COFINA

PLAN OF ADJUSTMENT

On February 4, 2019, Judge Laura Taylor Swain confirmed the *Third Amended Title III Plan of Adjustment of Puerto Rico Sales Tax Financing Corporation* (the "COFINA Plan").[1] Among other things, Judge Swain found that the COFINA Plan "represents a significant step on the path towards Puerto Rico's financial recovery, economic stability, and prosperity."[2]

On May 5, 2017, when the Puerto Rico Sales Tax Financing Corporation ("COFINA") filed for protection under Title III of the Puerto Rico Oversight, Management, and Economic Stability Act ("PROMESA"), COFINA had $17.64 billion of outstanding bond obligations (principal and unpaid interest), including approximately $7.76 billion of "senior" bond claims and approximately $9.88 billion of "junior" bond claims.[3] Under the COFINA Plan, holders of senior COFINA bonds are expected to receive a 93.01% recovery on their bonds, while holders of junior COFINA bonds are expected to receive a 56.41% recovery.[4]

The COFINA Plan, which incorporates a settlement between the Commonwealth of Puerto Rico and COFINA over ownership of the sales and use tax, provides that COFINA will receive (a) the first collections of the sales and use tax revenues up to 53.65% of the yearly Pledged Sales Tax Base Amount ("PSTBA")[5] beginning with payments made on July 1, 2018 and (b) all of the cash held in trust at Bank of New York Mellon, as trustee under the Bond Resolution, as of June 30, 2018 (approximately $1.2 billion). The Commonwealth will receive the remaining 47.35% of the PSTBA.

Although some have criticized the COFINA Plan as largely a victory for the hedge funds that hold most of the COFINA senior bonds,[6] Judge Swain found that "the Settlement relieves junior bondholders of the[] risks" associated with "the validity of the COFINA structure and the

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[1] Memorandum of Findings of Fact and Conclusions of Law in Connection with Confirmation of the Third Amended Title III Plan of Adjustment of Puerto Rico Sales Tax Financing Corporation ("Findings of Fact and Conclusions of Law"), No. 17-03284 (Bankr. P.R. Feb. 4, 2019), ECF No. 558.

[2] *Id.* at 6.

[3] *See id.* at ¶ 138.

[4] *See id.* at ¶¶ 75, 133 (citing *Third Amended Title III Plan of Adjustment of Puerto Rico Sales Tax Financing Corporation* §§ 1.114, 1.168).

[5] The PSTBA is an amount established under Act 91- 2006, as amended, and the Sales Tax Revenue Bond Resolution, as amended and restated on June 10, 2009 (the "Bond Resolution"), that currently must be received by COFINA from 5.5% of the sales and use tax before the Commonwealth can receive any of the other 5.5% of the sales and use tax. *See* COFINA Fiscal Plan (Aug. 29, 2018) at 5, available at http://www.aafaf.pr.gov/assets/cofina-fiscal-plan-august-2018.pdf (last visited Feb. 17, 2019).

[6] *See* Andrew Scurria, *Hedge Funds Bask in Puerto Rico Bond Deal*, WALL ST. J., Feb. 9, 2019 (noting that "Hedge funds accumulated senior-ranking Cofina bonds during a yearslong price deterioration that began in earnest in 2015, when former Gov. Alejandro Garcia Padilla declared Puerto Rico's public debt unpayable" and that "Tilden Park Capital Management LP and GoldenTree Asset Management LP are among the credit-market specialists that have reaped hundreds of millions of dollars in paper profits on those revenue bonds and are poised to collect more under settlement terms that provide them with stronger claims to repayment than before, according a Wall Street Journal analysis of court records and trading information."); *see also* Abner Dennis & Kevin Connor, *Hedge Funds Win, Puerto Ricans Lose in First Debt Restructuring Deal*, AM. PROSPECT, Feb. 8, 2019, available at https://prospect.org/article/hedge-funds-win-puerto-ricans-lose-first-debt-restructuring-deal (last visited Feb. 17, 2019).

ability of the SUT [the sales and use tax] to flow into COFINA" and that "senior COFINA bondholders are receiving less than par on their bonds (approximately 93% recovery . . .), while the junior bondholders are receiving a significant recovery."[7]

To confirm the Plan, Judge Swain had to find that the Plan satisfied a variety of requirements under PROMESA, including that the Plan is "feasible and in the best interest of creditors."[8]

