

EMILY LEBLANC*

What Happens When an Island Starts to Drown Under Its Own Weight? The Debt Crisis of Puerto Rico

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* Emily LeBlanc is a JD candidate at the University of Oregon School of Law. She is anticipated to graduate in May 2019. Ms. LeBlanc is a graduate of Lamar University with a Bachelor of Science degree in Political Science, *magna cum laude*. Ms. LeBlanc is grateful to Professor Andrea Coles-Bjerre for her advice, guidance, and enthusiasm on this Comment and on the subject of bankruptcy.

INTRODUCTION

Hurricanes, floods, and earthquakes are recent natural disasters to have hit the Commonwealth of Puerto Rico. Compounding these natural disasters is one that is man-made: the Puerto Rican debt crisis. Current estimates are that Puerto Rico owes more than \$73 billion to its bondholders.¹ How did this happen?

This Comment is an examination of the legislation designed to help Puerto Rico restructure its finances and reorganize and/or discharge its debt. The Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) passed June 2016 because neither Puerto Rico nor any of its municipalities, as merely a territory of the United States, have access to the U.S. bankruptcy system. This Comment will (1) consider the island's legal history and how its territorial status helped bring Puerto Rico into the current debt crisis, (2) compare PROMESA to what would have been available through the U.S. bankruptcy system in Chapter 9, (3) explore the constitutional repercussions stemming from the lack of Puerto Rican representation to the Board, (4) examine the financial options under consideration at the time of this Comment, and (5) consider what other options Puerto Rico should have in addition to PROMESA through an examination of the debt restructuring processes of Detroit, Michigan, and Greece.

I

HISTORY OF PUERTO RICO'S LEGAL STATUS AND FINANCIAL SITUATION

*“Those who cannot remember the past are condemned to repeat it.”*²

Since its founding, Puerto Rico has struggled with governance. As a colonial island, Puerto Rico had little autonomy in the financial, social, or governmental decisions that dictated its behavior.³ For a majority of Puerto Rico's existence, it was a possession of the Spanish government.

¹ Matt Egan, *Who Owns Puerto Rico's Mountain of Debt? You Do*, CNN (Oct. 9, 2017, 9:46 AM), <http://money.cnn.com/2017/09/27/investing/puerto-rico-debt-who-owns-trump/index.html>.

² Attributed to George Santayana. See Caleb Flamm, *George Santayana (1863–1952)*, <https://www.iep.utm.edu/santayan/> (last visited Sept. 27, 2018).

³ FRANCESCO CORDASCO, *THE PUERTO RICANS: 1493–1973: A CHRONOLOGY & FACT BOOK* (Francesco Cordasco & Eugene Bucchioni eds., 1973).

The governors, primarily military or political appointees, had almost complete control over all decisions on the island.⁴

As late as 1898, Puerto Rico had deep ties with Spain.⁵ The strongest of those ties were military and economic.⁶ The Spanish used the large, safe port of San Juan as a base to launch offensive and defensive attacks.⁷ Following the American and French revolutions, what little self-governing autonomy Puerto Rico had was stripped from it due to Spain's fear of rebellion from its remaining territories.⁸ Following the Spanish-American War, the 1899 ratification of the Treaty of Paris gave the United States full political control of the island,⁹ after which Puerto Rico operated in a quasi-political state that was generally controlled by a United States political appointee.¹⁰ These appointees were unfamiliar with large-scale governance, generally did not speak Spanish, and did not have much interest in running the country or engaging with the local political culture.

Puerto Rico operated as a possession of the United States; some local governance was accepted, but most decisions came from Washington, D.C., by way of the governor. Puerto Rico did not have a Congressionally approved constitution until after the passage of Public Law 600 in 1952.¹¹ Public Law 600 authorized the people to “organize a government pursuant to a constitution of their own adoption.”¹² The constitution that was ratified was “overwhelming[ly] approv[ed]” by the people and modeled after the U.S. Constitution.¹³

The current political status of the island is one that is semi-sovereign. The Governor and state representatives are democratically elected with moderate autonomy over local matters, such as implementing local taxes and running elections.¹⁴ However, there are still many drawbacks. The single elected Puerto Rican representative

⁴ *Id.*

⁵ *Id.* at 19.

⁶ *Id.*

⁷ *Id.*

⁸ *Id.* at 79.

⁹ *Id.* at 6.

¹⁰ *See id.* at 82–84.

¹¹ R. SAM GARRETT, CONG. RES. SERV., RL32933, POLITICAL STATUS OF PUERTO RICO: OPTIONS FOR CONGRESS 9–10 (2011).

¹² Puerto Rico Federal Relations Act of 1950, Pub. L. No. 81–600 § 1, 64 Stat. 319 (1952).

¹³ *Puerto Rico v. Sanchez Valle*, 136 S. Ct. 1863, 1866 (2016).

¹⁴ GARRETT, *supra* note 11, at 9.

to the House of Representatives cannot vote, Puerto Ricans cannot vote in federal elections, nor were any of the plenary powers of Congress ceded to Puerto Rico. Matters of citizenship status, federal taxation, federal laws, and the like are still within the control of Congress.¹⁵

There have been legal struggles for Puerto Rico. In decisions referred to collectively as the Insular Cases, the Supreme Court has notably regarded Puerto Rico as a possession of the United States.¹⁶ As such, Puerto Rico does not fully enjoy the same rights and privileges as the states.¹⁷ This arrangement has some advantages for Puerto Rico, including having access to the financial markets of the United States, access to the dollar, access to federal aid programs such as Social Security, and having military protections.¹⁸ The drawbacks to this arrangement are, as we see today, quite serious.

A. Island Finances: Past

Historically, Puerto Rican society was agrarian and very poor. The main cash crops were sugar, coffee, and tobacco.¹⁹ Due to its distance from the mainland of either of the island's colonizers, Puerto Rico did not receive the financial benefit of being a colony until nearly the end of the 1800s when fresh capital and lowered tariffs revitalized the sugar industry.²⁰ From the early 1890s to the late 1930s, Puerto Rico changed significantly.

More than a quarter of Puerto Rico's total wealth, and substantially more of its productive wealth, was owned by foreigners, total national income increased over the period . . . [however], there is little evidence to suggest that the average income figures meant improvements in the standard of living of the mass of working and nonworking people, and economically, politically, and culturally, the forces of U.S. capitalism weighed ever so heavily on . . . Puerto Ric[o].²¹

The World War II era was difficult for the island. Puerto Rico relied upon ships for export of products and import of needed food supplies,

¹⁵ *Id.*

¹⁶ *Id.* at 12.

¹⁷ For a full history of the Insular Cases, see JUAN R. TORRUELLA, *THE SUPREME COURT AND PUERTO RICO: THE DOCTRINE OF SEPARATE AND UNEQUAL* (1985).

¹⁸ See CORDASCO, *supra* note 3, at 82.

¹⁹ *Id.* at 5; JAMES DIETZ, *ECONOMIC HISTORY OF PUERTO RICO* 26 (1987).

²⁰ DIETZ, *supra* note 19, at 61.

