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PRO BANKRUPTCY

McKinsey Clients Won Puerto Rico Contracts as Firm Advised Government

The consulting firm has helped the territory's oversight board review contracts with companies that are also its clients

McKinsey has collected roughly $120 million for advising Puerto Rico's financial-oversight board.

PHOTO: ARND WIEGMANN/REUTERS

By Alexander Gladstone

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McKinsey & Co. has been a top government consultant since 2016 in Puerto Rico, helping the U.S. territory's financial overseers manage its spending. In that time, corporate clients of the consulting firm have won tens of billions of dollars of government business, new disclosures show.

Since McKinsey began its work for Puerto Rico's financial-oversight board, the firm has helped the board review and evaluate contracts with companies that are also McKinsey's consulting clients, according to disclosures it filed in federal court last month and other public documents. McKinsey clients include some of the largest fuel suppliers to Puerto Rico, an infrastructure company with a major role in operating the territory's electrical grid and contractors that support its public-health system.

A McKinsey spokesman said that the firm served these clients on unrelated matters and that its work for them hasn't conflicted with its work for the oversight board.

Hundreds of other companies with financial interests in Puerto Rico also have ongoing ties to McKinsey, according to the firm's disclosures and other court records and public documents.

Most of these client relationships weren't formally disclosed until last month, when a new federal law required McKinsey and other professional advisers to detail any ties to clients with creditor claims or other interests in Puerto Rico.

The disclosures were required under the Puerto Rico Recovery Accuracy in Disclosures Act, a transparency law written in 2018 after some lawmakers raised concerns that the firm had undisclosed conflicts of interest in its work for the oversight board, which McKinsey has denied.

McKinsey has collected roughly $120 million so far for advising the oversight board, which was established by the federal government in 2016 in response to the debt crisis that Puerto Rico was facing. The board leads Puerto Rico's financial planning and has authority over the island territory's budgets, its spending and its court-supervised bankruptcy process.

In responses to inquiries regarding McKinsey, a spokesman for the oversight board said it takes its disclosure obligations under the new law seriously "and remains committed to transparency and full compliance with [the disclosures act] by all its contractors and vendors."

A Puerto Rican flag hangs from a building in Old San Juan. Puerto Rico won court approval of a $30.5 billion debt restructuring in January.

PHOTO: DERICK E. HINGLE/BLOOMBERG NEWS

The board spokesman also said that the oversight board doesn't shape contract terms with vendors and that its contract review process is limited to ensuring the contract is the result of a competitive bidding process and is consistent with Puerto Rico's fiscal plans.

The spokesman for McKinsey said that while the firm supported the financial-oversight board in reviewing vendor contracts that the government of Puerto Rico submitted to the board for approval, "as part of this work, we did not advise on which vendors the government contracted with, nor did we participate in the government's contract negotiations with vendors."

Professional advisers in corporate bankruptcies normally must divulge any financial connections to the business they are advising, as well as to its creditors or any other party in interest, to help ensure the advice they give isn't tainted with bias or conflicts of interest.

The advisers working for Puerto Rico faced no such requirements until President Biden signed the new federal law in January, extending the disclosure rules to Puerto Rico's municipal bankruptcy case, setting last month as the deadline for McKinsey and other firms to comply.

In its disclosure last month, McKinsey said that it counts as a client infrastructure company Quanta Services Inc., which half owns the joint venture that last year took over operation of electricity service in Puerto Rico, a historically public function. Quanta didn't respond to requests for comment.

McKinsey also disclosed a client relationship with managed-care company Molina Healthcare and staffing firm ManpowerGroup, which won contracts worth up to $900 million and $250 million, respectively, from public-health authorities since McKinsey began working in Puerto Rico, according to public filings by the oversight board. Molina and Manpower Group didn't respond to requests for comment.

McKinsey didn't include its connection with Puma Energy Caribe LLC in its disclosures. The energy supplier is a McKinsey client that since 2018 has been awarded contracts worth more than $2.1 billion to ship diesel and bunker fuel to Puerto Rico's state-run utility system.

