No.

IN THE
Supreme Court of the United States

THE COMMONWEALTH OF PUERTO RICO,
ALEJANDRO GARCÍA PADILLA,
as Governor of the Commonwealth of Puerto Rico,
and CÉSAR MIRANDA RODRÍGUEZ, as Secretary of
Justice of the Commonwealth of Puerto Rico,

Petitioners,

v.

FRANKLIN CALIFORNIA TAX-FREE TRUST, *et al.,*

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the First Circuit

PETITION FOR WRIT OF CERTIORARI

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August 21, 2015

QUESTION PRESENTED

Whether Chapter 9 of the federal Bankruptcy Code, which does not apply to Puerto Rico, nonetheless preempts a Puerto Rico statute creating a mechanism for the Commonwealth's public utilities to restructure their debts.

PARTIES TO THE PROCEEDINGS BELOW

Petitioners, the Commonwealth of Puerto Rico, Alejandro García Padilla, as Governor of the Commonwealth of Puerto Rico, and César Miranda Rodríguez, as Secretary of Justice of the Commonwealth of Puerto Rico, were appellants in the First Circuit. In addition, Melba Acosta Febo and John Doe, as agents for the Government Development Bank of Puerto Rico, were appellants in the First Circuit.

Respondents, Franklin California Tax-Free Trust, Franklin New York Tax-Free Trust, Franklin Tax-Free Trust, Franklin Municipal Securities Trust, Franklin California Tax-Free Income Fund, Franklin New York Tax-Free Income Fund, Franklin Federal Tax-Free Income Fund, Oppenheimer Rochester Fund, Municipals Oppenheimer Municipal Fund, Oppenheimer Multi-State Municipal Trust, Oppenheimer Rochester Ohio Municipal Fund, Oppenheimer Rochester Arizona Municipal Fund, Oppenheimer Rochester Virginia Municipal Fund, Oppenheimer Rochester Maryland Municipal Fund, Oppenheimer Rochester Limited Term California Municipal Fund, Oppenheimer Rochester California Municipal Fund, Rochester Portfolio Series, Oppenheimer Rochester Amt-Free Municipal Fund, Oppenheimer Rochester Amt-Free New York Municipal Fund, Oppenheimer Rochester Michigan Municipal Fund, Oppenheimer Rochester Massachusetts Municipal Fund, Oppenheimer Rochester North Carolina Municipal Fund, Oppenheimer Rochester Minnesota Municipal Fund, and BlueMountain Capital Management, LLC, for and on behalf of investment funds for which it acts

as investment manager, were appellees in the First Circuit.

The Puerto Rico Electric Power Authority (PREPA) was a defendant in the district court but was not a party to the proceedings in the First Circuit.

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INTRODUCTION

This case involves Puerto Rico's ability to respond to the most acute fiscal crisis in its history. The Commonwealth's three major public utilities, which provide electricity, water, and roads for its citizens, have a combined debt of some $20 billion, which they cannot pay. But neither can those utilities simply shut down the electricity, or the water, or the roads. The utilities thus need to restructure their debts in a way that is fair not only to their creditors but also to the people they serve.

The decision below, however, holds that Puerto Rico—unlike the fifty States—lacks access to *any* legal mechanism to restructure the debts of its public utilities. It is undisputed that, since 1984, the federal Bankruptcy Code has precluded Puerto Rico from authorizing its "municipalities"—including, as relevant here, its public utilities—from restructuring their debts under Chapter 9 of the Code. But just because Puerto Rico's public utilities cannot restructure their debts under *federal* law does not mean that they cannot restructure their debts under *Commonwealth* law. Nothing in the federal Bankruptcy Code purports to leave a jurisdiction, like Puerto Rico, that is outside the scope of Chapter 9 in a "no man's land" where its public utilities cannot restructure their debts under *either* federal law *or* its own law.

To the contrary, it has been settled since the earliest days of the Republic that States and Territories have the power to enact their own restructuring laws. And it is equally settled that entities excluded from the federal Bankruptcy Code—such as banks and insurance companies—are

not thereby foreclosed from restructuring their debts under state or territorial law. There is thus no basis to conclude that the exclusion of Puerto Rico from Chapter 9 represents a limitation on the Commonwealth's power to create its own mechanism for restructuring the debts of its public utilities. Here, Puerto Rico exercised that power by enacting a statute—the Recovery Act—that creates such a restructuring mechanism.

