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## **A Warning on Bankruptcy in Puerto Rico's Debt Crisis.**

WASHINGTON — Puerto Rico's financial troubles are so complex and far-reaching that bankruptcy alone will not solve them, and might even make them worse, experts on financial distress told lawmakers in Washington on Tuesday.

Instead, they recommended appointment of a federal control board, saying it would have a better chance of resolving Puerto Rico's debt in the short term and preventing the island from falling into debt again in the future.

As evidence, witnesses pointed to Detroit's recent experience with municipal bankruptcy, the largest so far in American history. Bankruptcy proceedings helped Detroit reduce its debts, they said, but did not leave the city with a recovery plan.

The impairment in value of Detroit's bonds was so severe that it damped investors' appetite for municipal bonds over all — not just Detroit's but other cities' too.

By contrast, some pointed to the financial crisis that gripped Washington in the late 1990s. The district never went bankrupt but was placed under supervision of a financial control board and now enjoys a double-A bond rating.

"In my view, the time is now for Congress to create an authority that would have as its goals both achieving financial stability and a balanced budget for the island," said Anthony A. Williams, who served as Washington's chief financial officer during the period of federal supervision.

He and others who testified before the House Subcommittee on Indian, Insular and Alaska Native Affairs said a strong control board could set the stage for an eventual restructuring of all of Puerto Rico's \$72 billion debt.

Puerto Rico officials have been saying that they want to restructure the debt but do not expect to be able to do so without the protection of Chapter 9, the bankruptcy chapter used by insolvent municipalities.

But some legal analysts now say the Territorial Clause of the United States Constitution gives Congress authority to enact laws that would give Puerto Rico the ability to restructure without declaring bankruptcy.

Such a law has not yet been drafted.

Tuesday's hearing was one step in that direction. The subcommittee is one of the bodies that the House speaker, Paul D. Ryan, Republican of Wisconsin, instructed to draft a suitable legislative package for Puerto Rico by the end of March.

The full House Natural Resources Committee plans to hold one more hearing first.

Even though such a measure would give Puerto Rico new powers for dealing with its creditors, Mr.

Williams said he was sure it would also draw complaints that Congress was depriving Puerto Rico's citizens of self-determination. He said that was the initial reaction when he took control of Washington's finances.

"Whatever negative hue and cry is initially heard readily erodes," Mr. Williams said, "as positive developments, achieved by a neutral body, start taking hold."

The positive developments would appear, he and other witnesses said, if Puerto Rico took its steps toward recovery in the right order. That would mean straightening out its own fiscal affairs first, rebuilding business confidence, improving tax collections, stemming the tide of residents leaving the island — and only then restructuring its debts.

"The people who leave are the people who pay taxes," said Simon Johnson, a professor of entrepreneurship at the M.I.T. Sloan School of Management and a former chief economist of the International Monetary Fund. He said the loss of population was a critical problem because it left the island's debt burden on fewer shoulders.

Another witness, Carlos Garcia, a former chairman of Puerto Rico's Government Development Bank, described the island's previous experience with a control board, one created by its own legislature in 2009.

Mr. Garcia said the board quickly found almost \$4 billion in debt that no one had noticed before, slowed the growth of new debt, lengthened maturities and set up a program to cushion people who lost their jobs. The main problem with that board, he said, was that it was created with just a two-year mandate, which was too short.

"What happened after the local control board disappeared is painfully known to all of us, as we sit here today, trying to find constructive solutions for a re-enacted Puerto Rico crisis," he said.

Puerto Rico has been struggling to keep up with the payments on its \$72 billion debt, defaulting on some of its bonds while servicing others. But its biggest payments since the crisis began are due at the end of June, and if it defaults on those, there is talk of Congress having to create another unpopular bailout mechanism like the Troubled Asset Relief Program of 2008 that rescued banks on the verge of failure during the subprime mortgage crisis.

That is why members of Congress and the Treasury Department are trying to get a law on the books in time to take Puerto Rico through that date without incident.

Thomas Moers Mayer, a bankruptcy lawyer representing bondholders, said that Chapter 9 municipal bankruptcy would not help Puerto Rico, even if the island were allowed to use it, because it would limit restructuring to the debt of Puerto Rico's public corporations. That would do nothing to help the government balance its own budget, he said.

Mr. Mayer testified about the effect of Chapter 9 bankruptcy in Detroit, saying that it had given that city's emergency manager a way to reduce debt, but not a way to bring about an economic recovery or streamline its government operations.

"The city exited Chapter 9 with the same 28 government agencies it had when it entered bankruptcy," said Mr. Mayer, a partner with the firm of Kramer Levin Naftalis & Frankel. "Note that Puerto Rico has at least 120 government agencies, and 78 municipalities for an island with 3.5 million people."

Reducing debt even worked against Detroit in some ways, Mr. Mayer said. Investors took significant

losses and have not been eager to invest there ever since.

“Even now, over a year after Detroit emerged from bankruptcy, Detroit has no access to the low-cost ordinary municipal market,” he said. When Detroit must borrow, it does so with the help of the State of Michigan. The unsecured notes that it issued as part of its bankruptcy settlement “trade at around 23 cents on the dollar,” Mr. Mayer said.

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