



## PUERTO RICO FORWARD

### Episode 19: COFINA and the Next 40 Years of Exploitation

#### TRANSCRIPT

*Andrew Mercado-Vázquez*

As you all know, this program's mission statement is to discuss the economic and legal structures that govern the colonial relationship between the United States of America (hereinafter USA) and Puerto Rico (hereinafter PR). Few topics within the PR issue allow for the fulfillment of this mission as easily as the much discussed, and even more criticized COFINA deal. In today's episode I'll provide a review of what COFINA is and why it's another example of austerity in the US's largest colony.

To begin, let's answer the most basic question: what is COFINA? The word itself is actually an acronym for *Corporación del Fondo de Interés Apremiante*. Its official English translation is *Puerto Rico Sales Tax Financing Corporation*. As the name implies, COFINA is a corporation. From a legal standpoint, this means that it is its own entity that is separate from the government. COFINA's genesis can actually be traced to 2006, when its organic law was approved.<sup>1</sup> Known in English as the *Puerto Rico Sales Tax Financing Corporation Act*,<sup>2</sup> Public Law 91 was approved on May 13th of 2006, creating COFINA.

A visit to the Government Development Bank for Puerto Rico's website actually yields a quick description of the aforementioned entity:

COFINA issued Puerto Rico Sales Tax Revenue Bonds to provide funds for the Commonwealth of Puerto Rico to repay certain debt obligations to the GDB [which is the Government Development Bank for Puerto Rico] and PFC [which is the Puerto Rico Public Finance Corporation]. The bonds, issued under resolutions adopted by COFINA's board of directors will be payable from and secured by a security interest created by the Resolution in a specified portion of the newly created sales tax ("Pledged Sales Tax"). Legislation enacted in 2006 approved for the first time in Puerto Rico a sales and use tax (SUT) of 5.5% for the benefit of the central government and a separate 1.5% for the benefit of municipalities of Puerto Rico. Act 91 also created a Dedicated Sales Tax Fund,

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<sup>1</sup> Ley de la Corporación del Fondo de Interés Apremiante, Ley Núm. 91-2006

<sup>2</sup> Puerto Rico Sales Tax Financing Corporation Act, Act No. 91-2006

to be held and owned by COFINA separate and apart from the central government's General Fund, and provided, among other things, that each fiscal year the first receipts of the Commonwealth's Sales Tax, in the amount specified in the law, be deposited in this special Dedicated Fund and applied to the payment of the Sales Tax Revenue Bonds. On July 1, 2015, the total SUT was increased to 11.5%.<sup>3</sup>

So put simply, the purpose of COFINA is to secure money for the payment of past debt that otherwise had no identified source of payment. How does it do it? Why by selling bonds of course! The main idea is the following: PR's government had a debt that had no hope of being paid back. In order to acquire the funds necessary to cover this debt, COFINA's board of directors would adopt a resolution to issue a certain amount of bonds, called *Sales Tax Revenue Bonds*, to be sold on the bond market, and use said revenue to pay off the aforementioned debt. So up to now we have new debt being created in order to pay off old debt. Of course, this new debt would have to eventually be paid back. In order to do that, a portion of the Sales and Use Tax (hereinafter SUT) would be sequestered and be transferred directly to a separate government fund called the *Dedicated Sales Tax Fund* which is owned by COFINA. Said fund would have the exclusive purpose of paying for the Sales Tax Revenue Bonds issued by COFINA.

However, over time the temptation to use COFINA, not just to pay off old debt, but rather to sell additional bonds and thus secure more liquidity for government operations, proved too great. In a report<sup>4</sup> commissioned by the Financial Oversight and Management Board from a law firm called *Kobre & Kim LLP*<sup>5</sup> (hereinafter *the K&K Report*), we're confronted with an infuriating truth: instead of securing funds to pay off a debt, COFINA created more of it.

