



PUERTO RICO FORWARD

Episode 16: PROMESA, PT.3

Transcript

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Welcome my friends to part three of our discussion of the *Puerto Rico Oversight, Management, and Economic Stability Act*¹, or PROMESA for short. So far we've actually covered A LOT of information regarding this far reaching piece of legislation, including a couple of cases that have had a direct impact on the way the law is applied. Make sure you're up to date and listen to the last two episodes in order to receive the full benefit of our discussion.

In today's installment, we'll be covering the duties and powers that the members of the Financial Oversight and Management Board (hereinafter FOMB or Board) actually have, and that allow them to enforce PROMESA's requirements.

Title two of PROMESA contains all the responsibilities of the Board, and right out the gate, it's dominance of the territorial government is firmly established. In part, Sec 201 reads the following way:

[T]he Oversight Board shall deliver a notice to the Governor providing a schedule for the process of development, submission, approval, and certification of **Fiscal Plans**. [...] The Oversight Board shall consult with the Governor in establishing a schedule, but the Oversight Board shall retain sole discretion to set or, by delivery of a subsequent notice to the Governor, change the dates of such schedule as it deems appropriate and reasonably feasible."² (*emphasis added*)

Here we find one of the most important and fundamental elements of all PROMESA: the almighty **FISCAL PLAN**. In regards to what a fiscal plan's actual purpose is, PROMESA states that it's to "...provide a method to achieve fiscal responsibility and access to the capital markets..."³

¹ Puerto Rico Oversight, Management, and Economic Stability Act, 48 U.S.C. §§ 2101–2241 (2016) [hereinafter *PROMESA*]

² *Id.* at §201(a)

³ *Id.* at §201(b)(1)

As we pointed out in the first part of this series, according to PROMESA, the FOMB is chartered with the task of providing for a way for Puerto Rico (hereinafter PR) to regain “...access to the **capital markets**.”⁴ (*emphasis added*) As we can observe, the concept of **capital markets** is a very important element in evaluating whether or not the FOMB is doing its job properly; and that makes it worth discussing.

Broadly speaking, capital markets are markets where long-term debt or equity-backed securities are bought and sold. One example of a “long-term debt” is a government bond, which is in fact the main concern of PR’s current economic crisis. PR’s general obligations bonds alone make up about 22% of the archipelago’s total public debt.⁵ So what EXACTLY does the FOMB need to do in order to access “capital markets”? Well the answer might lie in the hands of *rating agencies*.

In an article written in 2014 for the BBC, Author Rebecca Marston wrote a simple yet well rounded introduction to the subject of credit agencies. The piece highlights that credit agencies are nothing more than “[p]rivate-sector firms that assign credit ratings for issuers of debt[.]”⁶ Marston goes on to explain that “[a] credit rating takes into account the debt issuer’s ability to pay back its loan...”⁷ which in turn “...affects the interest rate applied to the security (eg a bond) being issued[.]”⁸

Without a doubt, when it comes to how well a bond will sell in the capital market, rating agencies have a great amount of influence.

Professors Cynthia E. Clark, and Sue Newell of Bentley University, in an article published by the Cambridge University Press, provide us with a vital look into just how important rating agencies are in capital markets.

[T]he capital market is one of the core institutions of society. As such, it requires the collective efforts of many constituents who work across organizations to maintain compliance with the roles, norms and rules considered to be legitimate. Sustaining such compliance usually requires significant ongoing maintenance work. [...] [W]hile there are several maintenance practices identified recently, we focus on policing. Policing stresses maintenance as a function of outlining rules and doling out rewards or punishments from a legitimate authority. Therefore,

⁴ *Id.* at §101(a)

⁵ Víktor Rodríguez and Sonia E. Rivera, *Radiografía de la Deuda de Puerto Rico*, Metro Puerto Rico
<https://www.metro.pr/pr/noticias/2015/09/29/radiografia-de-la-deuda-de-puerto-rico.htm>
! (last visited on Feb. 17th, 2019)

⁶ Rebecca Marston, *What is a rating agency?*, BBC News (Oct. 20th, 2014)
<https://www.bbc.com/news/10108284> (last visited on Feb. 17th, 2019) [hereinafter *BBC*]

