NATIONAL BANKRUPTCY CONFERENCE
A Voluntary Organization Composed of Persons Interested in the Improvement of the Bankruptcy Code and Its Administration

April 8, 2016

Comments on the Discussion Draft of an Act Entitled "Puerto Rico Oversight, Management, and Economic Stability Act"

The National Bankruptcy Conference is pleased to provide comments on the March 29, 2016, discussion draft of a bill entitled "Puerto Rico Oversight, Management, and Economic Stability Act." We refer to the bill in this Statement either as "the Act" or by the name ascribed to it in Section 1(a), "PROMESA." The Conference is a voluntary, nonprofit, nonpartisan, self-supporting organization of approximately 60 attorneys, law professors and bankruptcy judges who are leading scholars and practitioners in the field of bankruptcy law. Its primary purpose is to advise Congress on the operation of bankruptcy and related laws, and about any proposed changes to those laws. Attached to this Statement is a Fact Sheet about the Conference, including a list of Conferees.

The Conference has reviewed the discussion draft, which, if enacted, would not be codified as part of the United States Code. PROMESA contains five largely but not entirely independent Titles: Title I, which establishes an oversight board ("**Oversight Board**") for the Commonwealth of Puerto Rico; Title II, which enumerates the responsibilities of the Oversight Board; Title III, which provides for the adjustment of debts of Puerto Rico and other territories as well as territorial instrumentalities; Title IV, entitled "Miscellaneous Provisions"; and Title V, the Puerto Rico Revitalization Act. Due to the press of time, to the work-in-progress nature of the Act and to the special expertise of the Conferees, we focus in this letter on Title III, although we have included a few significant comments about other Titles, and we have provided our assessment in somewhat summary fashion, and, as noted without suggesting new or replacement language. We also have not looked for typos and the like, but when we noticed apparent minor errors in the course of our review, we note them below. The Conference, including its Drafting Committee, stands ready to comment on later drafts or on other parts of the Act, if requested.

This letter addresses the Act both by concept and by particular sections.

<u>The Use of "Oversight Board."</u> The first sentence of section 101(a) establishes the Puerto Rico Financial Oversight and Management Board. The second sentence refers to it as the "Oversight Board," which term is used throughout the Act. It is defined in section 403(1) to mean "the Puerto Rico Financial Oversight and Management Board established under section 101(a)." But section 302, which determines who may be a debtor, includes in paragraph (1)(A) a territory that is subject to "an Oversight Board pursuant to an Act of the U.S. Congress" and requires in paragraph (2) that "the Oversight Board has issued a certification …." If the intention is to make territories other than Puerto Rico eligible for

Title III, section 302 should refer more generally to "an *o*versight *b*oard" rather than to *the* Oversight Board, which is only for Puerto Rico.

Authorization to file. The preconditions/prerequisites for initiating a Title III case should be clarified. Section 104(i) provides for the Oversight Board to certify a voluntary agreement with holders of its debt. It is followed by section 104(j), which provides that the Oversight Board must certify the filing of a Title III petition and plan of adjustment provided that the plan of adjustment is consistent with the applicable fiscal plan. Section 202(a), however, authorizes the Oversight Board to determine that a petition—presumably one initiating a Title III case—should be filed despite the Government of Puerto Rico's failure to deliver timely audited financial statements, among other things, or in the case of exigent circumstances. Section 302(2) requires only an Oversight Board certification under section 203(a) [which should reference section 202(a)]. Section 302(2) does not reference the certification under section 104(i); presumably, it should, particularly since section 104(i) favors compromise and the legislative summary issued by the House Committee on Natural Resources indicates that the Title III case is intended as a last resort.

Case versus Proceeding. The filing of a petition under section 304(a) commences a case under Title III. But section 301(a) makes sections of the Bankruptcy Code applicable to "PROCEEDINGS UNDER THIS TITLE." And section 412(a)(3) references benefit reductions "… made in previous municipal bankruptcy proceedings …." The term "proceedings" in both sections 301(a) and 412(a)(3) should be changed to "cases."

Objection to the Petition. Section 304(b) authorizes the court to hear objections and to dismiss the Title III case "… if the debtor does not satisfy the requirements under section 302." Since section 304(a)(2) requires that the Oversight Board must make a determination that the debtor satisfies the requirements of section 302, does that mean that the Oversight Board's determination cannot be the subject of an objection because section 304(a)(2) is limited to noncompliance with the requirements of section 302? And since there is no good faith requirement in the Act, does that mean that a decision of the Oversight Board is not subject to review even if made in bad faith?

