



NEW BILL ENTAILS DEBT-REORGANIZATION PROCESS FOR P.R. PUBLIC CORPORATIONS

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Senate Bill 1164, the Public Corporations Debt Compliance & Recovery Act (Act), was recently signed by the Puerto Rico governor. The Act establishes a debt-enforcement, recovery and restructuring system for eligible local public corporations experiencing financial insolvency.

It creates two debt-relief solutions—a consensual debt-relief process and a debt-enforcement judicial process. The Act will have a significant impact on both distressed eligible governmental entities and the creditors of such entities.

According to the Act, the provisions of title 11 of the U.S. Code, applicable to municipalities or corporations in state of insolvency (chapter 9 and chapter 11 proceedings), are inapplicable to the commonwealth's public corporations, and no statute provides an orderly recovery regime for those that may become insolvent.

The Act creates the Public Corporations Debt Compliance & Recovery Act Courtroom at San Juan's Court of First Instance, a specialized court that will have exclusive competence and jurisdiction over all matters arising under or related to this Act.

Chapter 2 of the Act

Chapter 2 of the Act contemplates a consensual debt-relief process, providing a mechanism for eligible public corporations to adopt a recovery program with minor court intervention. This chapter enables such eligible entities to become financially self-sufficient, allocates the burdens of the recovery program equitably among all stakeholders and provides the same treatment to all creditors.

Chapter 2 was designed based on case law that determined no impairment of contractual obligations exist when adopting a debt-adjustment regime if the following characteristics are met: (i) the existence of a fiscal emergency that necessitates the enactment of this legislation; (ii) a supermajority vote of creditors in order to bind the minority; (iii) the creation of an impartial oversight board to supervise compliance with the recovery program; (iv) ratable distributions; and (v) court approval.

Chapter 3 of the Act

The debt-enforcement process contemplated in chapter 3 of the Act is a model

similar to chapters 9 and 11 of title 11 of the U.S. Code. This chapter is a system to ensure orderly payment of debt to the extent of each eligible public corporation's capacity to do so.

Of great concern to the U.S. Supreme Court is the petitioner's autonomy to establish the debt-restructuring terms. To address this concern, chapter 3 adopts even more stringent economic standards than chapters 9 and 11 of the Bankruptcy Code. To be eligible for chapter 3, a petitioner must be (i) currently unable or at serious risk of being unable to pay valid debts as they mature while performing its public functions without additional legislative or financial assistance; (ii) ineligible for relief under chapter 11 of title 11 of the U.S. Code; and (iii) authorized to file a petition by its governing body and the GDB or by the GDB at the governor's request on behalf of the public corporation.

Objection by creditors already raised in federal lawsuit

Although the Act is the government's initiative to ensure continuity of essential services to the public in an attempt to stabilize the fiscal situation of Puerto Rico's public corporations, it has already met stern opposition.

U.S. mutual funds holding billions of dollars in Puerto Rico debt have sued the commonwealth, accusing it of passing a law modeled after the U.S. Bankruptcy Code that could undermine investors' rights. Under its Constitution, Puerto Rico doesn't have the power to enact a bankruptcy law to adjust its debts.

The complaint contends Puerto Rico improperly passed an Act modeled after title 11 of the U.S. Bankruptcy Code, which is used by U.S. corporations to reorganize. It is expected other creditors will follow suit and join in this lawsuit in the exercise of their legal rights. The passage of the Act has adversely affected the municipal-bond market, reducing prices of revenue bonds issued by Puerto Rico's government.

If you have any questions about how the Act may have an impact on you, and how to best protect your interests and rights, contact Firm Member & Federal Litigation Chair Kenneth Suria at ksuria@estrellallc.com and/or Bankruptcy & Reorganization Practice Manager Paul Hammer at phammer@estrellallc.com at your convenience.