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Written Statement
Senate Committee on Energy and Natural Resources
Hearing on Puerto Rico: economy, debt, and options for Congress
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Chairman Murkowski, Ranking Member Cantwell, and Members of the Committee:

I want to thank the Committee for giving the Commonwealth of Puerto Rico ("Commonwealth" or "Puerto Rico") the opportunity to participate in this hearing.

Introduction

The plain and simple truth is that, notwithstanding the unprecedented emergency liquidity measures that Puerto Rico has implemented over the last year, the Government of Puerto Rico may run out of sufficient money to meet all of its obligations in the ordinary course before the end of the year and will inevitably have to choose between paying its creditors on time and providing essential government services to the island's 3.5 million American citizens.

As many of you know, in early 2015 we commissioned a team of world-renowned economists led by Dr. Anne Krueger, the former Chief Economist at the World Bank and First Deputy Managing Director of the International Monetary Fund (IMF), to undertake a comprehensive analysis of Puerto Rico's fiscal and economic challenges as well as a debt sustainability analysis, the first ever by any administration.

Dr. Krueger's findings – detailed in a report often referred to as the "Krueger Report" – described that a number of economic shocks have contributed to Puerto Rico's economic stagnation and that, even with significant and painful reforms to reverse Puerto Rico's economic trends, large residual financing gaps would persist well into the next decade, implying a critical need for debt relief from a significant proportion of the principal and interest falling due in Puerto Rico in the next several years.

After the release of the Krueger Report I constituted the Working Group for the Fiscal and Economic Recovery of Puerto Rico (often referred to as the "Working Group") and tasked it with developing the Fiscal and Economic Growth Plan for Puerto Rico. The Fiscal and Economic Growth Plan, which was released on September 9, 2015, reviews the historical measures taken to increase taxes and reduce expenses; analyzes the current liquidity and fiscal position of Puerto Rico; recommends certain fiscal and economic reform and growth measures, including critical measures that require action by the U.S. Government; proposes to create a financial control board appointed by the governor upon the recommendation of a nationally recognized executive search firm or other independent third party; and identifies significant projected financing gaps (even assuming the implementation of the recommended fiscal reform and economic growth measures) that requires widespread debt relief.

The bottom-line is that Puerto Rico faces a $28 billion funding gap over the next five (5) years, and serious action must be taken both by the Government of Puerto Rico and the U.S. Government to close that gap. But even if serious action is taken (notwithstanding all the implementation risks of doing so), Puerto Rico will still face a funding gap of approximately $14 billion over the next five (5) years, which will require substantial debt relief.

Today, however, I would like to focus on three topics. *First*, and most critically, I will discuss the debt crisis that Puerto Rico faces right now, which, if not addressed, threatens 3.5 million Americans with the disruption of essential government services. *Second*, I will address a misconception raised in the Finance Committee hearing on the Financial and Economic Challenges in Puerto Rico related to the availability of current and reliable financial information, which availability should not be used as a justification for failing to take action to solve this imminent crisis. *Finally*, I will provide an update regarding PREPA's ongoing restructuring efforts and the progress it has made and challenges it continues to face.

Debt Crisis

Based on current information, the Commonwealth will have a negative cash balance of $29.8 million in November 2015. The Commonwealth's illiquidity will only grow worse when a $355 million debt service payment on bonds of the Government Development Bank for Puerto Rico ("GDB") comes due on December 1, 2015. These GDB bonds are supported by a guarantee from the Commonwealth, and the GDB, which faces its own liquidity crisis, is not expected to be able to make the payment on its own based on current information. Accordingly, Puerto Rico's negative cash balance will swell to $205 million by year end. And by the end of Puerto Rico's current fiscal year (June 2016), Puerto Rico's cash balance will be further deteriorate to *negative* $512 million. These numbers are optimistic in that they assume the Commonwealth will be successful in implementing a number of "one-time" liquidity measures (such as continuing to defer payments to suppliers (the past due amount of which already exceeds $1.6 billion) and $291 million of refunds due to taxpayers), measures that simply cannot be sustained without having a material adverse effect on the local economy. As we cannot pay debt service out of a negative cash balance, a default on some of our debt obligations is inevitable.

