ENGLISH VERSION

A blow to government contractors and suppliers

If Judge Laura Taylor Swain endorses the adjusment plan proposed by the Board, thousands of companies could lose millions of dollars for services rendered that have not yet been paid for yet

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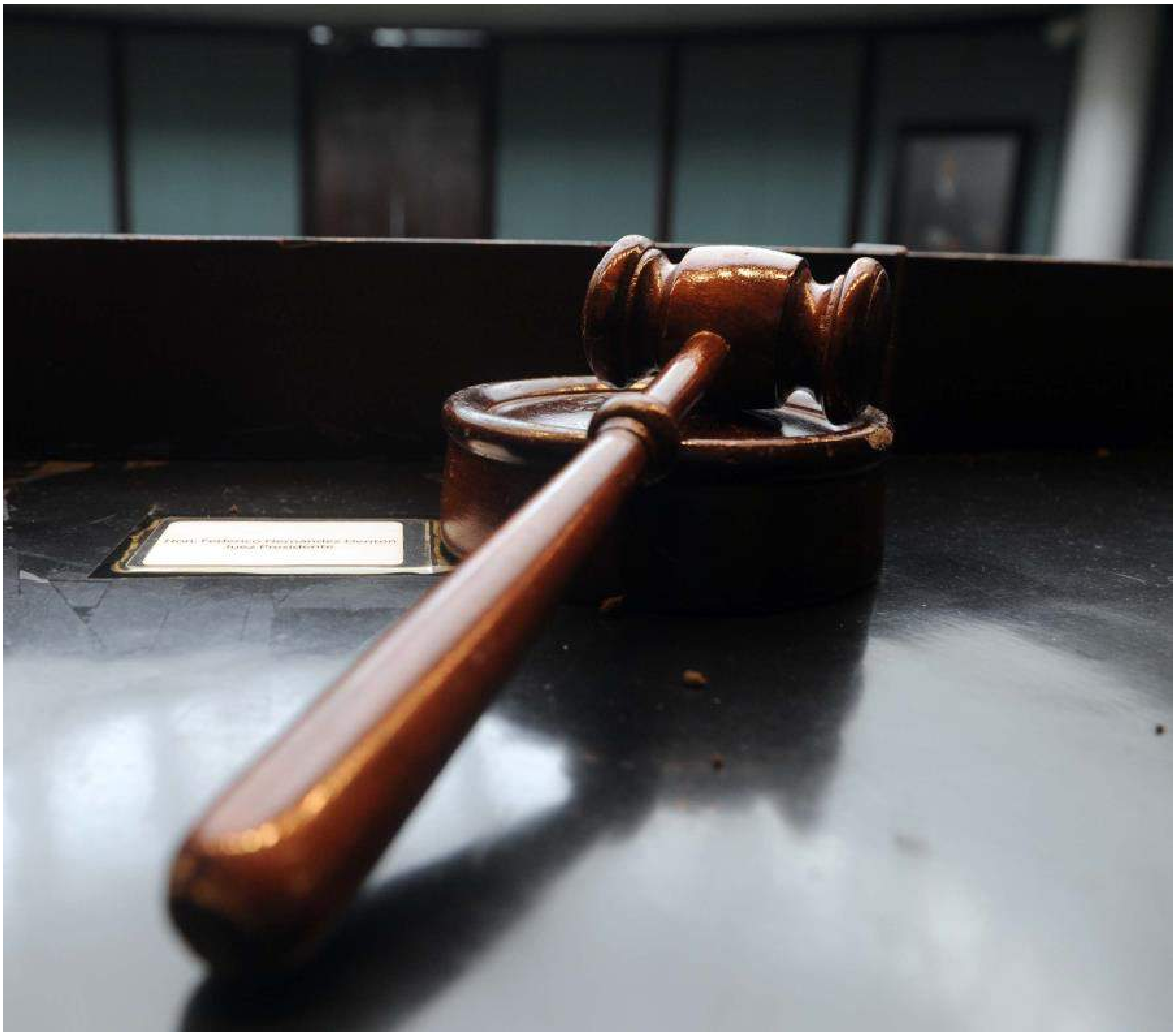

According to the PAO, the government would only pay about 1.8 cents on every dollar owed on general unsecured debts. (GFR Media)

If U.S. District Judge Laura Taylor Swain approves - without changes – the Oversight Board´s plan of adjustment (POA), thousands of businesses and nonprofit organizations in Puerto Rico could lose hundreds of millions of dollars for work done or products sold to the government that have not yet been paid for yet.

