PUERTO RICO FORWARD

Episode 17: PROMESA, PT.4

Transcript

Andrew Mercado-Vázquez

Well my friends, all good things must come to an end. Welcome to the final installment of our four part series discussing the *Puerto Rico Oversight, Management, and Economic Stability Act*[1], or PROMESA for short. Considering PROMESA's complex structure and nature, I strongly recommend to our supporters to listen to the series in order so as to avoid possible confusions.

In my effort to bring to a close this general overview of PROMESA and its various effects, the fact that we've only been able to scratch the surface of its implications is not lost on me. Although we've highlighted what I consider to be the most important parts of PROMESA and have taken the time to discussed how certain provisions of said law have served as a basis for court rulings and political games, it is YOU, the listener, or reader, who will truly accomplish a deep understanding of the matter. If you truly see yourself as an ally in the fight of the Puerto Rico (PR) issue, I encourage you to really dig deep into matters that have a lasting and significant impact on the subject, such as PROMESA. This series provides a basic, well rounded introduction, but our goal must always be mastery; and that's on each one of us as individuals.

We begin today's discussion we're diving into the sections of the bill that handle the process of adjusting PR's debt, more commonly known as *Title III*. Now, as I've discussed before, PR's municipalities, unlike any of the fifty states of the Union, cannot use the bankruptcy proceedings described in Chapter Nine of the US Bankruptcy Code. However, this was not always the case. For years PR did in fact have access to Chapter Nine's municipal bankruptcy protections. That all changed when in 1984, for reasons that are still unknown, Congress decided to explicitly eliminate PR's access. That action that seemed to have gone largely unnoticed would have a huge impact decades later, and would serve as the hub argument for passing PROMESA. There is great irony in the fact that Congress would use its own irrationality to justify the construction of a new bankruptcy scheme tailor-made for

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

territorial possessions. By taking PR out of Chapter Nine, Congress fostered the necessary conditions that would later justify its legislation of Title III.

Although I won't go further into detail about the legal ramifications of PR's inability to access Chapter Nine Bankruptcy, you can visit episode eight of this podcast to know more. There I go into detail on the matter. For the purpose of this episode, a simple summary will suffice.

Since PROMESA adopts many sections of the US Bankruptcy Code, discussing Title III is impossible without first providing an overview of bankruptcy procedures in general. In an article published in May of 2018 in the *Colorado Lawyer*, Judge Tomas B. McNamara[2] does an excellent job in describing the fundamental elements of US bankruptcy law. He begins by pointing out that

> The cornerstone of American bankruptcy law is the chance for a "fresh start." The Bankruptcy Code provides "a procedure by which certain insolvent debtors can reorder their affairs, make peace with their creditors, and enjoy 'a new opportunity in life with a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.'" Animated by these laudable goals, bankruptcy protects the "honest but unfortunate debtor," while at the same time serving as a safety valve to ensure the future vitality of the U.S. economy.[3] (*citations omitted*)

Judge McNamara then moves on to succinctly describing the structure of the US Bankruptcy Code:

> In a broad sense, the statutory scheme recognizes two main types of bankruptcy: liquidation and reorganization. And there are two main types of debtors: individuals (consumers) and entities (businesses). Bankruptcy cases may be pursued under any of six separate chapters. Chapter 7 governs liquidation for individuals and entities through the auspices of an independent Chapter 7 trustee. Chapter 9 uniquely addresses reorganization of municipalities. Chapter 11 is normally thought of as the mechanism for reorganization of businesses, but it may also be used by individuals to reorganize. Chapter 12 is designed to protect family farmers and fisherman, including both individuals and businesses engaged in farming and fishing. Chapter 13 serves as the platform of

---

2 Thomas B. McNamara is a U.S. Bankruptcy Judge for the District of Colorado, where he has served since being appointed by the U.S. Court of Appeals for the Tenth Circuit in 2015.