In January 2009, a new administration led by Governor Luis Fortuño calculated Puerto Rico's fiscal imbalance to be in excess of \$3 billion. On January 8, 2009, the Governor declared a fiscal emergency and shortly thereafter, on January 14, 2009, signed Act No. 1 into law ("Act 1-2009"). Act 1-2009 further amended Act 91-2006 to increase the portion of the SUT revenues allocated to COFINA and to expand the permitted uses of COFINA bond proceeds. Under Act 1-2009, COFINA bond proceeds were now permitted to be used for a number of purposes beyond paying or refinancing extraconstitutional debt, including to fund Puerto Rico's general operating expenses. In 2009 through 2011, COFINA

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<sup>3</sup> Government Development Bank for Puerto Rico [http://www.gdb.pr.gov/investors\\_resources/cofina.html](http://www.gdb.pr.gov/investors_resources/cofina.html) (last visited Jun. 7, 2019)

<sup>4</sup> KOBRE &KIM, LLC, THE INDEPENDENT INVESTIGATOR'S FINAL INVESTIGATIVE REPORT, (Aug. 20, 2018) [hereinafter *K&K Report*]

<sup>5</sup> Kobre & Kim Disputes and Investigations <https://kobrekim.com/> (last visited Jun. 7, 2019)

continued to issue bonds, and the outstanding principal amount of COFINA bond issuances increased to approximately \$16.3 billion.<sup>6</sup>

So, as the preceding paragraph points out, over the years COFINA mutated and transformed from an independent entity that managed a fund whose sole purpose was to pay off old debt, to a large scale debt-creating machine that was used and abused in order to finance the archipelago's operating expenses. For proof of this, look no further than the staggering difference between the value of bonds issued when COFINA began operating *versus* the amount it grew to. The K&K Report sheds light on this as well:

...Act 91-2006 created a mechanism to pay or refinance Puerto Rico's so-called "extraconstitutional debt" in existence as of June 30, 2006, which, according to the Act's "Statement of Motives," had substantially affected Puerto Rico's credit. "Extraconstitutional debt" (also called "appropriation debt") means Puerto Rico debt payable solely from legislative appropriations with no identified source of repayment and not backed by Puerto Rico's full faith, credit and taxing power. [...] A year later, [...] Act No. 56 of July 5, 2007 [...] created a special fund called the "*Fondo de Interés Apremiante*" (the "FIA Fund" or the "Dedicated Sales Tax Fund") and required that a portion of the revenues collected from the SUT be transferred to the FIA Fund. Under Act 56-2007, the FIA Fund was transferred to COFINA, and COFINA was authorized to issue bonds, pledge the moneys deposited into the FIA Fund to secure payment on the bonds, and use the proceeds of the bond sales to pay or refinance the extraconstitutional debt in existence as of June 30, 2006. According to statements by [the Government Development Bank], such extraconstitutional debt totaled approximately \$6.847 billion at that time. [Currently] [r]epresenting \$17.6 billion in outstanding debt, the bonds that COFINA issued ("COFINA Bonds") constitute nearly 25% of Puerto Rico's total public sector debt.<sup>7</sup>

That's right my friends. COFINA's debt ballooned to almost three times its original amount; and to make matters worse, the new debt created was a type of *extraconstitutional debt* that, despite being a blatant contradiction, was technically backed by the local government's taxation power. To understand why this is important, we need to take a look at PR's Constitution.

Article VI Section 2 of Puerto Rico's Constitution states, in part, the following:

**[N]o direct obligations of the Commonwealth for money borrowed directly by the Commonwealth evidenced by bonds or notes for the payment of which the full faith credit and taxing power of the Commonwealth [sic] shall**

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<sup>6</sup> K&K Report, *Supra* note IV at 159

<sup>7</sup> K&K Report, *Supra* note IV at 157-158

**be pledged shall be issued by the Commonwealth if the total of (i) the amount of principal of and interest on such bonds and notes, together with the amount of principal of and interest on all such bonds and notes theretofore issued by the Commonwealth and then outstanding, payable in any fiscal year and (ii) any amounts paid by the Commonwealth in the fiscal year next preceding the then current fiscal year for principal or interest on account of any outstanding obligations evidenced by bonds or notes guaranteed by the Commonwealth, shall exceed 15% of the average of the total amount of the annual revenues raised under the provisions of Commonwealth legislation and covered into the Treasury of Puerto Rico in the two fiscal years next preceding the then current fiscal year; [...] and the Commonwealth shall not guarantee any obligations evidenced by bonds or notes if the total of the amount payable in any fiscal year on account of principal of and interest on all the direct obligations referred to above theretofore issued by the Commonwealth and then outstanding and the amounts referred to in item (ii) above shall exceed 15 percent of the average of the total amount of such annual revenues.<sup>8</sup>**  
(*Emphasis added*)

