

## Overview of Plan of Adjustment

Prior to March 15, 2022, the Commonwealth and many of its component units suffered a fiscal, economic and liquidity crisis, the culmination of many years of significant governmental deficits, an economic recession that persisted since 2006, prior liquidity challenges, a high unemployment rate, population decline, and high levels of debt and pension obligations. As the Commonwealth's tax base shrunk and its revenues were affected by prevailing economic conditions, an increasing portion of the Commonwealth's general fund budget consisted of health care and pension-related costs and debt service requirements through fiscal year 2019, resulting in reduced funding for other essential services. The Commonwealth's historical liquidity constraints, among other factors, adversely affected its credit ratings and its ability to obtain financing at reasonable interest rates.

On June 30, 2016, the United States Congress enacted the Puerto Rico Oversight, Management, and Economic Stability Act ("PROMESA") to address these problems, which included the establishment of the Financial Oversight and Management Board for Puerto Rico (the Oversight Board), an in-court restructuring process under Title III of PROMESA, and an out-of-court restructuring process under Title VI of PROMESA. Thereafter, the Commonwealth and other governmental entities including, the Puerto Rico Sales Tax Financing Corporation ("COFINA"), the Employees Retirement System of the Government of the Commonwealth of Puerto Rico ("ERS"), the Puerto Rico Highways and Transportation Authority ("HTA"), the Puerto Rico Electric Power Authority ("PREPA"), and the Public Building Authority ("PBA") initiated proceedings under Title III, and the Government Development Bank for Puerto Rico ("GDB"), the Puerto Rico Infrastructure Financing Authority ("PRIFA"), and the Puerto Rico Convention Center District Authority ("PRCCDA") initiated proceedings under Title VI, each at the request of the Governor to restructure or adjust their existing debt.

On July 30, 2021, the Oversight Board—as representative to the Commonwealth, ERS, and PBA in their respective Title III cases—filed its *Seventh Amended Title III Joint Plan of Adjustment of the Commonwealth of Puerto Rico, et al.* [ECF No. 17629] (the "Seventh Amended Plan") and a corrected disclosure statement related thereto [ECF No. 17628], which was approved by the United States District Court for the District of Puerto Rico (the "Title III Court").

On October 26, 2021, the Governor signed into law Act No. 53 of 2021 (Act 53), known as the "Law to End the Bankruptcy of Puerto Rico," which provided legislative approval for the bond transactions contemplated in the Seventh Amended Plan conditioned on the elimination of its monthly pension cut provisions in an amended version of that plan.

On November 3, 2021, the Oversight Board filed its *Modified Eighth Amended Title III Joint Plan of Adjustment of the Commonwealth of Puerto Rico, et al.* [ECF No. 19053] (the "Eighth Amended Plan"), which further revised the Seventh Amended Plan to eliminate its monthly pension cut provisions consistent with Act 53, among other things. The hearing to consider confirmation of the Eighth Amended Plan commenced on November 8, 2021 and concluded on November 23, 2021. The final modified version of the Eighth Amended Plan was filed on January 14, 2022 [ECF No. 19813-1] (as confirmed, the "Commonwealth Plan of Adjustment").

On January 18, 2022, the Title III Court entered its findings of fact and conclusions of law in connection with the Eighth Amended Plan [ECF No. 19812] (the "Findings of Fact") and an order confirming the Eighth

Amended Plan [ECF No. 19813] (the “Commonwealth Confirmation Order”). In both the Commonwealth Confirmation Order and Findings of Fact, the Title III Court found that Act 53 properly authorized the issuance of new bonds and provided adequate means for implementation of the Commonwealth Plan of Adjustment.

Between January 28, 2022 and February 17, 2022, six appeals of the Confirmation Order were filed in the First Circuit. By March 11, 2022, the First Circuit denied all parties’ motions for a stay pending appeal, which allowed the Commonwealth Plan of Adjustment to become effective despite the appeals. Oral argument on the merits of the appeals is currently scheduled for April 28, 2022.

On March 15, 2022 (the “Effective Date”), the conditions precedent to the Effective Date of the Commonwealth Plan of Adjustment were satisfied and/or waived by the Oversight Board, and the plan became effective. Accordingly, the Commonwealth Plan of Adjustment has been confirmed and is currently effective as of the date hereof.

