Oversight Board pursuant to Section 205(a) even when those recommendations may have been previously rejected by the Legislature or the Governor.
- Section 204 requires the Governor to submit to the Oversight Board *any* law enacted by the Puerto Rico Legislature, along with a cost estimate and a certificate of compliance with the Fiscal Plan. If the Oversight Board finds

that the law is significantly inconsistent with the Fiscal Plan or if no cost estimate is submitted, then the Oversight Board is authorized to prevent the enforcement of such law or take any other actions it considers necessary. (Sections 204(a)(1) and (a)(5))

- Sections 204(b)(2) and (b)(4) require the government of Puerto Rico to submit to the Oversight Board certain contracts, rules, regulations, and executive orders for review, and is authorized to prevent the execution or enforcement of any contract, rule, regulation, or executive order it deems, in its sole discretion, to be inconsistent with the Fiscal Plan.
- Section 204(c) requires that the Oversight Board review any reprogramming of funds proposed by the Puerto Rico legislature to determine whether such reprogramming is consistent with the Fiscal Plan. We are concerned that this section contains no provisions for the expedited reprogramming of funds in the event of a natural or public health emergency.
- Section 205 authorizes the Oversight Board to make "recommendations" to the government of Puerto Rico on a broad scope of subjects, ranging from the management of public finances, to alternatives for meeting pension obligations, to the privatization or commercialization of government activities, and, while the government of Puerto Rico can refuse to adopt such recommendations, the Oversight Board can require they be included in the mandatory annual Fiscal Plan. (Section 201(b)(1)(K))

Given all of the above, we conclude that H.R. 5278, as currently drafted, invests the Oversight Board with powers that far exceed those necessary for it to execute its core fiscal oversight function and, therefore, *does not comply* with the principle of respecting existing Puerto Rican political institutions and processes.

PRINCIPLE 2—FINAL DECISION-MAKING AUTHORITY REGARDING TAXATION AND PUBLIC EXPENDITURES MUST REST WITH PUERTO RICO'S DEMOCRATICALLY ELECTED OFFICIALS

This is a fundamental principle of democratic governance that should not be compromised. While we agree that Puerto Rico has been negligent in the management of its public finances, a wholesale takeover of Puerto Rico's fiscal institutions is not the solution. Puerto Rico needs technical assistance that helps restore health to its fiscal institutions, not oversight measures that upend their legitimate role in fiscal management.

In this respect we would like to point out the following provisions of H.R. 5278:

- Section 202 sets forth a procedure for approving annual budgets, but if the Governor and the Legislature fail to develop and submit a "certifiable budget" within the established deadline, then the Oversight Board is authorized to develop the budget for that fiscal year. This is problematic because it is entirely foreseeable that differences will arise between the Oversight Board and the government of Puerto Rico regarding spending priorities and taxation sources to finance those priorities, yet the final decision rests with the Oversight Board. (Section 202(e)(3))

- Pursuant to Section 204, the Governor is required to submit quarterly reports to the Oversight Board setting forth the actual revenues and expenses for the previous quarter and to compare them with the approved budget. If there are significant variances, the Oversight Board will notify the Governor and require that the government of Puerto Rico implement measures to correct those variances. If the Governor fails to correct such variances within an established period of time, then the Oversight Board is required to "make appropriate reductions in non-debt expenditures." (Section 203(d)(1)) Therefore, this section establishes, *ex ante*, a strong bias in favor of austerity policies that could prove to be counterproductive in the context of a stagnant or contracting economy. In addition, implementing across the board cuts, in the event that Puerto Rico is not meeting its budgetary targets, could have a material adverse effect on the delivery of public education, health, security and other essential services.