> Typos/Corrections – Section 304. First, the heading of section 304(c) should be "Order for Relief" rather than "Order of Relief." Second, section 304(d)(2) does not follow the opening phrase of (d). To fix that, the phrase "The court may not" should be moved so it is the opening phrase in section 304(d)(1), and "or" should be changed to "and" at the end of 304(d)(1). Finally, section 304(d)(2) should be changed to "No court shall order a stay of such proceeding pending the appeal."

Federal Jurisdiction Question Raised by Section 304(e). Section 304(e) provides that postpetition debt is valid even if it is determined that the court lacked jurisdiction. We question whether Congress can validate action taken by a court that lacks jurisdiction. A possible fix is for the Act to confer jurisdiction to the extent that the court authorizes the incurring of debt, but even that might raise issues.

Reconciling Sections 303 and 309. Section 303 is modeled on Bankruptcy Code section 903, but unlike in a case under chapter 9, the interaction under the Act is between the federal government

and a territorial government and is thus not limited by the Tenth Amendment concerns that gave rise to section 903. Under the Act, however, the territorial government is subject to the broad powers and authority given to the Oversight Board. For example, even though the fiscal plan is nominally formulated by the Governor, the Oversight Board has ultimate certification authority for the fiscal plan and is not subject to control by the Governor or the legislature. And section 306, which is analogous to Bankruptcy Code section 904, limits the power of the court, but nevertheless authorizes the Oversight Board rather than the debtor to waive the limitation of the court's power. Moreover, as noted above, the Oversight Board is not required by PROMESA to act in good faith. Sections 309(a) and (b) appoint the Oversight Board as the "agent for the debtor" and the "representative of the debtor," and while section 309(a) makes the appointment subject to section 303, as noted above, it is the Oversight Board rather than the territory, that wields the power. In light of the foregoing, and in light of the fact that the introductory paragraph renders the provision subject to "other provisions of the Act," the introductory paragraph is either superfluous given the Oversight Board's broad authority or might refer to the territory's residual authority, as modified by the Act. In either case, the introduction is unclear and should be redrafted. The two subparagraphs raise the issue that the Supreme Court will likely resolve within the next two months in *Commonwealth of Puerto Rico v. Franklin California Tax-Free Trust* (No. 15-233). No matter which way the Supreme Court rules, if the intention of Congress is to bar territories that have not sought Title III from compositions that include binding creditors who have not consented, the Act should provide so expressly.

Section 305(c) – Removal. Section 305(c)(1) authorizes the removal of a claim or cause of action over which a district court has jurisdiction under 305(a) to the "district court for the district in which the civil action is pending." This district is not necessarily the one in which the Title III case is pending. Generally, the goal of removal in bankruptcy cases is to consolidate litigation in the district in which the bankruptcy case is pending. This is accomplished by allowing transfer of a removed case to that district under 28 U.S.C. § 1412. However, that provision applies only to cases or proceedings under title 11, so a similar transfer provision is needed for cases removed under PROMESA section 305(c)(1). Absent consent of all parties, the general transfer of venue provision (28 U.S.C. § 1404) probably is not sufficient, because it limits transfer to a district in which the civil action might have been brought, which again may not be the district where the Title III case is pending.

> Typos/Corrections – Section 305. The phrase "the district courts shall have" in section 305(a), appears in the opening sentence and, therefore, should be deleted from section 305(a)(1) and (2). Also, section 305(a)(3) does not follow the opening sentence in section 305(a). That can be fixed by redesignating section 305(a)(3) as section 305(b), and redesignating the remaining subsections (b) and (c) as (c) and (d), respectively.

Venue of Title III Cases. Under sections 307(1) and (2), a petition initiating a Title III case ordinarily will be filed in the district court for the territory or for the territorial affiliate of the territorial instrumentality debtor. The placeholder language marked with brackets in section 307(3), authorizes the Oversight Board to determine that such a district "will not provide for proper case management" and to thus instead file in "the district court for the jurisdiction in which the Oversight Board maintains an office that is located outside the territory." Section 102

requires the Oversight Board to maintain an office in the District of Columbia as well as in San Juan, Puerto Rico. The Act is silent as to whether the Oversight Board may have an office elsewhere. As a matter of bankruptcy policy, we believe that the chapter 9 model ought to be followed, such that cases have a proper venue only in the district in which the debtor is located. A Title III case for Puerto Rico set in the District of Columbia or another distant venue selected in the unfettered discretion of the Oversight Board seems contrary to the best interests of the residents of Puerto Rico as well as the creditors who chose to do business with it. We also recommend the adoption of a variant of Bankruptcy Code section 921(b), which would give to the Chief Judge of the Circuit the power to choose the district judge who will preside over the Title III case (including a district judge from outside of the district in which the case was filed).

Rulemaking – Section 308. Section 308(b) is unnecessary although not harmful. Each new federal law does not need its own rules enabling act, because 28 U.S.C. § 2072 already authorizes the Supreme Court to promulgate rules for district courts and courts of appeals. Since the Supreme Court has authority to promulgate bankruptcy rules, it may also amend them.