The purpose of this clause is to establish a “bright-line-rule” as far as how much *constitutional debt* could be “serviced”. For those don’t already know, the term *debt service* within the context of finance refers to “...the cash that is required to cover the repayment of interest and principal on a debt for a particular period.”<sup>9</sup> This type of debt, *constitutional debt*, is characterized by being backed by “...the full faith, credit, and taxing power of...” the government of PR. However, PR’s Constitution goes a step further and prohibits the archipelago’s government from approving a debt service that surpasses fifteen percent (15%) “...of the average of the total [...] annual revenues raised [...] and covered into the Treasury of Puerto Rico in the two [preceding] fiscal years...”<sup>10</sup> So in other words, the process would be the following: 1) identify the total revenues for each of the immediately last two fiscal years; 2) calculate the average between the two amounts; 3) figure out what amount represents fifteen percent (15%) of said average. Once completed, this process would result in an amount that was supposed to be a clear limit to how much new constitutional debt could be serviced. A violation of clause would be deemed unconstitutional, therefore illegal.

The importance Section 2 in discussing COFINA cannot be overstated. However, it must be read in conjunction with the same Article’s Sections Seven (7) and Eight (8) in order to really have a full picture of its importance.

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<sup>8</sup> P.R. CONST. art. VI, § 2.

<sup>9</sup> Will Kenton, *Debt Service*, Investopedia  
<https://www.investopedia.com/terms/d/debtservice.asp> (last visited Jun. 7, 2019)

<sup>10</sup> P.R. CONST. art. VI, § 2.

Section 7. The appropriations made for any fiscal year **shall not exceed the total revenues, including available surplus**, estimated for said fiscal Year unless the imposition of taxes sufficient to cover said appropriations is provided by law.

Section 8. **In case the available revenues including surplus for any fiscal year are insufficient to meet the appropriations made for that year, interest on the public debt and amortization thereof shall first be paid**, and other disbursements shall thereafter be made in accordance with the order of priorities established by law.<sup>11</sup> (*emphasis added*)

Commonly known as the *Balanced Budget Clause*, Sec. 7 sets a limit to the amount in appropriations made by PR's government. Merriam-Webster defines the word "appropriate" as "...to set apart for or assign to a particular purpose or use..."<sup>12</sup> In the specific context of operating a government, to appropriate is to single out a certain amount of money so that it be used for a specific purpose. For example, in general, for a federal agency to make payments out of the US Treasury, it would have to do so using funds that have been identified, i.e. appropriated, through legislation. Once we understand what appropriations are, the purpose of the balanced budget clause becomes clear: PR's government is constitutionally impeded from setting aside more than the money it has in "...total revenues [plus] available surplus...". Although its text seems to be simple and straight forward, its Spanish counterpart has been the source of contention for decades.

You see, before PR was allowed to have its "own" constitution, Section 34 of the Jones-Shafroth Act<sup>13</sup>, commonly known as simply the Jones Act, was the controlling statute in regards to how much money could be appropriated by the archipelago's local government, and provided the following instructions:

No appropriation shall be made, nor any expenditure authorized by the legislature, whereby the expenditure of the Government of Porto Rico [sic] during any fiscal year shall exceed the **total revenue** then provided for by law and applicable for such appropriation or expenditure, including any available surplus in the treasury, unless the legislature making such appropriation shall provide for levying a sufficient tax to pay such appropriation or expenditure within such fiscal year.<sup>14</sup> (*emphasis added*)

As we can see, the English version of both the PR Constitution's Balanced Budget Clause and Sec. 34 of the Jones Act identify "**total revenue**" as the limiting factor to the amounts that

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<sup>11</sup> P.R. CONST. art. VI, §§ 7-8.

<sup>12</sup> Merriam-Webster <https://www.merriam-webster.com/dictionary/appropriate#h2> (last visited Jun. 7, 2019)

<sup>13</sup> Jones-Shafroth Act, Pub. L. No. 64-368, 39 Stat. 951.

<sup>14</sup> *Id.* at §34

can be appropriated by the archipelago's central government. As a result, the approval of PR's Constitution did not alter the underlying concept of what a total revenue is, in as far as establishing a balanced budget, and therefore, according to the English version of said statutes, said process suffered no change. However, the Spanish version of both texts do not yield the same synergy.