The First Circuit, however, held that Puerto Rico has the worst of both worlds: it is not entitled to the *benefits* of Chapter 9, but remains subject to the *burdens* of Chapter 9. In particular, the First Circuit held that 11 U.S.C. § 903(1)—a provision of Chapter 9 that sharply limits the ability of jurisdictions within the scope of that Chapter to restructure their debts beyond the scope of that Chapter—preempts the Recovery Act.

The court thereby turned Chapter 9 on its head. Section 903(1) is part and parcel of Chapter 9: on the one hand, Congress created a federal mechanism for States to restructure their municipal debts while, on the other, Congress limited their ability to restructure those debts outside that mechanism. It makes no sense to read a limitation on Chapter 9 to apply to a jurisdiction, like Puerto Rico, that is outside the scope of that Chapter in the first place.

Indeed, it is anomalous in the extreme to think that Congress—*sub silentio* and through an amendment to a statutory definition—foreclosed Puerto Rico from access to *any* legal mechanism for restructuring the debts of its public utilities, which provide basic and essential services to its citizens. Nor is it any answer to assert, as did the First

Circuit, that Puerto Rico can always ask Congress to change the law: the question here is whether the law should be interpreted in such an anomalous and draconian manner in the first place.

This is one of the rare cases that calls for this Court's immediate review even in the absence of a conflict among the lower courts. Given the anomalous treatment of Puerto Rico in the federal Bankruptcy Code, no circuit split is realistically possible here. And anyone who has even glanced at the headlines in recent months knows that the Commonwealth is in the midst of a financial meltdown that threatens the island's future. By holding that the federal Bankruptcy Code precludes Puerto Rico's public utilities from restructuring their debts not only under federal law but also under Commonwealth law, the First Circuit decided "an important question of federal law that has not been, but should be, settled by this Court." S. Ct. R. 10(c). And because that decision leaves Puerto Rico's public utilities, and the 3.5 million American citizens who depend on them, at the mercy of their creditors, this Court's review is warranted—and soon.

OPINIONS BELOW

The First Circuit's decision has not yet been published in the Federal Reporter, but is reported at 2015 WL 4079422 and reprinted in the Appendix ("App.") at 1-68a. Similarly, the district court's opinion has not yet been published, but is reported at 2015 WL 522183 and reprinted at App. 69-137a.

JURISDICTION

The First Circuit issued its decision on July 6, 2015. App. 1-2a. This Court has jurisdiction under 28 U.S.C. § 1254(1).

PERTINENT STATUTORY PROVISIONS

Pertinent statutory provisions are set forth in the Appendix.

STATEMENT OF THE CASE

A. Background

This case arises out of a fiscal crisis that has crippled Puerto Rico. *See* Recovery Act Stmt. of Motives, App. 139-40a. In recent years, the Commonwealth has faced an economic recession, high unemployment, and a declining population, all of which have contributed to a declining tax base and decreased revenues. *Id.*, App. 147-48a. In January 2013, the Commonwealth's deficit for fiscal year 2012-13 was projected to exceed $2.2 billion. *Id.*, App. 139a. Even after significant budget cuts, the deficit for that fiscal year ultimately exceeded $1.2 billion. *Id*. And, despite additional fiscal discipline measures approved by the Legislative Assembly, the deficit for the 2013-14 fiscal year reached $650 million. *Id*. Under these circumstances, the Legislative Assembly declared a state of "fiscal emergency" early last year. *Id.*, App. 144-45a, 166a.

The fiscal crisis has hit the Commonwealth's public utilities particularly hard. The combined deficit of the three main public utilities in fiscal year 2012-13 was approximately $800 million, and their overall combined debt reached $20 billion. *Id.*, App. 139-40a. For the first time in the Commonwealth's history, the principal rating agencies downgraded

the Commonwealth's general obligation bonds (and the bonds of most of its public utilities) to below investment grade. *Id.*, App. 141a. The attendant increases in interest rates, along with the reduction in access to capital markets, have further limited these corporations' liquidity and financial flexibility. *Id.*, App. 141-42a.

Among the public corporations most acutely affected by the current fiscal crisis is the Puerto Rico Electric Power Authority (PREPA), which employs over 7,000 people and supplies virtually all of the Commonwealth's electric power. In recent years, PREPA has experienced severe reductions in its net revenues and has incurred net losses and cash flow shortfalls due to the prolonged weakness in the Commonwealth's macroeconomic conditions (high energy, labor, and maintenance costs) and investments in capital improvements. *Id.*, App. 145-46a. PREPA's utility rates, which are twice the average rate in the continental United States, have adversely affected the Commonwealth's economic development and stifled necessary capital investments. *Id.*, App. 146-47a.