I stress that, while these sums may seem small in comparison to Puerto Rico's overall indebtedness of $73 billion plus approximately $45 billion in unfunded pension liabilities (notwithstanding that we reformed our largest pension system from a defined benefit to a defined contribution plan), a negative cash balance poses an immediate and grave danger to the American citizens living in Puerto Rico. If Puerto Rico is unable to provide adequate assurance of future payment to its suppliers, service providers, and employees, the Commonwealth's ability to provide essential government services to its citizens will be put in severe jeopardy. Police and fire protection, medical services, social services and every other government service on which Puerto Rico's 3.5 million American citizens rely will be at risk. A disruption of essential government services will only exacerbate the massive outmigration of Puerto Ricans to the mainland, which last year reached almost 100,000 persons. The Government's cash crunch has already affected taxpayers, which will see their tax refunds delayed for almost a year, and individuals and businesses who provide essential services to the government, which have not been paid in months. This is and should be unacceptable.

Additionally, while Puerto Rico has done everything in its power to avoid defaulting on its obligations (including reducing its public employee headcount to the 66 public employees per 1,000 persons, which is lower that the U.S. average), when faced with the prospect of either making payments on debt obligations or paying for essential public services, Puerto Rico will have no choice but to default. Nobody wants this, but it is a reality, and the consequences will be grave. With no insolvency regime in place, Puerto Rico's creditors will engage in a classic "race to the courthouse." The Government will be embroiled in countless complex and crippling legal battles that will further drain Puerto Rico of critical resources and prevent it from implementing many of the measures designed to achieve fiscal and economic sustainability. Much of this litigation is likely to be "intercreditor," that is, litigation between and among different groups of creditors seeking to establish the relative priority of their claims, which will have potentially devastating effects on Puerto Rico's access to its tax revenues and therefore on its ability to continue to provide essential services to its citizens.

Notwithstanding this crisis, we have never asked Congress for a bailout, and we are not seeking one today. We ask for (i) access to a legal regime that would allow to restructure Puerto Rico's liabilities in an orderly manner; (ii) equitable treatment in Medicaid and Medicare funding, incentives to grow Puerto Rico's economy; (iii) reforms that stimulate employment and labor force participation; and (iv) an exemption from the Jones Act (like that of the U.S. Virgin Islands).[1]

By taking action on these measures now, you can help prevent the situation from spiraling further out of control.[2] Waiting will only allow the situation to grow worse and more expensive and difficult for Congress to address down the road. The window to take action to avert an imminent crisis is rapidly closing. The time is now.

Financial Information

It became apparent after the Finance Committee hearing that a misconception about the availability of reliable and up-to-date financial information regarding Puerto Rico's finances and its financial crisis is being used by some commentators as "justification" for not taking action to prevent this humanitarian crisis. The unavailability of reliable and up to date financial information is a "red herring" resulting from disinformation being propagated by

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[1] Congress should not allow short-term distress investors who have amassed significant financial stakes speculating that Puerto Rico will be forced to default in the absence of a restructuring regime to drive national policy, particularly at the cost of the futures of 3.5 million Americans. While some of these investors have argued that extending bankruptcy protections would represent a bailout, it in fact does not require the expenditure of a single Federal tax dollar. Nor can distress investors suggest that providing a legal framework would be unfair because they purchased debt with the expectation that Chapter 9 would be unavailable. Instead, Congress already effectively dealt with this argument when it adopted Chapter 9's predecessor provision and made it applicable to both future and existing obligations. Indeed, every purchaser of Puerto Rico bonds was well aware that Congress has the right and authority to make Chapter 9 available to Puerto Rico.