²¹ *Id.* at 133.

and those ships were routinely attacked by the Germans.²² The threat of starvation increased because the “Farmers’ Association . . . would never accept the suggestion of conversion from cane to food” because it would cut into their profit margins too heavily.²³ Food shortages were common during this time, and prices on imported food rose an average of 90 percent.²⁴ Agricultural firms’ reluctance to switch production from sugar cane to food to save its workers from starvation, coupled with the weakness of the sugar industry, shifted political emphasis “toward what was thought to be the most efficient way to increase economic growth and employment rapidly at the least cost to the government.”²⁵ The government decided the most efficient way to increase economic growth would be to shift Puerto Rico’s economy from agriculture to industrialization post–World War II with the implementation of Operation Bootstrap in the late 1940s. Operation Bootstrap, as it was called because the Puerto Ricans were attempting to “lift [themselves] up by [their] own bootstraps,”²⁶ was a combination of incentives for manufacturers and foreign investors. Most of the offered incentives were based on tax exemptions. “On May 13, 1948, the legislature approved Act No. 184 granting full local tax exemption—income, property, excise, and municipal taxes—to new industries for a period of ten years, with an additional three years of partial exemption.”²⁷ Combining Act No. 184 with the Jones-Shafroth Act’s (Jones Act) federal tax advantages (discussed later in this section), Puerto Rico’s fiscal policies were designed to attract large corporations in order to change the underlying structure of the economy.

B. Island Finances: Present

Puerto Rico receives revenue from external and internal sources. The external revenue sources originate from the United States federal

²² *Id.* at 202.

²³ *Id.* at 202 (front for the sugar producers and roughly corresponding to that better-known American phenomenon, the California Farmers’ Association).

²⁴ *Id.* at 203.

²⁵ *Id.* at 207.

²⁶ A.W. MALDONADO, TEODORO MOSCOSO AND PUERTO RICO’S OPERATION BOOTSTRAP 69 (1987).

²⁷ *Id.* at 57–58.

government.²⁸ Puerto Rico receives federal funding similar to the funding received by all states within the United States for various initiatives. Those funds are allocated to needs such as road maintenance and federal programs.²⁹ Internal revenue sources come from three different principle streams. First, the general revenue fund is composed of tax revenue.³⁰ Second, the special fund is composed of “earmarked taxes, proceedings from general obligation bonds, or transfers from the General [Revenue] Fund.”³¹ The third principle stream is the revenue from public enterprises.

Declining revenue returns, both internal and external, are attributed to several reasons. First, financial problems from some of the state-run enterprises created holes that bonds were offered to fill. Second, privatization of some of the state-run enterprises, like the telephone company, reduced the revenues received.³² Third, as the policies of the federal government shifted, the funding received through some of the programs that residents took part in, such as food stamps and other “War on Poverty” and “New Federalism” programs,³³ also changed. Puerto Rico has no recourse to address the wide fluctuations of federal funds because Puerto Rico’s government is dependent upon the current administration’s political agenda.

What is a bond and why are the bonds important to Puerto Rico? Bonds are fixed income investments.³⁴ Normally, a government entity issues a bond to fund a project or activity. Bonds are not dependent upon market price; a bond is set at a fixed, contractual interest rate³⁵ to be paid over the life of the bond, called a maturity date, rather than its value fluctuating based on market price. For investors, bonds make an attractive base for an investment portfolio, as the return is meant to be stable. The issuance of bonds is important to Puerto Rico because it allows the government to finance large projects, such as the state-run power company.³⁶ Puerto Rico also issues bonds to cover large deficits

²⁸ James Alm, *Assessing Puerto Rico’s Fiscal Policies*, in *THE ECONOMY OF PUERTO RICO: RESTORING GROWTH* 319, 324 (Susan M. Collins et al. eds., 2006).

²⁹ *Id.* at 325.

³⁰ *Id.* at 324.

³¹ *Id.*

³² *Id.* at 326.

³³ *Id.* at 327.

³⁴ *Bond*, INVESTOPEDIA, <https://www.investopedia.com/terms/b/bond.asp> (last visited Jan. 3, 2018).

³⁵ *Id.*

³⁶ DIETZ, *supra* note 19, at 207.

in the budget that the local tax base is unable to fill.³⁷ How is Puerto Rico able to issue bonds that are so attractive to investors?

In 1917, Congress passed the Jones-Shafroth Act (Jones Act or Act). The Jones Act granted a number of rights to the citizens of the island; the Act made it so that only U.S. ships are able to enter the ports of Puerto Rico and, most importantly for our purposes, exempted Puerto Rican bonds from federal, state, and local taxes.³⁸ This so called “triple tax exempt[ion]”³⁹ allows a bondholder to receive the interest payments without paying taxes on that interest regardless of the location of the bondholder. The states were not able, and are still not able, to take advantage of this bond exemption. The sections of the Act regarding ship entry and the tax exemption for bonds are still in effect.

The financial incentives, for both investors and Puerto Rico, were too much to resist.⁴⁰ Puerto Rico’s triple tax-exempt bonds enabled investors to have a solid base for their portfolios; investors readily purchased many of the bonds at issuance. Capitalizing on the investors’ enthusiasm, Puerto Rico issued the bonds and collected the funds. After collection, Puerto Rico funded projects the government wanted.

The island issued bond after bond, refinancing old debt with new debt.⁴¹ Refinancing the debt and using the bonds to finance needed public works made the Puerto Rican government “reliant on the issuance of debt.”⁴² The island’s eroding tax base prevents the bond-funded projects from sufficiently amortizing the debt.⁴³ As of 2002, the general revenue fund increasingly relies more heavily on individual (39.3 percent) and corporate income taxes (36.6 percent).⁴⁴ However, with corporations leaving after tax exemptions expire, and residents leaving to seek better employment opportunity on the mainland, the tax base does not reflect the current reality of where tax policies need to be in order to properly amortize the debt.

³⁷ *Id.*

³⁸ Jones-Shafroth Act, Pub. L. No. 64–368 § 3, 39 Stat. 951 (1917).

³⁹ DIETZ, *supra* note 19, at 207.

⁴⁰ Francesca Trianni & Ellie Ismaildou, *The Next Financial Catastrophe You Haven’t Heard About Yet: Puerto Rico*, TIME (Mar. 12, 2014), <http://time.com/20416/the-next-financial-catastrophe-you-havent-heard-about-yet-puerto-rico/>.

⁴¹ *Id.*

⁴² Milton Vescovacci, *The Demise of Puerto Rico Is in Part Attributed to U.S. Congressional Action*, BLOOMBERG LAW (June 23, 2016), <https://www.bna.com/demise-puerto-rico-n57982074653/>.

⁴³ Alm, *supra* note 28, at 328.

⁴⁴ *Id.*

Adding more fuel to the bond fire, Section 936 of the Internal Revenue Code was codified in 1976 as a tax incentive for corporations.⁴⁵ Those incentives included a business deduction—100 percent tax deduction of dividends paid to a parent company by a subsidiary if more than 80 percent is owned by a foreign entity.⁴⁶ An example of this ownership structure would be if foreign Corporation A owned 85 percent of the stock for Subsidiary B. Sub B had a profitable year and paid a dividend to its shareholders. Corporation A would be able to deduct 100 percent of the dividend it received from Sub B. For tax purposes in Puerto Rico, corporations owned within the United States were considered “foreign.”⁴⁷ This setup allowed for dividends to be paid to the parent company tax free. This made for an excellent way to move dividends from company to company without having to pay taxes as the parent company received the funds.

Puerto Rico, still suffering from the financial hardships of the early half of the century and from the downturn in the export of sugar and tobacco,⁴⁸ looked for a way to lure industry and foreign corporations. Puerto Rico decided to use a property tax incentive to help convince corporations to move their businesses to the island. This property tax incentive would allow deferment of the property taxes for a set number of years before payments would begin. Thus, foreign corporate investment in Puerto Rico was very lucrative given the Section 936 tax incentives coupled with the property tax payment delays and ignited the territory’s industrial boom.