When faced with similar crisis conditions, the fifty States may authorize their public utilities to restructure under Chapter 9 of the federal Bankruptcy Code. *See* 11 U.S.C. § 109(c), App. 274-75a. Puerto Rico's public utilities, in contrast, are categorically excluded from restructuring their debts under Chapter 9. *See* 11 U.S.C. § 101(52), App. 273a. Accordingly, the Commonwealth enacted the Recovery Act last year to allow those entities to restructure their debts in a fair and orderly manner. *See* Recovery Act Stmt. of Motives, App. 149-55a. As

the Legislative Assembly explained, "the current fiscal emergency situation requires legislation that allows public corporations, among other things, (i) to adjust their debts in the interest of all creditors affected thereby, (ii) provides procedures for the orderly enforcement and, if necessary, the restructuring of debt in a manner consistent with the Commonwealth Constitution and the U.S. Constitution, and (iii) maximizes returns to all stakeholders by providing them going concern value based on each obligor's capacity to pay." *Id.*, App. 154a. The Act thus creates a mechanism for Puerto Rico's public corporations to restructure their debts so that they can continue to provide essential public services like dependable electricity and clean water while at the same time protecting their creditors. *Id.*; *see also id.*, App. 144a (Recovery Act will allow public corporations to continue to provide "services necessary and indispensable for the populace").

To that end, the Act establishes two types of procedures to address a public corporation's debt burden. The first, set forth in Chapter 2, is a market-based approach that contemplates limited court involvement. *See id.* Ch. 2, App. 157-60a (summary), 210-20a. Under this Chapter, a public corporation chooses debts to renegotiate with its creditors. *See id.* § 202(a), App. 211a. Creditors representing at least 50% of the debt in a given class must participate in the vote on whether to accept those changes, and at least 75% of participants must approve them. *See id.* § 202(d)(2)(A)-(B), App. 213a. Once Puerto Rico's Government Development Bank (GDB) and a specialized court established by the Act approve the consensual debt relief transaction, the instruments governing the creditors' claims are

deemed amended to reflect the renegotiated terms. *See id.* § 202(d), App. 212-13a; *id.* § 115(b), App. 187-88a.

The Act also allows Puerto Rico's public utilities to seek relief under Chapter 3, which involves enhanced judicial oversight and is modeled on Chapter 9 of the federal Bankruptcy Code. *Id.*, App. 160-64a (summary); App. 221-71a. To file under Chapter 3, a public utility files a petition that includes a list of affected creditors and a schedule of claims, which stays a broad range of actions against the petitioner. *See id.* §§ 301, 302, 304, App. 221-27a. Either the GDB or the petitioner must then file a proposed plan or proposed transfer of the utility's assets, which the court can confirm only if it "provides for every affected creditor in each class of affected debt to receive payments and/or property having a present value of at least the amount the affected debt in the class would have received if all creditors holding claims against the petitioner had been allowed to enforce them on the date the petition was filed." *Id.* §§ 310, 315(d), App. 234a, 238a. At least one class of affected debt must accept the plan with a majority of all votes cast and with the support of at least two-thirds of affected debt in the class. *See id.* §§ 312, 315(e), App. 235-36a, 238a. As under Chapter 2, all affected creditors are bound by the plan after it is approved by the specialized court. *See id.* § 115(b), App. 187-88a.

The Puerto Rico Legislature passed the Recovery Act on June 25, 2014, and the Governor signed it into law just three days later.

B. Proceedings Below

On June 28, 2014—the very day that the Governor signed the Recovery Act into law—some of the respondents (investment funds that hold PREPA bonds) filed a lawsuit challenging the Act's validity and seeking declaratory and injunctive relief. Several weeks later, the remaining respondents (also PREPA bondholders) filed a similar lawsuit. The lawsuits alleged, among other things, that the Recovery Act is preempted by Section 903(1), a provision of Chapter 9 of the Bankruptcy Code.

In February 2015—without hearing oral argument—the district court (Besosa, J.) denied petitioners' motion to dismiss, granted summary judgment to the respondents who had requested it, and permanently enjoined petitioners from enforcing the Recovery Act. *See* App. 69-137a. As relevant here, the court agreed with respondents that the Act is preempted by Section 903(1), even though Chapter 9 does not apply to Puerto Rico in the first place. *See* App. 94-111a.

