



Recap of House Subcommittee Hearing on Puerto Rico Chapter 9 Uniformity Act of 2015—H.R. 870

On February 26, 2015, testimony was presented to the House Judiciary Committee's Subcommittee on Regulatory Reform, Commercial and Antitrust Law (the "Subcommittee") regarding H.R. 870, the "Puerto Rico Chapter 9 Uniformity Act of 2015" ("H.R. 870").¹ This *Commentary* provides an overview of that testimony as well as the written testimony of each witness who testified before the Subcommittee and the [text of H.R. 870](#).

Hearing Overview

H.R. 870 was introduced by the Resident Commissioner of Puerto Rico, Representative Pedro R. Pierluisi, on February 11, 2015. Anecdotal comments from the Representatives participating in the Subcommittee hearing, particularly Representative Issa, indicate that this bill is being fast tracked and will be sent to the full House Judiciary Committee for a vote in the near future.

The hearing room was jam-packed—not a single open seat and at least a dozen or standing on the periphery. The hearing on H.R. 870 lasted from 11:30 a.m. to approximately 12:45 p.m. Current and former prominent Puerto

Rican elected officials—the President of the Puerto Rico Senate, Eduardo Bhatia, among others—attended the hearing and were recognized by the Subcommittee Chairman, Representative Tom Marino (R-PA). Numerous members of the Puerto Rican media were also present.

Four witnesses testified before the Subcommittee: [John A. E. Pottow](#), professor at the University of Michigan Law School; [Melba Acosta](#), President of the Government Development Bank for Puerto Rico (the "GDB"); [Robert Donahue](#), Managing Director at Municipal Market Analytics, Inc.; and [Tom Mayer](#), Partner and Co-Chair, Corporate Restructuring and Bankruptcy Group at Kramer Levin Naftalis & Frankel LLP (current counsel to funds managed by Franklin Municipal Bond Group and by Oppenheimer Funds, Inc.).

Each witness submitted written testimony to the Subcommittee prior to the start of the hearing. Each witness's oral testimony concisely summarized his or her written submission. As discussed below, only one witness, Tom Mayer, spoke in opposition to H.R. 870. The remaining three witnesses spoke in support of H.R. 870.

¹ This *Commentary* is meant to summarize what occurred during the Subcommittee hearing. The views, opinions, and recommendations of the witnesses and Members of Congress are not endorsed by or necessarily reflective of those of Jones Day. Issues regarding the scope and application of Chapter 9 are complicated. For further information on this subject matter, please contact any of the *Commentary's* authors.

There were 10 Subcommittee members present at some point during the hearing, six of which questioned the witnesses: Chairman Marino and Representatives Issa (R-CA), Conyers (D-MI), Johnson (D-GA), Pierluisi (D-PR), and Cicilline (D-RI). Of the questioners, only Representative Issa indicated some skepticism regarding the need for H.R. 870, with the remaining questioners all voicing support for the Act. Virtually every questioner yielded any time he or she had remaining to Representative Pierluisi, who then took up the balance of the allotted time to criticize Mr. Mayer's written and oral testimony. Representative Pierluisi dug into details of Mr. Mayer's testimony and attacked specific points.

Points Made in Support of H.R. 870

Puerto Rico's Exclusion from the Bankruptcy Code's Definition of "State" May Be a Legislative Anomaly. There is no evidence that Puerto Rico was intentionally excluded from this definition by Congress. Evidence indicates that Puerto Rico was inadvertently omitted from the definition and that Congress made attempts to correct this error, but, for some unknown reason, such efforts never yielded the intended result.

H.R. 870 Does Nothing to Authorize a Chapter 9 Filing by Puerto Rico or Any of its Municipalities. It merely gives Puerto Rico the same right every other "state" has: the ability, if it so chooses, to enact a law that authorizes a "municipality" to seek relief under Chapter 9 of the Bankruptcy Code.

Chapter 9 Relief will Make a Smoother Restructuring of Debt Possible. If Chapter 9 relief is available to municipalities in Puerto Rico, it will facilitate a more coordinated and orderly restructuring of debt associated with the Puerto Rico Electric Power Authority ("PREPA"), the Puerto Rico Aqueduct and Sewer Authority ("PRASA"), and the Puerto Rico Highways and Transportation Authority ("PRHTA"). One witness stated that Chapter 9 would provide a powerful motivating tool to bring all interested parties into an organized restructuring effort.

Current Rules Provide an Ineffective Restructuring Framework. The current rules under which public corporations in Puerto Rico may restructure debts present grave uncertainty and provide a wholly inadequate legal framework to effectuate a highly complex financial restructuring. The most notable example cited was the possibility of the appointment of a "receiver" over PREPA who would have

"vague powers" and would be prohibited from "encumbering or dispos[ing] of property."

