



**GOVERNOR OF PUERTO RICO**  
**Ricardo Rosselló Nevares**

February 26, 2018

VIA FEDERAL EXPRESS AND E-MAIL

Honorable A. Mitchell McConnell  
Senate Majority Leader  
United States Senate

Honorable Charles E. Schumer  
Senate Minority Leader  
United States Senate

Honorable Paul D. Ryan  
Majority Leader  
United States House of Representatives

Honorable Nancy Pelosi  
Minority Leader  
United States House of Representatives

*Re: Community Disaster Loan (CDL) Program*

Dear Senators and Representatives:

I write to bring to your attention the U.S. Department of Treasury's ("UST") arbitrary conduct over the last four months, which has effectively blocked Puerto Rico's access to approximately \$4.7 billion in CDL program funds that Congress made available last fall. The damage and devastation from Hurricanes Irma and Maria left no doubt that Puerto Rico was in desperate need of federal assistance to restore and maintain essential services for the Island's 3.4 million residents. In fact, Congress acted swiftly in late October to grant the Commonwealth of Puerto Rico (the "Government" or the "Commonwealth") immediate access to federal loans through the CDL program to compensate for loss in tax or other revenues, whether temporary or permanent, which imperils the Government's ability to maintain public services. Despite Congress' swift actions, the UST has failed to timely advance the loans and has imposed conditions inconsistent with the CDL program's very purpose.

As noted in one Congressional report: "left with few options available to make up for lost revenue, local governments may need to reappropriate funds from other portions of their budget or scale back

their operations.”<sup>1</sup> Regrettably, without any rational justification, the UST’s actions to date have put Puerto Rico in the dangerous financial dilemma it now unnecessarily confronts. Namely, the Government may be forced to cut deeply into its liquidity reserves and make the untenable choice of which essential services to cut so that it can maintain other essential services. Puerto Rico, through no fault of its own, and as a direct result of the UST’s misguided delay and policy decisions contrary to Congressional intent and the spirit of the CDL program, presently risks near term interruption of its electric, utility, and water/sewage facilities.

I urgently seek your intervention in this matter to avoid further harm and suffering for the residents of Puerto Rico. Suffice it to say, any material interruption to Puerto Rico’s public services will only exacerbate outmigration of its population to the mainland and further deepen and prolong Puerto Rico’s decade-old fiscal and economic crisis. The balance of this letter provides the relevant background of the events that have unfolded since late October.

## I. Summary

On October 26, 2017, Congress enacted the *Additional Supplemental Appropriations for Disaster Relief Requirements Act* (the “Appropriations Act”), which authorized \$36.5 billion of disaster relief funds to support recovery efforts in the aftermath of Hurricanes Harvey, Irma, and Maria. The disaster relief package included approximately \$4.9 billion in loans under the CDL program for which Puerto Rico, the U.S. Virgin Islands (“US VI”), and local governments of Florida and Texas are eligible.<sup>2</sup> Despite Congress’s clear intent to make federal disaster relief readily available to aid U.S. citizens impacted by these unprecedented storms, the UST has delayed the CDL process for more than four months, and then, without apparent or implied Congressional authority, recently imposed conditions inconsistent with the Appropriations Act. The UST’s blatant failure to implement Congressional will in this matter has jeopardized continuity of Puerto Rico’s essential services, and is merely the latest example in a long-standing pattern of depriving Puerto Rico equal access to federal assistance on the same terms provided to the states.<sup>3</sup>

At my direction, immediately following the Appropriations Act’s adoption, the Puerto Rico Fiscal Agency and Financial Advisory Authority (“AAFAF”) sought to engage the UST in negotiations to

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<sup>1</sup> See Congressional Research Service, Jared Brown, “FEMA’s Community Disaster Loan Program: History, Analysis, and Issues for Congress” (“CRS FEMA Report”) at 1.

<sup>2</sup> Of this \$4.9 billion, Puerto Rico was to be given access to approximately \$4.7 billion, with the balance to go to US VI.

