



GOVERNMENT OF PUERTO RICO

Federal Affairs Administration

May 16, 2019

The Honorable Raul M. Grijalva
Chairman
U.S. House of Representatives
Committee on Natural Resources
1324 Longworth House Office Building
Washington, DC 20515

Dear Chairman Grijalva:

In accordance with the Rules for the Committee on Natural Resources, Committee Rule 3(o), on behalf of Governor Ricardo Rosselló, please find enclosed the requested responses to the questions for the record presented by Committee Members upon the conclusion of the oversight hearing entitled, *The Status of the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA): Lessons Learned Three Years Later*.

Should you require additional information or have any questions, please do not hesitate to contact me at 202-778-0710 or via email at glaws@prfaa.pr.gov.

Sincerely,

A handwritten signature in blue ink, appearing to read "George H. Laws Garcia".

George H. Laws Garcia
Acting Executive Director
Puerto Rico Federal Affairs Administration



I. Questions from Democratic Members

Questions from Chairman Grijalva for Hon. Ricardo A. Rosselló, Governor of Puerto Rico

Question 1: Section 2141 (b)(1)(B) of PROMESA requires that Fiscal Plans approved by the Fiscal Oversight and Management Board (FOMB) for Puerto Rico "ensure the funding of essential public services." In your testimony, you mentioned that you and your Administration have not formally defined the term. How do you define "essential public services"?

Response: From the Government's perspective, "essential public services" consist of the government services that the Government believes are necessary to operate the government of Puerto Rico and preserve our economy and the well-being of our citizens. When the Government submits fiscal plans and budgets, those proposals reflect what we believe are essential public services. We refer the Committee to the contents of the Commonwealth fiscal plan, as certified on May 9, 2019, for the details of those services.

Questions 2: What framework and targets has your Administration implemented to ensure that "essential public services" are available to the residents of Puerto Rico? Also, do you consider PROMESA should be amended to include a more specific definition of "essential public services"?

Response: Every year, each government agency works closely with our Office of Management and Budget to determine how best to protect our people and our economy through appropriate budgeting for essential services. PROMESA should not be amended to include a more specific definition of "essential public services" as essential services will vary and will be a function of available resources and the policy initiatives of the duly elected territory government.

Question 3: How are the PROMESA Fiscal Plans developed? Does the FOMB write them and send them to you for your approval or is it a collaborative effort?

Response: PROMESA section 201 sets forth the process by which fiscal plans must be developed and certified by the Financial Oversight and Management Board ("FOMB" or "Oversight Board"). Under PROMESA, the fiscal plan process begins when the Oversight Board "deliver[s] a notice to the Governor providing a schedule for the process of development, submission, approval, and certification of Fiscal Plans."¹ The Oversight Board may consult with the Governor in establishing the fiscal plan schedule but retains sole discretion to change the schedule dates as it deems "appropriate and reasonably feasible."²

¹ PROMESA § 201(a).

² Id.



After receiving the schedule notice, the Commonwealth or the appropriate governmental entity or public corporation (as applicable) must develop its fiscal plan proposal, which the Governor must submit to the Oversight Board by the deadlines established under the schedule.³ The Oversight Board then reviews the Governor's fiscal plan proposal to determine whether it satisfies the 14 requirements set forth under PROMESA section 201(b)(1) (the "Certification Requirements").⁴ If the requirements are satisfied, the Oversight Board can certify the proposed fiscal plan.⁵ If the requirements are not satisfied, the Oversight Board must provide the Governor with a "notice of violation" and "an opportunity to correct" the fiscal plan proposal.⁶ The Governor may submit as many revised fiscal plans to the Oversight Board as permitted under the fiscal plan schedule.⁷ However, if the Governor fails to submit a fiscal plan proposal that the Oversight Board determines in its sole discretion satisfies the Certification Requirements, then the Oversight Board may develop and certify its own fiscal plan.⁸ Alternatively, PROMESA section 201(f) provides that the Governor and Oversight Board may jointly develop a fiscal plan that meets the Certification Requirements.

The Government takes the fiscal plan process very seriously. It submits thoughtful, fulsome fiscal plans that include detailed data and projections as well as many substantive policy proposals for how to continue Puerto Rico's rebuilding and revitalization.

Importantly, my Administration has complied with all aspects of the fiscal plan process since taking office in January 2017 and has met all deadlines established by the Oversight Board for the submission of fiscal plan proposals.

Question 4: Other than opposing the various labor reforms that the FOMB proposed, has your administration been supportive or opposed to the cuts to education, the University of Puerto Rico and healthcare? Have you proposed budgets to restore those cuts that were rejected by the FOMB?

Response: My Administration is committed to ensuring that Puerto Rico residents have access to affordable healthcare and education. In fact, these are among our highest priorities. The elected Government agrees with the Oversight Board that the University of Puerto Rico ("UPR") must increase its revenues through modest increases in tuition and other charges while also transitioning to a leaner operational structure. However, we disagree on the means to achieve these ends. Although the elected Government has proposed to gradually increase UPR tuition by fiscal year

³ See id. § 201(c)(2).

⁴ See id. § 201(c)(3).

⁵ See id. § 201(c)(3)(B).

⁶ Id. § 201(c)(3)(B).

⁷ See id. § 201(d)(1).

⁸ See id. § 201(d)(2).



2023, the Oversight Board has sought a more aggressive 65% tuition increase, while also reducing scholarships for low-income students. To reduce UPR's overhead, the Government has proposed a voluntary transition program, which allows eligible workers to transition to nonprofit and non-governmental organizations or the private sector in exchange for a tax-free economic incentive. The Oversight Board would take this program a step further by eliminating any vacated positions while also imposing involuntary terminations and reductions in federally funded personnel.

My Administration vehemently objects to short-sighted, draconian measures that would save some money now while forfeiting our investments in the future. In light of the Commonwealth's current financial crisis, modest cuts to these programs may be inevitable. But the entire burden should not fall on the island's young people, who are the foundation of the prosperous future that we are all striving to build for Puerto Rico.