As of the Effective Date, the Commonwealth Plan of Adjustment reduced the Commonwealth’s total funded debt obligations from approximately \$34.3 billion of prepetition debt to only approximately \$7.4 billion, representing a total debt reduction of 78%. This debt reduction will also reduce the Commonwealth’s maximum annual debt service (inclusive of COFINA debt service) from approximately \$4.2 billion to \$1.15 billion, representing a total debt service reduction of 73%. Also as of the Effective Date, all of the legacy Commonwealth general obligation bonds, ERS bonds, and PBA bonds were discharged, and all of the Commonwealth, ERS, and PBA obligations and guarantees related thereto were discharged. In addition, all Commonwealth laws that required the transfer of funds from the Commonwealth to other entities are deemed preempted, and the Commonwealth has no obligation to transfer additional amounts pursuant to those laws. Importantly, effectuating the Commonwealth Plan of Adjustment provides a path for Puerto Rico to access the credit markets and develop balanced annual budgets.

A critical component of the Commonwealth Plan of Adjustment is the post-Effective Date issuance of new general obligation bonds (the “New GO Bonds”) and contingent value instruments (“CVIs”) that provides recoveries to GO and PBA bondholders, as well as holders of clawback claims against the Commonwealth and certain of its component units and instrumentalities.

Municipal governments typically issue amortizing debt—i.e., debt with principal maturities due on a regularly scheduled basis over a duration that varies generally between 20 and 40 years. The Commonwealth’s New GO Bonds will mature over 25 years and will include both Capital Appreciation Bonds (“CABs”) and Current Interest Bonds (“CIBs”). All of the CABs and CIBs will have term bonds with mandatory sinking fund payments. This is intended to optimize cash available to pay debt service since the municipal market has a yield curve, and bonds are not priced to the average life as is the case in other markets, because specific investors may purchase bonds in differing parts of the maturity curve, including individual investors, corporations and mutual funds.

The New GO Bonds were issued with an aggregate original principal amount of approximately \$7.4 billion, consisting of approximately (i) \$6.6 billion of New GO CIBs, (ii) \$442.5 million of New GO CABs with a 5.375% interest rate, and (iii) \$288.2 million of New GO CABs with a 5.0% interest rate. They have 11 different maturity dates and will be secured by (a) a statutory first lien, (b) a pledge of the amounts on deposit in the Debt Service Fund, and (c) a pledge of the Commonwealth’s full faith, credit and taxing

power in accordance with Article VI, Section 2 of the Commonwealth Constitution and applicable Puerto Rico law. The New GO Bonds are dated as of, and will accrue or accrete interest from, July 1, 2021.

The Commonwealth Plan of Adjustment also provides for the issuance of CVIs, an instrument that gives a holder the right to receive payments in the event that certain triggers are met. The Commonwealth Plan of Adjustment establishes revenue-based performance benchmarks and permits the holders of CVIs to receive payments on account of the CVIs only if the benchmarks are exceeded. The CVIs issued under the Commonwealth Plan of Adjustment are based on over-performance collections of the Commonwealth's 5.5% sales and use tax (SUT), with some CVIs also being subject to over-performance collections of rum tax. The CVIs represent a conditional promise by the Commonwealth to pay CVI holders only if the SUT or rum tax baselines are exceeded in a given fiscal year. The outperformance metric will be measured as of the end of each fiscal year (i.e., June 30) beginning in fiscal year 2022 and is based on a SUT and rum tax collections baselines for fiscal years 2022 to 2043 as established in the Board-certified fiscal plan for the Commonwealth, dated May 27, 2020. As with the New GO Bonds, the Commonwealth pledged its full faith, credit and taxing power under the Puerto Rico Constitution and applicable Puerto Rico law for payment of the CVIs. The CVIs will be deemed issued on July 1, 2021.

The CVIs are also divided into two categories: (i) general obligation debt CVIs (GO CVIs), which will be allocated to various holders of GO bondholder claims; and (ii) clawback debt CVIs (the Clawback CVIs), which will be allocated to claims related to HTA, PRCCDA, PRIFA, and MBA bonds. The GO CVIs have a 22-year term. The Clawback CVIs have a 30-year term. The GO CVIs are subject to a lifetime cap of \$3.5 billion, with maximum annual payments of \$200 million plus any unused amounts from previous years subject to cumulative annual payments not exceeding \$400 million. Similarly, the Clawback CVIs are subject to a \$5.2 billion aggregate lifetime cap, allocated across the different types of bond claims, with maximum annual payments of (i) \$175 million plus any unused amounts from previous years, not to exceed cumulative annual payments of \$350 million, for fiscal years 1-22 of the 30-year term; and (ii) \$375 million plus any unused amounts from previous years, not to exceed cumulative annual payments of \$750 million, for fiscal years 23-30 of the 30-year term. The CVIs also apply an annual payment waterfall in which the first \$100 million will be paid to GO CVIs and the next \$11,111,111 will be paid to Clawback CVIs.