So, what happened? With the growing commercial sector, Puerto Rico finally looked to be headed toward financial solvency—until the tax reform efforts launched in 1996. There was a sharp decline in manufacturing jobs after the repeal of Section 936 in 1996.⁴⁹ Section 936 was phased out over a ten-year period.⁵⁰ After the repeal, to give Puerto Rico and its investors time to adjust to the new tax realities, the

⁴⁵ Gavin Elkins & Scott Greenberg, *Tax Policy Helped Create Puerto Rico’s Fiscal Crisis*, TAX FOUND. (June 30, 2015), <https://taxfoundation.org/tax-policy-helped-create-puerto-rico-s-fiscal-crisis/>.

⁴⁶ *Id.*

⁴⁷ *Id.*

⁴⁸ CORDASCO, *supra* note 3, at 154.

⁴⁹ *Puerto Rico in Crisis Timeline*, CTR. FOR PUERTO RICAN STUDIES, 4 (2017), https://centropr.hunter.cuny.edu/sites/default/files/PDF_Publications/Puerto-Rico-Crisis-Timeline-2017.pdf.

⁵⁰ DAVID BRUMBAUGH, CONG. RES. SERV., RS20695, THE PUERTO RICAN ECONOMIC ACTIVITY TAX CREDIT: CURRENT PROPOSALS AND SCHEDULED PHASEOUT (2000).

island's financial managers continued to issue bonds and investors continued to buy them, despite the island's near insolvency.⁵¹ The island was almost insolvent because

following the elimination of the tax incentives in 1996, the gross domestic product in Puerto Rico went from approximately 10% in 2000 to approximately -3.5% (that's right, negative 3.5%) in 2006 and then thereafter it has hovered at less than 0% GDP. Hundreds of jobs were lost as Puerto Rican subsidiaries of mainland corporations closed down and moved their operations to Mexico and other Caribbean countries.⁵²

Puerto Rico, in an unsuccessful attempt to offset some of the tax damages, attempted to pass its own tax reform.⁵³ The last of the tax breaks was phased out in 2006, a mere two years before the Great Recession hit the United States and many people suffered from the financial crisis. Things went from bad to worse after that; tax revenue continued to fall after Puerto Rico's population migrated to the mainland in search of work.⁵⁴

C. Bankruptcy Efforts

In a fiscal crisis many individuals, including city government officials, turn to the federal government for assistance. That help exists in the form of bankruptcy relief. Puerto Rico is not eligible for bankruptcy relief due to a Congressional provision that defines "state" as excluding the municipalities of the island.⁵⁵ This definition allows for only the municipalities located in states within the United States to take advantage of the privileges of statehood. Due to the denial of the privilege of a federal bankruptcy, Puerto Rico attempted to pass its own bankruptcy code in June 2014, the Puerto Rican Corporation Debt and Recovery Act (Recovery Act).⁵⁶

The Recovery Act was an attempt by Puerto Rico to convince its creditors to negotiate the debt down and restructure the payments.⁵⁷ The Recovery Act mirrored the Federal Bankruptcy Code. The

⁵¹ MALDONADO, *supra* note 26, at 57–58.

⁵² *Id.*

⁵³ *Id.*

⁵⁴ Heather Long, *Puerto Rico's Crisis: How Did It Get So Bad?*, CNN (May 12, 2016), <http://money.cnn.com/2016/05/12/investing/puerto-rico-debt-crisis/index.html>.

⁵⁵ MALDONADO, *supra* note 26.

⁵⁶ *Puerto Rico v. Franklin California Tax-Free Trust*, 136 S. Ct. 1938, 1943 (2016).

⁵⁷ *Id.*

Recovery Act provided a court-supervised restructuring to help provide the most recovery available for the broadest group of creditors.⁵⁸ Those creditors still had to vote to approve the plan.⁵⁹

Two of the largest creditors, Franklin California Tax-Free Trust and BlueMountain Capital Management, LLC, brought suit alleging Puerto Rico did not have the authority to enact their own version of bankruptcy.⁶⁰ The Supreme Court granted certiorari to determine whether or not the 1984 amendment to the Federal Bankruptcy Code definition of “state” removed Puerto Rico from the preemption provision.⁶¹ The Court found Puerto Rico was not a “state” for purposes of being a debtor under bankruptcy provisions and could not avail itself of bankruptcy protections. However, Puerto Rico is still subject to preemption provisions as a “state.”⁶² What does it mean to be subject to preemption provisions? Preemption means that within the realm of federal jurisdiction, federal law will overcome local laws. This left Puerto Rico with no other option but to petition Congress for assistance.

Puerto Rico has a state-but-not-a-state problem as it is subject to federal laws as a territory but is without the privileges of statehood. This problem left Puerto Rico trying to pay its debts, but the government defaulted on a \$35.9 million payment in early 2014, and more than \$2 billion in payments were due by July 1 of the same year.⁶³

In response to the default to the debt, Congress passed the Puerto Rico Oversight, Management and Economic Stability Act (PROMESA) in June of 2016.⁶⁴ Puerto Rico’s troubles worsened because of a massive hurricane. In early September 2017, Hurricane Irma swept past the island causing 30-foot waves, 100+ mph winds, deaths by lightning strikes, and power outages.⁶⁵ Then came Hurricane Maria, a massive storm that the National Weather Service classified as

⁵⁸ *Id.*

⁵⁹ *Id.*

⁶⁰ *Id.*

⁶¹ *Id.*

⁶² *Id.*

⁶³ *Puerto Rico in Crisis Timeline*, *supra* note 49, at 5.

⁶⁴ Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA), Pub. L. No. 114–187, 130 Stat. 549 (2016) [hereinafter PROMESA].

⁶⁵ John P. Cangialosi et al., *Hurricane Irma—Tropical Cyclone Report*, NAT’L HURRICANE CTR. (June 30, 2018), https://www.nhc.noaa.gov/data/tcr/AL112017_Irma.pdf.

a Category 4 storm at landfall.⁶⁶ Maria wiped out much of the infrastructure and left great devastation in its wake after landfall on September 20, 2017. Six months after landfall, many residents of Puerto Rico were still without power or potable water, and people were leaving the island at a faster rate than before.⁶⁷ Conservatively, the damage done to Puerto Rico is estimated to range from \$30 billion to \$95 billion in repairs and loss of economic output.⁶⁸

II PROMESA

*“A Promise made is a debt unpaid.”*⁶⁹

Promesa means “promise” in Spanish.⁷⁰ The irony of the translation may or may not be lost on a Congress that ended the tax benefits that aided Puerto Rico. However, PROMESA may be the only lifeline thrown to Puerto Rico from the United States government in the current political cycle. PROMESA is legislation that is designed for Puerto Rico based on the Federal Bankruptcy Code (the Code). This section of the Comment will detail the differences and similarities between PROMESA and Chapter 9 of the Code and discuss the changes and provisions of PROMESA that will likely have the most impact.

A. Chapter 9 Provisions

In 1934, Congress enacted what is currently known as Chapter 9 in the Code.⁷¹ Chapter 9 allows municipalities that need financial

⁶⁶ Richard J. Pasch et al., *Hurricane Maria—Tropical Cyclone Report*, NAT'L HURRICANE CTR. (Apr. 10, 2018), https://www.nhc.noaa.gov/data/tcr/AL152017_Maria.pdf.

⁶⁷ Alexia Fernández Campbell, *5 Things to Know About Puerto Rico 100 Days After Hurricane Maria*, VOX (Dec. 29, 2017, 7:18 PM), <https://www.vox.com/2017/12/23/16795342/puerto-rico-maria-christmas>.

