

## A Series of Poor Choices: How Puerto Rico Can Move Forward With or Without Chapter 9

By Joseph J. Luzinski

As members of the United States Congress debate about potential political solutions for struggling Puerto Rico's economic woes, the commonwealth must hope for the best – receiving permission to file for Chapter 9 bankruptcy protection – but plan for the worst.

Puerto Rico's government has already defaulted on \$37 million of bond payments. At this advanced level of distress, Puerto Rico faces a series of poor choices if bankruptcy is not an option. Every decision is made under the microscope of public opinion.

In business today, there are two common aspects of restructurings that occur: fixing the balance sheet and fixing operations of the business. Often times, a business has too much leverage or debt. Chapter 11 can be used to change the capital structure or move debt down the capital structure to equity, which lowers leverage and the costs of debt service. One of the purposes of Chapter 11 is to provide a fresh start and some breathing room for the business to reorganize operations, liquidate unprofitable business segments or divisions, offload burdensome contracts and return to profitability. This is what I refer to as fixing the business.

Puerto Rico needs to fix both the balance sheet and the business. Much of what the media is reporting seems to be related to a political solution to make law changes to allow a bankruptcy type of restructuring to occur, which solves the issue of fixing the balance sheet. They also must fix the business, i.e. the government infrastructure to provide tax revenue sufficient to deliver the critical services necessary in a cost-effective and efficient manner. This is, in my opinion, a practical problem that politicians do not wish to address as they perceive it to be a “no win” situation that will create discord for the government, businesses and residents. As we have seen in the bankruptcy of Detroit and media accounts of the austerity provisions agreed to by Greece, there are a great number of complex issues that need to be assessed and implemented to provide opportunities to fix the business.

As the title of this article suggests, there are a series of poor, or difficult, choices to be made. Once the choices are made, they need to be implemented. Reductions of jobs, services and programs have to be made to live within the tax basis of the commonwealth. The economy and market are trending in the wrong direction presently. For Puerto Rico, there will likely not be market conditions that make for better days ahead. The tax base and structure of their economy is broken and needs a fix that will take years to implement.

### **Looming Issues**

Some of the significant issues Puerto Rico must address in the short term include:

- **Change:** The commonwealth cannot continue along the same path it has been traveling. Its government needs to admit there is a problem, discuss it and get past it. Otherwise, the defaults will continue and residents will keep fleeing the island to move to the U.S.
- **Priorities:** The Puerto Rican government must prioritize what governmental services are more important to citizens, such as health and safety issues, and ensure the critical services are maintained. On the other end, it has to decide what programs or projects will not be funded, serviced or completed.
- **Leadership:** In times of extreme distress, a government must show leadership and clearly communicate internally and externally what the plan is. Once its plan is established, it has to stick to the plan, as there will always be opposition.
- **Fiscal Responsibility and Accountability:** Puerto Rico has no choice but to put a moratorium on any debt payments. As evidenced by this month's default, the commonwealth was going to experience further defaults. Once it gets past the defaults, it can move on with a plan.
- **Creditor Engagement:** The commonwealth should act as if it was already in bankruptcy and show its creditors it can work through the issues, ideally in a collaborative manner.
- **Legal System:** Showing good faith is paramount in a situation like this, so Puerto Rico needs to work through any available options and let the legal systems work. At the same time, the government must buy time to formalize, finalize and implement a plan to turnaround its finances.

All parties involved are standing at the precipice with locked arms. The nature of leverage causes some parties to wish to push other parties close to the edge to get a better deal. But if your economic fates are inextricably linked together, then you do not wish to be pushed or jump off the cliff. At some point, a deal can happen.

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