

Questions for the Record
Senator Orrin G. Hatch
Senate Judiciary Committee
Hearing: “Puerto Rico’s Fiscal Problems:
Examining the Source and Exploring the Solution”
Tuesday, December 1, 2015

Questions for all Panel II Witnesses

1. Would extending Chapter 9 to Puerto Rico carry any negative consequences for the island? I’m not talking just about bondholders. I’m talking about the commonwealth as an entity. If Congress extended Chapter 9 to Puerto Rico and island municipalities began taking advantage of Chapter 9, how would that impact the island’s bond rating, its creditworthiness, its attractiveness as an investment location, etc.? Is there a scenario under which extending Chapter 9 to Puerto Rico would actually make the island’s fiscal situation worse?
2. We’ve heard arguments that extending Chapter 9 to Puerto Rico would be unfair to bondholders because it would reduce their return on their investments. Some have argued that any Chapter 9 extension should apply only to future debts. As an initial matter, it would be helpful to know whether past bankruptcy code reforms have applied to existing debts, or whether bankruptcy reforms have typically applied only to future debts. Can you offer any insight on this matter? And if past reforms have applied to existing debts, have any of those reforms been analogous to what we’re considering here—namely, extension of bankruptcy access to entities who previously had no such access? I asked this question at the hearing, but I didn’t get a complete answer and I believe it’s extremely important.
3. Another question on Chapter 9 and retroactivity: If Congress steps in and changes the rules of the game after the fact to allow municipalities to discharge existing debts, do we need to worry about the message that sends to other debtors and other creditors across the country? Parties negotiate contracts according to existing laws. If we step in and suddenly change the rules, does that tell parties in other situations that the rules are actually more up for grabs than they might think? Does that tell other states or other municipalities outside Puerto Rico that if things get bad enough, Congress will simply change the rules to help ease the pressure?

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Answers to Follow-Up Questions from Senator Hatch

Hearing on Puerto Rico's Fiscal Problems, December 1, 2015

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It is a pleasure to reply to Senator Hatch's questions for the record. By way of preface, let me say that I remain convinced that the first step and indeed the sine qua non of addressing Puerto Rico's severe debt and financial management, or mismanagement, problems is the appointment by Congress of an Emergency Financial Control Board. Of course, this control board can be given another name, as long as the substance of its undoubted authority is provided for. It appears to me in reading the proposed statutory provisions for the "Puerto Rico Financial Responsibility and Management Assistance Authority" contained in "The Puerto Rico Assistance Act of 2015," S. 2381, that this is the case. The case is strengthened by the bill's provisions for a Chief Financial Officer for the government of Puerto Rico.

Once the control board is in place and in possession of the requisite financial information and analysis, it continues to be my recommendation that it should be required to report to Congress on the alternatives for addressing Puerto Rico's massive debt, specifically whether a bankruptcy regime, other debt restructuring or refinancing, or other actions would be the most appropriate and efficient, considering all the factors.

My answers to the three questions are as follows:

1. Puerto Rico already has debt ratings at the bottom of the scale, is shut out of the municipal debt market, and now has a well-deserved terrible financial reputation, as a fiscally and economically failing government-centric, welfare state. It is not clear whether a bankruptcy filing, whether under a revised Chapter 9 or a new territorial chapter of the bankruptcy code, would make any of that worse. Entities can go through bankruptcy and then later re-emerge as good credits, as for example in the municipal sector, Orange County, California, which was the largest municipal bankruptcy in history at the time of its insolvency. States of the U.S. often resist bankruptcy filings by their municipalities because they do not want the reputational damage to spread to their other cities and public bodies or the state itself. This concern would not apply in the case of the current Puerto Rico, which already appears insolvent on an overall basis. As stated above, I believe the first step should in any case be a control board, which should then recommend what the next steps should be.
2. The historical question about past bankruptcy code changes is very interesting and worthy of research, but not being a historian of bankruptcy laws, I unfortunately do not know the answer and have not seen it in my summary review of the history. The underlying intuition of the question seems reflected in the history of U.S. state laws because of the Constitutional provision

that “No State shall... pass any... Law impairing the Obligation of Contracts.” But this obviously does not apply to federal bankruptcy laws. As to the extension of bankruptcy procedures to entities who previously had no such access, the addition of bankruptcy for municipalities, in 1934 and 1937, is itself one notable example, as was the 19th century innovation of allowing debtors voluntarily to petition into bankruptcy, instead of being forced into it by their creditors.

3. It seems to me that this question depends in part on whether one thinks a territory is easily analogized to a U.S. state, or conversely, whether a territory is so obviously distinct and different from a state that the ideas do not transfer. The complete jurisdiction of Congress over a territory, which has always been the case, as entirely distinct from its relation to a state, inclines me to the latter view. However, I would never even consider a bankruptcy regime for Puerto Rico without first installing an emergency financial control board (by whatever name one prefers). To allow bankruptcy without first exercising reformed control over Puerto Rico’s finances, would, in my opinion, be a fundamental mistake and a very bad precedent.

Thank you for the opportunity to share these views.