



Insight

# Puerto Rico Faces Backlash After Litigation Freeze Expires

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Puerto Rico's stay on litigation that protected it from lawsuits expired at midnight this past Monday after the Puerto Rican administration failed to reach a deal with bondholders. Puerto Rico was granted the temporary stay under the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) passed by Congress in 2016. The stay prevented the island from being sued for failing to pay its debt payments, buying Puerto Rico time to work with creditors on a restructuring plan. The stay, originally expiring on February 15, 2017, was extended to a May 1 deadline by the Financial Oversight and Management Board – created under PROMESA to assist Puerto Rico with its debt restructuring.

Governor Ricardo Rossello tried to strike a debt restructuring deal with its creditors over the weekend. However, creditors rejected the [proposal](#), which would have paid as much as 77 cents on the dollar to some creditors, and 58 cents on the dollar for sales-tax debt. With the May 1 deadline passed, Puerto Rico is now vulnerable to legal challenges by creditors, with one [lawsuit](#) filed early Tuesday morning.

## Puerto Rico's \$70 Billion Debt

Puerto Rico's debt has been growing over the last few years and currently stands at \$70 billion. The debt is a result of Puerto Rico's use of municipal bonds. Under the Jones-Shaforth Act of 1917, residents in the U.S. and other U.S. territories can invest in most Puerto Rican bonds without paying interest on the income. This led to an influx of investment dollars to Puerto Rican bonds. After tax breaks for U.S. companies operating in Puerto Rico were gone, the Puerto Rican economy entered a recession. To balance its budget, the Puerto Rico government began to use the money from bond investments, despite it being borrowed funds. This practice led to a rapid accumulation of debt and Puerto Rico's current debt crisis.

## The Title III Process

With the passing of the May 1 deadline, Puerto Rico's best option may be to enter PROMESA's Title III process, which is a court-supervised process akin to proceedings under chapters 9 and 11 of the U.S. Bankruptcy Code. If entered, the Title III process would afford Puerto Rico the same bankruptcy protection from creditors that Chapter 9 does. Given the willingness for creditors to let the legal stay expire, it seems that Puerto Rico may only be able to restructure its debt using the courts.

## Conclusion

This past weekend Congress reached a budget deal to avoid a government shutdown, providing almost \$300 million in Medicaid funds to Puerto Rico. While this helps to ease some of the financial pressures on the island, it is not a solution to Puerto Rico's debt problem. Puerto Rico's aging population and emigrating labor force will only lead to more financial woes. In order to deal with its debt, Puerto Rico's only option may be Title III.