3 Thomas B. McNamara, *Fresh Start at the Bankruptcy Court,* 12 Colorado Lawyer 12 (2018)

> reorganization for most individuals who have regular income. And Chapter 15 deals with international or cross-border insolvency cases.[4]

Most important for today's discussion is Judge McNamara's brief description of the six foundations that must be considered in all bankruptcy procedures: full disclosure, breathing space, notice, maximization of value, equality of distributions, and a fresh start:

> Full disclosure is one of the quid pro quos for bankruptcy protection. It starts with the petition. Early in every bankruptcy case, the debtor—whether an individual or an entity— must disclose all assets and liabilities through a statement of financial affairs and schedules. The debtor's income and expenses also must be itemized. […] [As to the element of "breathing space"], [m]ost debtors are under immense financial strain before they file bankruptcy. Many are in the midst of foreclosures, evictions, garnishments, or other forms of collection on adverse state and federal judgments. Reorganization or orderly liquidation would be almost impossible without some breathing space for the debtor. Bankruptcy provides that key protection through the automatic stay. Upon the filing of a bankruptcy petition, the automatic stay bars the commencement or continuation of most types of legal proceedings against the debtor or efforts to enforce judgments or collect assets from the debtor. [On the other hand], [n]otice is fundamental to bankruptcy and implicates due process. At the beginning of the bankruptcy case, the debtor must identify all creditors so that the creditors can be sent notice of the bankruptcy case. […] The failure to properly list creditors and adequately provide notice to parties in interest impedes the bankruptcy proceedings and may result in denial of the relief requested by the debtor. [Moving on to "maximization of value"], [t]he Bankruptcy Code serves social utility by promoting maximization of value when possible. […] [A]s a general matter, debtors and trustees must show that they used sound business judgment with respect to proposed asset sales, post-petition financing, and new equity arrangements. Sound business judgment implies, at least, an initial assessment of value, some marketing or exploration of alternatives, and a sale or financing process that is transparent. [In regards to the element of "equality in distribution"], [b]ankruptcy stops the "race to the courthouse" by competing creditors and instead requires equality of distribution among similarly situated creditors. This does not mean that all creditors are treated equally. In successful reorganizations, distributions are made pursuant to the terms of confirmed plans. In liquidations, distributions are made by trustees. […] But whether the proceedings are for liquidation or reorganization, the guiding principle is parity for those creditors in the same class. [Lastly, the idea of "a fresh start" recognizes that] [f]or individuals, the holy grail of bankruptcy is a discharge of debts. The discharge releases a debtor from

---

4 *Id.* at 13

> personal liability for most types of pre-petition debt and enjoins post-bankruptcy collection of such debts. Successfully reorganized corporate debtors also may be entitled to a limited discharge. The discharge allows the debtor a fresh start—a "new opportunity" to proceed unencumbered by pre-petition debts.[5] (*citations omitted*)

In light of this very short introduction to the basic principles of US bankruptcy law, let us now review PROMESA's Title III quasi-bankruptcy procedure.

The first two sections of PROMESA's Title III procedure essentially specify the particular sections from the US Bankruptcy Code that apply to a Title III process[6] and define specific terms[7] relevant to it. For the purpose of our discussion, the most important statement in these sections is the definition of what is a debtor: "The term 'debtor' means the territory or covered territorial instrumentality concerning which a case under this title has been commenced."[8] Put simply, the term *debtor* is what's used to refer to, in this specific case, PR or any of its covered governmental instrumentalities. As is the case for most laws, PROMESA does a poor job at clearly transmitting its purpose and implications, so it's important to keep in mind that throughout today's discussion, whenever you hear the word *debtor*, think PR.

As we continue on, we find that Section 303 of the bill contains very interesting statements. In part, it affirms the following: "...this title does not limit or impair the power of a covered territory to control, by legislation or other wise, the territory or any territorial instrumentality there of in the exercise of the political or governmental powers of the territory or territorial instrumentality […]."[9] This statement is so broad that it might even lull some readers into a false sense of reassurance and safety from the reach of Congress. However, the exceptions that follow dispel such notions.