<sup>3</sup> Notably, in Jefferson County, Alabama, which was struck with tornadoes and where prior government officials had been convicted of construction fraud, FEMA did not designate the county as a “high risk” applicant in the applicable disaster declarations. See also Department of Homeland Security Office of Inspector General Report, American Samoa 2009 Earthquake and Tsunami After-Action Report (October 2010), at 19 - 24 (Noting that Samoa was not officially designated as “at risk” to allow for corrective actions and associated timelines, which has not been made available to Puerto Rico.).

make CDL funds available without delay. Despite AAFAF's full compliance with every UST information request and AAFAF's participation in numerous calls, little or no progress has been made in closing the CDL. This delay has forced the Government to rely on its own limited liquidity to fund an emergency loan to the Puerto Rico Electric Power Authority ("PREPA") to continue its operations and avoid a disastrous interruption of electric power to the Island. Despite court approval of the loan (over a chorus of objections by PREPA and Commonwealth bondholders), PREPA's liquidity remains dangerously thin, and PREPA will require an additional cash infusion in the next 30-45 days.

On February 20, 2018, almost four months after the Appropriations Act was signed into law, the UST finally transmitted the terms and conditions for a reduced \$2.065 billion loan to Puerto Rico from CDL funds under the Appropriations Act (the "UST Proposal"). Unfortunately, the UST Proposal imposed restrictions seemingly designed to make it extremely difficult for Puerto Rico to access these funds when it needs federal assistance the most. On February 21, 2018, in a conference call with UST representatives, we conveyed our specific concerns with respect to the UST Proposal. The UST representatives responded on that call by dictating "5 Guiding Principles" discussed below that have effectively rendered the UST Proposal as a "take it or leave it" proposition. Contrary to CDL rules and regulations, the UST indicated on this call that it "does not intend to forgive the loan,"<sup>4</sup> and that any inclusion of a "forgiveness" provision in a CDL proposal would be simply "misleading."

## II. Background and Overview of CDL Program and Appropriations Act

The CDL program, currently codified in Section 417 of the *Robert T. Stafford Disaster Relief and Emergency Assistance Act*, is meant "to provide financial assistance to local governments that are having difficulty providing government services because of a loss in tax and other revenue following a disaster."<sup>5</sup> The CDL program, managed by the Federal Emergency Management Agency ("FEMA"), is the only program designed specifically to provide assistance to local governments to help compensate for revenue shortfalls.<sup>6</sup> Notably, "FEMA may cancel a loan up to the amount of the local governments' tax and other revenues are insufficient to meet its cumulative spending budget."<sup>7</sup>

The Appropriations Act authorized CDL funding for direct loans "to be used to assist local governments in providing essential services as a result of Hurricanes Harvey, Irma, or Maria" and specifies that "a territory or possession, and instrumentalities and local governments thereof, of the United States shall be deemed to be a local government . . ." The Act also states that the loan "issued to a territory or possession, and instrumentalities and local government thereof, may be based on the projected loss of tax and other revenues and on projected cash outlays not previously budgeted for a

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<sup>4</sup> A unique provision of the CDL Act of 2005 preventing CDL loans from being cancelled was superseded in 2007, which allowed for forgiveness of such loans. See CRS FEMA Report at 24. In that regard, FEMA has well-established cancellation for loan forgiveness. See generally CRS FEMA Report at 24.

<sup>5</sup> See CRS FEMA Report at 1.

<sup>6</sup> Id.

<sup>7</sup> Id.

period not to exceed 180 days from the date of the major disaster, and may exceed \$5,000,000.” The Appropriations Act also provides that the territories, local governments and their instrumentalities “may each receive more than one loan with repayment provisions and other terms specific to the type of lost tax and other revenues and on projected unbudgeted cash outlays for which the loan is provided.” Importantly, Congress provided that the loans made under the Appropriations Act may be canceled in whole or in part “at the discretion of the Secretary of Homeland Security in consultation with the Secretary of the Treasury.”

### **III. AAFAF Has Promptly Taken All Necessary Steps to Obtain CDL Funding**

FEMA requested information related to CDL funding in late October 2017. AAFAF immediately began providing information on a rolling basis to the UST and FEMA starting on November 8, 2017. This included detailed financial information for the Commonwealth, PREPA, and the Puerto Rico Aqueduct and Sewer Authority (“PRASA”), such as their official budget, non-operating expenditures, revenue line items, budgeted expenditure line items, disaster-related expenditures, and cash flow information to the UST and FEMA via email on November 8 and 17, 2017, and on each of December 5, 7, 10, 13, 19, and 21, 2017, among other dates. Throughout the process, AAFAF repeatedly expressed to UST and FEMA—in both e-mails and telephone conferences—the matter’s urgency and the uncertain liquidity for Puerto Rico and its public corporations. These included emails on November 14, 2017, and each of December 7, 9, 13, and 19, 2017. AAFAF continued promptly to comply with all subsequent information requests and has generally made itself available to assist in any manner necessary.