In prior communications with the Committee we suggested that the Oversight Board focus its efforts on ensuring that annual General Fund spending does not exceed (1) cyclically adjusted revenues, as determined and certified by an independent panel of professional economists and other fiscal policy experts, minus (2) a small structural surplus. Within and subject to that limitation, the Puerto Rican legislative assembly would assign funds among and between the Commonwealth's government agencies and departments according to its own spending priorities. [1] This fiscal rule sets up a clear, simple, objectively determined, and easy to monitor limit on spending that could be enforced by the Oversight Board.

The objective is to keep expenditure below what the Puerto Rico government can raise in taxes in the long run (thereby ensuring sustainability), while allowing deficits whenever the economy is operating below potential and tax revenue is abnormally low (thereby guaranteeing flexibility and contributing to macroeconomic stabilization). The fiscal rule would include a target for achieving a cyclically adjusted fiscal surplus: on average (across the economic cycle) Puerto Rico would run a fiscal surplus to pay down its debt.

The combination of a well-designed fiscal rule and a federal Oversight Board focused on sound implementation of the rule ensures: fiscal sustainability, the necessary flexibility to deal with contingencies, and local democratic control over spending priorities, as the rule sets a cap for expenditures, but does not prescribe the composition of those expenditures.

[1] By definition, the term "cyclically adjusted revenues" does not include the proceeds of debt financing or any non-recurrent revenues.

If Puerto Rico fails to meet its budgetary target during any given fiscal year, then the Oversight Board could be empowered to withhold the disbursement of federal funds, as an incentive for the Puerto Rican government to comply.

Unfortunately, the fiscal provisions of H.R. 5728 take a heavy-handed approach towards achieving a "balanced budget" in a short period of time, disregarding Puerto Rico's constitutional and statutory provisions concerning taxation and public spending. Therefore, we must conclude that these provisions *fail to satisfy* the principle that final decision-making authority regarding taxation and public expenditures remain with Puerto Rico's democratically elected officials.

PRINCIPLE 3—THE PROCEDURES TO RESTRUCTURE PUERTO RICO'S DEBT MUST TREAT BOTH CREDITORS AND DEBTORS FAIRLY AND EQUITABLY AND PROVIDE, EX ANTE, A CLEAR AND FEASIBLE PATH FOR ACTUALLY DELIVERING MEANINGFUL DEBT RELIEF

This is perhaps the part of the bill that has undergone the most significant progress since the first draft was made public a couple of months ago. While we recognize the improvements that have been made in this area, the procedures set forth in H.R. 5278 still need to be adjusted to ensure they will work in an efficient manner.

To be fair, we acknowledge that multiple difficult issues always arise when drafting these kinds of provisions. In the case of Puerto Rico, these difficulties arise in part from the island's complex debt structure and in part from the Committee's intent to create a new territorial debt restructuring process, which combines principles drawn from the U.S. Bankruptcy Code and principles from the realm of sovereign debt restructuring.

H.R. 5278 requires that prior to the commencement of any debt adjustment or restructuring process under Title III of the bill, the debtor must have made a good faith effort to reach a voluntary agreement with its creditors. (Section 206(a)(1)) This means that the debt restructuring process starts with the provisions set forth in Title VI—Creditor Collective Action.

Title VI Requirements

Title VI ostensibly sets up a process for creditors and debtors to reach a voluntary agreement to modify the terms and conditions affecting one or more series of bonds issued by a Puerto Rico debtor.

The first step in this process is to set up a series of pools, or groups of bondholder claims, to vote on the proposed modifications. In our opinion, Section 601(d) sets up an unduly complicated claim classification procedure that further fragments an already complex debt structure, and which may effectively preempt reaching a negotiated agreement.

In prior communications with the Committee we suggested deleting this text in its entirety and recommended that Section 601(d) require instead that all financial claims against an Issuer that are "substantially similar" in nature be pooled together in a single class. This legal standard for classifying claims has been subject to judicial scrutiny under the U.S. Bankruptcy Code. That precedent could be a valuable reference for settling creditor disputes arising out of or in connection with the classification of their claims under Title VI. In addition, using this standard would prevent further wrangling between creditor classes with respect to the classification of their claims in the event that negotiations fail and it is necessary to file a petition for debt adjustment pursuant to Title III.