Considering that the English versions of the Balanced Budget Clause and Sec. 34 of the Jones Act use the same terms, one would reasonably expect the same to occur with their Spanish versions. However, the official Spanish translation of Sec. 34 of the Jones Act uses the phrase "*rentas totales*" to translate "total revenue".<sup>15</sup> On the other hand, the official Spanish translation of the Balanced Budget Clause uses the phrase "*recursos totales*".<sup>16</sup> As a result, the Spanish counterparts of the Balanced Budget Clause and Sec. 34 of the Jones Act use different words, that of course, have different meanings. While "rentas" appears to generally be one of the accepted Spanish translations of the word *revenue*, which is defined as "...the yield of sources of income (such as taxes) that a political unit (such as a nation or state) collects and receives into the treasury for public use...",<sup>17</sup> "recursos" is not.<sup>18</sup> The direct English translation of "recursos" is *resources*,<sup>19</sup> which is defined as "...a source of supply or support: an available means..."<sup>20</sup>

To most people, the differences between one word and another might be of little importance. Nonetheless, within the context of laws and legislation, words are everything; especially considering the historical context within which these conflicting translations emerged. As I already mentioned, before PR was allowed to have its own constitution, Sec. 34 of the Jones Act was the controlling statute in regards to assuring the approval of a balanced budget. Of course, this changed once PR's Constitution was approved. From that point on, the Balanced Budget Clause replaced Sec. 34 of the Jones Act, and with this switch came a conflict of interpretation.

Local authorities and legal advisors, taking into account the differences in the language of each statute's Spanish version, came to different interpretations as to their effect. In particular, one school of thought believed the change had effectively broadened the origins of

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<sup>15</sup> Carta Orgánica de 1917 (Ley Jones), 1 LPRA Documentos Históricos § 34 (2017).

<sup>16</sup> Const. de P.R. art. VI, § 7.

<sup>17</sup> Merriam-Webster <https://www.merriam-webster.com/dictionary/revenue> (last visited Jun. 7, 2019)

<sup>18</sup> Google Translate  
<https://translate.google.com/#view=home&op=translate&sl=en&tl=es&text=revenue>  
(last visited Jun. 7, 2019)

<sup>19</sup> Google Translate  
<https://translate.google.com/#view=home&op=translate&sl=es&tl=en&text=recursos>  
(last visited Jun. 7, 2019)

<sup>20</sup> Merriam-Webster <https://www.merriam-webster.com/dictionary/resources> (last visited Jun. 7, 2019)

the funds that could be considered when balancing the budget. The most important example of this thesis is an opinion written by PR's Justice Secretary back in 1974 (hereinafter Opinion).<sup>21</sup> The Opinion essentially concludes that the Balanced Budget Clause's use of the word *resources* implied that the local government was no longer restricted to only consider its *revenues*.<sup>22</sup> This difference is important because it has long been accepted that the concept of *revenues*, given its more restrictive meaning, did not include moneys generated by the sale of government bonds, but rather referred to those generated through taxation.<sup>23</sup> This interpretation represented a shift towards a less restrained budget approval process, effectively allowing for bond sales to be used in balancing the government's budget.

However, although dominant, this point of view has not gone unchallenged. In an article published in 2016 titled *La Constitución de Puerto Rico y Su Requisito de un Presupuesto Balanceado*,<sup>24</sup> Professor Carlos A. Colón de Armas essentially rows the boat the other way, stating that both the legal and academic communities have a long established hermeneutic practice when determining a law's meaning: if the text is clear, there is no need for interpretation.<sup>25</sup> Perhaps even more persuasive is the fact that, as Prof. Colón de Armas affirms, when someone uses debt to cover costs it is factually inescapable to conclude that current resources have been exceeded.<sup>26</sup>

Both Secs. 2 and 7 of Art. 6 of PR's Constitution have or could serve as a genuine legal basis to question COFINA's constitutionality. However, without Art. 6 Sec. 8 of PR's Constitution, there might have never been a real motive question COFINA's validity in the first place. Said Section reads the following way:

**In case the available revenues including surplus for any fiscal year are insufficient to meet the appropriations made for that year, interest on the public debt and amortization thereof shall first be paid, and other disbursements shall thereafter be made in accordance with the order of priorities established by law.**<sup>27</sup> (*emphasis added*)

This means that, from a constitutional point of view, in the event that PR's revenues are not enough to pay for the appropriations of that fiscal year, **public debt interest and its**

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<sup>21</sup> Op. Sec. Just. Núm. 1974-15, 21 de mayo de 1974.