According to the POA, if the figures are correct and if the Board wins the lawsuits filed by the Special Claims Committee (CRE, Spanish acronym), the government would only pay about 1.8 cents on every dollar owed on general unsecured debts.

While GO bondholders would receive over .65 cents on every dollar, public employees would see an increase in the employer's contribution to the health plan and certain pensions would see cuts up to 8.5 percent, the central government's unsecured general creditors would be the most affected one with a cut of nearly 98 percent.

On paper, these general creditors appear in the POA Classification of Claims as "Class 27: CW General Unsecured Claims".

Who are the unsecured creditors?

According to the claims filed in court, those creditors at the bottom of the list are citizens or companies that won a lawsuit against the government, taxpayers who have not received their refunds, and above all, thousands of contractors and suppliers who have provided services, equipment or materials to the government for years.

"This is outrageous, it's disappointing, it's abusive, it's totally unfair," told Negocios engineer Ramón Ortiz, co-founder of Unitech Engineering Group.

Since September 27, when the Board filed the POA in federal court, Ortiz can't believe that after 10 years waiting to be paid for the work done for the Housing Department, now he will only receive - if he's lucky - about $198,000. That is, if the Board's projection in the adjustment plan is confirmed.

The government's debt with Unitech totals $11 million for the construction of Arenales I and II communities, where dozens of families in Dorado live today and for works in the Corea and Vista Hermosa communities in Bayamón and Juana Díaz, respectively.

While Ortiz, an engineer who graduated from the University of Puerto Rico in Mayagüez and son of public employees who worked really hard, and his partner, Héctor Ocasio, were waiting for the government to pay them, the banks and the bonding company wanted to receive their part.

Ortiz ended on the street when the government did not pay them. The bank seized as much as it could and the bonding company is waiting for the claim that now seems to be vanishing after the Board´s proposal. In the case of his partner, Ocasio, having a renowned company with its back against the wall since they weren´t paid for the work done, literally cost him his life.

"Between 125 and 150 families depended on us. I lost my company, my partner, who was my friend, my brother," said Ortiz, who is part of the Unsecured Creditors Committee (UCC) in Title III cases.

Unitech's lawsuit is just one of nearly 3,000 that appear in Title III cases court records. There is another list of claims handled by Prime Clerk.

However, both lists are confusing because they include a combination of bondholders, failed banks such as Doral Bank - which still seeks to receive a refund from the government - or local diaries such as Suiza Dairy and Vaquería Tres Monjitas, which seek to collect their credit for a litigation associated with the Milk Industry Regulation Office (ORIL, Spanish acronym).

But those lists also include hospitals and companies like Crecemos, dedicated to providing therapies to children with special needs, and companies like Cardinal Health and Universal Care - that have sold medical supplies to government hospitals for years. According to the amount claimed, medical services - which would be considered as essential service - top the list.

There are also claims filed by academic institutions such as the Inter-American University of Puerto Rico (UIPR, Spanish acronym) and the Central Caribbean University.

The UIPR told Negocios that the Board's proposal could imply losing a $5 million claim for services rendered to the government.

“This news is shocking because we are talking about resources we can longer count on,” said the Central Caribbean University President Waleska Crespo in referring to a debt of over $2 million that the Health Department has not paid in almost two decades.

According to Crespo, if an adjustment like the one proposed by the Board were implemented, that would represent another blow to medical services for the most disadvantaged population.

In the case of the Central Caribbean University, Crespo explained, it would represent a double blow. On one hand, the University is a training workshop for future Internal Medicine doctors and, on the other, it´s a service point for the poorest patients in the northern part of the island. Not recovering that amount also means losing an avenue to make investments in infrastructure or patient services.

Objection to the plan

The UCC, a group of creditors appointed by the U.S. Trustee to negotiate in Title III cases said in a statement addressed to government creditors that they understand the plan proposed by the Board should not and cannot be approved for several reasons.

According to this group, the Board´s proposal contemplates paying, at best, 1.8 percent of the claims. Meanwhile, other groups of unsecured creditors and bondholders could recover almost the total.

While the Board has stated that the plan may be changed or rejected by the court, the projected recovery percentage for general unsecured debts is buried on page 289 of the disclosure statement that the Board filed along with the POA.

"I can understand the need for an adjustment, but not on this scale," said the former president of the College of Certified Public Accountants, Cecilia Colón Ouslán, when she learned of the Board's proposal.