Questions 5/6: The Middle States Commission on Higher Education has placed the University of Puerto Rico (UPR) in show-cause status due to its fiscal situation and financial projections. The UPR is at risk of losing its accreditation and access to federal funds. Has your Administration engaged and collaborated with other stakeholders, such as the University Board, to develop the UPR's budget and Fiscal Plan? Please share information about the stakeholders that have participated in the process and the extent of their participation.

Response: UPR has maintained accreditation for each of its 11 campuses for an additional year, as it was able to deliver fiscal year 2016-17 single audit, audited financial statements and show substantial compliance with the Middle States Commission on Higher Education ("MSCHE") Standards. After the UPR was placed into a "Show Cause" status by MSCHE, it provided sufficient evidence to maintain its accreditation for an additional year, while it continues to take concrete steps in the accreditation process.

After duly complying with MSCHE's request, on March 18, 2019, UPR maintained accreditation for all campuses during the "Show Cause" process, which will last an additional year.

In its letter, MSCHE stated that UPR "provided compelling evidence" that:

- the quality of the learning experience for the student has not been at risk at any time;
- the Institution has the potential to remedy the non-compliance issues identified by the MSCHE within the extension period;
- the Institution has developed reasonable plans to meet the reaffirmation expectations of the MSCHE within the period of extension;



- the UPR has the support of the Central Administration of the UPR, the Fiscal Oversight Board and other entities for the institutional compliance in progress; and
- the Institution has been affected by other circumstances beyond its control.

On or before May 1, 2019, the UPR was required to submit a report regarding the status of completion of the single audit and the audited financial statements for the 2017-18 fiscal year to MSCHE and the U.S. Department of Education to meet the aforementioned Standards and Requirements. On April 30, 2019 the UPR submitted its single audit and audited financial statements for the 2017-18 fiscal year to the MSCHE. The Puerto Rico Fiscal Agency and Financial Advisory Authority (“AAFAF” by its Spanish acronym), as the Government’s fiscal agent and financial advisor, has provided support to the UPR Board and its central administration on the development of all its fiscal plan and budget submissions, including the latest April 5, 2019 fiscal plan.

Questions 7/8: The agreement reached between PREPA and a good part of its creditors will cause an increase of up to 4.6 cents per kilowatt hour, which when added to other scheduled adjustments for the rate, would imply an increase of up to 30% in the cost of energy in Puerto Rico in several years. - Has the Government considered how this will hurt workers in Puerto Rico who on average make less than \$20,000 per year, or slow down the creation of jobs by local businesses? Can local businesses and the people of Puerto Rico afford a 30% increase in energy cost? Wouldn't a rate increase hurt the ability of Puerto Rico's economy to recuperate?

Response: The agreement reached between PREPA and a significant percentage of its creditors paves the way for the transformation of the electric system and results in a fair outcome for all stakeholders. Key benefits of the transaction are:

1. The transition charge is fixed and capped (i.e., no floating charge or uncapped charge to consumers). It is low in the early years to provide time for the expected efficiencies and upgrades to the electric system to be realized.
2. The transaction will achieve \$2.1 billion in debt service savings for the period from 2020 through 2039 as compared to the contractual terms of the debt. These savings represent \$3.3 billion in additional savings versus the terms of the restructuring support agreement that was not certified before the PREPA Title III filing.
3. Creditors are taking meaningful haircuts to claims.
 - Includes haircuts to Assured’s claims (and not just those of the uninsured bondholders).
 - The Government eliminates the possibility of risk of a loss in litigation that could result in materially higher recoveries to



GOVERNMENT OF PUERTO RICO

Federal Affairs Administration

creditors (and locks in the agreed to haircuts regardless of the outcome of any litigation).

- 10% of the bondholder recovery is contingent and based on performance.

Questions 9/10: The Trump Administration has expressed concerns regarding financial controls in Puerto Rico to justify reluctance to provide further funding for disaster relief and recovery for the island. In terms of financial controls, what is the division of fiduciary responsibilities among the Governor's office, the Puerto Rico Fiscal Agency and Financial Advisory Authority, the Puerto Rico Comptroller, and the FOMB?

Response: The financial controls of the Government of Puerto Rico and its instrumentalities are carried out by multiple entities. The Office of the Governor exercises a general oversight role over the Executive Branch of the Government of Puerto Rico and ensures that its public policies are duly implemented by the agencies. AAFAF serves as fiscal agent, financial advisor and disclosure agent of the Government of Puerto Rico, its instrumentalities and municipalities. AAFAF also serves as liaison between the Governor and the Oversight Board, oversees the implementation of the Fiscal Plan and the Certified Budget and represents all government entities in the renegotiation of the public debt. On the other hand, the Office of the Comptroller of Puerto Rico was created by Article III, Section 22 of the Constitution of Puerto Rico and is attached to the Legislative Branch. The main duties of the Office of the Comptroller are to examine all revenues, accounts and disbursements of the Government of Puerto Rico, its public corporations and municipalities to determine if they have been made in accordance with the law. The Office of the Comptroller also administers the centralized registry of contracts of the Government of Puerto Rico. Finally, the Oversight Board's powers are established in PROMESA and are mainly related to the certification of Fiscal Plans and Budgets and to the restructuring of public debt.

Questions 11/12: Section 208 (b) of PROMESA requires a report on discretionary tax abatement agreements. Your Administration has avoided publicly disclosing the contents of the report. However, without this information it is difficult to track how much revenue Puerto Rico is losing from individually tailored corporate tax breaks. Why has that information not been disclosed? Please provide an analysis of how much Puerto Rico benefits from these tax breaks versus how much controlled foreign corporations (CFC's) bring to the island's economy.

Response: The Government of Puerto Rico has prepared a tax expenditure report that is compliant with PROMESA Section 208 (b). This report has been shared in draft form with the FOMB. The FOMB has indicated it has comments and may require additional information. Once the FOMB and Government finalize the report, the intent is to make key information, analysis, and conclusions public.