The McKinsey spokesman said the firm unintentionally omitted its connection to Puma from last month's disclosure and will add the client relationship in a supplemental filing.

McKinsey disclosed ties to EcoElectrica LP, which owns a gas-fired power plant on the island's south, but didn't disclose the firm's separate client relationship with EcoElectrica parent company Naturgy Energy Group SA . In 2019, the public utility awarded EcoElectrica and Naturgy a contract worth $9 billion for EcoElectrica to provide power and Naturgy to supply natural gas.

The disclosures also didn't include New Fortress Energia LLC, an energy contracting business owned by McKinsey client SoftBank Group Corp. that won a $1.5 billion contract in 2019 to convert two publicly owned power-generation facilities to natural gas.

The McKinsey spokesman said that Naturgy and New Fortress weren't on a "material interested parties" list approved by the court and that, because of that, the firm didn't search for or disclose connections to either company. Naturgy and New Fortress didn't respond to requests for comment.

Lawmakers and officials' concerns about conflicts of interest have dogged McKinsey's work in Puerto Rico following news reports in 2018 that the firm's investment arm held Puerto Rican municipal bonds at the same time its consultants were advising the oversight board on how those same debts should be restructured.

McKinsey maintains it has a strict barrier between its consulting business and its investment office, MIO Partners Inc., and that information doesn't pass between them. An investigation commissioned by the oversight board in 2019 found that had it known of McKinsey's bondholdings, it would have "required divestiture of the bonds or an explanation as to why ownership of these bonds did not present a disabling conflict." The 2019 investigative report, written by an outside law firm, also found that McKinsey's internal policies "effectively mitigated the impact of any potential conflicts" arising from MIO's owning Puerto Rico bonds.

Last year, McKinsey paid $18 million to settle Securities and Exchange Commission allegations that it failed to guard against the risk of insider trading in MIO's investments, including its Puerto Rico holdings. The SEC alleged that McKinsey partners who decided on investments for MIO sold about $1 million of Puerto Rican bonds in 2017 when they had access to confidential information about the government's financial condition. The firm's settlement with the SEC included no admission of wrongdoing and no allegation that insider trading had occurred.

The firm also paid $15 million in 2019 to settle civil allegations by the Justice Department that it failed to make required disclosures of potential conflicts in several corporate bankruptcy cases. McKinsey also denied wrongdoing in that case.

Under the new transparency law, fees can be denied to any professional if they aren't a "disinterested person," meaning they aren't a creditor and don't have an interest "materially adverse" to the financial interests of the Puerto Rican government and its stakeholders.

The federal judge overseeing Puerto Rico's bankruptcy case has discretion over whether McKinsey can collect future payments for its services or be able to hold on to the fees it has already received, which were paid out on an interim basis.

The McKinsey spokesman also said that the firm's internal policies include a code of professional conduct that "limits the sharing of client confidential information to colleagues with a legitimate need to know and who are authorized to access the information."

He added that McKinsey deploys staffing procedures to ensure that "members of the firm who have acquired confidential information about a client may not serve another client if that confidential information could materially disadvantage the first client."

Puerto Rico won court approval of a $30.5 billion debt restructuring in January. But public agencies including the power authority remain under bankruptcy-court protection. Its restructuring partly depends on the privatization of electricity transmission and distribution by the Quanta-owned venture, Luma. Fuel is the biggest driver of electricity prices in Puerto Rico, which relies heavily on imported fossil fuels and pays several times as much for power as most mainland U.S. consumers.

Puma and Naturgy are among the vendors counted as McKinsey's clients with public deals reviewed by McKinsey on behalf of the oversight board, billing records show.

The records show that McKinsey in May 2019 reviewed Puma's contract to supply diesel fuel to Puerto Rico's bankrupt public power utility, and a short-term contract extension was granted two months later. Puma later lost its deal to supply diesel but has received other contracts amounting in total to more than $1.8 billion as recently as this month to supply a different fuel product to the utility.

A Puma spokesman said, "as I understand it, McKinsey were engaged with a general strategy review and wouldn't have been advising on specifics like this."

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