

July 11, 2017

Memorandum for Policymakers from the Ad Hoc Group of
Puerto Rico General Obligation Bondholders

**STRIKE 3: OVERSIGHT BOARD'S FALSE STATEMENTS TO
U.S. SENATOR TOM COTTON**

A simple question: *Does Puerto Rico's certified fiscal plan respect the constitutional priority given general obligation (GO) bonds?*

If the Federal Oversight Board were acting legally, it would be easy for it to answer this simple question with a convincing “yes,” as PROMESA Section 201(b)(1)(N) requires. But the Board first dodged the issue, and now it has resorted to outright deceit.

Strike 1: On March 22, Representative LaHood posed this simple question to the Board's Chair, Jose Carrión, at a hearing before the House Committee on Natural Resources' Subcommittee on Indian, Insular and Alaska Native Affairs:

“When we passed PROMESA, Section 201(b) made it clear that the [Puerto Rico] constitution will be upheld. The constitution says that when available resources are insufficient, constitutional debt [GO bonds] shall be paid first. And when this [fiscal] plan was certified by the Board, it treats constitutional debt as a last expense. I am wondering how the Board [could] certify this plan if it violates Section 201 of PROMESA.”

Mr. Carrión could not answer Rep. LaHood's question: “I am not an attorney. I would refer to my attorneys. The Board has not taken a position on the GO vs. COFINA issue.”

Strike 2: Concerned with this testimony, [Senators Tillis and Cotton wrote the Board on April 7:](#)

“During a recent hearing ... you were asked if the Fiscal Plan complied with Section 201(b)(1)(N) of PROMESA. As you know, PROMESA requires that a certified fiscal plan ‘*respect the relative lawful priorities or lawful liens ... in the constitution ...*’ Unfortunately, your answer to this question was unsatisfactory. ... [W]e request that the Board promptly supply our staffs with a compliance certification for the Fiscal Plan and set forth in detail how each requirement of Section 201(b)(1) of PROMESA has been satisfied.” (Emphasis added.)

The [Oversight Board's April 25 reply to this question](#) yet again was a blatant non-response: “‘Respect’ provides flexibility ...” It appears the Board “respected” the Senators' question with the same “flexibility” with which it respects the constitutional requirement that GO bonds be paid ahead of literally all other expenditures of Puerto Rico's government.

Strike 3: Not one to be trifled with, [Senator Cotton wrote back to the Board last month:](#)

“The Oversight Board claims that Congress, in using the word ‘respect,’ actually gave the board ‘flexibility’ to decide which legal obligations to meet – which, in my book, is the exact opposite of what the word ‘respect’ means.”

As explained below, [the Oversight Board's June 22 response to Senator Cotton](#) employs a bold tactic that amounts to multiple choice among falsehoods. In essence, the Board is telling Sen. Cotton: “Here are three blatantly fake and mutually inconsistent answers (including some we never mentioned before). We hope we can fool you into accepting one of these.”

Oversight Board's Fake Answer No. 1

In its June 22 letter, the Board first throws this newfound explanation against the wall:

“In fact, consistent with the priority in the Puerto Rico Constitution of General Obligation bonds over other Commonwealth debt, the certified fiscal plan includes in the funds available for debt service, the tax revenues otherwise channeled to other public entities, thereby rendering the funds available to be allocated to debt service on the General Obligation bonds to the maximum extent they are property of the Commonwealth and not of COFINA.” (Emphasis added.)

Fake Answer No. 1 is premised on the GO bonds having a priority only in relation to other debt. This is false, and the Board knows it. ***Debt service on GO bonds comes ahead of literally all other disbursements*** – whether for debt, pension liabilities or anything else. Puerto Rico's Constitution (Art. VI, Sec. 8) could not be clearer on this point:

“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 [GO] 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.”

To like effect, Section 4(c) of Puerto Rico's Office of Management and Budget Organic Act reiterates the top priority given to GO bonds and lists the various lower priorities given to all other expenditures. Specifically, when resources are insufficient in any fiscal year, Puerto Rico must apply its limited funds in the following order:

- First: “the payment of interest and amortizations corresponding to the public [i.e., GO] debt.”
- Second: “commitments entered into by virtue of legal contracts in force, judgments of the courts in cases of condemnation under eminent domain, and binding obligations to safeguard the credit, reputation, and good name of the Government of the Commonwealth of Puerto Rico.”
- Third: “regular expenses” related to government operations, such as “[c]onservation of public health,” “[p]rotection of persons and property,” “[p]ublic education programs,” and “[p]ublic welfare programs.”
- Fourth: “construction of capital works or improvements.”
- Fifth: “contracts and commitments contracted under special appropriations.”