The Commonwealth Plan of Adjustment classifies claims into 69 classes, with each receiving the following aggregate recoveries:

- Various categories of Commonwealth bond claims (Classes 15-50): 73% recovery consisting of cash, New GO Bonds, and GO CVIs.
- Various categories of PBA bond claims (Classes 1-12, 14): 79% recovery in cash in addition to the New GO Bonds and GO CVIs that PBA bondholders receive on account of their guarantee claims against the Commonwealth.
- Various categories of clawback creditor claims (Classes 59-63): 23% recovery consisting of the Clawback CVIs.
- ERS bond claims (Class 65): 16% recovery consisting of cash and interests in the ERS Private Equity Portfolio (as defined in and established under the Commonwealth Plan of Adjustment).
- Various categories of general unsecured claims (Classes 13, 58, and 66): 21% recovery in cash.

- Other miscellaneous claims (Classes 52-57, 64, 67-69): 26% recovery in cash.

For general unsecured claims, the Commonwealth Plan of Adjustment provides for separate levels of creditor cash recoveries at each debtor, as applicable. All general unsecured claims against the Commonwealth, ERS, and PBA are discharged, except certain Eminent Domain/Inverse Condemnation Claims (as defined in the Commonwealth Plan of Adjustment) that are not discharged until they receive payment in full, subject to an appeal of the Title III Court's ruling on such claims. If that ruling is reversed, then the Eminent Domain/Inverse Condemnation Claims will be dischargeable and impaired. All other general unsecured creditors at the Commonwealth will receive up a pro rata share of the general unsecured creditor reserve fund (the "GUC Reserve"), plus amounts received by the Avoidance Actions Trust (as defined in and established under the Commonwealth Plan of Adjustment) up to 40% of the value of their claim. The GUC Reserve was funded with \$200 million on the Effective Date and will be replenished with an additional aggregate total amount of \$375 million funded in incremental amounts annually through December 31, 2025. Depending on the outcome of the appeal regarding Eminent Domain/Inverse Condemnation Claims, the GUC Reserve amount could be reduced by up to \$30 million. ERS's general unsecured creditors will receive pro rata cash distributions from a fund established for ERS general unsecured creditors, which consists of \$500,000 plus any net recoveries by the Avoidance Actions Trust allocable to ERS. PBA's general unsecured creditors will be entitled to a cash payment equal to 10% of their claim upon allowance.

Importantly, the Commonwealth Plan of Adjustment preserves all accrued pension benefits for active and retired public employees under Class 51. However, participants of the Retirement System for the Judiciary of the Commonwealth of Puerto Rico (JRS) and Teachers Retirement System of Puerto Rico (TRS) will be subject to a benefits freeze and the elimination of any cost-of-living adjustments previously authorized under the JRS and TRS pension plans.

During the pendency of the PROMESA cases, a variety of legal issues were raised related to creditor claims. As a result of the recoveries provided under the Commonwealth Plan of Adjustment, the COFINA plan of adjustment, and the Title VI qualified modifications for GDB, PRIFA, and PRCCDA, substantially all of those litigation proceedings have been resolved and dismissed. Certain claims, however, were not discharged under the Commonwealth Plan of Adjustment, including: (i) the Eminent Domain/Inverse Condemnation Claims (Class 54); (ii) the Tax Credit Claims (Class 57); (iii) the resolution of certain claims subject to the ACR process (see Commonwealth Plan of Adjustment § 82.7); and (iv) certain Underwriter Actions related to indebtedness issued by the Commonwealth or any of its agencies or instrumentalities against any non-debtors (see Commonwealth Plan of Adjustment § 92.2(f)). Additional litigation proceedings also will be dismissed upon the effective date of the HTA plan of adjustment, which is currently expected to be proposed in April 2022.

For further information, refer to the final versions of the Commonwealth Plan of Adjustment, Findings of Fact, and Confirmation Order can be accessed on the Commonwealth's Title III docket available [here](#).