Second, Section 601(f) requires the Issuer to deliver certain information prior to any solicitation of acceptance or rejection of a Modification. The required information includes:

- A description of the Issuer's economic and financial circumstances, which are, in the Issuer's opinion, relevant to the proposed Modification;
- If the Issuer is seeking Modifications affecting any other Pools of claims, a description of such other Modifications;
- If a Fiscal Plan with respect to the Issuer has been certified by the Oversight Board, a copy of the applicable Fiscal Plan; and
- Any other information as may be required under applicable securities laws.

While these information requirements are reasonable, the difficulty of gathering, organizing, and validating such detailed information should not be underestimated, especially given that the statutory stay on litigation under Section 405 is relatively short.

Third, Section 601(g) requires that any Modification proposed for the approval of bondholders must be a Qualifying Modification. In turn, a Modification is considered a Qualifying Modification if:

- The Issuer proposing the Modification has previously consulted with holders of Bonds in each Pool of such Issuer that will be affected by the Modification;
- Each exchanging holder of Bonds of any series in a Pool affected by the Modification is offered the same consideration (terms);
- The Modification is certified by the Administrative Supervisor (the Oversight Board) as being (1) consistent with the requirements set forth in section 104(i)(1); (2) in the best interests of the creditors; and (3) feasible; *or*
- Notwithstanding the three previous requirements, the Administrative Supervisor has issued a certification that (1) the requirements set forth in Section 104(i)(2) have been satisfied; *or* (2) the Modification is consistent with a restructuring support or similar agreement executed by the Issuer

prior to the establishment of the Oversight Board and to be implemented pursuant to the laws of the territory.

The first two requirements for a Modification to be considered a Qualifying Modification are straightforward and reasonable. The other two requirements are somewhat puzzling.

Section 104(i) is entitled "Voluntary Agreement Certification" and requires the Oversight Board to issue a certification that an Issuer has "successfully reached a voluntary agreement with holders of its Bond Claims" if such agreement provides for a sustainable level of debt or if an applicable Fiscal Plan has not been yet certified for that Issuer, the voluntary agreement is limited solely to an extension of applicable principal maturities and interest on such Bonds for a period of up to one year, during which time no interest will be paid on the Bond Claims affected by the voluntary agreement.

We find it odd, that one of the requirements for a Modification to be considered a Qualifying Modification is that an agreement has been reached with the holders of Bond Claims, *unless* the legislative intent is to exempt such "negotiating table agreements" from the voting requirements set forth in Section 601(j). If that is the legislative intent, then the current language needs to be significantly clarified and fine-tuned.

The other requirement is even more puzzling. Section 601(g)(4) disregards the prior requirements and cross-references to Section 104(i)(2). That Section, in turn, states that the *effectiveness* of any *voluntary agreement* shall be conditioned on (1) the Oversight Board delivering the certification described in Section 104(i)(1); and *either* (2) the agreement of a *majority* in amount of Bond Claims that is to be affected by such agreement; *or* (3) confirmation of a plan of adjustment pursuant to Section 314 *or* the entry of a Court order approving a Qualifying Modification pursuant to Section 601.

Again, the intent appears to establish a process to allow a Qualifying Modification to become effective and binding without going through the voting procedures set forth in Section 601(j). If that is the legislative intent, then we suggest the Committee set forth this parallel process in a separate section so as to avoid confusion in the interpretation and implementation of Title VI of H.R. 5278.