Despite AAFAF’s prompt cooperation, the UST did not provide AAFAF with economic or other material terms for the CDL program or provide any path to documentation of the loan. On January 9, 2018, UST and FEMA sent a letter to the Government regarding implementation of a “Cash Balance Policy” for accessing CDL funding. This policy effectively requested Puerto Rico to exhaust its own resources before the UST and FEMA would provide access to the CDL program funds. The request appeared to stem from the Government’s disclosure, on December 18, 2017, of a report (the “Initial Report”) indicating that the bank account balances for Puerto Rico government entities aggregated approximately \$6.875 billion. But as the Initial Report made clear, it reflected a preliminary analysis of hundreds of bank accounts of the Government and instrumentalities, and was not intended, nor should it have been construed, to provide an accurate picture of available funds for the Government’s immediate and unrestricted general use. Representatives from the Government testified under oath before the Financial Oversight and Management Board for Puerto Rico confirming this on January 19, 2018. Specifically, these representatives explained that the majority of the funds discussed in the Initial Report are unavailable as a result of ongoing litigation, have restricted uses under federal or Puerto Rico law (such as federal funds and debt reserve accounts), or are deposited by entities that are legally separate from the Commonwealth and cannot be readily accessed.

#### **IV. Government of Puerto Rico's Commitment to Provide Interim Funding to PREPA to Avoid a Catastrophic Shutdown**

The devastation wrought by Hurricanes Irma and Maria exponentially worsened PREPA's already strained financial situation. PREPA's General Fund cash balance as of the week ended January 19, 2018 had fallen to approximately \$187 million, and as a result, PREPA requested Court approval of emergency funding to borrow up to \$1 billion from the Commonwealth through an unsecured, superpriority loan. Despite the favorable terms the Commonwealth offered, PREPA's request met with numerous objections from PREPA and Commonwealth bondholders. The Commonwealth bondholders believed such a transaction would prejudice them since funds that they believe secured their debt were being loaned to PREPA. Further, the PREPA bondholders objected on the grounds that their debt would become junior in priority to the Commonwealth's superpriority loan.

Before the Commonwealth's emergency funding, PREPA's cash balance was so low that it began implementing its emergency shutdown plan to preserve critical services for as long as possible. Even after receiving emergency funding, PREPA projects that it will need an additional infusion of liquidity within 30-45 days to sustain operations.

In the face of the many bondholder objections and Judge Swain's initial decision to hold the requested borrowing in "abeyance," funding was delayed several precious days as PREPA sought to negotiate the terms of a smaller borrowing from the Commonwealth. Ultimately, Judge Swain entered an order approving a loan from the Commonwealth of up to \$300 million to allow PREPA to continue operations. Under Joint Resolution 16-2018 and subject to further order by Judge Swain, that amount could be increased to \$550 million. PREPA estimates that it needs closer to \$1 billion, however, to be confident that it can continue operations in the near to medium term.

Requiring the Commonwealth to contribute a significant portion of its scarce liquidity to PREPA will put the Commonwealth under further financial strain. It is therefore critical that CDL funding be approved in the near-term to assure PREPA can meet its ongoing operational costs and that the Commonwealth can continue to address unexpected contingencies in the Title III cases, such as professional fees, costs of administration, and adverse outcomes in litigation before the Court.

#### **V. The UST's Preliminary Terms and Conditions Dramatically Deviate from the Appropriations Act's Spirit**

After months of delay, on February 20, 2018, the UST finally presented the UST Proposal to AAFAF. The proposal included terms for a \$2.065 billion commitment to support actual, immediate cash needs as necessary to maintain essential services of Commonwealth and its public corporations, including PREPA. But the UST Proposal also includes terms that, on their face, substantially deviate from the purposes and Congressional intent of the Appropriations Act. Specifically, the UST has told AAFAF that the UST will only lend pursuant to terms consistent with five "principles":

1. Any loan terms must provide for maximum protection for the United States taxpayers;

2. Any loan terms must account for the “indefinite and unknown” future of PREPA;
3. Any loan terms must include detailed reporting and protective covenants;
4. The UST believes the Commonwealth has sufficient liquidity to repay and the United States taxpayers should not accrue risk of a loan;<sup>8</sup> and
5. Any loan terms must be consistent with customary terms provided to debtor-in-possession lenders in cases filed under chapter 11 of the Bankruptcy Code.<sup>9</sup>