GOVERNMENT OF PUERTO RICO

Federal Affairs Administration

Puerto Rico provides approximately \$180 million in annual tax credits to certain corporations through incentives aimed at attracting foreign direct investment, promoting economic development, and social betterment.

Separately, Puerto Rico provides customized tax incentive packages to certain CFCs. In aggregate, these CFCs provide well over \$2.0 billion per year in Act 154, non-resident withholding, and other tax revenues. This is in addition to investing in a work force with thousands of high-paying job opportunities. Without a competitive tax incentive structure, many of these corporations would not remain in Puerto Rico, thereby depriving the Commonwealth of much needed industry, jobs, and tax revenue.

Individual taxpayer information has not been published because it is confidential under Puerto Rico law. However, aggregated data on tax abatement agreements has been published. Furthermore, the Government is in the process of enacting the Incentives Code of Puerto Rico, which will completely reform the process of granting tax credits and other tax abatements to incorporate ROI analysis. The Incentives Code will also provide for the periodical publication of aggregated data regarding tax abatements.

II. Questions from Republican Members

Questions from Rep. Jennifer Gonzalez-Colon for Hon. Ricardo A. Rosselló, Governor of Puerto Rico

Question 1: As you know, the Congressional Task Force on Economic Growth in Puerto Rico - which was established by PROMESA - issued a report in 2016 with various recommendations to help address Puerto Rico's fiscal crisis. Among those recommendations was permanently lifting the cap on the rum tax cover over. While Congress did pass legislation lifting the cap through 2022, we have yet to permanently lift the cap. Can you please discuss how Puerto Rico would benefit from such legislative action?

Response: Under the current construct, permanently lifting the cap on the cover-over to \$13.25 per barrel would result in an incremental \$25 million - \$30 million in revenues to Puerto Rico's general fund while Puerto Rico rum producers would receive an additional \$60 million - \$65 million annually. Increased incentive payments to local rum producers help keep Puerto Rico competitive and retain a valuable industry for the island as well as providing additional funds to continue providing services such as public safety, education and healthcare to our citizens



Questions from Rep. Rob Bishop for Hon. Ricardo A. Rosselló, Governor of Puerto Rico

Question 1/2: Please provide a list of all the supposed laws and reforms your Administration has enacted since taking office. Please provide a list of all supposed laws and reforms that your Administration has actually been able to implement since taking office.

Response:

I am proud to report that my Administration has enacted and implemented more laws and reforms than any other Administration in Puerto Rico's history. My Administration's record speaks for itself, including achieving a series-low unemployment rate, the highest private sector nonfarm payroll numbers in four years and eight consecutive months of positive year-over-year job creation. Please see listing below of all laws enacted and implemented since we took office:

- Act 1-2017 – The Participative Public Private Alliances Act. This act strengthens the P3 legal framework to facilitate critical infrastructure investments and improve public services.
- Act 2-2017 – The Puerto Rico Fiscal Agency and Financial Advisory Act. Creates the necessary legal framework to implement and comply with PROMESA and with the Fiscal Plan.
- Act 3-2017 – The Act to Attend Puerto Rico's Fiscal, Budget and Economic Crisis and to Guarantee the Operation of Government of the Government, which allows for taking immediate emergency and cost cutting measures to reduce the Government's operating expenses.
- Act 4-2017 – The Labor Transformation and Flexibility Act, which amended several labor legislations with the intention of improving labor market competitiveness, improving the labor participation rate, and halting the migration of citizens to external labor markets.
- Act 5-2017 – The Puerto Rico Financial Emergency and Fiscal Responsibility Act, which amended the prior Act 21-2016 to prioritize essential services over debt payments and extended the emergency period for revenue claw-backs to August 1, 2017 pursuant to Executive Order 2017-31.
- Act 8-2017 – The Act for the Administration and Transformation of Human Resources in Government, which allows for the transfer of workers across the Government to achieve savings through mobility and attrition.
- Act 13-2017 – Enterprise Puerto Rico Act, which creates a not for profit corporation to promote the economic development of Puerto Rico, attract foreign direct investment and incentivize investments in technology in collaboration with the private sector.
- Act 15-2017 – Created the Office of the Inspector General of Puerto Rico.



GOVERNMENT OF PUERTO RICO

Federal Affairs Administration

- Act 17-2017 – Act to Promote Puerto Rico as a Destination; enables the creation of a destination marketing organization (DMO).
- Act 18-2018 – Reforms, simplifies and expedites the permitting process.
- Act 20-2017 – Department of Public Safety Act, which consolidates law enforcement and other public safety agencies under a Public Safety Department.
- Act 24-2017 – Increases transit violation penalties and fines to increase the Government's revenues.
- Act 25-2017 – Provides measures for enforcing collection of sales taxes on internet transactions to generate \$35 million to \$55 million in new revenue.
- Act 26-2017 – The Fiscal Plan Compliance Act, which levels out marginal benefits across the Government and its instrumentalities to generate \$130 million in savings, increases revenues, and expedites the process of asset disposition.
- Act 37-2017 – Reorganizes PREPA's Board of Directors to comply with the Fiscal Plan for said public corporation.
- Act 43-2017 – Includes medical tourism services and telemedicine facilities as eligible services under this Act 20-2012 and eliminates bureaucratic requirements that restricted conferring tax incentives to applicants.
- Act 45-2017 – Amends Act 22-2012 to require investor to make an annual contribution of at least \$5,000 to nonprofit entities that operate in Puerto Rico; places a 5% tax on Individual Resident Investor's long-term net capital gains recognized ten years after becoming a Puerto Rican resident, but before January 1st, 2036, on stocks and bonds that he or she possessed before becoming a Puerto Rican resident; and eliminates bureaucratic requirements that restricted conferring tax incentives to applicants.
- Act 46-2017 – Extends the emergency period established by Act 5-2017 and authorizes the Governor to further extend such period by executive order.
- Act 81-2017 – Establishes the Office of Municipal Management attached to the Office of Management and Budget and eliminated the Office of the Commissioner of Municipal Affairs.
- Act 106-2017 – Establishes a pay-as-you go ("PayGo") system and creates a new Defined Contribution Plan similar to a 401k Retirement Plan for public employees.
- Act 109-2017 – Establishes the legal framework to restructure the Government Development Bank (GDB) debt pursuant to the Restructuring Support Agreement ("RSA") authorized by the Fiscal Oversight and Management Board under Title VI of PROMESA.