⁷ *Id.*

⁸ *Id.*

policing typically has both a sanctioning and an inducement element, sometimes practiced simultaneously. In this way, policing work attempts to maintain compliance within the institution through auditing, monitoring and endorsement of specific practices. [W]e consider the rating work of [rating agencies] as a policing mechanism aimed at maintaining the capital markets because ratings of corporate information provide rewards and punishments to those being rated while also inferring the rules of optimal corporate conduct. Given that reliable information is at the heart of the institutional order of the capital markets and investors make decisions based on the assumption that prices at anytime “fully reflect” all available information, ratings’ quality is of the utmost importance.⁹ (citations omitted)

It’s hard to imagine any other type of firm that has a greater impact on “access to capital markets” than that of a credit rating agency. As a result, whether we like it or not, in order for PR to rejoin the ranks of other jurisdictions in the race to sell debt, it will need to appease private rating firms like Standard & Poor’s, Moody’s and Fitch. But how? Well, let us look at Standard & Poor’s (hereinafter S&P) method of evaluation so as to have an idea of what is taken into account when assigning a rating to a long-term debt.

Going back to the aforementioned BBC article, the author points out that

Standard & Poor’s says a committee of between five and eight people decides the actual rating. They base their assessment on a range of financial and business attributes that might influence the repayment, some of which may depend on the issuer of the bond (i.e. the borrower). When asked why it changes ratings, S&P responded: “The reasons for ratings adjustments vary, and may be broadly related to overall shifts in the economy or business environment - or more narrowly focused on circumstances affecting a specific industry, entity, or individual debt issue.” S&P gave a long list of indicators it might use, including “economic, regulatory and geopolitical influences, management and corporate governance attributes, and competitive position”.¹⁰

Clearly, a credit agency such as S&P takes a wide range of elements into consideration when rating a government bond. As a result, almost everything a government does will have an impact, be it small or large, on how well its bonds sell in the capitol market. This all-encompassing view that rating agencies have might explain why PROMESA created a list of requirements for the creation of a Fiscal Plan. Among the requirements, we find that it must:

⁹ Cynthia E. Clark, and Sue Newell. *Institutional Work and Complicit Decoupling across the U.S. Capital Markets: The Work of Rating Agencies*, 23 Business Ethics Quarterly 1, 5 (2013)

¹⁰ BBC, *Supra* note 6

...provide for estimates of revenues and expenditures in conformance with agreed accounting standards [...]; [...] ensure the funding of essential public services; [...] provide adequate funding for public pension systems; [...] provide for the elimination of structural deficits; [...] improve fiscal governance, accountability, and internal controls; [...] enable the achievement of fiscal targets; [...] create independent forecasts of revenue for the period covered by the Fiscal Plan; [...] include a debt sustainability analysis; [...] provide for capital expenditures and investments necessary to promote economic growth[.]¹¹

It seems clear that having such a long list of requirements is necessary since the Fiscal Plan is at the center of PR being able to “access capital markets”.

According to PROMESA, said Fiscal Plan “...shall cover a period of fiscal years as determined by the Oversight Board **in its sole discretion** but in any case a period of **not less than 5 fiscal years** from the fiscal year in which it is certified by the Oversight Board.”¹² (*emphasis added*)

Now, I have said again and again that PROMESA is one of the most blatant examples of anti-democratic colonialism to date. By far, my generation has never witnessed such a grotesque use of the US Constitution’s Territorial Clause. But for those of you who might think I’m being dramatic, the bill’s text provides the following: “The Governor **may not submit to the Legislature a Territory Budget** [...] for a fiscal year **unless the Oversight Board has certified the Territory Fiscal Plan for that fiscal year** [...], unless the Oversight Board **in its sole discretion** waives this requirement.”¹³ (*emphasis added*)

Part of structuring and establishing long term policies in any government is the ability to create a budget that responds to the concerns and desires of the population. Being able to decide how public funds will be spent is a cornerstone of all governmental institutions. Without it, few, if any, social programs and basic services would be possible. Never the less, Congress seems to have assigned little importance to this widely accepted element of governance.

