Questions for the Record
Senator Orrin G. Hatch
Senate Judiciary Committee
Hearing: "Puerto Rico's Fiscal Problems:
Examining the Source and Exploring the Solution"
Tuesday, December 1, 2015

Questions for all Panel II Witnesses

1. Would extending Chapter 9 to Puerto Rico carry any negative consequences for the island? I'm not talking just about bondholders. I'm talking about the commonwealth as an entity. If Congress extended Chapter 9 to Puerto Rico and island municipalities began taking advantage of Chapter 9, how would that impact the island's bond rating, its creditworthiness, its attractiveness as an investment location, etc.? Is there a scenario under which extending Chapter 9 to Puerto Rico would actually make the island's fiscal situation worse?

2. We've heard arguments that extending Chapter 9 to Puerto Rico would be unfair to bondholders because it would reduce their return on their investments. Some have argued that any Chapter 9 extension should apply only to future debts. As an initial matter, it would be helpful to know whether past bankruptcy code reforms have applied to existing debts, or whether bankruptcy reforms have typically applied only to future debts. Can you offer any insight on this matter? And if past reforms have applied to existing debts, have any of those reforms been analogous to what we're considering here—namely, extension of bankruptcy access to entities who previously had no such access? I asked this question at the hearing, but I didn't get a complete answer and I believe it's extremely important.

3. Another question on Chapter 9 and retroactivity: If Congress steps in and changes the rules of the game after the fact to allow municipalities to discharge existing debts, do we need to worry about the message that sends to other debtors and other creditors across the country? Parties negotiate contracts according to existing laws. If we step in and suddenly change the rules, does that tell parties in other situations that the rules are actually more up for grabs than they might think? Does that tell other states or other municipalities outside Puerto Rico that if things get bad enough, Congress will simply change the rules to help ease the pressure?

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Question for Mr. Ravitch:
Working with then-Governor Hugh Carey, you were one the leading architects of the major restructuring of New York City's finances and debt – helping avoid the bankruptcy of that city in 1975. You also have extensive experience in public finance, having served as the chairman of the Metropolitan Transportation Authority and as chairman of the New York State Urban Development Corporation U-D-C.

- From your experience in public finance, what policies best assist state, city and local governments that are facing the type of debt crisis currently being experienced by Puerto Rico?

There is a limited amount of precedent for Chapter 9 of the Bankruptcy Code.

- How did the lack of case law interpreting Chapter 9 impact the 1975 restructuring of New York City's finances and the recent Detroit bankruptcy?
- What thoughts do you have on how the Chapter 9 process can be improved?

TO; The Senate Judiciary Committee

FROM: Richard Ravitch

SUBJECT: My response to the questions you requested.

1.There are no circumstances under which the Commonwealth or its citizens could possibly be better off if the Congress does not extend restructuring authority through some form of bankruptcy process. Puerto Rico cannot pay its debts; it will default. The only question is whether or not it will do so in an orderly supervised process or in chaos with massive litigation in both Puerto Rico and New York. Every level of government faces disorderly defaults, liquidity crises and a growing inability to provide essential government services.

2. Clearly the Congress has the power under article 4 of the Constitution to give the Commonwealth the power to file in a bankruptcy court of the United States. Whether the result is unfair to bondholders or to pension beneficiaries or recipients of essential public services depends on the wisdom of of the restructuring plan and the bankruptcy court that **will** ultimately approve it. Retroactivity is not an issue; the bankruptcy laws were enacted by the Congress to assist the municipalities of this country during the Great Depression. Obviously, they were intended to apply retroactively to help cities that couldn't pay all of their debts. Retroactivity was not ever raised as an issue while many amendments to the original bankruptcy statute were debated and enacted. The Supreme Court of the United States as held that the Congress has the power to retroactively impair existing contractual obligations under its Bankruptcy Clause power.

3. I respectfully suggest that the message that needs to be sent to other creditors around the country h as more to do with the adequacy of the disclosure of the financial condition of the debtor than it does with the process by which a judgment is made as to how the needs of a society are to be balanced against an inability to pay all the money creditors. The failure of the debtor to disclose all of the material facts can be remedied under the securities and exchange laws of the United States. Enacting restructuring authority for the Commonwealth of Puerto Rico sets no precedent for States because constitutional limitations do not apply to territories.
It is impossible to fail to note that the $3 billion of general obligation bonds that were purchased in 2014 with full knowledge of the deteriorating fiscal condition of the Commonwealth. That is why the interest rate was more than three times greater than the rate paid by creditworthy municipal borrowers.

4. I wish to offer the following recommendations; the authority being sought should sunset within a short period of time after the restructuring is accomplished. This would ensure that no future government would borrow as promiscuously and then be able to take advantage of the bankruptcy laws. A federally appointed control

Board should be created to ensure compliance with the restructuring plan and future prudent fiscal practices.

As to the question of what policies best assist local governments facing similar crises I offer the following thoughts:

States and local governments should be required to balance their budgets in accordance with generally accepted accounting principles; that is; current revenues must match current expenditures. Such a statutory rule is the explanation why the city of New York has never had another fiscal crisis.
New York didn't file in 1975. But had it not had the statutory power to do so the debt wouldn't have been restructured, the wage freezes and layoffs wouldn't have happened, the State wouldn't have raised taxes; don't know what the chaos would have produced. But the uncertainty of that very question is why the President and Congress provided over 2 billion dollars of loans after swearing a month earlier they would never do so.
I don't believe the absence of real case law affected the result in Detroit. The facts were sui generis; the actions of the governor, the business community, the creditors and unions were motivated by the uniform conviction that without a Court approved Plan of Adjustment everyone would be in much worse shape.
The most important change to Chapter 9 should be a better definition of the word "feasibility" particularly with respect to its duration.
The best cure is avoidance by using responsible fiscal practices.
I would be pleased to discuss any of these questions should there be any interest.