Petitioners appealed, but the First Circuit affirmed. *See* App. 1-68a. The panel majority agreed with the district court that Section 903(1) expressly preempts the Recovery Act, *see* App. 21-41a, and in addition held that the Act would frustrate the purpose of that provision, *see* App. 41-43a. Judge Torruella concurred in the judgment invalidating the Recovery Act, but opined that Chapter 9 is unconstitutional insofar as it excludes Puerto Rico from its scope. *See* App. 46-68a.

This petition follows.

REASONS FOR GRANTING THE WRIT

I. Section 903(1) Does Not Preempt The Recovery Act.

The decision below reflects a fundamental misunderstanding not only of federal bankruptcy law but also of federalism. The First Circuit wrenched a single provision of Chapter 9—Section 903(1)—from its statutory context and treated it as a free-floating provision of the U.S. Code. The court thereby violated basic principles of statutory interpretation. Section 903(1) is a proviso to a clause that does not apply to Puerto Rico, located within a chapter of the Bankruptcy Code that does not apply to Puerto Rico. The statutory context thus makes clear that Section 903(1) does not apply to Puerto Rico, and the history of that provision only confirms the point.

That point is further reinforced by background preemption principles, which apply with full force to Puerto Rico. In our federal system, the general rule is that Congress does not lightly displace the legislative powers of the States and Territories, and there is no indication that it wished to do so here. And it is particularly implausible to assume that Congress meant to deprive Puerto Rico's public utilities—which provide the Commonwealth's people with essential public services like electricity, water, and roads—of any legal mechanism to restructure their debts, thereby leaving them at the mercy of their creditors. If Congress wanted Chapter 9 to be the sole method of restructuring municipal debt, even for jurisdictions categorically ineligible for Chapter 9 relief, it could and would have said so.

A. The Text, Structure, And History Of Section 903(1) Neither Compel Nor Allow A Conclusion Of Preemption.

The decision below violates the cardinal rule that courts must read the words of a statute "'in their context and with a view to their place in the overall statutory scheme.'" *King v. Burwell*, 135 S. Ct. 2480, 2489 (2015) (quoting *FDA v. Brown & Williamson*, 529 U.S. 120, 133 (2000)). "Our duty, after all, is 'to construe statutes, not isolated provisions.'" *Id.* (quoting *Graham Cty. Soil & Water Conserv. Dist. v. United States ex rel. Wilson*, 559 U.S. 280, 290 (2010)). This is hardly a novel or controversial proposition. *See id.* at 2497 (Scalia, J., joined by Thomas & Alito, JJ., dissenting) ("I wholeheartedly agree with the Court that sound interpretation requires paying attention to the whole law, not homing in on isolated words or even isolated sections. Context always matters."); *see also Samantar v. Yousuf*, 560 U.S. 305, 319 (2010); *Richards v. United States*, 369 U.S. 1, 11 (1962).

Chapter 9 of the Bankruptcy Code exists to permit a municipality—*i.e.*, a "political subdivision or public agency or instrumentality of a State," 11 U.S.C. § 101(40), App. 272a—to restructure its debts under federal law. Every section of Chapter 9 works in service to that end. *See* 11 U.S.C. §§ 901-46. Section 903(1) is no exception. Section 903 expressly "reserve[s] … State power to control municipalities," 11 U.S.C. § 903, App. 279a, and Section 903(1) ensures that States eligible to participate in Chapter 9 cannot undermine the federal scheme by limiting the relief that they can provide their municipalities under state law.

The First Circuit, however, focused myopically on Section 903(1), as if that provision resolved this case. *See* App. 21-41a. But the Commonwealth has never disputed that Section 903(1), if applicable to Puerto Rico, would preempt the Recovery Act. By its terms, that provision specifies that "a State law prescribing a method of composition of indebtedness of [a] municipality may not bind any creditor that does not consent to such composition." 11 U.S.C. § 903(1), App. 279a. The question here, however, is not whether Section 903(1), if applicable, would preempt the Recovery Act, but whether Section 903(1) applies to Puerto Rico in the first place.