Retroactivity Could Create Risks. In response to concerns over the constitutionality of retroactively applying H.R. 870, witnesses noted that municipal bond funds, as estimated by Fitch Ratings Inc., reduced their Puerto Rico holdings by approximately 65 percent beginning in the second and third quarters of 2013. Market trades indicate that these funds are now held by opportunistic investors with a higher risk tolerance and awareness. Today it is estimated that municipal bond funds collectively own less than one-third of the island's debt, with holdings concentrated in largely insured, general government issuers. Additionally, witnesses pointed out that risks outlined in the August 2013 PREPA Offering Statement included, among other things, a risk that the ability to fund operations and finances could be negatively affected if current and prior fiscal headwinds continue. Thus, investors holding PREPA bonds during or after August 2013 were expressly warned of the risk that their debt could be impaired. Further, witnesses noted that the U.S. Supreme Court has dealt with retroactivity in the context of contract rights impaired in bankruptcy cases before and did not find such retroactive impact to be unconstitutional.

Professor Pottow did note, however, that retroactivity is a concern only under the Takings Clause of the United States Constitution (U.S. Const. amend. V), which is implicated only when property rights are impaired. He noted that these concerns are "rare" because, typically, secured creditors have many protections under the Bankruptcy Code. Testimony on this subject was cabined, however: while one could argue that the Bankruptcy Code's invalidation of property rights *might* implicate the Takings Clause, the issue has never been definitively resolved by the U.S. Supreme Court, and its resolution would be complicated and involve interpreting the intersection of the Bankruptcy Clause and Takings Clause jurisprudence. See [Pottow](#) at p. 4.

Risk Premium Could Affect Bonds Issuances. Puerto Rico is currently paying a "risk premium" for all issuances because there is "uncertainty in the market" with respect to the island's ability to facilitate a coordinated restructuring. This may negatively affect upcoming bond issuances that are necessary to provide the central government and the GDB with liquidity.

PREPA, PRASA, and PRHTA are Likely to Become More Self-Sufficient. The current Governor and other elected officials are working together to make PREPA, PRASA, and PRHTA self-sufficient. With a clear debt adjustment mechanism it is more likely that these entities will be restructured in an appropriate manner and become financially independent from the central government.

Passage of H.R. 870 May Avert a Great Fiscal Crisis. More importantly, it could avoid the potential for a request to the federal government for financial aid or a bailout.

H.R. 870 has Bipartisan and Strong Support. This support comes from members of Congress and Puerto Rico's leaders in addition to support from the National Bankruptcy Conference, notable bankruptcy practitioners and bankruptcy academics.

Mr. Mayer's Points Made in Opposition to H.R. 870

Puerto Rico Should Not Have Access to Chapter 9. According to Mr. Mayer, it is wrong to allow Puerto Rico to have access now to Chapter 9 when billions of dollars of bonds were issued in reliance on the fact that Puerto Rico's debt could not be altered through a Chapter 9 restructuring. Mr. Mayer pointedly stated that "H.R. 870 breaks the faith with those millions of men and women."

The Public Corporations Are Not Exercising All Available Options to Manage Their Debt and Operating Expenses. They should, among other things, cut expenses, increase rates, and engage in more robust collection efforts before going down the Chapter 9 path or any other restructuring scenario.

Chapter 9 is Bad Policy for Bondholders, and Detroit was not a Success Story for Such Bondholders. Mr. Mayer stated that Chapter 9 should be altered to be more like the law prior to the 1978 enactment of the Bankruptcy Code with respect to bondholders: specifically, the requirement of an affirmative bondholder vote before a plan affects bondholders. This would be akin to the pre-1978 requirement that a Chapter 9 petition be accompanied by a plan accepted, in writing, by

creditors owning not less than 51 percent of the securities affected by the plan.

Professor Pottow rebutted Mr. Mayer's arguments on this last point by pointing out that certain Detroit bondholders may receive a 74 percent recovery. He also stated that Mr. Mayer's testimony is colored on this point because his Detroit clients agreed to a settlement whereby they recovered only 13 percent because of the strong arguments that those Detroit bonds were illegal and the bondholders accordingly should receive nothing.

Both Chairman Marino and Representative Issa voiced concern regarding the impact of "retroactively" impairing debt obligations and whether such conduct stands on firm constitutional grounds.

Various documents, including letters and other notes in support of H.R. 870, were moved into the record during the Subcommittee hearing. Also, Chairman Marino gave Subcommittee members one week to submit additional questions in writing to the witnesses. Those questions and any responses will become part of the hearing record.

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