GOVERNMENT OF PUERTO RICO

Federal Affairs Administration

- Amended by Act 147-2018
- Act 122-2017 – Establishes a procedure for the reorganization of agencies and corporations of the Government of Puerto Rico, in order to create agile and more efficient governmental entities. Authorizes the Governor to submit Plans of Reorganization to the Legislative Assembly, for its review, approval or rejection, to create, outsource, conglomerate, coordinate and consolidate agencies, functions, services, programs and powers of the agencies.
- Act 120-2018 – Creates the Puerto Rico Electric Power System Transformation Act to establish the legal framework for the sale, disposition or transfer of assets, operations, functions and services of PREPA.
- Act 131-2018 – Implements the Model Forest Reorganization Plan.
- Act 141-2018 – Implements the Department of Economic Development and Commerce Reorganization Plan.
- Act 171-2018 – Implements the Department of Natural and Environmental Resources Reorganization Plan.
- Act 211-2018 – Implements the Public Service Regulatory Board Reorganization Plan.
- Act 212-2018 – Implements the Education Council Reorganization Plan.
- Act 241-2018 – COFINA Reorganization/POA implementation.
- Act 257-2018 – Tax Reform (multiple amendments to the Internal Revenue Code).
- Act 17-2019 – Establishes the Puerto Rico Energy Public Policy Act, which adopts the regulatory framework applicable to the P3 transaction of PREPA.

Question 3: We've often heard you say the Oversight Board is interfering with public policy and that's not their mandate yet the law, PROMESA, requires the Board to certify your Government's budget. How is the Board able to do their job without having a say in policies that have to be funded by the budget?

Response: In contrast to the powerful control board model used to restructure the District of Columbia's debts in 1995, PROMESA embodies a dual scheme of shared powers for Puerto Rico. Under PROMESA section 303, Congress clearly intended to preserve the self-determination of the people of Puerto Rico by reserving all "political and governmental powers of the territory" to the elected Government of Puerto Rico.⁹ This dual scheme was acknowledged in PROMESA's

⁹ See *In re Fin. Oversight & Mgmt. Bd. for P.R.*, 583 B.R. 626, 635 (D.P.R. 2017) ("PROMESA section 303 reserves the territory's political and governmental powers to the territory.").



legislative history¹⁰ and has also been recognized by the U.S. District Court for the District of Puerto Rico overseeing the Commonwealth's Title III cases.¹¹

With PROMESA's enactment, Congress sought to strike a careful balance between preserving the representative Government's flexibility to make policy decisions to achieve fiscal responsibility and entrusting the Board with a meaningful oversight role.¹² Congress granted the Board oversight authority to prevent past abuses, such as funding deficits through borrowing. In that regard, ensuring financial transparency and accountability to the Government's stakeholders is an essential element of the fiscal plan process.¹³

Under PROMESA's framework, the Board can make recommendations to the Government as to the policy choices needed to meet fiscal targets established in the certified fiscal plan. But the Board cannot, through a series of anti-democratic measures,¹⁴ control or usurp the elected Government's exclusive authority to determine the policies within the fiscal plan's parameters that are appropriate to protect the interests of the electorate to whom the Government is accountable. Congress intended for the "governor and the board to work together for the benefit of the people of Puerto Rico, not to have parallel governing structures."¹⁵

If the Oversight Board were to adopt a policy over the Government's objection, the District Court has correctly noted that the Oversight Board would "face[] the

¹⁰ See H.R. Rep. 114-602(I), 2016 WL 3124840 at *110 (PROMESA "pairs a comprehensive debt restructuring mechanism . . . with an independent and temporary oversight board (which is not a federal entity)—not a heavy-handed control board—to help ensure that the Puerto Rico government conducts itself in a responsible, transparent, and disciplined manner").

¹¹ See *In re Fin. Oversight & Mgmt. Bd. for P.R.*, 583 B.R. 626, 633 (D.P.R. 2017) ("The degree of unilateral power that Congress has granted to the Board stands in contrast to the powers Congress granted to the [D.C. Board].").

¹² While the Board's fiscal planning powers "give it a strong and substantially determinative voice in overall strategy regarding the Commonwealth's revenues, expenses, and general direction for responsible financial management," the Board does not have the power to impose specific policies on the Government." *In re Fin. Oversight & Mgmt. Bd. for P.R.*, 583 B.R. 626, 633 (D.P.R. 2017). Rather, "Congress did not grant the [Board] the power to supplant, bypass, or replace the Commonwealth's elected leaders and their appointees in the exercise of their managerial duties whenever the Oversight Board might deem such a change expedient." *Id.*

¹³ PROMESA § 201(b)(1)(F) (fiscal plan must "improve fiscal governance, accountability, and internal controls").

¹⁴ H.R. Rep. 114-602(I) (2016) ("Under H.R. 5287, the anti-democratic provisions empowering the oversight board to impose its recommendations over the objection of the Puerto Rico government has been removed. The board is still authorized to make policy recommendations and to obtain a written response from the Puerto Rico government regarding whether it will, or will not, implement those recommendations. Section 201 does require the fiscal plan put forward by the Puerto Rico governor to 'adopt appropriate recommendations' submitted by the oversight board under Section 205, but the term 'appropriate' provides the governor with significant flexibility to adopt sound recommendations and to decline to adopt unsound recommendations.").