Fourth, assuming a proposed Modification becomes in effect a Qualifying Modification, then Section 601(j) states that an Issuer would be allowed to make such Qualifying Modification if it is consented to or approved by the affirmative vote of the holders of the right to vote *at least two-thirds* of the Outstanding Principal amount of the Outstanding Bonds in *each* Pool that have voted to approve or reject the Qualifying Modification, *provided*, that holders of the right to vote not less than a majority of the *aggregate* Outstanding Principal amount of all the Outstanding Bonds in *each* Pool have *voted to approve* the Qualifying Modification.

In our view, there could be a misprint in this Section, because if at least *two-thirds* of the holders of the Outstanding Principal amount in *each* Pool have voted to approve a Qualifying Modification, then by definition at least a *majority* of the holders of the *aggregate* Outstanding Principal amount of all Outstanding Bonds in each Pool *must* have voted to approve the Qualifying Modification.

Perhaps, the intent of the drafters was to require something similar to the following:

- At least 51% of the holders of bonds in *each* Pool set up for an Issuer, taken individually, consent to the proposed Qualifying Modification; and
- At least 66.66% of the holders of bonds in *all* affected Pools set up for an Issuer, when aggregated together, consent to the proposed Qualifying Modification.

The logic underlying this kind requirement is that a Qualifying Modification should bind "the holders of all affected bonds, even if the holders of one series of bonds have not voted (overwhelmingly) in favor of the modification, so long as a supermajority of the holders of all of the other series of bonds have approved the cross-series modification." [2]

Therefore, we recommend that the language in Section 601(j) be revised to clarify the required thresholds and ensure they are consistent with the intent of the drafter.

Fifth, Section 601(m) states that a Qualifying Modification will be binding if:

1. The holders of the requisite majority set forth in Section 601(j) have consented to or approved the Qualifying Modification;
2. The Administrative Supervisor certifies that:
    a. The voting requirements have been satisfied;
    b. The Qualifying Modification complies with the requirements of Section 104(i)(1); and
    c. Any conditions on the effectiveness of the Qualifying Modification have been satisfied or waived.
3. Holders of Bonds whose claims are secured by a lien on property and who rejected or did not consent to the Qualifying Modification, either
    a. Retain the lien securing such Bond Claims; or
    b. Receive on account of such Bond Claims, through deferred cash payments, substitute collateral, or otherwise, at least the equivalent value of the lesser of the amount of the Bond Claim or of the collateral securing such Bond Claim; and

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[2] *Sovereign Debt Management*, Rosa M. Lastra and Lee Buchheit, editors, Oxford University Press, 2014, p. 409.

4. The District Court enters an order certifying that the requirements of Section 601 have been satisfied.

In prior communications with the Committee we set forth our view that a Qualifying Modification should be binding upon all holders of Bonds in a Pool for which a Qualifying Modification has been duly proposed *immediately* after the Calculation Agent certifies that the Qualifying Modification has been approved by or consented to by the requisite majority. (See Section 4.12 of the *Euro Area Model CAC 2012*) In any event, bondholders have the right to submit the results of any voting or consent process to judicial review pursuant to Section 601(n).

Therefore, we recommend eliminating all the other requirements set forth in this section, with the exception of (1) the carve-out for holders whose claims are secured by a valid and legally binding lien on property and (2) the District Court order to make the Qualifying Modification binding on any holdouts.

Title III—Adjustment of Debts

This Title incorporates by reference several sections from the U.S. Bankruptcy Code, mostly from Title 11, to provide a legal framework for restructuring territorial debts under the aegis of a court-supervised process.

According to Section 302 an entity may be a debtor under Title III of H.R. 5278 if:

1. The entity is:
    a. A territory that has requested the establishment of an Oversight Board or has had an Oversight Board established for it; or
    b. A covered territorial instrumentality.
2. The Oversight Board has issued a certification under Section 206(b)—such certification requires that the Oversight Board determine that:
    a. The entity has made good-faith efforts to reach a consensual restructuring with creditors;
    b. The entity has adopted procedures necessary to deliver timely audited financial statements; and
    c. The entity has made public draft financial statements with sufficient information to allow any interested person to make an informed decision with respect to a possible restructuring.
3. The entity has prepared and adopted a Fiscal Plan certified by the Oversight Board.
4. No order approving a Qualifying Modification has been entered with respect to such entity; or if an order approving a Qualifying Modification has been entered with respect to such entity, the entity is unable to make its debt payments notwithstanding the approved Qualifying Modification.