These “principles” fly in the face of the of the spirit and purpose of Appropriations Act, which was intended to provide funding “based on the projected loss of tax and other revenues” of Puerto Rico, PREPA and other public corporations of the Commonwealth. The UST Proposal focuses almost exclusively on repayment and risk reduction, rather than relief for residents of the Island. By providing that “loans to a territory or possession, and instrumentalities and local governments thereof, may be cancelled in whole or in part . . . at the discretion of the Secretary of Homeland Security in consultation with the Secretary of the Treasury,” Congress contemplated that loans issued under the Appropriations Act may not ultimately be repaid.<sup>10</sup> To be faithful to this provision, the likelihood that Puerto Rico will repay any loan should be secondary to the relief such loans will provide to Puerto Rico and its residents. But the UST Proposal’s principles, as set forth in Schedule A, are based upon the concept of maximum assurance of loan repayment (e.g., priming liens, full faith and credit of the Commonwealth) and are more akin to aggressive provisions sought by profit-making financial institutions and hedge funds in chapter 11 business reorganization cases.

Further, the requirement that the Commonwealth (rather than PREPA) borrow under the loan also deviates from the Appropriations Act’s legislative intent and from recent guidance provided by Judge Swain in the Commonwealth Title III case.<sup>11</sup> The UST is requiring that the Commonwealth borrow and then “on-lend” such funds to PREPA, since the UST views the Commonwealth as less of a credit risk (notwithstanding that the governing principal of the Appropriations Act is “relief,” not repayment of the loan). But such a structure does not address the differing interests of all the relevant stakeholders in the Title III cases, which Judge Swain indicated should be considered.

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<sup>8</sup> This so-called principle is contrary to the stated purpose of the CDL program of relieving local governments of making the difficult choice of providing one essential service for its residents over another caused by a shortfall in operating revenues due to a disaster event.

<sup>9</sup> Customary debtor-in-possession loans in Chapter 11 business reorganizations are very often tight and restricted in nature and completely antithetical to the policy concerns under the CDL program, which is aimed to provide the maximum level of flexibility to maintain essential services.

<sup>10</sup> See supra footnote 3.

<sup>11</sup> In approving the \$300 million loan from Commonwealth to PREPA in its Title III case, Judge Swain expressed concern that Commonwealth creditors may lodge potential challenges to a loan where the Commonwealth funds its other entities.

Finally, the UST has contended that, for PRASA to gain access to CDL loans, it must commence a Title III proceeding under PROMESA. The UST is insisting on a Title III filing for PRASA because of the UST's desire to be assured repayment through imposition of a "priming" lien, which would not be available under a less costly, consensual out-of-court Title VI restructuring. The Government believes a Title III filing for PRASA is costly and unnecessary, as a Title VI consensual debt modification may be achieved with its bondholders. The UST's insistence on this prerequisite for a CDL loan to PRASA again rests on the notion that assurance of loan repayment—which is simply neither mandated nor required under the Appropriations Act—should be the primary consideration.

## VI. Conclusion

By passing the Appropriations Act, Congress clearly intended to make CDL funding of \$4.7 billion available this past November to the Commonwealth and its public corporations to assist them in the face of severe revenue losses following Hurricanes Irma and Maria.<sup>12</sup> Despite PREPA's continuing to face dire liquidity constraints that have forced it to seek emergency funding from the Government, the UST has (i) recklessly delayed Puerto Rico's access to the Congressionally approved CDL funding; (ii) inexplicably reduced the initial funding amount of \$4.7 billion to \$2.03 billion; (iii) created serious obstacles for Puerto Rico to obtain access to that reduced amount of funding; and (iv) overridden the ability of any CDL loan issued to Puerto Rico to be forgiven, in clear contravention of applicable law. While the President and Congress opened the door for emergency relief for Puerto Rico last fall through the Appropriations Act, Puerto Rico now approaches spring in the same precarious financial situation with the prospect of statutorily approved federal aid being quashed by the UST.

The Government of Puerto Rico's main objective now is to work closely and collaboratively with all relevant parties to obtain approval of the CDL and avoid both: (i) a catastrophic shutdown at PREPA due to its imminent liquidity issues, and (ii) unnecessary strain on the Government of Puerto Rico's liquidity position, given all of the uncertainties it presently faces in its Title III case.