¹⁵ H.R. Rep. 114-602(I), at *114.



challenge of managing implementation of the policy in a way that garners the genuine cooperation of Puerto Rico’s elected government and the citizens of the island who voted for them, as well as the confidence of stakeholders and potential new investors whose interest in doing business with the Commonwealth will be crucial to the Oversight Board’s ability to fulfill its charge in providing a method to achieve access to the capital markets.”¹⁶ As a practical matter, the Oversight Board’s ability to impose its own policies on the Government is highly constrained. The Governor and the Legislature were elected to serve the people of Puerto Rico. The people look to the leadership of its elected officials to guide and implement the policies for which they voted for. Ultimately, the Governor and Legislature—not the Oversight Board—are accountable to the electorate and can be replaced in future elections if the people of Puerto Rico so choose. Accordingly, the Oversight Board and the Government must work together to find common ground on policies that will put the Commonwealth on stronger financial footing, while also preserving the goals and ambitions of the people. It is through this dialogue that the Oversight Board has influence over Government policy, but its implementation has always rested solely with the Government. As the U.S. District Court recognized:

[T]he Oversight Board has not been given power to affirmatively legislate. Thus, with respect to policy measures that would require the adoption of new legislation or the repeal or modification of existing Commonwealth law, the Oversight Board only has budgetary tools and negotiations to use to elicit any necessary buy-in from the elected officials and legislators. Elected officials and legislators, on the other hand, have the ability to obstruct implementation altogether, or complicate it in such a way as to cripple Puerto Rico’s ability to use it to promote the needed return to fiscal responsibility and access to capital markets.¹⁷

The statutory structure of PROMESA, therefore, ensures that neither the Government nor the Oversight Board holds all of the cards, which should “motivate the parties to work together, quickly, for positive change” rather than engaging in “mutual sabotage.”¹⁸

Question 4/5: There have been instances where the Oversight Board has advised your Administration not to take a particular action because they judged such action would violate either the certified fiscal plan, budget, or cause harm to the local economy. For example, you chose to ignore the Board and continue issuing Christmas Bonuses to Public sector employees against their recommendation. Another example, your Executive Order 2018-33 which raised the minimum

¹⁶ *Rosselló Nevaes v. The Fin. Oversight & Mgmt. Bd. for P.R.*, 330 F.Supp.3d 685, 701 (D.P.R. 2018).

¹⁷ *Id.*

¹⁸ *In re. Fin. Oversight Bd. for P.R.*, 583 B.R. 626, 637 (D.P.R. 2017).



GOVERNMENT OF PUERTO RICO

Federal Affairs Administration

wage to \$15 for public infrastructure projects that utilize Federal disaster relief funding, against the recommendation of the Oversight Board and local business sector. What led to these decisions you made to ignore the recommendations of the Board?

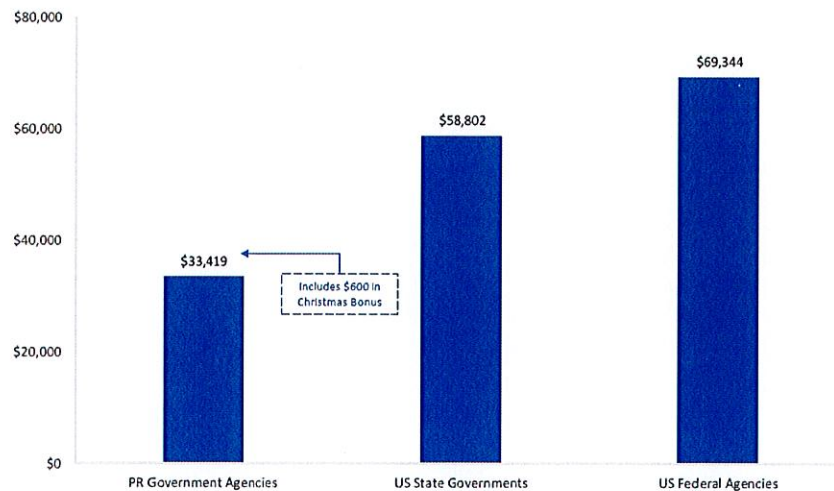
Response: As previously discussed, the Oversight Board is not a control board and PROMESA always intended to preserve the self-determination of the people of Puerto Rico. Hence, the Board can issue “recommendations” on public policy, not “commands”. And, as such, may use its fiscal plan and budget certification powers to establish broad parameters within which the Government must operate, but cannot use those powers to micromanage policy. In other words, the Board can define the size of the room, but only the Government can decide where to place the furniture. In the various iterations of its certified Commonwealth fiscal plans, the Board recommended measures affecting government-employee compensation, including: (i) maintaining a payroll freeze; (ii) limiting paid holidays to 15 days annually across all public employees; (iii) prohibiting carryover of sick and vacation days between fiscal years; (iv) prohibiting any future liquidation of sick and vacation days; (v) eliminating Christmas bonuses for all public employees; and (vi) standardizing employee healthcare benefits so that all employees receive \$125 worth of benefits per month. Notably, the Government was in favor of several compensation-related reforms. For example, in 2017, the Government enacted Act 26, which implemented public-sector labor reforms, including: (i) implementing a maximum 15 holidays each year for Government agencies and public corporations and (ii) limiting Christmas bonuses to a maximum of \$600. While these reforms overlapped with the Board’s recommendations, the Board sought to make these measures permanent and, in the case of the Christmas bonuses, sought to expand Act 26 by eliminating Christmas bonuses entirely. Because the Government viewed the Oversight Board’s aggressive recommendations as too draconian, the Government rejected those recommendations. In addition, the Government opposed those measures because they would reduce government employee compensation and increase outmigration when Puerto Rico could least afford it by stripping important protections from working families. Furthermore, many of those measures required legislation to implement, which the Oversight Board cannot compel. Importantly, the limited areas of disagreement between the Government and Oversight Board on labor reform issues are insignificant as compared to Commonwealth’s overall budget. For example, the cost of implementing the annual Christmas bonus is only approximately \$70 million per year, representing a miniscule percentage of the Commonwealth’s \$8.7 billion annual General Fund budget. This is only slightly more than approximately \$65 million annual budget for the operation of the Oversight Board during fiscal year 2019. In addition,



GOVERNMENT OF PUERTO RICO

Federal Affairs Administration

Commonwealth employees make far less than federal employees, even after receiving the Christmas bonus.¹⁹



Eliminating the Christmas bonus would amount to an immediate reduction in the already low average worker's compensation. As such, the Government declined to adopt these measures because they would effectively reduce compensation for all employees when Puerto Rico's residents are still suffering the dramatic economic effects of Hurricanes Irma and Maria.