[2] The costs of not having access to a restructuring regime are already weighing on the island. Specifically, despite reaching a consensual restructuring agreement with holders of nearly $4 billion of PREPA's debt, PREPA has been prevented from consummating the restructuring transaction by 3 institutions that are holding out. With no debt-adjustment regime in place, PREPA has no mechanism by which to bind these hold-outs to the will of the majority. Failure to consummate this transaction will not only mean that PREPA is unable to restructure its overwhelming debt burden, but will also prevent PREPA from going forward with plans to modernize its antiquated and unreliable infrastructure, forcing millions of Americans to wonder whether they will have power each day – a fear to which I can personally attest. While the availability of a legal mechanism to adjust Puerto Rico's debts may seem theoretical, the consequences of not having such a framework in place are very real for PREPA, for PREPA's employees and for the 3.5 million Americans who depend on PREPA for electricity. There are 18 other entities on the island facing this same issue.

those with vested interests in seeing Congress defer taking action so as to force Puerto Rico into a disorderly default. As you are no doubt aware, a number of institutions, many of whom have made a short-term bet on the outcome of Puerto Rico's dire financial situation, have literally spent millions of dollars on a coordinated lobbying campaign to propagate disinformation of this type. To be perfectly clear, in the last six months, Puerto Rico has been more transparent about its financial situation than at any point in its history, and it has engaged some of the best professionals in the world to provide up-to-date financial information to key stakeholders, all of which has been made publicly available.

For example, over the last four months, Puerto Rico has commissioned – and made publicly available – the Krueger Report, which includes a comprehensive and up-to-date debt sustainability analysis, the first ever commissioned by the Government, prepared by independent and internationally recognized experts. The Krueger Report is also unprecedented in presenting, for the first time, a consolidated long-term revenue and expense projection for the Commonwealth. In addition, at the request of our creditors, we commissioned a comprehensive liquidity analysis prepared by Conway MacKenzie (the "Conway Report"), the same financial management and consulting firm that the City of Detroit hired to assist it during its bankruptcy proceedings.[3] As discussed above, the Conway Report concluded that Puerto Rico's liquidity is running extremely low and the Commonwealth will face a major cash crunch during the months of November and December of 2015. We also published on our website the Puerto Rico Fiscal and Economic Growth Plan ("FEGP"), which contains our plan to stabilize our finances by increasing revenues and reducing expenses, and to grow our economy. Furthermore, note that the Puerto Rico Treasury Department publishes revenue results on a monthly basis.

Both of the Krueger Report and the Conway Report were commissioned to provide independent third-party expert reports on the sustainability of the Commonwealth's debt, long-term revenue and expense projections and the current liquidity position of the Commonwealth. In addition, creditors and their advisors that are willing to sign confidentiality agreements may access additional material non-public information, including certain data supporting the reports that were released publicly. The fact that the Commonwealth has shared more detailed background information on the Krueger and Conway reports with creditors and advisors is standard practice in debt restructuring negotiations and should not be used to suggest the Commonwealth has not been forthcoming and

[3] All of the reports commissioned by Puerto Rico and the GDB have been made public on GDB's website at http://www.bgfpr.com/.

transparent with respect to its current financial crisis. Finally, in the coming days, we will be issuing the Commonwealth Report, a quarterly document that provides updated information on all the various aspects of the Government finances, including up-to-date revenue, expense, debt, pension and litigation information, along with relevant risk factors and descriptions of recent material events. This too will be publicly available on the GDB website. In fact, during the past two years, the Commonwealth has sought to publish this report on a quarterly basis, which had previously been published only once a year or in connection with a public bond offering.

The Government has kept the market updated with recent and relevant information, such as the Krueger Report, the FEGP, the Conway Report, monthly revenue and economic data, as well as May and June updates to the Commonwealth Report, among others. The issuance of our financial statements has taken longer than expected in large part due to the Government's fiscal condition, and the additional tests that our auditors are conducting regarding liquidity and other variables. Delays in the release of audited information is common in corporate and municipal distressed situations such as the one faced by Puerto Rico, as auditor demands become more searching and time-consuming. However, all the information necessary to make a proper evaluation of the Commonwealth's finances and liquidity position is public and has been vetted by third parties.

In addition, as part of the FEGP, the Commonwealth is conducting an overhaul of its financial, accounting and payroll system in order to unify the patchwork of existing Governmental platforms, improve the Government's ability to monitor its fiscal situation on a real time basis and eliminate unnecessary delays in the preparation of financial information. Furthermore, the FEGP also requires the implementation of an ambitious 5-year plan to strengthen the Commonwealth's economic statistical systems and analysis by modernizing national accounts with an estimated investment of $3 million per year. Federal assistance in modernizing our financial systems would help improve the fiscal and economic decision making.