Feasibility

In chapter 11 bankruptcy cases, feasibility requires the court to find that "[c]onfirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization."[9] In chapter 9 bankruptcy cases (applicable to municipalities), feasibility requires an evaluation not only of whether the debtor can pay its debts, but also whether the debtor can provide future public services at the level necessary to its viability as a municipality.[10] In response to objections to the COFINA Plan relating to feasibility, the Financial Oversight and Management Board for Puerto Rico (the "Oversight Board")[11] explained that COFINA does not provide any public services, and that issues relating to the Commonwealth's ability to provide future public services were not before the Court because the Plan restructures ***COFINA's*** debts and not the Commonwealth's (suggesting that the analysis under chapter 9 is not applicable to COFINA).[12]

As to feasibility, Judge Swain found that "COFINA's Fiscal Plan projections . . . demonstrate, as a result of COFINA's ownership of the COFINA Portion, COFINA's ability to fulfill its obligations under the [COFINA] Plan."[13] Judge Swain relied on Citigroup Global Markets, Inc.'s analysis of the COFINA Fiscal Plan to find that the COFINA Plan is feasible, noting that "Citi's analysis of the COFINA Fiscal Plan showed that sound assumptions—that stimulus from disaster funds, structural and fiscal reforms to the Puerto Rico economy, and improvements in tax collection methods will maintain a robust amount of personal consumption in the Commonwealth—justify the COFINA Fiscal Plan's SUT projections."[14] The Court explained that "the debt service on the COFINA Bonds is slightly below 53.65% of the PSTBA, virtually identical to the amount contemplated by the COFINA Fiscal Plan."[15]

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[7] *See* Findings of Fact and Conclusions of Law, ECF No. 558 at ¶ 143 (Judge Swain also notes that "[h]ad an event of default been recognized, or the SUT revenues been insufficient to satisfy all bondholders outside of this settlement, junior bondholders would bear the risk of not receiving any monies prior to senior bondholders being paid in full.").

[8] *See* Puerto Rico Oversight, Management, and Economic Stability Act ("PROMESA") Pub. L. No. 114-187, § 314(b)(6), 130 Stat. 549 (2016).

[9] *See* 11 U.S.C. § 1129(a)(11).

[10] 1 COLLIER PAMPHLET EDITION 11 U.S.C. § 943 (2018) (citing *In re Mount Carbon Dist.*, 242 B.R. 18 (Bankr. D. Colo. 1999)).

[11] The Oversight Board is the representative of COFINA in the Title III bankruptcy case.

[12] *See* Omnibus Reply of Puerto Rico Sales Tax Financing Corporation to Objections to Second Amended Title III Plan of Adjustment, No. 17-03284 (Bankr. P.R. Jan. 9, 2019), ECF No. 443, Ex. A at 13.

[13] Findings of Fact and Conclusions of Law, EFC No. 558 at ¶ 129.

[14] *Id.* at ¶ 151.

[15] *Id.* at ¶ 150.

Best Interest of Creditors

The best interest of creditors test required the Court to consider whether available remedies under the non-bankruptcy laws and the constitution of Puerto Rico would result in a greater recovery for creditors than is provided by the COFINA Plan.[16] Judge Swain found that the alternative to the COFINA Plan is protracted litigation, which could lead to an all-or-nothing recovery for either the Commonwealth or COFINA and whose result was at best uncertain. Judge Swain explained that continued litigation would skyrocket costs and that "it could be months, if not years, before a court issues a final, unappealable order resolving who is entitled to the SUT Revenues."[17] Judge Swain also noted the "robust acceptance of the Plan by the various classes [of creditors]."[18] Judge Swain concluded that the COFINA Plan is in the best interest of creditors finding that the Oversight Board had demonstrated that:

> [A]bsent approval of the Plan and the Settlement Agreement, COFINA would be embroiled in ongoing litigation that would likely last months or even years. Beyond the costs associated with that litigation, COFINA's bondholders would also bear a substantial risk of an unfavorable outcome that would invalidate the Commonwealth's transfer of SUT revenues to COFINA. Furthermore, COFINA's subordinate bondholders would bear a further risk that, if an event of default occurred, their claims against COFINA would not be addressed until after satisfaction of the claims of senior bondholders.[19]

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[16] *Id.* at ¶ 147.