Question 6: A key component of establishing PROMESA and the Oversight Board was to promote financial transparency on the island. The Commonwealth has only produced [1] set of audited financial statements (for the fiscal year 2014-2015), which was not a clean audit, which meant external auditors were unable to verify that the information provided by the Commonwealth was reliable. Has the Government completed Financial audits for Fiscal Years 2016, 2017, or 2018? What's the delay with completing these audits? Shouldn't a timely completion of these audits be a priority? It would seem to me that completing these audits would go a long way towards helping restore Puerto Rico's credibility and commitment to responsible fiscal management.

Response:

Reliability of Financial Statements

While we recognize the importance of the audited financial statements, I must stress that my Administration is providing to the FOMB and others more current financial

¹⁹ Source: OMB Budget (unaudited), Office of Personal Management, compensation for PR government employees includes salary and benefits excluding PayGo. PR Government data is for FY19. Data for US States and Federal employees is for 2017.



information than ever before on government tax receipts and disbursements, including monthly tax revenue reports, weekly cash balance reports, among others.

The Commonwealth recently released the fiscal year 2016 financial statements on May 3, 2019. We must highlight that the audit opinions for fiscal year 2016 showed a marked improvement from 2015. The fiscal year 2015 audit report included a disclaimer of opinion in 3 of 13 opinion units and an adverse opinion in another opinion unit. **There are no disclaimers and no adverse opinions in the fiscal year 2016 audit report.**

There are only two specific matters causing the disclaimers, adverse opinions and modified opinions in fiscal year 2015 and the modified opinions in 2016. These matters are the following:

1. *Implementation of Governmental Accounting Standard No. 68, Accounting and Financial Reporting for Pensions ("GASB 68")* – This Pronouncement was effective for financial statements ending on June 30, 2015. The actuarial report required by this accounting pronouncement was issued by the Retirement Systems in 2018. As a result, a majority of the public corporations issued their 2015 financial statements before the actuarial information was available to determine their proportional share of the net pension obligation. Those financial statement did not include either the proportional share of the net pension obligations or amounts based on preliminary unaudited analyses resulting in the modifications to the audit opinions.

As discussed further below, lack of planning by the prior administration was a factor in the delay of the actuarial report and a contributing factor to the delay in the completion of the 2015 audit.

2. *Government Development Bank Liquidity Issues* – A substantial portion of cash held by agencies and public corporations was deposited in the Commonwealth's Government Development Bank. The Bank had liquidity and solvency issues that eventually resulted in a loss of those deposits to the depositing agencies, corporations and municipalities. The prior administration did not issue instructions requiring the assessment of a potential custodial credit loss until October 2016, after many of those entities had already issued their 2015 financial statements. As a result, their financial statements did not take into consideration the custodial credit risk loss on deposits in GDB and consequently led to modifications to the audit opinions.



The Commonwealth determined that the custodial credit loss should be recognized in the financial statements for fiscal year 2015 that were issued on June 2018. This determination needed extensive investigation and analysis to determine the facts and the evaluation of accounting guidance applicable required consultations directly with the Governmental Accounting Standard Board as well with the auditors to determine when to recognize and how to measure the custodial credit risk loss. This process was also a factor in the delay in the completion of the 2015 audit.

We must note that these matters could have been corrected in the 2015 financial statements and the opinion modifications by requiring the restatement and re-issuance of the component unit financial statements. This, however, would have caused further delays in the issuances of financial statements. We expected that these issues should not affect the 2017 financial statements and anticipate further improvements in the audit opinions.

Timeliness of Financial Statements

Several situations have contributed to the lengthy delay in completion of the audited financial statements. The prior administration issued the fiscal year 2014 financial statements in June 2016, a delay of over one-year from the deadline for Consolidated Annual Financial Report.

1. When my Administration took office in January 2017, we found the following:
 - a. The accounting books of the central government for the fiscal years ending on June 30, 2015 and 2016 were not closed;
 - b. As discussed earlier, there was no planning for the implementation of the GASB 68, which required extensive work, including actuarial evaluations;
 - c. Late instructions to all Commonwealth entities of Puerto Rico for the assessment of the custodial credit loss caused by the liquidity problems at the GDB, as discussed earlier;
 - d. Outdated accounting systems, including multiple systems that do not interface with each other; and
 - e. Lack of personnel and resources due to budgetary constraints.
2. Hurricane Irma and Maria further complicated the process causing:
 - a. Temporary delays in the accounting and auditing processes to deploy resources to address emergency situations;
 - b. Further delays at various agencies and corporations due to lack of reliable power;
 - c. Damage to some of government buildings and contamination of the accounting and employee records; and



- d. Migration of public employees.
3. Informational requirements from the FOMB and others: In addition to the daily accounting processes, the limited personnel at central accounting and at the agencies and public corporations must deal with multiple requests for financial information and assistance from internal units, the FOMB, Commonwealth and federal inspector generals, among others, including:
 - a. Information for the preparation of the multiple iterations of fiscal plan and budgets;
 - b. Support for the financial statement audits;
 - c. Periodic reports to FOMB reports;
 - d. Bank account investigation made by the FOMB;
 - e. Information for the Title III claims handling process;
 - f. Participation in the implementation of new operational and accounting systems critical to providing timely and accurate financial information in the future; and
 - g. Changes to budgetary practices by the FOMB that have, in turn, require changes in reporting practices and recasting of prior year information
4. New accounting pronouncements: The Governmental Accounting Standards Board periodically issues or updates accounting guidance. In some instances, the implementation of that guidance is time-consuming and complex, as was the case for GASB 68, as discussed above. For fiscal year 2017, a new rule requiring disclosure of Tax Abatements will be implemented.
5. Disclosure requirements: The Commonwealth's fiscal situation and the legal and other matters being dealt with by the FOMB and the Title III court require extensive up-to-date disclosures in the financial statements. Updates for recent events will often cause last minute delays in issuance of the reports.
6. New Developments: My Administration is taking bold steps to address the territory's fiscal challenges. Some of these actions will have financial reporting implications that will require time and efforts to address and resolve. An example of that was the impact of the GDB liquidity issues in 2015. For fiscal year 2018, the transition to a PayGo system for employee pensions will pose new financial reporting challenges. Similarly, the restructuring of debt by the GDB and COFINA will impact fiscal year 2019.