⁶⁸ Jill Disis, *Hurricane Maria Could Be a \$95 Billion Storm for Puerto Rico*, CNN MONEY (Sept. 28, 2017, 3:04 PM), <http://money.cnn.com/2017/09/28/news/economy/puerto-rico-hurricane-maria-damage-estimate/index.html>.

⁶⁹ Attributed to Robert W. Service, BRAINYQUOTE, https://www.brainyquote.com/quotes/robert_w_service_187117?src=t_debt (last visited July 18, 2018).

⁷⁰ *Promesa*, Spanish to English Dictionary, OXFORD DICTIONARY, <https://es.oxforddictionaries.com/translate/spanish-english/promesa> (last visited July 18, 2018).

⁷¹ *Chapter 9—Bankruptcy Basics*, UNITED STATES COURTS, <http://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-9-bankruptcy-basics> (last visited July 18, 2018).

restructuring to file bankruptcy in Federal Bankruptcy Court.⁷² The Code defines a municipality as a “political subdivision or public agency or instrumentality of a State.”⁷³ Chapter 9, with some modifications, acts similarly to a Chapter 11 or Chapter 13 bankruptcy claim. An automatic stay is put in place to protect the debtor’s assets while additionally prohibiting a mandamus action against an officer of the municipality.⁷⁴ An automatic stay is an immediate injunction that prohibits the collection of debts against the debtor for the entirety of the process of bankruptcy. The automatic stay also provides protection for creditors because it puts all the creditors on an even playing field: all actions against the debtor’s assets need court approval no matter the secured status of the creditor.

Additionally, under the automatic stay in Chapter 9, payments to bondholders can be paid without violating the stay.⁷⁵ This provision is to ensure the special revenues being collected and guarantee the debt can be paid to the bondholders.⁷⁶

The Court plays a limited role in the reorganization of the municipality debtor.

Section 904 limits the powers of the bankruptcy courts to ‘interfere with (1) any of the political or governmental powers of the debtor; (2) any of the property or revenues of the debtor; or (3) the debtor’s use or enjoyment of any income-producing property’ unless the debtor consents or the plan so provides.⁷⁷

An appointed United States Trustee will appoint a creditors committee, but there will not be an examination of the debtor; no move for an appointment of a trustee is allowed, nor a conversion of the case, nor supervision of the administration of the case by the trustee.⁷⁸ Creditors will not be allowed to propose competing plans, and if certain requirements are met, the debtor’s proposed plan is binding on the dissenting creditors.⁷⁹

“Neither creditors nor the court may control the affairs of a municipality indirectly through the mechanism of proposing a plan of

⁷² *Id.*

⁷³ 11 U.S.C. § 101(40) (2016).

⁷⁴ MALDONADO, *supra* note 26, at 57–58.

⁷⁵ *Id.*

⁷⁶ *Id.*

⁷⁷ *Id.*

⁷⁸ *Id.*

⁷⁹ *Id.*

adjustment of the municipality's debts that would in effect determine the municipality's future tax and spending decisions."⁸⁰ Additionally, bondholders are treated differently dependent upon the type of the bond.⁸¹ If the bond is a general obligation bond, the debt is treated as general debt and the municipality is not obligated to pay interest during the course of the case.⁸² If the bond is a special revenue bond, interest on that bond will be paid if revenue is available.⁸³

B. Comparing PROMESA to Chapter 9

This Section is a comparison between the provisions in PROMESA and the provisions in a Chapter 9 municipal bankruptcy. This section will discuss six differences between the two types of legislation. The first difference between PROMESA and a Chapter 9 bankruptcy is the establishment of the Oversight Board (the Board). The Board consists of seven voting members appointed by Congress and the President and one nonvoting member, the Governor.⁸⁴ The Board has broad authority to enact reforms and enforce implemented austerity measures.⁸⁵ The Board implements these plans to "ensure accountability in the territory and its institutions."⁸⁶ The Board's sweeping powers include the ability to prevent various acts of the local government including "legislative acts, executive orders, regulations, rules, and contracts," or any other function that might hinder the growth of the economy under the Board's direction.⁸⁷ The composition of the Board will be discussed in further detail in Part 3.

The second difference between PROMESA and a Chapter 9 bankruptcy is the debtor's autonomy and plenary powers. In a Chapter 9 bankruptcy, a municipality retains the authority to propose a debt adjustment plan without creditor affirmation.⁸⁸ However, PROMESA does not allow the Governor nor the Legislature to propose a plan or modify a plan without the approval of the Board.⁸⁹ Additionally,

⁸⁰ *Id.*

⁸¹ *Id.*

⁸² *Puerto Rico v. Franklin California Tax-Free Trust*, 136 S. Ct. 1938, 1943 (2016).

⁸³ *Id.*

⁸⁴ PROMESA, *supra* note 64, at § 101(e)(1)(A), 130 Stat. 549 (2016).

⁸⁵ DIETZ, *supra* note 19, at 3.

⁸⁶ *Id.* at 4.

⁸⁷ *Id.* at 26.

⁸⁸ *Chapter 9—Bankruptcy Basics*, *supra* note 71.

⁸⁹ PROMESA, *supra* note 64, § 104(j)(1), 130 Stat. 549 (2016).

PROMESA does not allow for any actions by the Puerto Rican government to “issue debt or guarantee, exchange, modify, repurchase, redeem, or enter into similar transactions with respect to its debt” for the entire time the Board is in operation.⁹⁰ Puerto Rico will need to have access to capital markets so that in the future it will be able to finance projects again. PROMESA is designed so that the Board structures the financial affairs in a way that is fiscally responsible for years to come.⁹¹

The third difference is that fiscal responsibility measures are implemented via “recommendations” by the Board.⁹² The Governor or the Legislature (whichever is applicable) is required to submit plans for implementation of the recommendations. If the recommendations are not adopted, the governing body submits a “statement of rejection of the recommendations, and the Governor or the Legislature shall submit such statement of explanations to the President and Congress.”⁹³ This last requirement, in this author’s opinion, is extreme and feels akin to public shaming.

The fourth difference is that Puerto Rico has little choice but to follow the recommendations of the Board at this time. Little to no outside assistance from the federal government for repayment of the debt is allowed. Section 210 of PROMESA specifically states that “[t]he full faith and credit of the United States is not pledged for the payment of any principal of or interest on any bond, note, or other obligations issued by a covered territory or covered territorial instrumentality.”⁹⁴ Congress found that without these measures, the government of Puerto Rico would be unable to “obtain capital markets in the future.”⁹⁵

The fifth difference between PROMESA and a Chapter 9 bankruptcy is the automatic stay. In a Chapter 9 bankruptcy, the automatic stay is in place for the entirety of the plan. There are special provisions to prevent creditors from attempting to use the inhabitants of the municipality as leverage to pay the debts and from orders of

⁹⁰ *Id.* at § 207.

⁹¹ DIETZ, *supra* note 19, at 12.

⁹² PROMESA, *supra* note 64, § 205(a).

⁹³ *Id.* at § 205(b)(3).

⁹⁴ *Id.* at § 210(a).