5. At least *five* of the seven members of the Oversight Board vote to approve the issuance of the certificate authorizing the filing of a restructuring petition pursuant to Title III.
6. The entity desires to effect a plan to adjust its debts.

These requirements are in addition to the provisions set forth in Title VI. In our view, this cumbersome process could allow creditors to unfairly game the system or run down the clock until the stay on litigation pursuant to Section 405 expires. In order to address these issues, in prior communications with the Committee we recommended deleting the existing text in its entirety and allowing an Issuer to file a petition under Title III if the Issuer certifies to the Oversight Board that it has (1) undertaken in good faith a consensual negotiation process in accordance with the terms of Title VI; and (2) failed to reach an agreement with the requisite majority of bondholders. In our opinion, no additional requirements/certifications/votes by the Oversight Board should be necessary or required after *a good faith* attempt to reach a negotiated solution between sophisticated business parties has failed.

Pursuant to Section 304 the Oversight Board, and only the Oversight Board, has the authority to commence a case by filing a petition for adjustment with the District Court.

In addition, jurisdiction is vested in the regular U.S. District Court, *not* the U.S. Bankruptcy Court, but pursuant to Section 310 the applicable rules will be the Federal Rules of Bankruptcy Procedure. Thus, the bill establishes a hybrid judicial process that may cause undue delay in the debt adjustment proceedings, as Bankruptcy Rules of Procedure will be applied in a forum not used to applying such rules.

Section 312 establishes that the Oversight Board may file a Plan of Adjustment but only after the issuance of a certificate under Section 104(j). That section, in turn, requires that the Plan of Adjustment be consistent with the Fiscal Plan.

Pursuant to Section 314, the Court shall confirm the Plan of adjustment if:

- The Plan complies with the provisions of Title 11 of the U.S. Bankruptcy Code, that have been incorporated by reference through Section 301 to a case under Title III of the Act;
- The Plan complies with the provisions of Title III of H.R. 5278;
- The debtor is not prohibited by law from taking any action necessary to carry out the Plan;

- The holders of claims specified in section 507(a)(2) of the U.S. Bankruptcy Code will receive cash equal to the allowed amount of such claims; [3]
- The debtor has obtained any legislative, regulatory, or electoral approval necessary, under applicable law, to carry out the provisions of the Plan;
- The Plan is feasible and in the best interests of the creditors; which requires the Court to consider whether available remedies under non-bankruptcy laws and the constitution of the territory would result in a greater recovery for creditors than is provided by such Plan; and
- The Plan is consistent with the Fiscal Plan certified by the Oversight Board.

The second to last condition for approving a Plan of Adjustment is cause for concern because, while it is standard for a Bankruptcy Court to consider whether a proposed Plan of Adjustment is feasible and in the best interests of the creditors, the requirement for the Court to explicitly consider whether creditors are better off seeking remedies under other laws of the territory appears to give creditors a way to avoid the adjustment of their debts at the last minute.

In our view, this provision in essence gives creditors an unfair second chance to re-litigate the treatment of their claims under the Plan. We suggest eliminating the requirement that the Court consider whether creditors can obtain a better deal under non-bankruptcy laws because such requirement is unjust and unduly biased in favor of creditors.

Stay on Litigation

Section 405 provides, upon enactment of H.R. 5278, an automatic stay of all litigation against Puerto Rico and its instrumentalities to enforce bondholder claims. This stay remains in effect until the later of (1) February 15, 2017 or (2) six months after the establishment of an Oversight Board for Puerto Rico.