Subsections one (1) through three (3) of Section 303 directly limit the abilities of all three branches of the territory's government. When brought together, Sections 303(1), 303(2) and 303(3) state, in part, the following:

> [A] territory law prescribing a method of composition of indebtedness or a moratorium law […] may not bind any creditor of a covered territory or any covered territorial instrumentality thereof that does not consent to the composition or moratorium; a judgment entered under [said] law […] may not bind a creditor that does not consent to the composition; and unlawful executive orders that alter, amend, or modify rights of holders of any debt of the territory or

---

5 *Id.* at 14
6 PROMESA, *Supra* note 1, at §301
7 PROMESA, *Supra* note 1, at §302
8 PROMESA, *Supra* note 1, at §301(c)(2)
9 PROMESA, *Supra* note 1, at §303

> territorial instrumentality, or that divert funds from one territorial instrumentality to another or to the territory, shall be preempted by this Act.[10]

The cited text of the law results in the barring of all three of PR's government branches from taking any steps into directly resolving or restructuring its debt with its creditors. It's important to point out, as we did in Episode eight of this podcast, that PR did in fact attempt to legislate its own debt restructuring procedure. Of course, this resulted in an uproar from creditors and swift action on their part. The case that narrates this legal battle is Commonwealth Of Puerto Rico Et Al. V. Franklin California Tax-Free Trust Et Al.[11] which we also covered in in the same episode. There, the SCOTUS unequivocally and clearly affirmed that PR had no place legislating its own bankruptcy process.

Moving along, Section 304's text provides us with a first glimpse into the true power of the Financial Oversights and Management Board (FOMB) as created by PROMESA. It states the following: "A voluntary case under this title is commenced by the filing with the district court of a petition by the Oversight Board…"[12]. This short sentence, that otherwise inspires no sense of importance, is one of the most important aspects of PROMESA. It is the FOMB, and not PR, who is bestowed with the power to commence a Title III procedure.

Just as important and revealing is Section 315, which states the following:

> For the purposes of this title, the Oversight Board may take any action necessary on behalf of the debtor to prosecute the case of the debtor, including (1) filing a petition under section 304 of this Act; (2) submitting or modifying a plan of adjustment under sections 312 and 313; or (3) otherwise generally submitting filings in relation to the case with the court. **The Oversight Board in a case under this title is the representative of the debtor.**[13] (*emphasis added*)

This is an important point to highlight, because what this means is that it is the FOMB, and not the archipelago's government, who represents the interests of the people of PR in a Title III proceeding. In other words, it is the FOMB and not the democratically elected government of PR, who goes and speaks in the name of the people of PR. Keep that in mind the next time you read an article hear or read anything about PR's debt restructuring process. It is Congress' FOMB that's acting on behalf of the people of PR.

Moving along, as many of you may know PR's current debt restructuring procedures are taking place before the Honorable Judge Laura Taylor Swain. What you might not know is that Judge Taylor Swain was in fact hand picked for the job by the Chief Justice of the United States. This was done in accordance to Section 308(a) of PROMESA which states that "For cases in which the debtor is a territory, the Chief Justice of the United States shall designate

---

10 PROMESA, *Supra* note 1, at §§303(1)-303(3)

11 579 U.S. ___ (2016)

12 PROMESA, *Supra* note 1, at §304

13 PROMESA, *Supra* note 1, at §315

a district court judge to sit by designation to conduct the case."[14] However, Title III is silent in regards to the what considerations have to be taken into account in the selection of the judge that would "conduct the case". This allows for innumerable theories regarding what was considered in deciding to appoint Judge Taylor Swain to the position. But, instead of giving in to the seduction of speculation, lets consider Judge Taylor Swain's background.