"Such a different treatment between suppliers and other creditors who are also not secured is inexplicable," said economist Joaquin Villamil referring to the figure estimated for Class 27.

"It seems to me it´s an inconsistency to talk about promoting the local economy and businesses and not to honor agreement with those who financed the government now because we are talking about that many of these services are essential," said economist Antonio Fernós Sagebién.

The Board's logic

The POA is betting on cutting "once and for all," as the Board said, some $35 billion in central government bonds and some $50 billion in debts related to public employees retirement.

In the POA, these obligations are broken down into 39 classes or groups that would have to vote on the Board´s proposal when Judge Swain determines so.

Classes 1 through 24 bring together several government bondholders, such as General Obligations (GOs) and Public Buildings Authority (PBA) bonds that the Board considers legitimate and invalid. Class 25 includes retired public employees and those workers still active who contribute to the so-called System 2000, while class 26 includes public employees represented by the American Federation of State, County & Municipal Employees.

Classes 28 through 36 bring together claims related to the Highway and Transportation Authority (HTA), the Convention Center District Authority (ADC, Spanish acronym) and the Employees Retirement System (ERS). Class 38 includes class action for Compulsory Liability Insurance (SRO).

For the Board, the proposal would save the government millions of dollars in litigation and set a cap on the payment of public debt over the next three decades. This would reduce from almost $4 billion to about $1.5 billion the annual amount that would be reserved for bondholders.

The Board starts from the premise that PROMESA opened the door to reduce the debt owed to bondholders and to set aside the payment priority established in the Constitution and laws of Puerto Rico. This would make it possible to ensure pension payments now and in the long term.

However, in that balance of interests, the Board privately recognizes that unsecured claims or specific sources of payment, such as debts to suppliers and contractors or lawsuits against the state, would bear the brunt.

Not clear

"The plan addresses in detail secured debts and priority repayment issues. It is very specific for bondholders and retirees, but it does not specify what happens to suppliers, contractors, lawsuits," said former Puerto Rico Bankruptcy Court Judge Gerardo Carlo Altieri.

According to Carlo Altieri, who described the POA as an extensive and complicated document, less than a month after the filing of the adjustment plan, it is too early to know how much a supplier or contractor -who is waiting for payment for services rendered to the government- would receive.

William Vidal-Carvajal, who represents several entities doing business with the government and that have filed claims in Title III cases, agreed.

According to Vidal-Carvajal, while the Board offers payment projections in the adjustment plan, PrimeClerk has now asked its clients and others to provide updated information on their claims. This is to verify if the claim is still valid for the amounts reported when PROMESA Title III was invoked two years ago.

PrimeClerk is the firm the Board hired as managing agent for the largest municipal bankruptcy in the United States. October 23 is the deadline PrimeClerk set for claimants to submit the information required.

"I know about many clients who no longer have claims because the government has been paying them all this time," Vidal-Carvajal said.

Because it is a government entity, it is authorized to pay suppliers and other services while working in bankruptcy, without the need for the court to authorize such payments.

“The system doubled and even tripled many claims. Some people filed by mail and also by e-mail, so PrimeClerk is trying to adjust and do the accounting to see how much claims really total,” said Vidal-Carvajal.

If the total in claims is reduced, the level of recovery for suppliers and contractors could be higher than the Board´s projection of 1.8 percent.

However, Carlo Altieri explained that unlike the bankruptcy of a company, when it comes to a government's financial reorganization, the proposed adjustment brought to the table has other high public interest effects.

Carlo Altieri said that prioritizing pensions payment (an unsecured debt) became the Board´s public policy because not doing so could have had other adverse effects on the economy and on a significant part of the population.

But on the other hand, the former bankruptcy judge explained, the POA leaves thousands of other creditors in uncertainty.

"The proposal is uncertain because you don´t know how much could result from the preference actions filed by the Board and above all because the Board reserves the right to object to the claims even after the plan is approved," said Carlo Altieri.

"That means a supplier will have to vote whether or not to approve the plan without knowing if 180 days after the court approves the plan, the Board will object to their claim," said the former judge.

"There may be many of these companies that decide to go bankrupt if they cannot collect for their services and for what they sold to the government," said Carlo Altieri.

Classes 27 and 39

The Board´s plan provides that general unsecured debts in class 27 will be paid from a kind of trust described in the plan under the name of “CW GUC Pool”. This fund will be funded through an initial injection of $ 100 million.