Finally, as I mentioned earlier, the Puerto Rico legislature is considering legislation that provides for a control board (the "Board") to oversee the financial affairs of Puerto Rico's Government and each of its public corporations. The Board will be responsible for generating 5-year Commonwealth-wide budgets and certifying that the budgets of each public corporation conform to the Commonwealth budget. The Board will have broad information gathering powers and the ability to sanction public corporations and the Commonwealth itself for non-compliance. Sanctions will include, automatic budget cuts, hiring freezes, approval requirements for large contracts and publication of a notice of non-compliance. To facilitate this process and ensure transparency across the Government, all Government entities will be required to conform their accounting systems to that of the Department of Treasury by no later than July 1, 2018, among other steps to simplify and coordinate financial practices and reporting. These steps necessarily take time, but the foundation for their implementation is being laid and the results will be greater transparency, accountability and controls across the Government.

In short, any suggestion that Puerto Rico is not doing everything it can to provide up-to-date and accurate information to creditors, this Congress or the general public is simply not true. The breadth and depth of the fiscal and financial information published by the Commonwealth during the past six months is simply unprecedented. The situation is too dire to allow this fabricated misconception to delay immediate and necessary legislative action.

PREPA

As discussed above, while PREPA continues to face significant hurdles to implementing a consensual debt restructuring, namely, its inability to bind minority holdout creditors to the will of the majority without a restructuring regime in place, it has made significant progress in its efforts to do so, including reaching agreement on the terms of such a restructuring with the holders of nearly $4 billion of its debt. Like many other entities in Puerto Rico, however, a restructuring of its debt is only one piece, albeit a significant piece, of PREPA’s turnaround efforts. In addition to its debt burden, PREPA suffers from an outdated rate structure, aging and technologically obsolete generating facilities and infrastructure, and significant operational inefficiencies.

We have worked tirelessly to turnaround PREPA. In May 2014, I signed Act 57-2014 into law, pursuant to which an energy commission was established to exercise oversight over PREPA. The commission required PREPA to improve its services to the people and businesses of the Commonwealth, including by pursuing public-private partnerships to assist in the construction and operation of new generation facilities. Following the passage of Act 57-2014, PREPA initiated discussions with its key creditors and negotiated forbearance agreements in connection with which it retained a chief restructuring officer to implement operational reforms and lead its restructuring efforts. In addition to the more than $600 million in sinking fund payments that these agreements relieved PREPA from making, and the access they provided to various trust accounts during the forbearance period, PREPA’s chief restructuring officer identified and implemented steps to achieve between $245 and $390 million in annual operational savings and up to $260 million in one-time liquidity measures. The sources of these savings have ranged from day-to-day operational changes such as inventory tracking, purchasing controls, limiting cash payments and other industry-standard practices, to prevention of theft, enhanced collection efforts and a consolidation of PREPA's vendor relationships. PREPA is also actively examining its business to reduce and eliminate its operating deficit. Significantly, notwithstanding the cost cutting associated with these efficiencies, PREPA has managed to instill a culture of safety and accountability in its workforce during this time.

These measures have enabled PREPA to continue to operate over the last 18 months in spite of its severe liquidity crisis. Unfortunately, with no restructuring regime in place, PREPA's breathing room may soon be exhausted. In the first half of 2016 nearly $1.5 billion of debt will come due, an amount that PREPA will be likely unable repay. The consequences of a disorderly default of the island's only electricity provider could be catastrophic for the people of Puerto Rico. I urge you in the strongest of terms not to let that happen.

Conclusion

In conclusion, I thank the Committee for recognizing the urgency of these matters by holding this hearing, and for giving Puerto Rico the opportunity to participate. I look forward to working with all of the members of the Committee to ensure the health, safety and well-being of the 3.5 million Americans that call Puerto Rico home. And I urge you to maintain your focus on Puerto Rico's fiscal emergency; the future of 3.5 million Americans depends on what you do next.