Fake Answer No. 1 embeds a second deceit – stating that the fiscal plan “includes in the funds available for debt service, the tax revenues otherwise channeled to other public entities, thereby rendering the funds available to be allocated to debt service on the General Obligation bonds.” In

fact, the Oversight Board refuses to dedicate those rechanneled revenues to GO debt service or even say how they are being spent.

Oversight Board's Fake Answer No. 2

If Fake Answer No. 1 were correct, there would be no need to offer other answers incompatible with it. Yet the Board's June 22 letter also offers Fake Answer No. 2:

“The ‘flexibility’ mentioned in my April 25 letter referred to the fact that PROMESA’s instruction to respect relative priorities in section 201(b)(1) is one of many instructions including instructions to ensure funding of essential services, to provide adequate funding for public pension systems, and to provide for capital expenditures and investments. Therefore, the revenues must be allocated among all PROMESA’s requirements and that requires flexibility.”

Here again, the Board is engaged in sheer fabrication. PROMESA Section 201(b)(1) lists numerous independent requirements, *all of which* – including the requirement that the GO bonds’ constitutional priority be respected – must be satisfied in order for the Board to certify a fiscal plan. There is absolutely nothing in that section (nor does the Board cite to anything) that would allow a fiscal plan to be certified if any requirement is not fully satisfied – let alone anything that gives the Board the flexibility to determine which requirements it should satisfy.

Fortunately, Puerto Rico has more than sufficient resources to satisfy the requirements of Section 201(b)(1). Rather than complying with those requirements, the Board has simply gone rogue – picking winners and losers as the Board sees fit rather than as Congress prescribed. And even if (as is not the case) it were impossible to satisfy all these requirements, it would be Congress’s prerogative – not the Board’s – to consider modifying them.

Oversight Board's Fake Answer No. 3

When all else fails, call upon divine destiny. So it is with the Board’s Fake Answer No. 3:

“That said, the fiscal plan is still better for creditors than any alternative the Oversight Board had. ... If we take even more money away from public services (whether creditors consider them essential or nonessential) so we can pay more debt, ... [t]hat would propel the downward spiral, and over time, creditors would receive much less.”

How convenient? Last March – after just six months of part-time work by its unpaid members, and with mere weeks of work by some of its key advisors – the Board certified a ten-year fiscal plan of such exquisite optimality and precision that any further reduction in the cost of government –whether for essential or nonessential services – would make creditors worse off.

The Board’s Fake Answer No. 3 embeds a cornucopia of flaws. To list but a few:

- Even if the Board’s purported macro-economic conclusion were true, it would be irrelevant to the question raised by Senator Cotton – whether the fiscal plan respects the constitutional priority afforded the GO bonds. Indeed, Fake Answer No. 3 amounts to an admission that the fiscal plan does not respect that priority. The Board is effectively saying, “Sure, we violated your priority, but you should thank us that we did.”

- The Board offers not a shred of evidence to support this position – not in its June 22 letter to Senator Cotton, nor anywhere else. To the contrary, the Board has for months consistently refused to provide creditors with any usable transparency concerning its analyses and has taken the position in Puerto Rico’s bankruptcy case that its analyses are exempt from review by both the court and the creditors. This intransigence is extreme and implies that the Board’s analysis could not withstand scrutiny.
- Despite this intransigence, our group and many other creditors have already identified many factual and analytical errors in the Board’s work.
- The Board’s contention that it has so swiftly and conveniently discovered the “Goldilocks” of fiscal plans and the perfect justification to grandfather bloated government is preposterous on its face – bespeaking hubris more than wisdom, power rather than persuasion, a sense of impunity rather than openness to honest challenge.
- The Board’s purported macro-economic analysis is glaringly myopic. It assumes that Puerto Rico would pay no price – whether in future borrowing costs or in attracting investment to the island – for unnecessary resort to and prolongation of bankruptcy, and for utter disregard of the rule of law. If Puerto Rico could, as the Board contends, utterly disregard the constitutional priority that was the bedrock of past bond offerings, why would any investor ever rely on Puerto Rico’s laws again?
- Finally, the Board perhaps has forgotten that the Puerto Rican Constitution was twice approved by the U.S. Congress. Does the flawed interpretation of this document, and how PROMESA relates to it, by a federally appointed Board reflect not only on our adherence to our own Constitution, but the priority that we apply to our own debt?

Conclusion

The Board’s continual dissembling in front of Congress provides a window into a much larger problem. The Board has gone rogue. It is flagrantly disregarding PROMESA. It is reaching self-serving, preposterous conclusions based on shoddy and secretive work. It is responding to Congressional and creditor inquiries dishonestly and dismissively. And it has repeatedly derailed consensual negotiations with creditors. Far from helping provide the solution, the Board has become the biggest impediment to solving Puerto Rico’s fiscal challenges.