⁹⁵ *Examining Challenges in Puerto Rico’s Recovery and the Role of the Financial Oversight and Management Board: Hearing Before the H. Comm. on Natural Resources, 115th Cong. 7 (2017)* (testimony of Natalie Jaresko) [hereinafter *H. Comm. on Natural Resources*].

mandamus forcing payment on a debt.⁹⁶ In PROMESA, the automatic stay had an expiration date built in—February 15, 2017, or six months after the Board was established.⁹⁷ There are provisions for extensions, as needed and dependent solely upon Board approval, while the plan is being approved.⁹⁸ Congress found the limited life of the stay “advance[d] the best interests common to all stakeholders” and that to ensure “all creditors have a fair opportunity to consensually renegotiate terms of repayment based on accurate financial information that is reviewed by an independent authority. . . .”⁹⁹

PROMESA requires the Board to file annual reports describing the government’s progress and adherence to the recommended austerity measures.¹⁰⁰ These reports must also include descriptions of:

- “progress made by the territorial government in meeting the objectives of this Act during the fiscal year;”
- any “assistance provided by the [Board] to the territorial government;”
- “recommendations to the President and Congress on changes to this Act or other Federal laws;
- other actions of the Federal Government, that would assist the territorial government in complying with any certified Fiscal Plan;” and
- a report which details the “precise manner in which funds allocated to the [Board] . . . have been spent.”¹⁰¹

This is very different from how Trustees and other agents in a Chapter 9 bankruptcy behave. As of now, no requirements exist for a Trustee or an authorized person to submit reports to Congress and the President.

The sixth and final difference between PROMESA and a Chapter 9 bankruptcy discussed in this section is the comparison of the actions of the Trustee and the dissolution of the Board. In a Chapter 9 bankruptcy, the Trustee has a limited role; there is no oversight of the debtor’s

⁹⁶ *Id.*

⁹⁷ PROMESA, *supra* note 64, § 405(d)(1)(A)(i)-(ii).

⁹⁸ *Id.*

⁹⁹ *Id.* at § 405(m)(5)(A)-(B).

¹⁰⁰ *Id.* at § 208(a)(1).

¹⁰¹ *Id.* at § 208(a)(2)-(4).

finances, the Trustee does not supervise the administration of the case, nor does the Trustee have authority to move for an appointment of an examiner or a conversion.¹⁰² Compare those rather diminished capacities of the Trustee in a Chapter 9 bankruptcy to the broad, powerful obligations and privileges of the Board discussed above. Once the Board has deemed to have completed its task, the Board is terminated by certification by itself that the following conditions have been met: one, the “applicable territorial government has adequate access to short-term and long-term capital credit markets at reasonable interest rates to meet the borrowing needs of . . . government;” and two, the government has developed its budgets for at least four consecutive fiscal years, and during the year of termination the expenditures did not exceed the revenues.¹⁰³

III THE CONSTITUTIONAL PROBLEMS OF THE UNELECTED OVERSIGHT BOARD

The Oversight Board has broad powers granted to it by Congress. The powers granted to the Board are not checked by the traditional checks and balances found in other sections of the government. The unelected Board has political freedom to recommend harsh changes to make Puerto Rico more fiscally responsible. This Section discusses the constitutional ramifications of the Board and its unelected members.

The Board members are appointed and approved by Congress and the President.¹⁰⁴ These appointees come from a wide variety of backgrounds. There is a former bankruptcy judge,¹⁰⁵ a CEO of a New York bank, a former Government Development Bank (GDB) leader, a scholar who served during the Bush administration, and a former budget director from California.¹⁰⁶ The Executive Director of the Board, Natalie Jaresko, receives a salary of \$625,000. This total salary does not include the additional security, lodging reimbursement, and

¹⁰² *Chapter 9—Bankruptcy Basics*, *supra* note 71.

¹⁰³ PROMESA, *supra* note 64, at § 210(a).

¹⁰⁴ *Id.* at § 101(e)(2)(A).

¹⁰⁵ Arthur J. González, *PROMESA CODEX*, <http://www.promesacodex.com/arthur-j-gonzacutetez.html> (last visited Aug. 3, 2018).

¹⁰⁶ Ed Morales, *The Technocratic Takeover*, JACOBIN MAGAZINE (Sept. 13, 2016), <https://www.jacobinmag.com/2016/09/puerto-rico-promesa-board-obama-trump/>.

chauffeur she receives while serving in her post.¹⁰⁷ Ms. Jaresko was also the Minister of Finance for Ukraine.¹⁰⁸ This salary differs dramatically from the \$275,000 paid to the executive director of the Detroit Bankruptcy.¹⁰⁹ The salary difference is significant in both amount and in what it represents: the idea that despite the debt, Congress does not value Puerto Rico. It could be argued that the position warrants high compensation due to the responsibilities involved. Despite this argument, this author feels Congress merely gives lip service to the austerity measures. PROMESA does not allow any branch of the Puerto Rican government to review the Board's actions or spending of the Board's \$2 million per month budget. Current democratic societies expect governmental accountability, open government, and fiscal responsibility. Understanding these expectations, it is not a surprise that the Puerto Rican people are displeased with the lack of input regarding how the money in the Board's large yearly budget is spent.¹¹⁰

Recently, creditors have brought constitutional challenges against the Board. For example, Aurelius Capital filed suit in August 2017 alleging, among other things, that the Appointments Clause of the United States Constitution is being violated.¹¹¹ The Appointments Clause of the U.S. Constitution requires the appointment of principle officers of the government by the President with the advice and consent of Congress.¹¹² Aurelius Capital contends that the Board members are principle officers of the United States and thus need appointment by the President and the advice and consent of Congress.¹¹³ According to Aurelius Capital, the Board's failure to go through this process violates the Appointments Clause and is unconstitutional.¹¹⁴

¹⁰⁷ *Detroit Paid Less for the Manager of Their Board*, NOTICEL (Mar. 31, 2017), <http://www.noticel.com/ahora/detroit-paid-less-for-the-manager-of-their-board/609226381>.

¹⁰⁸ *H. Comm. on Natural Resources*, *supra* note 93.

¹⁰⁹ *Id.*

¹¹⁰ PUERTO RICO SYLLABUS, <https://puertoricosyllabus.com/> (last visited Aug. 3, 2018).

¹¹¹ U.S. CONST., Art. II, § 2, cl. 2; *see also* Mary Williams Walsh, *Hedge Fund Sues to Have Puerto Rico Bankruptcy Case Thrown Out*, N.Y. TIMES (Aug. 7, 2017), <https://www.nytimes.com/2017/08/07/business/dealbook/puerto-rico-debt-oversight-board.html>.

¹¹² *See generally* Matthew Hunter, *Legislating Around the Appointments Clause*, 91 B.U. L. REV. 753 (2011).

¹¹³ *See* Walsh, *supra* note 111.

¹¹⁴ Nick Brown, *Puerto Rico Creditor Aurelius Asks U.S. Judge to Throw Out Bankruptcy*, REUTERS (Jan. 10, 2018), <https://www.reuters.com/article/us-puertorico-debt-bankruptcy/puerto-rico-creditor-aurelius-asks-u-s-judge-to-throw-out-bankruptcy-idUSKBN1EZ2UR>.

The Board responded to this claim by arguing that Puerto Rico is a territory, not a state, so there is no violation of the Appointments Clause¹¹⁵ since Congress retains sole discretionary powers over territories.¹¹⁶ Congress is merely extending the President's authority to the creation of this Board with its limited function and purpose.¹¹⁷

Additionally, the Board argued that PROMESA did not require the President to seek the advice and consent of Congress. Instead, PROMESA merely suggested a list of potential candidates. This suggestion is not mandatory, so the Board's action does not violate the Appointments Clause.¹¹⁸

IV THE DEBT: WHAT CAN BE DONE

Alexander Hamilton once said, "A national debt, if it is not excessive will be to us a national blessing."¹¹⁹ Currently the debt load of Puerto Rico is far from a national blessing. Puerto Rico's debt is massive, calculated as more than \$73,000,000,000 as of March 2018.¹²⁰ Puerto Rico will drown under its own weight if the promise of PROMESA falls short. This section will explore when the spending spree started, where the money went, who owns the debt, and what the options for Puerto Rico are in conjunction with the Board.