<sup>22</sup> *Id.*

<sup>23</sup> Google Translate

<https://translate.google.com/#view=home&op=translate&sl=en&tl=es&text=revenue>  
(last visited Jun. 7, 2019)

<sup>24</sup> This title could translate to English as "Puerto Rico's Constitution and its Requirement of a Balanced Budget".

<sup>25</sup> Carlos A. Colón de Armas, *La Constitución de Puerto Rico y Su Requisito de un Presupuesto Balanceado* 85 Rev. Jur. UPR 819, 827 (2016)

<sup>26</sup> *Id.*

<sup>27</sup> P.R. CONST. art. VI, § 8.

**amortization are to be paid before any other expenditure.** That means that certain bondholders, for example, have a right to be paid before schools, hospitals or any other public operation. As one could imagine, this constitutional protection for PR's creditors has served as a catalyst for the different sectors that argue against austerity. However, it also served as a legal battering ram for *constitutional* debt creditors to pierce any argument that otherwise tries to limit their preferential position. But before we go any further, let's take some time to understand the difference between *constitutional* debt and *extraconstitutional* debt.

As briefly alluded to, within the context of PR's overall economic crisis, *constitutional* debt is a type of public debt generated by the archipelago's central government.<sup>28</sup> The main characteristic that identifies a debt as *constitutional* is whether or not its backed by the full faith, credit and taxing power of PR's government. If it is, it will generally be deemed as *constitutional*. As I've already mentioned, the servicing of this kind of debt is controlled by Art. 6 Sec. 2 of PR's Constitution which imposes a fifteen percent (15%) rule when establishing debt service. Without a doubt, the most well known constitutional debt issued by the colonial government was created by selling *General Obligation Bonds*, more commonly known as G.O.'s.

On the opposite side of the spectrum we have *extraconstitutional* debt. As one would assume, this type of public debt is **NOT** backed by the full faith, credit and taxing power of PR's government.<sup>29</sup> In other words, despite the fact that PR's government is the debtor, payment of this type of debt has no guarantee of being satisfied through the use of the colonial government's ability to tax its citizens. Instead, specific revenue streams are identified as the source of payment. For example, bonds issued by PR's Highway and Transportation Authority are backed by the toll fees paid by drivers. Debt created by the issuance of such a bond, also known as *special revenue bond* due to its specified source of payment, are considered to create an *extraconstitutional* debt.

Given their drastically different sources of payment, each debt classification implies different valuations. In an article published in *QUARTZ* titled *How Puerto Rico's Financial Storm is Washing Over the Mainland*, author Jane Sasseen describes why extraconstitutional debt, despite **NOT** being backed by the colonial government's full faith, credit and taxing power, would actually be the easiest one to sell:

Investors like [special revenue bonds] because they are supposed to function like a lockbox: since the revenue stream is guaranteed, bondholders are protected from losses even if the borrower goes bankrupt. As a result, special revenue bonds are considered safer than general obligation bonds. That means they've

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<sup>28</sup> Espacios Abiertos <http://espaciosabiertos.org/diccionario/deuda-constitucional/> (last visited Jun. 7, 2019)

<sup>29</sup> Espacios Abiertos <http://espaciosabiertos.org/diccionario/deuda-extraconstitucional/> (last visited Jun. 7, 2019)



typically earned higher credit ratings and paid out lower interest rates. That's why states and cities like them, too: they cost taxpayers less. For governments with already weak financials [sic], the difference can be substantial.<sup>30</sup>

Because each type of debt has a different source of payment, titleholders of bonds sold as constitutional debt and bonds sold as extraconstitutional debt naturally have different concerns. These competing interests came to full bloom when the time came to decide which one would benefit from COFINA's funds. In a Memorandum<sup>31</sup> issued February 4<sup>th</sup>, 2019 by United States District Judge Laura Taylor Swain, a brief recount of a complaint filed by G.O. bonds places the contention between the two parties in plain view.