In biography published by well-known non-profit *The History Makers,*[15] Judge Swain's formation is quickly summarized:

> Judge Laura Taylor Swain was born in 1958 in Brooklyn, New York [...]. She graduated from Hunter College High School in New York City in 1975; and earned her B.A. degree in government from Harvard-Radcliffe College in 1979, and her J.D. degree from Harvard Law School in 1982. Upon graduating from law school, Swain clerked for Chief Judge Constance Baker Motley on the U.S. District Court for the Southern District of New York from 1982 to 1983. [...] In 1996, Swain was appointed as a judge of the U.S. Bankruptcy Court for the Eastern District of New York. In 1998, she became a founding board member of the Coalition for Consumer Bankruptcy Debtor Education, a non-profit organization. Swain was appointed by President Bill Clinton to the U.S. District Court for the Southern District of New York as a U.S. District Judge in 2000. […] Swain became an adjunct professor at Benjamin N. Cardozo School of Law in 2011. In 2017, Chief Justice John Roberts appointed Swain under the Puerto Rico Oversight, Management and Economic Stability Act (PROMESA) to oversee the debt restructuring cases in the Puerto Rican government-debt crisis.[16]

Without a doubt, Judge Swain's credentials leave little doubt in regards to her knowledge of bankruptcy proceedings. By all regards, she is a highly educated and capable judge. However, placing aside her academic pedigree, one question continues to linger: why did Chief Justice Roberts choose her? What made her specifically capable to oversee PR's debt restructuring? These questions, I believe, should not be tossed aside with a simple review of a person's credentials. These questions are important given the fact that no judge in history has had to oversee a process such as this one.

In an article published in the *New York Times* on May 5th, 2017, author Mathew Goldstein points out that "Because Puerto Rico's case will be the first to be heard under a federal law

[14] PROMESA, *Supra* note 1, at §308(a)

[15] The History Makers, https://www.thehistorymakers.org/background (last visited Mar. 25, 2019)

[16] The History Makers, https://www.thehistorymakers.org/biography/honorable-laura-taylor-swain (last visited Mar. 25, 2019)

for insolvent territories, called Promesa [*sic*], Judge Swain will be entering uncharted waters."[17] The article also points out a fact that is at the center of my concerns:

> In a terse one-line order on Friday, Chief Justice John G. Roberts Jr. of the Supreme Court tapped Judge Swain, of the United States District Court for the Southern District of New York, to preside over Puerto Rico's filing for a form of bankruptcy relief from its many creditors. It was up to Chief Justice Roberts to pick a federal judge to preside over the case based on a law passed last year by Congress for handling instances of financial insolvency involving United States territories, including Puerto Rico. **He offered no explanation for his selection.**[18] (*emphasis added*)

It seems strange, and to a certain degree suspicious, that Chief Justice Roberts announced his decision in such an unpalatable way. Certainly his selection was not the result of a random drawing of names. However it took place, careful consideration and serious pondering must have been part of the selection process; at least that's what I hope. After all, in the absence of certainty, that's all we have left. Hope.

We continue our last tour through PROMESA by visiting Section 312 of the Bill. There we find what is considered to be the main objective of the Title III process: the Plan of Adjustments (Plan). This section also affirms that, once again, it's the FOMB's will that reigns supreme: "**Only** the Oversight Board, after the issuance of a certificate pursuant to section 104(j) of this Act, may file a plan of adjustment of the debts of the debtor."[19] (*emphasis added*) Even after presented, the FOMB, subject to a few limitations, has the power to modify the plan if it deems it necessary.[20] Once the plan has been established, it's the Court's turn to evaluate the plans qualifications. In this regard, Section 314(b) states the following:

> The court shall confirm the plan if— (1) the plan complies with the provisions of title 11 of the United States Code, made applicable to a case under this title by section 301 of this Act;(2) the plan complies with the provisions of this title; (3) the debtor is not prohibited by law from taking any action necessary to carry out the plan; (4) except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the plan provides that on the effective date

---

17 Mathew Goldstein, *Judge in Puerto Rico's Debt Lawsuit Handled Major Financial Cases*, The New York Times (May 5, 2017) https://www.nytimes.com/2017/05/05/business/dealbook/judge-puerto-rico-case.html