[17] *See id.* at ¶ 130.

[18] *See id.* at ¶ 133.

[19] *Id.* at ¶ 148.

Compromise and Settlement of Commonwealth-COFINA Dispute

COFINA has an ownership interest in 53.65% of the PSTBA (*i.e.*, Pledged Sales Tax Base Amount), which will be used to fund debt service payments on new COFINA bonds that will be distributed to existing COFINA senior and subordinated bondholders under the COFINA Plan. Below is a chart showing the annual dollar amounts determined for each fiscal year of the Commonwealth ("FY") from 2019 to 2058, inclusive, in accordance with Section 3 of Act No. 91-2006, as amended.[20]

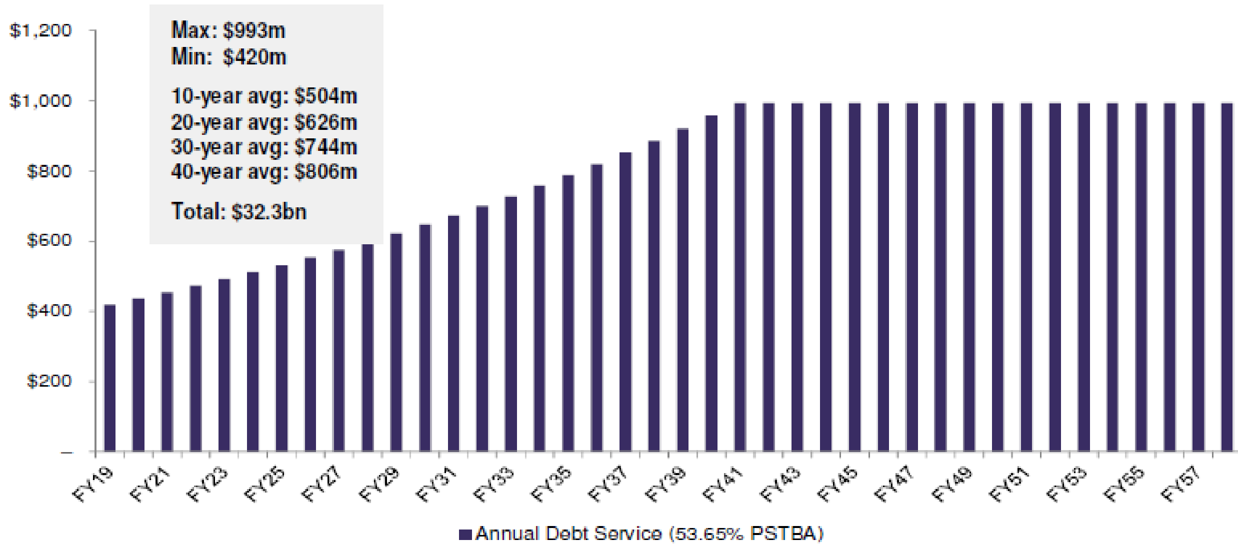
Fiscal Year	Pledged Sales Tax Base Amount	**COFINA 53.65% Portion Pledged Sales Tax Base Amount**	Commonwealth 46.35% Portion Pledged Sales Tax Base Amount
2019	783,197,251	420,185,325	363,011,926
2020	814,525,141	436,992,738	377,532,403
2021	847,106,147	454,472,448	392,633,699
2022	880,990,393	472,651,346	408,339,047
2023	916,230,008	491,557,399	424,672,609
2024	952,879,209	511,219,696	441,659,513
2025	990,994,377	531,668,483	459,325,894
2026	1,030,634,152	552,935,223	477,698,929
2027	1,071,859,518	575,052,631	496,806,887
2028	1,114,733,899	598,054,737	516,679,162
2029	1,159,323,255	621,976,926	537,346,329
2030	1,205,696,185	646,856,003	558,840,182
2031	1,253,924,033	672,730,244	581,193,789
2032	1,304,080,994	699,639,453	604,441,541
2033	1,356,244,234	727,625,032	628,619,202
2034	1,410,494,003	756,730,033	653,763,970
2035	1,466,913,763	786,999,234	679,914,529
2036	1,525,590,314	818,479,203	707,111,111
2037	1,586,613,926	851,218,371	735,395,555
2038	1,650,078,483	885,267,106	764,811,377
2039	1,716,081,623	920,677,791	795,403,832
2040	1,784,724,887	957,504,902	827,219,985
2041	1,850,000,000	992,525,000	857,475,000
2042	1,850,000,000	992,525,000	857,475,000
2043	1,850,000,000	992,525,000	857,475,000
2044	1,850,000,000	992,525,000	857,475,000
2045	1,850,000,000	992,525,000	857,475,000
2046	1,850,000,000	992,525,000	857,475,000
2047	1,850,000,000	992,525,000	857,475,000
2048	1,850,000,000	992,525,000	857,475,000
2049	1,850,000,000	992,525,000	857,475,000
2050	1,850,000,000	992,525,000	857,475,000
2051	1,850,000,000	992,525,000	857,475,000
2052	1,850,000,000	992,525,000	857,475,000