[O]n July 20, 2016, certain holders of GO Bonds filed a complaint in the United States District Court for the District of Puerto Rico against the Governor, Secretary of Treasury, and Office of Management and Budget Director seeking [...] an injunction to prevent certain measures taken by the government permitting transfers outside of the ordinary course. On November 4, 2016, the plaintiffs in that case filed a second amended complaint [...] adding new causes of action, including three causes of action relating to COFINA, and adding COFINA and other parties as defendants. On December 16, 2016, COFINA filed an answer to the second amended complaint [...]. Certain COFINA bondholders who intervened in the [case] also filed answers [...]. Plaintiffs [...] argue, among other things, that the Puerto Rico Constitution requires the Commonwealth to pay the GO Debt ahead of any other expenditure. They claim that, pursuant to Article VI, Section 8 of the Puerto Rico Constitution, if Puerto Rico's "available resources" are insufficient to meet all its appropriations, "interest on the public debt and amortization thereof shall first be paid, and other disbursements shall thereafter be made in accordance with the order of priorities established by law." They further allege the Pledged Sales Taxes are an "available resource" and that COFINA was created and has issued bonds in an attempt to evade the claim of holders of GO Debt on "available resources" and related constitutional limitations

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<sup>30</sup> Jane Sasseen, *How Puerto Rico's Financial Storm is Washing Over the Mainland*, QUARTZ <https://qz.com/1557486/puerto-ricos-bond-saga-is-messing-up-mainland-municipal-markets/> (last visited Jun. 7, 2019)

<sup>31</sup> MEMORANDUM OF FINDINGS OF FACTS AND CONCLUSIONS OF LAW IN CONNECTION WITH CONFIRMATION OF THE THIRD AMENDED TITLE III PLAN OF ADJUSTMENT OF PUERTO RICO SALES TAX FINANCING CORPORATION, In re: THE FINANCIAL OVERSIGHT AND MANAGEMENT BOARD FOR PUERTO RICO as representative of THE COMMONWEALTH OF PUERTO RICO *et al.*, Debtors. In re: THE FINANCIAL OVERSIGHT AND MANAGEMENT BOARD FOR PUERTO RICO, as representative of PUERTO RICO SALES TAX FINANCING CORPORATION, Debtor., No. 17 BK 3283-LTS (D.PR filed Feb. 4, 2019)

on the amount of public debt the Commonwealth was permitted to issue. [...] Certain holders and insurers of COFINA's Existing Securities, permitted to intervene in the [case], asserted that the Pledged Sales Taxes were legislatively rendered property of COFINA from their inception, thereby eliminating any possibility the taxes may be property or "available resources" of the Commonwealth. Such holders and insurers rely upon Act 91, which provides that the Pledged Sales Taxes "shall [not] constitute available resources of the Commonwealth of Puerto Rico [...]" They further assert that the question whether COFINA's property constitutes "available resources" should be certified to the Supreme Court of Puerto Rico because, in their view, its resolution would involve a pure and undecided issue of Puerto Rico constitutional law that would have long-lasting consequences for the Commonwealth. They assert that COFINA is essential in permitting Puerto Rico to access the capital markets on favorable terms, and that the plaintiffs in the [case] had been able to obtain higher interest rates on the Commonwealth's general obligation bonds precisely because COFINA's property was not available to repay them.<sup>32</sup> (*citations omitted*)

To anyone, this degree of conflict would reasonably be considered a huge obstacle for any attempt at cooperation. However, this is exactly what happened.

In a report<sup>33</sup> published January 15<sup>th</sup>, 2019 by the *Citizen Commission for the Comprehensive Audit of the Public Debt*<sup>34</sup> (hereinafter the Commission) said organization was able to discover that up to that point as few as seventeen (17) hedge fund groups owned as much as forty seven percent (47%) of COFINA's debt.<sup>35</sup> Many of these groups also own G.O. bonds. This, my friends, is no small detail, for it is the reason that a deal was struck in the matter of the COFINA bonds.

You see, as the Commission points out in its report, because these hedge fund groups had their hands on both constitutional and extraconstitutional debts, they lacked any motivation to question the constitutionality of any of the two.<sup>36</sup> As a result, the public's interest in not paying for a debt that might have been issued in violation of the PR Constitution, and therefore illegal, had no representation during this process.