The answer to that question is "no." Section 903(1) is not a standalone part of the U.S. Code. To the contrary, it is a proviso to Section 903, which in turn is part of Chapter 9. And the entire point of Chapter 9, as noted above, is to create a mechanism for a municipality to restructure its debts under federal law, *see id.* §§ 901-46; *see also City of Pontiac Retired Emps. Ass'n v. Schimmel*, 751 F.3d 427, 433 (6th Cir. 2014) (*en banc*; *per curiam*) (McKeague, J., joined by Batchelder, C.J., concurring) ("[Section] 903(1) does not exist in a vacuum," but "is part of, and in fact an *exception* to, the main point of a longer sentence.") (emphasis in original).

The First Circuit did not, and could not, deny that Puerto Rico's municipalities are categorically ineligible to restructure their debts under Chapter 9. *See id.* § 101(52), App. 273a. For that reason, there is no basis to apply Section 903(1), which is concededly part of Chapter 9, to those municipalities. Chapter 9 offers States—but not Puerto Rico—the *option* of allowing their municipalities to seek federal

bankruptcy protection. In exchange for providing that federal option, Congress limited the relief that States could provide those municipalities under their own laws. *See id.* § 903(1), App. 279a. In other words, Congress required States to take the bitter with the sweet. There is absolutely nothing in the text, structure, or history of the statute to suggest that Congress required Puerto Rico to take *only* the bitter without the sweet: a limitation on the relief it can provide municipalities under its own law *without* the option of authorizing those municipalities to restructure their debts under federal law.

Indeed, Section 903 has no legal or logical application to a jurisdiction, like Puerto Rico, that cannot authorize its municipalities to seek relief under Chapter 9. By its terms, Section 903 specifies that "*[t]his Chapter* [*i.e.*, Chapter 9] does not limit or impair the power of a State to control, by legislation or otherwise, a municipality of or in such State in the exercise of the political or governmental powers of such municipality, including expenditures for such exercise." *Id.* § 903, App. 279a (emphasis added). That "Reservation of State power to control municipalities" does not apply to Puerto Rico, which cannot authorize its municipalities to seek relief under "this chapter." *Id.* Chapter 9, in other words, cannot "limit or impair" the power of a jurisdiction to which it does not apply in the first place. *Id.* Because Section 903 simply negates an inference that cannot apply to Puerto Rico, Section 903 does not apply to Puerto Rico: it would be nonsensical for Congress to provide Puerto Rico with a shield against intrusion by a Chapter that, by definition, can have no effect on Puerto Rico.

And Section 903(1), by its plain terms, is nothing more than a proviso to Section 903. In particular, Section 903(1) excepts certain relief from the "power of a State to control ... a municipality of or in such State" that is otherwise "[r]eserv[ed]" by Section 903. 11 U.S.C. § 903, App. 279a. Thus, if Section 903 does not apply to Puerto Rico, it follows that Section 903(1) does not apply to Puerto Rico either. *See*, *e.g.*, *United States v. Morrow*, 266 U.S. 531, 534-35 (1925) ("[A proviso's] grammatical and logical scope is confined to the subject matter of the principal clause."); *id.* at 535 ("[T]he presumption is that, in accordance with its primary purpose, [a proviso] refers only to the provision to which it is attached."); *Abbott v. United States*, 562 U.S. 8, 30 (2010) ("As a proviso attached to § 924(c), the 'except' clause is most naturally read to refer to the conduct § 924(c) proscribes."); Thomas Moers Mayer, *State Sovereignty, State Bankruptcy, & A Reconsideration of Chapter 9*, 85 Am. Bankr. L.J. 363, 379 n.84 (2011) ("[Section 903(1)] appears as an exception to § 903's respect for state law in chapter 9 and thus appears to apply only in a chapter 9 bankruptcy."). Indeed, Section 903(1) includes a textual reference ("such municipality") back to Section 903, thereby underscoring that the two provisions not only *may* but *must* be read in tandem. 11 U.S.C. § 903(1), App. 279a.

The First Circuit never sought to explain how Section 903 applies to Puerto Rico, or how Section 903(1) applies to Puerto Rico if Section 903 does not. Instead, the First Circuit caricatured petitioners' contextual argument, asserting that it would require the court to "accept one of the two following propositions: Either states that do not authorize

their municipalities to file for Chapter 9 relief are similarly 'exempted,' and so not barred by § 903(1) from enacting their own bankruptcy laws. Or the availability of Chapter 9 relief for state municipalities, regardless of whether a particular state chooses to exercise the option, occupies the field of nonconsensual municipal debt restructuring, and § 903(1) merely aims to clarify that the operative clause of § 903 does not undermine that background assumption." App. 40a. But petitioners' contextual interpretation of § 903(1) does not require acceptance of either proposition.