Reconciling Sections 309(a) and 309(b). The former designates the Oversight Board as "agent of the debtor" for purposes of Title III, and the latter designates the Oversight Board as "representative of the debtor" in a case under Title III. It is unclear whether different powers were intended. If so, the statute should describe the different powers and duties; if not, one designation ought to be sufficient. If the choice is "agent," there is a well-defined law of agency. If it is "representative," the term might have a broader or different meaning that should be further described. For example, courts might import the case law under Bankruptcy Code section 323, but that section is designed to give a trustee capacity to act on behalf of an estate, not as an agent, but as a trustee, which imposes greater restrictions and obligations as well as power than on an agent. We are not sure that Congress intends that the Oversight Board have similar powers of a trustee. If so, then it would be better to say so explicitly, rather than indirectly by using "representative of the debtor."

Section 308 and the Federal Rules of Evidence. Section 308 incorporates the Federal Rules of Bankruptcy Procedure into Title III cases, and provides that "[t]o the extent just and consistent with the provisions of this title, the court shall apply the Federal Rules of Bankruptcy Procedure as if the case were a case under chapter 9 of title 11, United States Code." Bankruptcy Rule 9017 provides, *inter alia*, that the Federal Rules of Evidence apply in cases *under the Code*." Since a case under Title III is not a case under the Bankruptcy Code, rather than rely on the "to the extent consistent" language of 308, the provision should incorporate the Federal Rules of Evidence into cases under Title III of the Act.

> Typos/Corrections – Section 311(4). The phrase "within any fixed time by the court" should be changed to "within any time fixed by the court."

Reconciling Sections 316(a)(2) and 404(1). Pursuant to section 302(1), Puerto Rico is eligible for Title III relief as long as it is subject to an Oversight Board. Section 316(a)(2) provides that Title III applies to the adjustment of "debts, claims and liens created before, on or after the date of the enactment of this Act." Section 302(1) appears to be at odds with section 404(1), which provides that "Nothing in this Act may be construed—(1) to relieve any obligations existing as of the date of the enactment of this Act of the Government of Puerto Rico to repay any individual or entity

from whom Puerto Rico has borrowed funds, whether through the issuance of bonds or otherwise."

Does Section 404(1) Eliminate Cramdown? PROMESA Section 301(a) incorporates Bankruptcy Code sections 1125, 1126, 1129(a)(1), 1129(b)(2)(A) and 1129(b)(2)(B)—the chapter 11 provisions on voting and nonconsensual confirmation or cramdown, that is, confirmation under section 1129(b) over the rejection of a plan by an entire class of creditors. If the intention of Congress in section 404(1) is to prohibit modification of only certain types of debt, namely "borrowed funds," including bond debt, the incorporation of the nonconsensual confirmation provisions is relatively meaningless, because that would leave a significant portion of Puerto Rico's obligations exempt from cramdown treatment in a Title III case, while remaining debt that is not for borrowed funds, such as labor and pension obligations and obligations involuntarily incurred such as tort and civil rights claims, would be subject to cramdown treatment. The Conference believes that granting a Title III debtor the power to confirm a plan of adjustment over the rejection of the plan by an impaired class of creditors—including one comprising holders of bond debt—is critical to the success of a Title III case. Without cramdown, Title III would provide a dissenting class with absolute veto power over a plan of adjustment. The various protections afforded nonconsenting classes such as the prohibition against unfair discrimination as well as the incorporation of the absolute priority rule in sections 1129(b)(2)(A) and 1129(b)(2)(B), level the negotiation playing field, and should serve to encourage both sides to reach agreement, which is a stated goal of the House Committee on Natural Resources. Perhaps even more important, if read to protect "any individual or entity from whom Puerto Rico has borrowed funds," section 404(1) might even prohibit the ability of a plan to bind the dissenting minority members of an accepting class, which is typically the essence of a restructuring statute.

The quoted phrase might introduce another ambiguity or problem. Would its protection apply only to original holders, that is, those from whom "Puerto Rico has borrowed funds," or would it apply to all borrowed money obligations, even if the bonds representing the repayment obligation had traded since initial issuance? In the very liquid municipal debt market, it is hard to justify a statute that permits debt adjustment only of traded bonds, and the provision would likely have a dramatic effect on municipal bond markets.

> Typos/Corrections – Section 315(b)(6 and 7). The "and" at the end of section 315(b)(6) should be deleted, the period at the end of paragraph (7) should be changed to a semi-colon followed by "and."