This period can be extended by (1) an additional 75 days if the Oversight Board determines it is required to complete a voluntary process under Title VI; or (2) an additional 60 days if an application has been submitted to the District Court under Section 601(l)(1)(D) and the Court determines such an additional period is necessary to finalize its evaluation of a voluntary agreement under Title VI.

In any event, the stay provided by H.R. 5278 terminates upon the filing of a petition for adjustment under Title III. At that point the automatic stay provided by Section 362 of the U.S. Bankruptcy Code would become effective, as that section has been incorporated by reference through Section 301 of H.R. 5278.

[3] Section 507(a)(2) of the U.S. Bankruptcy Code provides for the payment of "administrative expenses allowed under Section 503(b) of this title and any fees and charges assessed against the estate under chapter 123 of title 28."

In prior communications with the Committee we stated that it is foreseeable that a significant part of the stay period could be consumed solving classification and pooling disputes under Section 601(d). The risk here is that there could be a gap in the stay period, for example, if voluntary negotiations fail and it takes a significant amount of time for the Oversight Board to approve the filing of a petition for adjustment under Title III.

Therefore, we suggest the stay period be set at a specific number of months (say, for example, 12) from the date of enactment of H.R. 5278 into law, and the stay period *be tolled* either (1) immediately; or (2) within a statutorily defined period of time, *after* an Issuer has made a good faith offer to negotiate new Bond terms pursuant to Title VI.

After careful consideration of the provisions of Title VI, Title III, and Section 405 regarding the stay on litigation, we conclude, that while progress has been made in this area, the debt adjustment provisions of H.R. 5278 still *fail to provide*, *ex ante*, a clear and feasible path for actually delivering meaningful debt relief. While this hybrid collective action/Chapter 11 mechanism may appear to be feasible in theoretical terms, we have strong reservations about whether it will accomplish its stated objectives in practice.

PRINCIPLE 4—NO CLASSES OF PUERTO RICO DEBT SHOULD BE EXCLUDED FROM THE RESTRUCTURING PROCESS

Several groups of bondholders have claimed that federal legislation regarding the adjustment of Puerto Rico indebtedness should not be applicable to Bonds which they claim have special protection under Puerto Rico law.

In our view this exclusion should not be granted because (1) it is an attempt to unfairly shift all the costs of debt adjustment to other creditors; and (2) it would render moot the debt sustainability analysis required by Section 201(b)(1)(I).

One of the objectives of developing a territorial Fiscal Plan under Section 201 is to determine how much debt is sustainable given reasonable estimates for economic growth, government revenues, and government expenditures to maintain essential services in operation. Excluding the debt service on General Obligation or COFINA bonds would complicate the debt sustainability analysis and perhaps even render it useless. In any event, Section 201(b)(1)(N) requires the Fiscal Plan to "respect the relative lawful priorities or lawful liens, as may be applicable, in the constitution, other laws or agreements." Therefore, while all Puerto Rico debts could be subject to adjustment under H.R. 5278, the bill respects the hierarchy of claims in effect at the time of enactment.

In our opinion, H.R. 5278 as currently drafted *satisfies* the principle that all Puerto Rico debt should be subject, at least potentially, to adjustment pursuant to any process set up by federal legislation.

PRINCIPLE 5—FEDERAL LEGISLATION CURRENTLY UNDER CONSIDERATION SHOULD INCLUDE THE CREATION OF A NEW JOINT (U.S. HOUSE/SENATE) ECONOMIC GROWTH TASK FORCE FOR PUERTO RICO

At first glance, it would appear that Section 409 satisfies this criterion because it orders the creation of a Congressional Task Force on Economic Growth in Puerto Rico.