A. Bond Spending Spree

The spending spree began when Puerto Rico needed a huge influx of capital. There was a need for investment in infrastructure, business, electricity, and education. The bonds issued by the local government were snatched up by investors eager to reap the benefits of the tax-free interest payments. The money collected from the sale of the bonds went, in t, to the establishment of the electrical control grid. The Puerto

¹¹⁵ Memorandum in Support of the Constitutionality of PROMESA at 1, *In Re: The Financial Oversight and Management Board for Puerto Rico*, No. 17-1929 (D.P.R. Dec. 6, 2017).

¹¹⁶ *Id.* at 2-3.

¹¹⁷ *Id.*

¹¹⁸ *Id.*

¹¹⁹ See Letter from Alexander Hamilton to Robert Morris (Apr. 30, 1781), <https://founders.archives.gov/documents/Hamilton/01-02-02-1167>. This quotation goes on to explain that taxes, without being excessive, are a spur to industry and can be used to cement the union.

¹²⁰ Mary Williams Walsh, *How Puerto Rico Is Grappling With a Debt Crisis*, N.Y. TIMES (May 16, 2017), <https://www.nytimes.com/interactive/2017/business/dealbook/puerto-rico-debt-bankruptcy.html>.

Rican Electric Power Authority (PREPA) is the state-owned and operated electric grid. PREPA has filed for relief under Title III, the debt restructuring provision of PROMESA.¹²¹ Some bonds were issued to help promote a system of universal health care.¹²² Others were issued to cover deficits in the budget.¹²³

After 2006, Puerto Rico was still searching for a way to repay its debts, so the territory began to issue new bonds to meet its financial needs.¹²⁴ The Puerto Rico Sales Tax Financing Corporation (COFINA) issued bonds based on special sales tax revenues to help guarantee the debt in a way that it had not been previously.¹²⁵ The so-called sales and use tax (SUT) was passed by the local government to benefit the central government at a rate of 5.5 percent and the municipalities were to receive 1.5 percent.¹²⁶ Those rates increased to 11.5 percent in 2015.¹²⁷

COFINA bonds are general obligation bonds. The payments on the general obligation bonds are constitutionally required to be paid ahead of almost every other government debt,¹²⁸ which helps create greater demand for the bonds. However, the funding needed to pay the interest on these general obligation bonds is lacking, leading Puerto Rico to default on payments.

B. Who Owns the Debt?

Bond ownership is difficult to trace precisely because many bonds are purchased en masse in a market that allows for anonymity. Puerto Rico only further complicates matters for bondholders' identification because the Government Development Bank (GDB) is reluctant to disclose bondholders' names and information without a court order.¹²⁹

¹²¹ Puerto Rico Electric Power Authority ("PREPA") Title III, No. 17-04780 (D.P.R. filed July 2, 2017), <http://dm.epiq11.com/#/case/PR1/info>.

¹²² Walsh, *supra* note 120.

¹²³ Mary Williams Walsh, *The Bonds That Broke Puerto Rico*, N.Y. TIMES (June 30, 2015), https://www.nytimes.com/2015/07/01/business/dealbook/the-bonds-that-broke-puerto-rico.html?mcubz=0&_r=1.

¹²⁴ *Investor Resources: Puerto Rico Sales Tax Financing Corp. (COFINA)*, GOV'T DEV. BANK OF PUERTO RICO, http://www.bgfpr.com/investors_resources/cofina.html (last visited July 20, 2018).

¹²⁵ *Id.*

¹²⁶ *Id.*

¹²⁷ *Id.*

¹²⁸ P.R. Const., Art. IV, § 2.

¹²⁹ Joel Cintrón Arbasetti et al., *Who Owns Puerto Rico's Debt Exactly? We Tracked Down 10 of the Biggest Venture Firms*, IN THESE TIMES (Oct. 17, 2017),

As of June 2018, no order for the identity of the bondholders has been issued. Recent data tracked by Bloomberg shows that close to \$14 billion of the total is owned by mutual fund companies within the United States.¹³⁰ Another \$1 billion is reportedly owned by a single wealthy investor named Seth Klarman.¹³¹ It is speculative but likely that so-called vulture firms make up the rest of the majority of the owners of the bonds.¹³² A vulture firm is an investment firm that “[i]n times of crisis . . . swoop[s] in to buy the cheapest, most troubled assets, giving desperate sellers an opportunity to exit. The investors get a chance to profit—from other peoples’ disasters.”¹³³ The remaining portion of the debt is the ever-increasing interest.¹³⁴

C. Options for the Board

Congress, in the House Committee report, was determined to right the financial wrongs perpetuated by past administrations, while still leaving the debt as the island’s burden.¹³⁵ This Congressional intent to saddle the island with the debt is further evidenced by the PROMESA clause that states the United States government will not back Puerto Rican debt.¹³⁶ Section 210 is explicit:

(a) IN GENERAL.—The full faith and credit of the United States is not pledged for the payment of any principal of or interest on any bond, note, or other obligation issued by a covered territory or covered territorial instrumentality. The United States is not responsible or liable for the payment of any principal of or interest on any bond, note, or other obligation issued by a covered territory or covered territorial instrumentality. (b) SUBJECT TO APPROPRIATIONS.—Any claim to which the United States is

http://inthesetimes.com/features/puerto_rico_debt_bond_holders_vulture_funds_named.html.

¹³⁰ Nancy Moran & Martin Z Braun, *Here Are the Top-Eight Holders of Puerto Rican Debt*, BLOOMBERG BUSINESSWEEK (Oct. 4, 2017, 2:11 PM), <https://www.bloomberg.com/news/articles/2017-10-04/here-are-the-top-eight-holders-of-puerto-rican-debt>.

¹³¹ David Dayen, *We Can Finally Track One of the Largest Holders of Puerto Rican Debt*, THE INTERCEPT (Oct. 3, 2017), <https://theintercept.com/2017/10/03/we-can-finally-identify-one-of-the-largest-holders-of-puerto-rican-debt/>.

¹³² *Venture Capitalist*, INVESTOPEdia, <https://www.investopedia.com/terms/v/vulture-capitalist.asp> (last visited Jan. 4, 2018).

¹³³ Katherine Burton & Katia Porzecanski, *Vulture Investing*, BLOOMBERG (May 31, 2017, 8:25 AM), <https://www.bloomberg.com/quicktake/vulture-investing>.

¹³⁴ Tim Worstall, *The Truly Horrible and Ghastly Mess Of Puerto Rico’s Bond Issuance*, FORBES (May 6, 2017, 9:11 AM), <https://www.forbes.com/sites/timworstall/2017/05/06/the-truly-horrible-and-ghastly-mess-of-puerto-ricos-bond-issuance/#37cbccd44224>.

¹³⁵ See generally *H. Comm. on Natural Resources*, *supra* note 95.

¹³⁶ PROMESA, *supra* note 64, at § 210.

determined to be liable under this Act shall be subject to appropriations. (c) FUNDING.—No Federal funds shall be authorized by this Act for the payment of any liability of the territory or territorial instrumentality.¹³⁷

This leaves the Board to make its recommendations to the Governor or the Legislature. So far, the Board has recommended government employee and teacher furloughs, a renegotiation of healthcare costs, and a reduction in professional services contracts.¹³⁸ As of June 2018, the Board is not considering any other solutions.