Eventually, as mentioned before, a deal was struck between PR's government, the Financial Oversight and Management Board (hereinafter FOMB), the COFINA bond holders and the

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<sup>32</sup> *Id.* at 14-16

<sup>33</sup> Comisión Ciudadana para la Auditoría Integral del Crédito Público, COFINA: DEUDA ILEGAL E ILEGÍTIMA, (Jan. 15, 2019) [hereinafter *CC Report*]

<sup>34</sup> Better known under its original Spanish name *Comisión Ciudadana para la Auditoría Integral del Crédito Público* <http://www.auditoriaya.org/english/> (last visited Jun. 7, 2019)

<sup>35</sup> *CC Report*, *Supra* note xxxii at 3

<sup>36</sup> *CC Report*, *Supra* note xxxii at 37

G.O. bondholders in regards to the COFINA debt. In a two part series published November 19<sup>th</sup> and 20<sup>th</sup>, 2018 on the news site *Eyes on the Ties*, Authors Abner Dennis and Kevin Connor (hereinafter Dennis and Connor) provide a simple review of the agreement:

The basis of the COFINA adjustment plan is the division of the collections generated by the SUT [...]. Of the 11.5% tax, 5.5% belonged to COFINA. From the start of the bankruptcy process in federal court, different groups of creditors and vulture funds have battled over who gets to extract this money. [...] The Fiscal Board and Judge Laura Taylor Swain [...] avoided deciding on this matter, preferring to open a mediation process that culminated in the following agreement that forms the basis of the newly approved adjustment plan: From the 5.5% portion of the SUT belonging to COFINA, 53.65% will be preserved for the bondholders of COFINA and the rest will be for the central government. [...] **The adjustment plan of COFINA will be effective for the next 40 years.**<sup>37</sup>  
(*emphasis added*)

Once approved, the agreement was touted by those involved as a fair deal that should be taken as a victory. The main justification for such celebration was the fact that the face value of the bonds had been reduced, more commonly known as a “haircut”, by 32%.<sup>38</sup> However, a closer look reveals no reason for celebration. Again, authors Dennis and Connor provide clarity:

To understand the cuts, it is necessary to understand the hierarchy of COFINA bonds. On the one hand, there are **senior bonds**, those whose debt is more secured, and which are the first in line to collect. Then there are the **subordinates or juniors**, which are next in line. Senior bonds total \$7.7 billion (44% of the total debt), while juniors total \$9.8 billion [which represents the remaining] (56%). Senior bonds were only cut by 7%; that is, they will be able to recover 93% of the nominal value of the bonds, while the juniors were cut by 46.1%...<sup>39</sup> (*emphasis added*)

Now, before you start feeling sorry for the bondholders, remember that these bonds are in the hands of hedge funds that bought them on the cheap. As a result, instead of suffering a loss, they actually perceived huge profits.

For example, many of the senior bonds were bought by vulture funds for fifty-five cents (\$0.55) on the dollar. However, after the agreement, senior bondholders would receive

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<sup>37</sup> Abner Dennis and Kevin Connor, *The COFINA Agreement, Part 1: The First 40 Year Plan*, *Eyes on the Ties*  
<https://news.littlesis.org/2018/11/19/the-cofina-agreement-part-1-the-first-40-years/>  
(last visited Jun. 7, 2019)

<sup>38</sup> *Id.*

<sup>39</sup> *Id.*

ninety-three cents (\$0.93) on the dollar. In total, senior bond-holding hedge funds would receive a profit of one billion, twenty-six million, three-hundred and five thousand, four-hundred and nineteen dollars (\$1,026,305,419.00).<sup>40</sup>

On the other hand, at the time of purchase by hedge funds, junior bonds were selling for an average of fifteen cents (\$0.15) on the dollar. Under the COFINA agreement, hedge funds that were junior bondholders would be paid fifty-four cents (\$0.54) on the dollar, which would result in a profit of about three-hundred and thirty-two million, two-hundred and fifty-seven thousand, sixty dollars (\$332,257,060.00).<sup>41</sup>

From the get-go, PR's financial crisis has been seen by hedge funds as a fantastic opportunity to make lots and lots of money through the misery and suffering of an entire nation; and the COFINA deal is but one example of just how much they have to gain, and how much we're set to lose.

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<sup>40</sup> Abner Dennis and Kevin Connor, *The COFINA Agreement, Part 2: Profits for the Few, Eyes on the Ties*  
<https://news.littlesis.org/2018/11/20/the-cofina-agreement-part-2-profits-for-the-few/>  
(last visited Jun. 7, 2019)

<sup>41</sup> *Id.*