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Advisory Insights: Highlights of Puerto Rico's Oversight, Management, and Economic Stability Act (PROMESA)

On June 30, 2016, President Obama signed the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA), which grants the Commonwealth and its component units access to an orderly mechanism to restructure their debts in exchange for significant federal oversight over the commonwealth's finances. In broad terms, PROMESA seeks to provide Puerto Rico with fiscal and economic discipline through the creation of a control board, relief from creditor lawsuits through the enactment of a temporary stay on litigation, and two alternative methods to adjust unsustainable debt.

First, to ensure fiscal and economic discipline, PROMESA creates a federally appointed oversight board that has plenary authority over Puerto Rico's finances. The board's primary function is to provide fiscal oversight through the development and approval of fiscal plans and budgets, and to enforce compliance with those plans and budgets through broad-based powers such as reducing non-debt expenditures and instituting certain hiring freezes.

The board also has oversight over legislative processes because PROMESA requires the board to review new laws and deny their enforcement if they are inconsistent with the approved fiscal plans and budgets. The board also has authority to review contracts to ensure compliance with the fiscal plan, and to prevent the execution or enforcement of a contract, rule, executive order or regulation to the extent that it is inconsistent with the approved fiscal plan.

Second, the enactment of PROMESA also operates as a broad-based stay on litigation, applicable to all entities, with respect to claims related to Puerto Rico's financial debt, as well as on enforcement of provisions in contracts that allow for termination and the exercise of remedies based on non-payment of financial obligations, among other conditions.

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July 1, 2016

Finally, PROMESA contains two methods to adjust Puerto Rico's debts. The first method is a streamlined process to achieve modifications of financial indebtedness with the consent of a supermajority of affected financial creditors. This method has benefits such as potential speed relative to a traditional restructuring through a formal in-court process. The second method is a court-supervised debt-adjustment process, which is modeled on Chapter 9 of the U.S. Bankruptcy Code. This process includes the so-called "cram-down" power, which may provide Puerto Rico with flexibility in debt adjustment, but it also gives the oversight board total control over the adjustment process and includes certain provisions designed to protect creditor interests.

On July 1, 2016, the Puerto Rico government released its audited financial statements for fiscal year 2014. The island's Comprehensive Annual Financial Report ("CAFR") shows the significant fiscal distress affecting the central government and its instrumentalities, as well as the uncertainty over their ability to meet future obligations, including debt-service payments. The CAFR further states that the commonwealth's ability to finance future budget deficits will be severely limited even if it achieves a comprehensive debt restructuring, and, therefore, that it will be required to, among other measures, reduce the amount of resources that fund important governmental programs and services in order to balance its budget.

As PROMESA seeks to help Puerto Rico achieve budgetary and fiscal balance through a debt restructuring or otherwise, it gives the oversight board control over such adjustment process and includes certain provisions designed to protect creditor interests, some of which are untested.

Many challenges lay ahead.