Unfortunately, Puerto Rico's insurmountable debt is not its only fiscal problem. Currently, the Board's analysis of the proposed budget for Fiscal Year 2018 shows an estimated loss of about "\$800 million of Affordable Care Act funding for [Puerto Rico's] healthcare system."¹³⁹ Additionally, there are problems with revenue collection after Hurricane Maria.¹⁴⁰ Moreover, businesses have been shut down or delayed in reopening, infrastructure is missing, and power is still out in some areas.¹⁴¹

V

POSSIBLE SOLUTIONS: DOMESTIC AND FOREIGN

Society enriches itself through the exploration of culture. Culture comes in many forms: art, music, museums, and exploring nature. Local governments make difficult choices when facing a budget crunch. Basic needs—roads, schools, electricity, water, etc.—have to be weighed against those things that make society richer. Does selling a public park to a developer for tax revenue help or hurt the citizens? Will keeping an art museum that generates low revenue help or hurt the local populace? Is there something special about the area that can attract tourists? What choices have been made by others that can be copied to help Puerto Rico?

Puerto Rico, Detroit, and Greece all have one thing in common—financial crises. The financial crisis that has embroiled Puerto Rico is not an unusual one. Puerto Rico is unique given its amount of debt and

¹³⁷ *Id.*

¹³⁸ *Puerto Rico Oversight Board Recommends Emergency Fiscal Measures*, REUTERS (Mar. 9, 2017, 1:50 PM), <https://www.reuters.com/article/puertorico-debt-board/puerto-rico-oversight-board-recommends-emergency-fiscal-measures-idUSL2N1GM287>.

¹³⁹ *Id.*

¹⁴⁰ *H. Comm. on Natural Resources*, *supra* note 95, at 3–4.

¹⁴¹ *Id.*

its struggle to alleviate this burden. Despite Puerto Rico's current singular option for recovery through PROMESA, there are some outside entities that have had similar experiences that may provide guidance for the Board and Puerto Rico. Detroit is an example of a recent U.S. municipality bankruptcy. Greece is an example of an entity that has semi-sovereign status within the European Union. Puerto Rico can use a combination of the examples provided by Detroit and Greece as a possible solution to the financial crisis it is currently experiencing.

A. Detroit and the Public Good

Detroit, Michigan, was the center of auto manufacturing in the United States during the automobile boom starting after World War II.¹⁴² With cheaper overseas labor costs, a downturn in car purchases, and a decline in overall manufacturing, Detroit lost people, lost revenue, and gained debts. With mounting costs from unfunded pensions and healthcare,¹⁴³ Detroit filed for Chapter 9 protection in 2013.¹⁴⁴ Selling assets to help settle debts is a typical solution in bankruptcy. Under this approach, Detroit considered selling one of its larger assets—the Detroit Institute of Arts (DIA) with an appraisal value of \$4.6 billion.¹⁴⁵ With the city facing upwards of \$18 billion in debt, the thought of selling even one of the works of art in the museum was tempting. Eventually, Detroit was able to keep the museum, public pressure notwithstanding, with the help of public and private funding.¹⁴⁶ The so-called Grand Bargain pulled in private funding from philanthropic foundations such as the Knight Foundation, the Ford Foundation, and the Mott Foundation. These major players would help release the DIA from the city's grasp, shield the art forever, and help

¹⁴² Thomas J. Sugrue, *From Motor City to Moto Metropolis: How the Automobile Industry Reshaped Urban America*, AUTO. IN AM. LIFE AND SOC'Y, http://www.autolife.umd.umich.edu/Race/R_Overview/R_Overview3.htm (last visited July 20, 2018).

¹⁴³ *Detroit "Clearly Insolvent," Says Emergency Manager*, BBC (May 13, 2013), <http://www.bbc.com/news/business-22514588>.

¹⁴⁴ *Detroit Bankruptcy Filing Marks New Low for Motor City*, CHICAGO TRIBUNE (July 19, 2013), http://articles.chicagotribune.com/2013-07-19/news/chi-detroit-bankruptcy-20130718_1_bankruptcy-filing-largest-municipal-bankruptcy-michigan-governor-rick-snyder.

¹⁴⁵ Randy Kennedy, "*Grand Bargain*" Saves Detroit Institute of Arts, N.Y. TIMES (Nov. 7, 2014), <https://www.nytimes.com/2014/11/08/arts/design/grand-bargain-saves-the-detroit-institute-of-arts.html>.

¹⁴⁶ *Id.*

Detroit pay down some debt.¹⁴⁷ Detroit came out of bankruptcy sixteen months later with its cultural treasures, implementing a new plan to pay its debts, and hoping for a more financially solvent future.

B. Greece and the International Monetary Fund

Despite being part of the European Union, Greece has struggled financially in recent years.

Since 2008, Greece has suffered the effects of the global financial crisis. As one of the weakest economies of the European Union, Greece is among the countries which have been affected the most. In 2010, the prime minister at that time, George Papandreou, signed the first “memorandum of understanding” with the Troika, which consists of the European Union (EU), the International Monetary Fund (IMF) and the European Central Bank (ECB). Since then the country’s debt has increased from 120 per cent of GDP to 180 per cent of GDP, and Greece has undergone a grueling experience resulting from the necessity of taking austerity measures to be able to repay its debt and restore itself to an economic footing acceptable to its creditors.¹⁴⁸

In addition to the agreed-upon austerity measures, Greece had another route to recovery—bailout loans. Greece was able to borrow funds from the International Monetary Fund (IMF) to assist in its recovery. The IMF, established in 1944 in response to the Great Depression, is an international economic group.¹⁴⁹ The IMF’s primary purpose is three-pronged: surveillance, loans, and capacity development.¹⁵⁰ Under the surveillance prong, the IMF monitors 189 member countries’ economic and financial policies.¹⁵¹ The IMF monitors policies and advises a policy change if there is something that could be detrimental to the worldwide economy. The lending prong allows the IMF to loan funds to member countries in economic downturns.¹⁵² Under the final prong, capacity development, the IMF

¹⁴⁷ Nathan Bomey et al., *How Detroit Was Reborn*, DETROIT FREE PRESS (Jan. 22, 2015), <https://www.freep.com/story/news/local/detroit-bankruptcy/2014/11/09/detroit-bankruptcy-rosen-orr-snyder/18724267/>.

¹⁴⁸ Abdellatif Darwish, *Greece and Its Financial Crisis*, AL JAZEERA CTR. FOR STUDIES, 2 (Aug. 16, 2015, 11:44 AM), <http://studies.aljazeera.net/en/reports/2015/08/20158169112264868.html>.

¹⁴⁹ *About the IMF*, INT’L MONETARY FUND, <http://www.imf.org/en/About> (last visited July 20, 2018).