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<sup>12</sup> Attached as Schedule A is a side by side comparison of high level issues created by the UST demands and the inconsistency of those demands with spirit and intent of the Appropriations Act passed by Congress.

If I can provide you with any additional information to facilitate our urgent request for help, please let me know. AAFAF is available to assist in any manner you deem necessary or so request.

Respectfully submitted,



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**Schedule A**

**CDL Term Sheet – High Level Issues/Inconsistency with Appropriations Act**

<i>Issue with US Treasury Proposal</i>	<i>Inconsistency with Appropriations Act/ Other Law</i>
<b><i>Full Faith and Credit</i></b>	
<ul style="list-style-type: none"> <li>All debt incurrence (including loans to PREPA) would be backed by the full faith and credit of the Commonwealth.</li> </ul>	<ul style="list-style-type: none"> <li>The federal legislation authorizes debt incurrence in excess of constitutional limits, but does not expressly provide that such debt be backed by the Commonwealth’s full faith and credit.</li> <li>In light of Puerto Rico’s constitutional debt limit, this protection cannot be offered in connection with the CDL Loans without an amendment to the existing federal legislation</li> </ul>
<b><i>On-lending Structure</i></b>	
<ul style="list-style-type: none"> <li>Proposal requires that the UST loan be first made to the Commonwealth, which would then “on-lend” to PREPA; thus, under Proposal, the Commonwealth assumes liability for debts of public corporations (including PREPA).</li> <li>The UST has intimated that the loans will not be forgiven under any circumstance and, therefore, it would be misleading to include such provision in any proposal.</li> </ul>	<ul style="list-style-type: none"> <li>The purpose of the legislation is for “relief,” not repayment of the loan – funds provided under the Act are to “be used to assist local governments in providing essential services as a result of Hurricanes Harvey, Irma, or Maria.”</li> <li>The on-lending requirement is a mechanism to mitigate the UST’s lending risk and fails to provide PREPA with direct funding from the UST under the Appropriations Act.</li> <li>Repayment is secondary to relief under the Act and Congress contemplated that loans issued under the Act may not be repaid given the cancellation provision. The Act provides “loans to a territory or possession, and instrumentalities and local governments thereof, may be cancelled in whole or in part only at the discretion of the Secretary of Homeland Security in consultation with the Secretary of the Treasury.”</li> </ul>
<b><i>Cash Balance/ Refinancing Mechanic</i></b>	

<ul style="list-style-type: none"> <li>• Under proposal, the UST would lend under maximum cash balance requirements tied to the Commonwealth’s liquidity, rather than PREPA (and refinancing is limited by the maximum cash balance).</li> </ul>	<ul style="list-style-type: none"> <li>• CDL intended to address revenue drops, not penalize the Commonwealth for conserving liquidity during its restructuring process – The legislation states that the loan “issued to a territory or possession, and instrumentalities and local governments thereof, may be based on the projected loss of tax and other revenues and on projected cash outlays not previously budgeted . . .”</li> <li>• Further, cash needs of the Commonwealth and PREPA should be considered separately, given the different functions and creditor groups.</li> </ul>
<p><b><i>Priming Lien on all Commonwealth and COFINA Revenues</i></b></p>	
<ul style="list-style-type: none"> <li>• Proposal requires that debt incurred is to be secured by a lien on all revenues of the Commonwealth and COFINA, which “primes” holders of Commonwealth’s general obligation and COFINA bonds.</li> <li>• The UST has informed us that they will inform Judge Swain that no federal loan will be issued to Puerto Rico if the Court does not approve a “priming lien” in favor of the UST.</li> </ul>	<ul style="list-style-type: none"> <li>• “Priming liens” at Commonwealth for funds “on-loaned” to PREPA may not meet legal standards, since Commonwealth creditors do not benefit from financing.</li> <li>• Further, until resolution of COFINA dispute, COFINA revenues are not available in light of current court order directing funds to interpleader account.</li> <li>• All bondholders are likely to object to a “priming” lien on all Commonwealth and COFINA revenues.</li> <li>• Commonwealth could end up becoming impaired if forced to “on-loan” to PREPA, since the UST is also asking for a “priming” lien on the Commonwealth’s own revenues.</li> </ul>