While we commend the Committee for including this mandate in H.R. 5278, we have several concerns with Section 409. First, the bill does not authorize any funds for the Task Force to carry out its mission. Second, the Task Force is required to submit a report no later than December 31, 2016, a period we consider to be inadequate to properly analyze the complexities of the Puerto Rican economy and the structural reforms that are necessary to jumpstart sustainable economic growth over the long-term. Third, in our view, a more thorough inquiry and analysis are needed to make specific recommendations regarding legal or program amendments that can spark sustainable growth for the island. These analytical tasks should distinguish between long-term efforts and short-term initiatives to jumpstart growth. Finally, the Task Force is required to consult only with the government of Puerto Rico and "the private sector of Puerto Rico." In our opinion, the Task Force should collaborate with a broader spectrum of stakeholder groups in Puerto Rico to develop a long-term economic growth strategy.

Section 409, therefore, *partially fulfills* the requirements of principle 5 regarding the establishment of a federal task force to analyze economic growth options for Puerto Rico.

With respect to economic growth, Title V of H.R. 5278 provides for the expedited consideration of certain critical infrastructure projects. While we understand the Committee's intent to provide a short-term stimulus to the Puerto Rican economy through investment in these kinds of infrastructure projects, in prior communications with the Committee we have stated that this Title needs to be carefully drafted to (1) avoid rewarding rent seeking behavior by private sector cronies of whichever political party happens to be in power in Puerto Rico and (2) prevent the inefficient allocation of scarce investment resources to projects whose economic and social costs exceed the expected benefits.

Puerto Rico needs short-run economic policies that curtail detrimental existing practices and move the island towards a sustainable growth path. In this context it is important to remember that one of the principal causes of Puerto Rico's current debt crisis was the reckless financing of infrastructure projects that never delivered the promised increase in economic activity, income or jobs.

We note that according to the Tobin Report of 1975, "the allocation of scarce investment funds in the longer run must be based, not on short run multiplier effects which accrue to *any* spending whatever its purpose, but on the return in sustained social profit."

Furthermore,

> In the absence of good long run planning, the employment implications of public investment *beyond* the construction phase have been neglected. Highways and electricity generation facilities have comprised the bulk of public investment, and they are extremely capital intensive. They provide very few jobs per dollar of equipment. Employment of unskilled labor has a low social cost in Puerto Rico, while funds borrowed at low rates in the state and municipal bond market has a cost—for a given use—above the interest rate. It is not enough to say a project "covers its costs". This reasoning is inadequate for many private investment decisions, and is even worse for most public investment decisions. A project that can "cover its financial costs" and generate employment in the construction sector while it is built has not established itself as viable. It must be viewed in competition with other investment projects.[4]

Therefore, any "Critical Project" considered pursuant to the provisions of this Title should be subject not only to a strict financial analysis but also take into account the return on alternative uses for that scarce investment capital.

PRINCIPLE 6—IF CONGRESS IS UNWILLING OR UNABLE TO ACT, THEN IT SHOULD EXPRESSLY ALLOW PUERTO RICO TO LEGISLATE ITS OWN LEGAL FRAMEWORK TO RESTRUCTURE ITS DEBT

The provisions of Chapter 9 of the Bankruptcy Code do not apply to Puerto Rico and its municipalities, while federal courts have decided that Puerto Rico cannot legislate its own bankruptcy law because the field has been pre-empted by Congress. As a result, Puerto Rico is currently in legal limbo with respect to its authority to adjust its debts. Puerto Rico is only asking that Congress *fill the existing legal gap* in a way that respects Puerto Rican democratic governance and political institutions.

If Congress is unable or unwilling to address this issue, then it is only fair that it allow Puerto Rico to legislate a debt restructuring framework of its own.

Conclusion

In sum, after a careful analysis and review of H.R. 5278, the Center for a New Economy, unfortunately, cannot endorse the bill as currently drafted for the reasons stated above.

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[4] Committee to Study Puerto Rico's Finances, *Report to the Governor*, December 11, 1975, commonly known as the James Tobin Report, p. 20.