If the Board wins the lawsuits it filed against certain suppliers or investment banks that have allegedly contributed to Puerto Rico’s fiscal collapse (known as “Avoidance Actions”), those revenues would go to the CW GUC Pool up to a maximum of $ 750 million. Money into that pot would be distributed among Class 27 claimants.

"It is possible that 1.8 percent becomes nothing because that depends on what is brought into the pot for the Avoidance Actions. It's totally unsecured,” said Carlo Altieri.

According to the Board´s estimates, the territorial government owes about $ 5,566 billion under class 27.

If any Class 27 creditor – such as a creditor with a favorable decision– prefers to settle his claim without waiting for the distribution through the fund, he may request conversion to Class 39.

Under this class, the creditor agrees to reduce his claim to the government to $ 10,000 and would receive that amount in cash.

Undermining the economy

However, according to public accountant Colón Ouslán, reducing debt or considering it as a loss in a company´s books is not as simple as it seems.

According to Colón Ouslán, who is also a lawyer, government payments have been so poor over the years that suppliers and contractors have often included a factor in the price to compensate for late payments.

"But in none of those cases, that factor will represent the investment that supplier had to make in order to provide the service or equipment to the government," said the also partner at TGCO CPA.

"A bondholder decided to invest already aware of the risks, but a supplier, a contractor is waiting for payment for the service provided," noted the executive.

According to Colón Ouslán, while government contractors or suppliers have waited years to receive the money for their services to the state, the fiscal framework isn't as patient.

In the case of government suppliers and contractors, the public accountant explained that these are companies that paid inventory taxes to the Municipal Revenues Collection Center (CRIM, Spanish acronym) and paid taxes to municipalities for their sales volume even though the government had not paid them.

“In the so-called tax reform, they approved a language so that those suppliers and contractors to whom the government hasn’t paid, can use that account to comply with their tax responsibility. What is supposed to happen now if that debt is reduced to less than two cents on the dollar?,” asked Colón Ouslán.

In her opinion, when a company is forced to write off debts it cannot collect, it is forced to create reserves, affecting the value of the assets of that entity. "A bank lends you counting that you will collect those debts," she explained.

“We are not in a boom period. Companies have been making adjustments for years, cutting back to deal with the whole economic issue,” said the public accountant.

If the cut proposed in the POA materialized, this would be the last straw for an economy that has shrunk by about 15 percent since 2006. According to official data, between 2009 and 2018, the Puerto Rico Bankruptcy Court received about 103,000 bankruptcy petitions under all the Bankruptcy Code chapters.

According to economist Villamil, it is likely that many of the suppliers and contractors have already registered as losses that money they haven’t collected from the government in years . But that doesn’t eliminate the fact that there was a destruction of value that is undermining the island’s production.

"I think this can have a very huge impact on local businesses and non-profit organizations," added the founder of Estudios Técnicos.

“When the government agrees to buy a service or product, the contract sets the budget line to pay for it. For a long time, the law wasn't complied with and no responsibilities were set, but now those who provided services to the government are the ones who are losing out,” Villamil said. "This is another element that affects certainty, credibility, and trust when interacting with the government."

“That has the effect of reducing production capacity. If a company doesn’t collect for what it sold, it cannot employ people, it reduces jobs, consumption and it stops injecting liquidity into the system,” explained Fernós Sagebién.

For Fernós Sagebién, the cut of nearly 98 percent proposed to government suppliers is another example of how the bankruptcy process in Puerto Rico didn´t have the same effects as other sovereign debt restructuring processes.

In short, when an economy cuts payments to its bondholders, they start from the premise that those who will suffer the adverse impact of that decision are people or entities mostly outside that country.

According to Fernós Sagebién, in Puerto Rico, the adjustment process under PROMESA has affected those who are allegedly being helped.

Fernós Sagebién recalled that in the case of Cofina (Puerto Rico Sales Tax Financing Corporation), subordinated bondholders, many of these cases in Puerto Rico, had a 50 percent cut by paying principals over 90 percent.

If the general unsecured debt is about $ 5.5 billion as the Board estimates and there is 98 percent cut as proposed in the POA, the decision would result in destruction equivalent to the budget of the Department of Education and the Vital program.

“You are not exporting the losses, you are nationalizing them,” said Fernós Sagebién and added that those “contractors and suppliers were the ones who built emergency rooms, who sold IV solutions to hospitals, blackboards, and equipment to schools. They are businessmen who paid payroll, to the State Insurance Fund Corporation, to the U.S. Internal Revenue Service, and have not been paid yet.”