The completion of the 2017 and 2018 audits and returning to timely financial reporting in the fiscal year 2019 audit cycle is a priority for my Administration. We continue to work diligently with our auditors and advisors with that objective. The audit for 2017 is in process and we expect completion by October 2019. We are concurrently working on the closing of the books at central accounting for fiscal year 2018. Audits at many agencies and corporations has already been completed for 2017 and work on their 2018 audits is already in process.

The systems and resource limitations, incremental requirements from the FOMB and the Title III processes, and implementation of new accounting rules will continue to present challenges in the near term. We are committed to working through those challenges with the ultimate goal of producing timely, reliable financial information as soon as possible.

Question 7/8: The Oversight Board recently notified your Chief Financial Officer that 28 public corporations and 66 municipalities have accrued \$340 million in debt since implementation of the PayGo system in 2017. What is your Administration doing to rectify this and ensure that government pensions are paid at all times as is required by law?

Response: First of all, it must be clarified that the information included by the Oversight Board in its April 30, 2019 letter regarding the outstanding PayGo debt of municipalities and public corporations is not up-to-date and does not reflect payments made by municipalities and public corporations in recent weeks. However, the Government recognizes that these entities have certain outstanding PayGo debts. The Retirement Board of the Government of Puerto Rico is working closely with the Office of the Chief Financial Officer (“CFO”) so that these debts are paid as soon as possible. Said process includes the implementation of various collection mechanisms and procedures provided in Act 106-2017. Finally, it should be emphasized that the disbursement of the pensions is guaranteed by the General Fund, so notwithstanding the outstanding debts, the payments to retirees has not been interrupted.

Question 9: Your Administration and the Oversight Board were working together to enact substantial labor reforms that would have made it easier for people to find jobs and reduce the administrative burden of formal employment in the market. How did this effort fail? Will your Administration continue to pursue these necessary reforms?

Response: First of all, I would like to establish for the record that my Administration has enacted and implemented substantial labor reform to help improve the prospects for Puerto Rico’s job market. On January 26, 2017, the Government enacted Act No. 4 of 2017 (“Act 4”) to improve Puerto Rico’s competitiveness and foster economic development, while relaxing certain legal requirements for hiring and retention of employees. Specifically, Act 4: (i)



established lower accrual rates for both vacation days and sick leave; (ii) approximately doubled the work hours required for accrual of Christmas bonuses; (iii) placed a \$600 cap on such bonuses; and (iv) reduced severance pay for unjust termination, among other reforms. These reforms were sufficient to increase labor market efficiency and revive economic growth, but their effects were forestalled as a result of the hurricanes in September 2017. Allowing the Act 4 reforms to take hold will afford the Commonwealth and its people more time to recover from the hurricanes before introducing dramatic, and potentially disruptive, changes to Puerto Rico's labor market.

In addition, the Government has instituted an "Earned Income Tax Credit" ("EITC") initiative and a work requirement for the Commonwealth's Nutritional Assistance Program ("NAP") as further enhancements to its already instituted comprehensive private-sector labor reform package of 2017. It is simply inaccurate to say that labor reform efforts have failed in Puerto Rico. The Government has worked substantially with the Oversight Board to implement many of its recommendations regarding private-sector human-capital and labor reforms to drive economic growth and competitiveness in Puerto Rico. For example, in connection with the May 2018 Commonwealth fiscal plan, we made substantial efforts to facilitate a comprehensive labor reform deal. As a result of those negotiations, the Oversight Board agreed to drop its demands for the elimination of the Christmas bonus and the reduction of minimum vacation and sick days for private sector employees in exchange for the repeal of Puerto Rico's Wrongful Dismissal Act ("Law 80"). The repeal of Law 80 would have made Puerto Rico an at-will employment jurisdiction, which the Oversight Board believed was a necessary change to provide more flexibility in reducing the Government's labor costs. However, the Puerto Rico Legislature lawfully exercised its powers and rejected the repeal of Law 80 in June 2018. Since then, the leadership of the Puerto Rico Legislature has not changed its view on this issue and, as a result, there are no plans to continue raising the repeal of Law 80 as a potential avenue of compromise regarding labor reforms.

Questions from Rep. Jody Hice for Hon. Ricardo A. Rosselló, Governor of Puerto Rico

Question 1: My understanding is that sections of the electrical grid either have been transitioned or are in the process of transitioning to natural gas. One of the problems being forecast is that there is a transport shortage due to the Jones Act and that a temporary waiver would allow for greater access to U.S. stores. What action have you taken to pursue a waiver?

Response:

Puerto Rico's energy sector is undergoing a historic transformation following my Administration's new policy announcements in January of 2018. As a result of our revised policy announcements, Puerto Rico and PREPA are transitioning to cleaner,



more modern, efficient and compliant electric generation, including natural gas-fired generation supplied by liquified natural gas (“LNG”) and renewable sources that include solar and wind. We are advancing in the transition to more LNG based generation to reduce our dependency on fuel oil and are sponsoring multiple generation projects to meet those objectives for the benefit of our citizens. We are seeking a waiver of the Jones Act that would permit these generating facilities to be supplied with LNG produced in the U.S., rather than LNG obtained from other, less secure, more costly sources.