[20] Disclosure Statement for the Amended Title III Plan of Adjustment of the Debts of Puerto Rico Sales Tax Financing Corporation, No. 17-3284 (Bankr. P.R. Nov. 16, 2018), ECF No. 4299, Ex. B at 105.

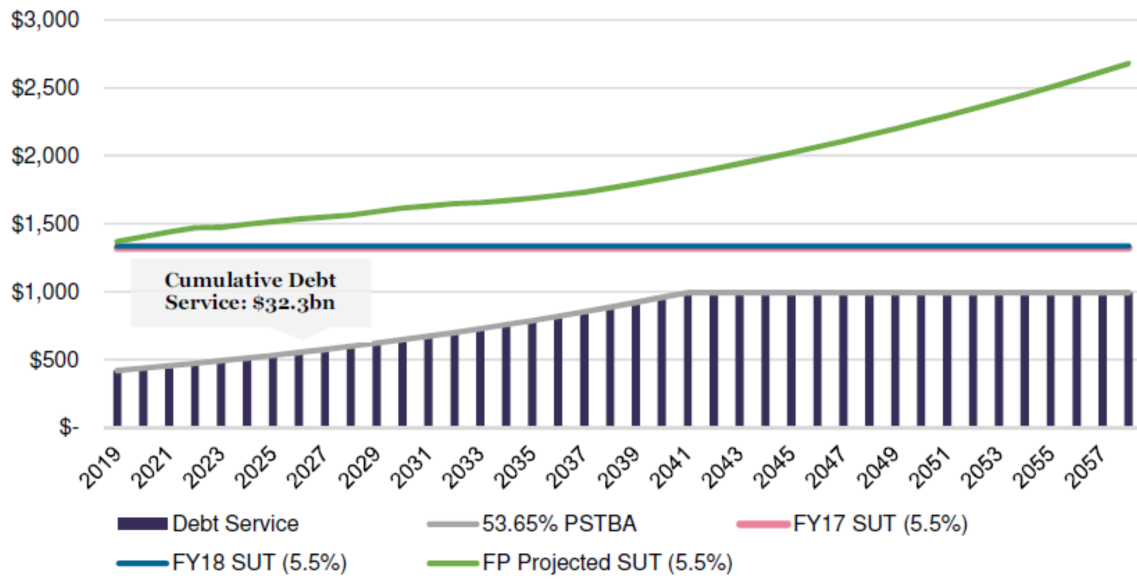
2053	1,850,000,000	992,525,000	857,475,000
2054	1,850,000,000	992,525,000	857,475,000
2055	1,850,000,000	992,525,000	857,475,000
2056	1,850,000,000	992,525,000	857,475,000
2057	1,850,000,000	992,525,000	857,475,000
2058	1,850,000,000	992,525,000	857,475,000

COFINA SETTLEMENT DEBT SERVICE ($M)

A total of $32.3 billion debt service payments will be made over the next 40 years. Senior COFINA bondholders will recover 93.01 cents on the dollar, and junior COFINA bondholders will receive 56.41 cents on the dollar. *See* COFINA Plan § 1.114 (Junior COFINA Bond Distribution) and § 1.168 (Senior COFINA Bond Distribution); *see also* Audited Financial Statements for COFINA for the Year Ended June 30, 2015). Below are illustrations of the annual 53.65% PSTBA and a sustainability analysis of the COFINA debt service using FY18 sales and use tax collections as the base.[21]



COFINA DEBT SUSTAINABILITY ANALYSIS ($M)



21 *Id*. ECF No. 4299, Ex. D at 10, 29.