Reconciling the Incorporation of Bankruptcy Code Section 365 and Act Section 203(b). Section 301(a) incorporates Bankruptcy Code section 365 and its treatment of executory contracts. *N.L.R.B. v. Bildisco & Bildisco*, 465 U.S. 513 (1984), held that labor agreements are executory contracts within the meaning of section 365, and while Bankruptcy Code section 1113 modified the *Bildisco* standard for rejection of labor agreements in chapter 11 cases, it did not alter that holding. *In re City of Vallejo, California*, 403 B.R. 72 (Bankr. E.D. Cal. 2009), *aff'd*, *Int'l Bhd. of Elec. Workers, Local 2376 v. City of Vallejo (In re City of Vallejo)*, 432 B.R. 262 (E.D. Cal. 2010), applied section 365 and the *Bildisco* rejection standard in the chapter 9 context because section 1113 is not incorporated into chapter 9. Since PROMESA's section 301(a) does not

incorporate section 1113, is it the intention of Congress that the *Bildisco* standard for the rejection of labor agreements apply? That is not addressed in the Act, but under section 315, the Title III plan of adjustment must be consistent with the fiscal plan approved by the Oversight Board. And the fiscal plan must include the requirements of section 203(b), including provisions to "ensure the funding of essential public services" and to "provide adequate funding for public pensions." The fiscal plan requirements of the Act might be inconsistent with the *Bildisco/Vallejo* standard, and taken as a whole, suggest that current bankruptcy case law cannot necessarily be applied in addressing discrete matters such as CBA rejection. In any event, additional clarity and guidance would be helpful.

Section 406. This appears to be the only section of the Act that amends the Bankruptcy Code. It would amend section 362(a) to make the automatic stay under the Bankruptcy Code applicable to "a petition filed under section 304(a) of the Territory Economic Stabilization and Investor Protection Act of 2016." We are not aware of the Territorial Economic Stabilization and Investor Protection Act of 2016. Was the reference to section 304(a) of that Act intended to be a reference to section 304(a) of PROMESA? If section 406 *is* intended to apply to a petition filed under section 304(a), section 406 is unnecessary because under section 301(a), Bankruptcy Code section 362 automatically applies in a Title III case. Thus, there is no need to amend section 362(a) of title 11 for the purpose of making the automatic stay applicable to cases under Title III of PROMESA.

National Bankruptcy Conference

A non-profit, non-partisan, self-supporting organization of approximately sixty lawyers, law professors and bankruptcy judges who are leading scholars and practitioners in the field of bankruptcy law. Its primary purpose is to advise Congress on the operation of bankruptcy and related laws and any proposed changes to those laws.

History. The National Bankruptcy Conference (NBC) was formed from a nucleus of the nation's leading bankruptcy scholars and practitioners, who gathered informally in the 1930's at the request of Congress to assist in the drafting of major Depression-era bankruptcy law amendments, ultimately resulting in the Chandler Act of 1938. The NBC was formalized in the 1940's and has been a resource to Congress on every significant piece of bankruptcy legislation since that time. Members of the NBC formed the core of the Commission on the Bankruptcy Laws of the United States, which in 1973 proposed the overhaul of our bankruptcy laws that led to enactment of the Bankruptcy Code in 1978, and were heavily involved in the work of the National Bankruptcy Review Commission (NBRC), whose 1997 report initiated the process that led to significant amendments to the Bankruptcy Code in 2005.

Current Members. Membership in the NBC is by invitation only. Among the NBC's 60 active members are leading bankruptcy scholars at major law schools, as well as current and former judges from eleven different judicial districts and practitioners from leading law firms throughout the country who have been involved in most of the major corporate reorganization cases of the last three decades. The NBC includes leading consumer bankruptcy experts and experts on commercial, employment, pension, mass tort and tax related bankruptcy issues. It also includes former members of the congressional staff who participated in drafting the Bankruptcy Code as originally passed in 1978 and former members and staff of the NBRC. The current members of the NBC and their affiliations are set forth on the second page of this fact sheet.

Policy Positions. The Conference regularly takes substantive positions on issues implicating bankruptcy law and policy. It does not, however, take positions on behalf of any organization or interest group. Instead, the NBC seeks to reach a consensus of its members - who represent a broad spectrum of political and economic perspectives - based on their knowledge and experience as practitioners, judges and scholars. The Conference's positions are considered in light of the stated goals of our bankruptcy system: debtor rehabilitation, equal treatment of similarly situated creditors, preservation of jobs, prevention of fraud and abuse, and economical insolvency administration. Conferees are always mindful of their mutual pledge to "leave their clients at the door" when they participate in the deliberations of the Conference.

Technical and Advisory Services to Congress. To facilitate the work of Congress, the NBC offers members of Congress, Congressional Committees and their staffs the services of its Conferees as non-partisan technical advisors. These services are offered without regard to any substantive positions the NBC may take on matters of bankruptcy law and policy.

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