These projects that will use natural gas derived from LNG as their primary fuel include:

1. The conversion of San Juan power generation units 5 & 6 to LNG:
 - a. PREPA executed a contract in March 2019 with New Fortress Energy (NFE) for the conversion and supply of LNG, which is expected to generate ~\$500M of savings over 5 years.
 - b. This project is located adjacent to PREPA’s San Juan Power Plant, near the main load centers in the North; the NFE facility will provide 25 TBtu of natural gas to San Juan Power Units 5 & 6.
 - c. The dual-fuel conversion cost of the power units is provided by NFE resulting in no capital outlay on the part of PREPA – and the conversion is expected to be completed by Q4-19.
2. New Palo Seco Power Plant Initiative:
 - a. Natural gas is planned for generation capacity at this existing site also in the North, close to the island’s main load centers. LNG is an affordable primary fuel, cleaner than fuel oil, and anticipated to yield ~\$135M in annual savings (based on Integrated Resource Plan (IRP) assumptions and modelling conducted in 2019).
 - b. Repowering Palo Seco is a core component to PREPA’s IRP Action Plan. PREPA has begun the development of a Request for Proposals for new generation at Palo Seco.
3. Additional projects contemplated in the 2019 IRP include:
 - a. Developing LNG terminals at Mayagüez & Yabucoa. PREPA has already begun conversion of four power generation units in Mayaguez, located in the western section of the Island to LNG use.
 - b. Possible development of a land-based LNG terminal in San Juan to supply a new combined cycle gas turbine (CCGT) and the San Juan 5&6 Combined Cycle.

With respect to the Jones Act, in December 2018, the Government of Puerto Rico requested a waiver from certain provisions of the Jones Act. It took this action because the Jones Act precludes deliveries of natural gas produced in the United States to Puerto Rico. This waiver would apply until a sufficient number of qualifying LNG carriers can be made available to transport LNG from the U.S.



GOVERNMENT OF PUERTO RICO

Federal Affairs Administration

mainland to Puerto Rico. Without such a waiver, the advantages of cost-effective, favorably located LNG supply sources will be denied Puerto Rico as it modernizes its electric generation fleet, and the opportunity for mainland U.S. LNG suppliers to penetrate the Puerto Rico market will be lost for many years to come. Key attributes of the request are:

1. The petition addresses barriers to long-term supply contracts with domestic producers of natural gas based on national security interests.
2. It is limited to 10-years or until Jones Act compliant vessels become available (which is currently not the case).
3. Jones Act exemption benefits to Puerto Rico and the mainland US include:
 - a. Ability to contract long-term fuel supplies from geopolitically stable resources (domestic suppliers).
 - b. Cost reductions from a Jones Act limited waiver helps support US critical industries like pharmaceuticals and biopharmaceutical operations located in Puerto Rico which serve the mainland and international pharmaceutical markets.
 - c. Providing stable, cost effective sources of electricity to US military installations in Puerto Rico.
 - d. Economic benefits:
 - i. Fuel savings to customers that reside in Puerto Rico;
 - ii. Spur economic development due to more cost-effective fuel; and
 - iii. Improve public health and environmental standards given the availability of clean burning alternative fuel supplies.

Since filing this waiver request, the applicants have supplemented the request once and have had a meeting on the request with representatives of the U.S. Department of Homeland Security (“DHS”), Customs and Border Protection, to discuss the request. The waiver request remains pending.

PREPA is hopeful that DHS and the Defense Department will grant its request to permit LNG to be transported in bulk from U.S. sources to Puerto Rico on vessels that are not Jones Act qualified pending availability of enough suitable LNG carriers that can qualify under the Jones Act. If they do, Puerto Rico energy consumers stand to save hundreds of millions of dollars in fuel costs, and U.S. LNG producers will have a secure domestic market for their projects.

Question 2: Puerto Rico experienced 710 homicides in 2017, and 641 in 2018 - more than any U.S. state and mostly gang related. Your police force is not only underpaid (\$40k/yr - 24% below avg) and in many cases owed money, but Colonel Michelle Fraley, who was the superintendent of the Puerto Rico police in 2017 during Hurricane Maria, told CBS News this past January that she wouldn't go outside past 6pm unless it was an absolute emergency requiring a hospital visit.



Twenty-one months after Hurricane Maria what is being done to protect your civilian women and children?

Response:

Over the past year, the Government has consistently expressed to the Oversight Board that the Puerto Rico Police Department (“PRPD”) cannot sustain the level of expense reductions as set forth in various iterations of Certified Fiscal Plans. The Government, including Department of Public Safety officials, PRPD, AAFAF, OCFO, have held numerous meetings with the FOMB to address concerns surrounding both the magnitude of expense reductions and the lack of reinvestment in PRPD. Additionally, PRPD has been experiencing high levels of attrition in FY19 putting additional strain on an already fragile system.

As a result of the aforementioned meetings, the Fiscal Plan certified on May 9, 2019 has included a number of revisions to ensure the police who protect Puerto Rico and its citizens are fairly compensated and PRPD is adequately staffed. These new investments include:

1. ~\$11,500 increase in officer salaries relative to FY2019 levels phased in over 2 years.
2. FY2019 salaries already included a \$1,500 raise per sworn officer instituted at the beginning of FY2019.
3. Increase life and disability insurance to \$250 per year per sworn officer starting in FY2020.
4. Social Security contributions for all police will begin in FY2020.
5. Payments to sworn officers for past services of \$122 million in FY2019, FY2020, and FY2021.
6. ~200 cadets will be hired each year to offset some of the 3% expected attrition.
7. \$42 million in funding for capital expenditures to purchase bullet proof vests, radios, and vehicles.

These reinvestments should help stabilize the Department and provide PRPD with the necessary budget to provide the safety that Puerto Rico and the 3.2 million U.S. citizen who live there deserve.

In addition to reinvestment, the Government continues to work closely with the Federal Government in the fight against crime on the island. I signed an agreement extending and expanding the collaborative efforts between the Government of Puerto Rico and federal law enforcement agencies. The memorandum of understanding includes, but is not limited to, the following:

1. Extending the drug enforcement task force created under a previous agreement;



2. Coordination between the police and district attorney's for drug-trafficking cases;
3. Government corruption;
4. White-collar crime;
5. Sexual exploitation of minors;
6. Human trafficking; and
7. Cruel treatment of animals.