¹⁵⁰ See generally *id.*

¹⁵¹ See generally *id.*

¹⁵² See generally *id.*

assists member countries through “technical assistance and training— [to help] member countries design and implement economic policies that foster stability and growth by strengthening their institutional capacity and skills.”¹⁵³

Member countries can borrow from the IMF via lines of credit, liquidity lines, and differential loans based on the immediacy of financial need.¹⁵⁴ A borrower must receive full consensus of the lending executive board to borrow a loan or line of credit.¹⁵⁵

IMF lending aims to give countries breathing room to implement adjustment policies in an orderly manner, which will restore conditions for a stable economy and sustainable growth. These policies will vary depending upon the country’s circumstances. For instance, a country facing a sudden drop in the prices of key exports may need financial assistance while implementing measures to strengthen the economy and widen its export base. A country suffering from severe capital outflows may need to address the problems that led to the loss of investor confidence—perhaps interest rates are too low; the budget deficit and debt stock are growing too fast; or the banking system is inefficient or poorly regulated.¹⁵⁶

C. Puerto Rico’s Options Outside of PROMESA

Puerto Rico is not a member of the IMF. However, the United States is a member country of the IMF. As an option for Puerto Rico to get to full financial recovery, the United States could borrow funds from the IMF and allow Puerto Rico access to them. To do so, Section 210 of PROMESA must be amended to allow for the full faith and credit of the U.S. government to back the loan from the IMF. If Congress still wanted Puerto Rico to be accountable for its finances, Puerto Rico could be required to pay back the IMF. In order to facilitate the repayment of the debt (while maintaining the credit of the United States), the federal government could make the payments on Puerto Rico’s behalf. Repayment from Puerto Rico could be made via withholding from pre-authorized payments. To make sure one particular section of federal funding was not singled out, Congress could authorize percentages to be withheld from each area of the

¹⁵³ See generally *id.*

¹⁵⁴ *Lending by the IMF*, INT’L MONETARY FUND, <https://www.imf.org/external/about/lending.htm> (last visited July 20, 2018).

¹⁵⁵ *Id.*

¹⁵⁶ *Id.*

budget. Additionally, as long as Puerto Rico is part of the United States, the Constitution does not allow for debts not to be repaid.¹⁵⁷

Another option for Puerto Rico is debt cancellation. This is not a new proposition. The United States used the Doctrine of Odious Debt for the cancellation of the debts of the former Spanish colonies of Puerto Rico and Cuba after the Spanish-American War in 1898.¹⁵⁸ The premise of the Doctrine is that the debt obtained for purposes contrary to the general populations should be eliminated.¹⁵⁹ The United States suggested the Doctrine again after the invasion of Iraq by the Bush Administration in 2004.¹⁶⁰ This doctrine of debt cancellation is not universally accepted because of fears of abuse by powerful nations.¹⁶¹ Despite the fears of abuse, other factors, such as upgrades to aging or inferior infrastructure, still lead to increased debt for many countries.

Some groups in Germany and Africa at G8 Summits are championing debt cancellation as a means by which countries in similar financial difficulties as Puerto Rico can move forward. Even if the doctrine of illegitimate or odious debt is broadly accepted, and even if a substantial portion of debt is cancelled, developing countries will continue to require means of financing their development projects. In other words, canceling debt today does not eliminate the need to take out new loans tomorrow if a country wants to make forward progress. Anticipating that exploitation and corruption cannot be totally eliminated, [some groups] have asserted that what is required is a way of adjudicating questions of debt in such a way that countries can demonstrate that debts attributed to them should be considered illegitimate, creditors can argue that contracts should be enforced, and destitute nations can reduce their debt burdens when they prove too onerous to be repaid without unjustly penalizing the country's people. These proposals, referred to as the Fair and Transparent Arbitration Mechanism ("FTAP"), would make it possible, for instance, for a country to effectively declare bankruptcy, see a portion of its debts forgiven, and be restored to creditworthy status, just as is

¹⁵⁷ U.S. CONST. amend. XIV, § 4 ("The validity of the public debt of the United States, authorized by law, including debts incurred for payment of pensions and bounties for services in suppressing insurrection or rebellion, shall not be questioned. But neither the United States nor any State shall assume or pay any debt or obligation incurred in aid of insurrection or rebellion against the United States, or any claim for the loss or emancipation of any slave; but all such debts, obligations and claims shall be held illegal and void.")

¹⁵⁸ Soren Ambrose, *Social Movements and the Politics of Debt Cancellation*, 6. CHI. J. INT'L L. 267, 282 (2005).

¹⁵⁹ *Id.*

¹⁶⁰ *Id.*

¹⁶¹ *Id.*

done for bankrupt individuals or companies, or even local governments, in industrialized countries like the US.¹⁶²

There have been some recent suggestions from the current administration that some of the debt will need to be forgiven.¹⁶³ This has angered many and relieved others. Aside from the contractual obligations of the bonds themselves, debt forgiveness for some bonds but not others leads to questions of fairness. From a pure financial perspective, the highest-cost debt should be forgiven first—the pensions. The pensions are not well funded, have no definitive end in sight, and cost the most. Rationally, that would be the first debt removed from the payment equation. However, societal costs of not paying pensions are incalculably high. Americans, starting around the New Deal era, have decided that retirement and pensions are important. The system was not perfect, but it rewarded grit and steadfastness. It was good for our economy and our culture.¹⁶⁴

CONCLUSION

Puerto Rico's financial ills leave many lessons for international communities. Bonds, specifically public projects finance bonds, must be centered on revenue streams that do not depend on an investment return from a small population.

For the island to be revenue dependent, the tax policies must be updated cohesively while satisfying the island's realistic goals and budgetary needs. The possible tax changes that would be beneficial are the following: tax policy reform/revision of government-owned money collection efforts, debt forgiveness or cancellation, and a revision of PROMESA to reflect the Puerto Rican government's need to obtain outside help.

First, the tax structure of the island, combined with renewed and updated collection methods of funds owed, should be changed to reflect

¹⁶² *Id.* at 282–83.

¹⁶³ Lucinda Shen, *President Trump's Puerto Rican Debt Comments Have Spooked Investors*, FORTUNE (Oct. 5, 2017), <http://fortune.com/2017/10/04/puerto-rico-donald-trump-debt-bankruptcy/>.

¹⁶⁴ Public pensions are a tradition for a reason; they made the American dream possible for generations. As they spread across the country from the 1930s through the 1960s, seniors who had worked all their lives were freed from the desperation and poverty that awaited those in earlier decades. More seniors could safely retire, and young workers were incentivized to work hard and accept demanding jobs, knowing they would be compensated for their efforts and commitment in retirement. See Andrew Collier, *America's Public Pensions Matter*, THE HILL (Sept. 8, 2018), <http://thehill.com/opinion/finance/384874-americas-public-pensions-matter>.

the current reality of the mobility of technology. With software making businesses less reliant upon physical location, adjustment to fiscal policies that are forward-looking will help to close the gaps for tax evasion and collection. Second, the tax base should be expanded. Doing so will allow the municipalities to rely more heavily on indirect taxation and help the government adjust to the reality of the mass exodus of individuals and corporations. Third, as discussed earlier, the debt cancellation or forgiveness of large debt portions will reduce the overall debt burden significantly. Debt reduction allows comprehensible alteration of the overall fiscal policies and adjustment to more reliable debt repayment schemes.

Finally, the revision of PROMESA that I propose will remove Section 210. Revising this particular section will expand Puerto Rico's ability to gain access to capital markets to fund projects that do not rely on inconsistent revenue streams. Removing Section 210 will allow for the full faith and credit of the United States to back whatever debt the island needs to be able to rebuild. Allowing the island to rebuild, through a well-reasoned and comprehensive debt program, will potentially lure back investors, foster a population of talented wage earners, and will allow Puerto Ricans the dignity of having their home and culture flourish. Furthermore, revision of Section 210 will aid Puerto Rico by allowing greater access to grants or low-interest financing from the IMF. With these reforms, Puerto Rico can refurbish its ailing public works projects, repair or replace damaged infrastructure, and, finally, free the island from the drowning weight of debt.