In any case, relieving PR’s governor from his power to submit to the archipelago’s legislative body a budget without the FOMB’s permission seems to be perfectly aligned with the Board’s mission statement: gain access to “capital markets”. As we mentioned before, one of the ways capital markets are able to maintain a certain degree of order and compliance from the individuals and institutions that interact with each other is through the use of policing mechanisms. One form of said mechanism is the rating agency, due to its ability to deter a certain behavior, while, sometimes at the same time, supporting another. As we’ve already

¹¹ PROMESA, *Supra* note 1, at §§201(b)(1)(A)-201(b)(1)(J)

¹² PROMESA, *Supra* note 1, at §201(b)(2)

¹³ PROMESA, *Supra* note 1, at §201(c)(1)

pointed out while using S&P as an example, rating agencies act like gatekeepers with a long list of requirements. Taking each requirement into account is crucial in successfully issuing long-term debt. If we accept this as true, we must also conclude that, at least to a certain degree, shaping a nation's budget is a viable method in meeting most of the above mentioned requirements.

Having the ability to determine the validity of a Fiscal Plan proposed by the Governor seems to not have been enough for the bill's drafters, since Sec. 201(c)(3) goes even further:

If the Governor fails to submit to the Oversight Board a Fiscal Plan that the Oversight Board determines **in its sole discretion** satisfies the requirements set forth [...] by the time specified in the notice[...], the Oversight Board shall develop and submit to the Governor and the Legislature a Fiscal Plan that satisfies the requirements set forth[...]. [...] If the Oversight Board develops a Fiscal Plan [...], such Fiscal Plan **shall be deemed approved by the Governor** [...].¹⁴

PROMESA further continues to diminish the role of the executive branch the further it defines the FOMB's powers. In a clear desire to leave no doubt, the text provides the following:

The Governor shall submit to the Oversight Board proposed Budgets [...]. [T]he Oversight Board shall determine in its sole discretion whether each proposed Budget is compliant with the applicable Fiscal Plan [...]. [I]f the Oversight Board determines that the Budget is not a compliant budget, the Oversight Board shall provide to the Governor a notice of violation [...]. [...] If the Governor fails to develop a Budget that the Oversight Board determines is a compliant budget the Oversight Board shall develop and submit to the Governor, in the case of an Instrumentality Budget, and to the Governor and the Legislature, in the case of a Territory Budget, a revised compliant budget.¹⁵

Now, so far what we've read from PROMESA relieves the governor from certain central duties of the executive branch. However, the Act also deals a serious blow to PR's legislative body. Specifically, the Bill points out the following:

The Legislature shall submit to the Oversight Board the Territory Budget adopted by the Legislature [...]. The Oversight Board shall determine whether the adopted Territory Budget is a compliant budget[...]. [I]f the adopted Territory Budget is not a compliant budget, the Oversight Board shall provide to the Legislature a notice of violation that includes a description of any necessary corrective action; and an opportunity to correct the violation [...]. If the Legislature fails to adopt a Territory Budget that the Oversight Board determines is a compliant budget[...], the Oversight Board shall develop a revised Territory

¹⁴ PROMESA, *Supra* note 1, at §§201(d)(2)-201(e)(2)

¹⁵ PROMESA, *Supra* note 1, at §§202(c)(1)-202(c)(2)

Budget that is a compliant budget and submit it to the Governor and the Legislature. If the Governor and the Legislature fail to develop and approve a Territory Budget that is compliant [...], the Oversight Board shall submit a Budget to the Governor and the Legislature [...] and such Budget shall be deemed to be approved by the Governor and the Legislature [...] [and] in full force and effect beginning on the first day of the applicable fiscal year.¹⁶

Having such a tight grip on the territory's finances seems to be necessary in molding PR's financial dimensions into a form appealing to the rating agencies. However, it falls short if not accompanied by healthy degree of control over what legislation is approved. After all, "regulation" and "corporate governance attributes" are also part of a rater's list of considerations. It seems that Congress had this in mind when it drafted Section 204 of PROMESA. I'll quote the text:

[No] later than 7 business days after a territorial government duly enacts any law during any fiscal year in which the Oversight Board is in operation, the Governor shall submit the law to the Oversight Board. The Governor shall include with each law submitted to the Oversight Board [a] formal estimate prepared by an appropriate entity of the territorial government with expertise in budgets and financial management of the impact, if any, that the law will have on expenditures and revenues. [...] The Oversight Board shall send a notification to the Governor and the Legislature if the Governor submits a law to the Oversight Board [...] that is not accompanied by the estimate required [or] that is not accompanied by [...] a certification [...]. [T]he Oversight Board may direct the Governor to provide the missing estimate or certification [...]. [...] If the territorial government fails to comply with a direction given by the Oversight Board [...] [the Board] may take such actions as it considers necessary to ensure that the enactment or enforcement of the law will not adversely affect the territorial government's compliance with the Fiscal Plan, **including preventing the enforcement or application of the law.**¹⁷ (*emphasis added*)

The law's text directly **and clearly** establish the FOMB's superiority over the PR government's executive **and** legislative branches.

It seems interesting that current discussions about PROMESA in the media seem to miss just how important rating agencies are in regards to PR regaining access to capital markets. Most of the narrative criticizing the bill revolves around its obvious injustice, and that to me, is a missed opportunity. Of course, this does not make said observations any less valid. Without a doubt, PROMESA's unjust nature must be continuously highlighted in order to prevent it from falling into the background, like every other issue regarding PR. In fact, this very series about

¹⁶ PROMESA, *Supra* note 1, at §§202(d)(1)-202(e)(3)(c)

¹⁷ PROMESA, *Supra* note 1, at §§204(a)(1)-204(a)(5)

PROMESA was thought up with that very same goal in mind. Making sure PROMESA is on our political radar must be a constant for everyone who loves and cherishes democracy and self-determination.

That said, what I consider to be a missed opportunity is just how clear PROMESA is at revealing how the public's interest lies at odds with the very worst parts of the current economic system. If we take a moment to consider the powers of the FOMB, and how said body is chartered with the task of establishing "...a method for a covered territory to achieve fiscal responsibility and access to the capital markets[,]"¹⁸ a profound implication becomes clear: the FOMB cannot act in the people's interest. Although obvious, this point is lost on most people. Controlling public spending the way PROMESA does really has nothing to do with "getting things in order" or securing the public's well-being, but rather a profound yearning to satisfy the desires of rating agencies and that of any other of the capital market's gate keepers.

Of course, some people would be right to argue that capital markets and the government bonds exchanged within them more often than not provide necessary liquidity for certain government functions that serve the public's interest to take place.

However, what I'm pointing out is that as soon as debt service stands in the way of social services, a decision must be made in regards to which one must yield to the other. In the case of PROMESA the choice was made as soon as the legislation was approved. The phrase "...access to capital markets..." carries with it a clear objective that is neither humane nor sensitive to the people's needs.

I can't help but wonder if Congress knew this when it drafted Section 207 of PROMESA. It reads as follows: "For so long as the Oversight Board remains in operation, no territorial government may, **without the prior approval of the Oversight Board**, issue debt or guarantee, exchange, modify, repurchase, redeem, or enter into similar transactions with respect to its debt."¹⁹ (*emphasis added*)

In addition to barring any attempt of PR accessing capital markets, Congress, in the apparent effort of tying up any loose ends, drafted the following:

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.²⁰

¹⁸ PROMESA, *Supra* note 1, at §101(a)

¹⁹ PROMESA, *Supra* note 1, at §207

²⁰ PROMESA, *Supra* note 1, at §210(a)

It's plain to see just how pointless it is for PR to even attempt to find any alternative out of it's current crisis outside of PROMESA's framework; and that's exactly the point.

It is my belief that Congress did not enact PROMESA for the purpose of relieving some of PR's economic woes, but rather to enforce what professors Clark and Newell might call a *policing mechanism*. Through its Plenary Powers, Congress not only charged the FOMB with the task of paving the way for PR's journey back into the "promised land" of capital markets, but also cut off any alternate paths.

The result is a legal landscape in which only one road exists. And although it leads to a place that promises no peace, it is the only option available since all other paths are blocked by an insurmountable obstacle called the Financial Oversight and Management Board. This makes the journey ahead a difficult one indeed.²¹

²¹ In the next episode of Puerto Rico Forward, I'll continue analyzing this unprecedented piece of legislation.