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## Puerto Rico Somewhat Unique Among U.S. Municipal Bankruptcies.

***Islanders will feel some cuts and, despite some optimism, a long-term fix is uncertain***

Puerto Rico's leaders who put the island into a form of bankruptcy on Wednesday have gained access to a powerful tool that has helped a handful of U.S. cities get back on their feet, restructuring experts say.

The island and its agencies owe creditors \$73 billion in what is the largest U.S. municipal bankruptcy. But when Puerto Rico entered the court-supervised restructuring process known as Title III, leaders gained the leverage to impose cuts on Wall Street firms and other investors in the island's debt, experts say.

"Chapter 9 is always the worst option until it's the only option," said Marc Levinson, referring to the section of the U.S. bankruptcy code used by municipalities. Mr. Levinson, a Sacramento bankruptcy lawyer, helped shepherd the California cities of Vallejo and Stockton through bankruptcy.

While Puerto Rico's bankruptcy will likely result in cuts to public workers' benefits and increased costs for government services, the filing has given some Puerto Rico residents optimism. Charles Cuprill, a bankruptcy lawyer for the island's small businesses, said construction is at a standstill and roads are in disrepair.

"Puerto Rico didn't have any other choice," he said.

As a U.S. territory Puerto Rico wasn't eligible for chapter 9, which is only available to U.S. municipalities. But federal lawmakers who recognized the island's problems passed an oversight law in June that gave it access to a form of bankruptcy that incorporates parts of chapter 9 law. Both forms of bankruptcy give leaders the power to halt lawsuits, the autonomy to govern during the process and the ability to propose a debt-repayment plan to a judge. Unpaid debts at the end of the process would be canceled.

Lawyers and advisers who have helped struggling cities like Detroit and Stockton navigate the bankruptcy process say the island's filing could ultimately improve the quality of life for its residents.

The cities used the process to cut debt and repair their reputation in the borrowing community. Before bankruptcy, "no one in their right mind would have loaned [them] money," said Mr. Levinson. The lawyer isn't involved in the Puerto Rican case but his firm, Orrick, Herrington & Sutcliffe, represents some creditors.

The Caribbean island of roughly 3.4 million people has an unemployment rate that tops 12%, more than twice the U.S. average. The territory has been in a recession for most of the past decade after Congress ended a series of generous tax breaks designed to grow the island's manufacturing sector and steer it away from agriculture after World War II. Global financial troubles in 2008 also hurt

growth.

Sprawling bureaucracy and high electricity costs have stunted business investment, while government cuts have closed everything from schools to social-service providers. The departure of some citizens has also sapped the island's tax base, further squeezing budgets. Puerto Rican leaders borrowed money to pay operating expenses. The cost of the mounting debt has kept island officials from providing services to citizens.

Mounting debt and a declining population are problems for many U.S. cities. Detroit officials had also blamed its financial problems on the loss of residents, who fled in large numbers for its safer suburbs. The 680,000-resident city filed for bankruptcy in July 2013 to negotiate cuts to \$18 billion in debt, blaming tax revenue that fell after the real-estate crash.

The judge that presided over Detroit's case said the city's failure to provide basic services that protect residents' health and safety was "inhumane and intolerable, and it must be fixed." Detroit's bankruptcy-exit plan proposed to cut \$7 billion in debt owed to Wall Street firms, city retirees and others. Its plan also called for \$1.7 billion reinvestment in removing blighted buildings and boosting police and fire services in the city.

In Stockton, a city of 300,000 in California's Central Valley that filed for bankruptcy protection in 2012, the response to the city's debt restructuring has been mixed.

"The stigma is starting to fade," said the city manager, Kurt Wilson, who noted that the bankruptcy filing brought financial stability, though the level of public services has yet to bounce back. Stockton residents, for example, have been disappointed that city staffing levels remain low. Retired city workers also suffered in the long run.

"When we took away their health care, it didn't come back," Mr. Wilson said.

Federal judges in charge of Detroit's and Stockton's bankruptcies ruled that pensions could indeed be cut. In Detroit, for example, city retirees agreed to take a 4.5% pension cut and lose cost-of-living increases. In San Bernardino, Calif., which filed for bankruptcy in 2012, officials have agreed to make full payments into the pension fund run by the California Public Employees' Retirement System. The system distributes payments to thousands of retired city workers—often their lone source of income.

Like Stockton, San Bernardino also stopped paying retiree health benefits.

Puerto Rico has more than 300,000 pensioners, and they are facing bigger cuts and possibly harsher consequences because teachers and police officers don't participate in Social Security, leaving them with no fallback if pensions are reduced. The island's public pension funds have fewer workers contributing, and the plans are now underfunded by an estimated \$45 billion. The federal financial oversight board wants to finance the plans on a pay-as-you-go basis once they exhaust their assets this year or next while reducing benefits by 10% on average to save \$540 million over a decade.

Widener University law professor Juliet Moringiello pointed out that Puerto Rico's problem are unique compared to municipalities on the U.S. mainland that used chapter 9 because, once debts are cut, it's unclear who will be in charge of fixing its broader economic problems.

"The big open question with Puerto Rico...is what gets fixed otherwise and who's going to do it," Ms. Moringiello said. "Once the debts are adjusted, is there the political will on the island to fix the structural problems?"

## **The Wall Street Journal**

By Katy Stech

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—Andrew Scurria and Heather Gillers contributed to this article.

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