18 *Id.*

19 PROMESA, *Supra* note 1, at §312(a)

20 *The Oversight Board, after the issuance of a certification pursuant to section 104(j) of this Act, may modify the plan at any time before confirmation, but may not modify the plan so that the plan as modified fails to meet the requirements of this title. After the Oversight Board files a modification, the plan as modified becomes the plan.* PROMESA, *Supra* note 1, at §313

> of the plan each holder of a claim of a kind specified in 507(a)(2) of title 11, United States Code, will receive on account of such claim cash equal to the allowed amount of such claim; (5) any legislative, regulatory, or electoral approval necessary under applicable law in order to carry out any provision of the plan has been obtained, or such provision is expressly conditioned on such approval; **(6) the plan is feasible and in the best interests of creditors, which shall require the court to consider whether available remedies under the non-bankruptcy laws and constitution of the territory would result in a greater recovery for the creditors than is provided by such plan**; and (7) the plan is consistent with the applicable Fiscal Plan certified by the Oversight Board under title II.[21] (*emphasis added*)

It's quite eye-catching to see that the sixth criteria that the court must take into account explicitly favors the interest of PR's creditors. Now, that might not be surprising given the fact that PROMESA birth was basically reared by bondholders and hedge funds. However, let's not forget who writes the Plan in the first place: the FOMB. So in plain English, what this means is that the FOMB, who acts in representation of the people of PR, **must take into account the interests of the creditors** if it wants the court to approve its proposed plan.

Even if we put aside the obvious implications of representing one party while acting in the interests of its opponent, could we say that this process upholds and respects the fundamental considerations as described by Judge McNamara? This, of course is an open question, and a moot one at that, since PROMESA has created a quasi-bankruptcy law that is tailor made for the territories. This, for all intents and purposes, places it beyond the reach of the basic considerations as developed over years of jurisprudence and legislation. Once again, Congress is peacock-proud of it's plenary powers over its territories, and used those powers to create a bankruptcy scheme that thumbs it's nose at any sense of fairness.

Although without a doubt important, I will not venture into the remaining titles of PROMESA; for now. The focus of this series has been the restructuring of PR's debt. However, I strongly and highly recommend a full reading of PROMESA, including that content which I have purposefully left out. Only then can a truly holistic view be accomplished.

That being said, Title VII deserves an honorable mention since it contains only one section and places in plain sight PR's colonial role within the US's economic structure: "It is the sense of the Congress that any durable solution for Puerto Rico's fiscal and economic crisis should include permanent, pro-growth fiscal reforms that feature, among other elements, **a free flow of capital between possessions of the United States and the rest of the United States**."[22] (*emphasis added*)

---

21 PROMESA, *Supra* note 1, at §314(b)

22 PROMESA, *Supra* note 1, at §701

Notice that this statement does not indicate in what direction the capital will flow. Due to the absence of clarity, one can only use past examples to conclude that what we have before us is yet another policy that allows for the continuation of PR’s economic exploitation through captive markets and consumption.

In summary, when we read PROMESA, and really take our time to understand its real world effects, a very perverse and undemocratic narrative is revealed: this bill uses the US Constitution’s Territorial Clause to create an oversight board, which is charged with the task of providing for a way for PR to regain “...access to the **capital markets**.”[23]. This in turn means that the FOMB, at least to a partial level, must execute such actions which are deemed favorable in the view of Credit Rating Agencies, which so happen to often be at odds with the general welfare of the people of PR. The FOMB then is authorized to appear before a Judge and speak in the name of that very people to who it owes no loyalty or favor, potentially binding an entire nation’s future to agreements that have no guarantee of fostering adequate economic growth and stability for its people; all the while keeping in mind the interests of creditors, not that of the archipelago.

Its an ugly scheme with draconian impulses that so far have resulted in the imposition of austerity measures that, far from easing PR’s colonial condition, have worsened it.

---

23 PROMESA, Supra note 1, at §101(a)