The first proposition is a straw man because petitioners' contextual interpretation rests on the premise that Section 903(1) does not apply to a jurisdiction, like Puerto Rico, that is categorically ineligible to invoke the Chapter 9 restructuring regime. The interpretation thus has no application to the States, which always have the *option* of authorizing their municipalities to file under Chapter 9, even if they decline to exercise that option. It does not follow, thus, that if Section 903(1) does not apply to Puerto Rico, then Section 903(1) does not apply to a State that has not authorized its municipalities to seek Chapter 9 protection.

The second proposition is simply perplexing, because petitioners' contextual interpretation does not involve "field preemption," or any other form of preemption. To the contrary, it recognizes a *limitation* on a provision, Section 903(1), that otherwise would have preemptive effect: that provision cannot apply more broadly than the principal clause that it modifies. The First Circuit's assertion that "ironically, it is [petitioners']

argument which relies on the notion of field preemption," App. 40a, is thus baffling.

Similarly, the First Circuit begged the question by asserting that "[i]f Congress had wanted to alter the applicability of § 903(1) to Puerto Rico, it easily could have written § 101(52) to exclude Puerto Rico laws from the prohibition of § 903(1)." App. 28a (internal quotation omitted). Congress wrote Section 101(52) in a way that renders Puerto Rico municipalities categorically ineligible for Chapter 9 relief by precluding Puerto Rico from authorizing them to seek such relief. Congress thereby took Puerto Rico outside the scope of Chapter 9: the word "State" appears nowhere in that Chapter *besides* Section 903, and—as explained above—Section 903 (and hence Section 903(1)) has no application to a jurisdiction, like Puerto Rico, that cannot authorize its municipalities to seek Chapter 9 relief. If Congress had wanted Section 903(1) to bind Puerto Rico, it hardly could have expressed that intent in a more roundabout way than through an exception to a rule that does not apply to Puerto Rico in a Chapter of the Code that does not apply to Puerto Rico.

The far more natural interpretation is that Chapter 9's reorganization regime *neither* encompasses Puerto Rico *nor* displaces Commonwealth law. *See* Stephen J. Lubben, *Puerto Rico & The Bankruptcy Clause*, 88 Am. Bankr. L.J. 553, 576 (2014) ("[S]ection 903 was only intended to apply to debtors who might actually file under chapter 9."). In other words, Congress created a mechanism for States to allow their municipalities to restructure their debts under *federal* law, and thereafter limited the relief that States could provide

those same municipalities under *state* law. Nothing in Section 903(1), or any other provision of the Bankruptcy Code, suggests that Congress sought to displace state restructuring law where federal restructuring law is unavailable.

The First Circuit's reliance on the history of Section 903(1) is equally misplaced. The court placed great weight on the fact that Puerto Rico, like other other territories and possessions, was included within the definition of "State" from 1938 until the overhaul of the Bankruptcy Code in 1978. App. 16a & n.12, 26a (citing Act of June 22, 1938, Ch. 575 § 1(29), 75th Cong., 3d Sess., 52 Stat. 840, 842 (1938)) (defining "State" in relevant part to "include the territories and possessions to which this title is or may hereafter be applicable, Alaska, and the District of Columbia"). It follows, the First Circuit declared, that Puerto Rico was covered by Section 903(1) at that time, and there is no indication that Congress intended to "'erode past bankruptcy practice'" when, in 1984, it precluded Puerto Rico from authorizing its municipalities to restructure their debts under Chapter 9. App. 4a, 23-24a (quoting *Cohen v. de la Cruz*, 523 U.S. 213, 221 (1998)). "'Fundamental changes in the scope of a statute are not typically accomplished with so subtle a move.'" App. 4a, 26-27a (quoting *Kellogg Brown & Root Servs. Inc. v. United States ex rel. Carter*, 135 S. Ct. 1970, 1977 (2015)).

But there was nothing at all "subtle" about Congress' enactment of a new definition of "State" in 1984. *See* Bankruptcy Amendments & Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 421(j)(6), 98 Stat. 333 (1984). Congress thereby

expressly and substantially altered the reach of the Code. Because Congress unquestionably "erode[d] past bankruptcy practice," *Cohen*, 523 U.S. at 221, by stripping Puerto Rico of the benefits of Chapter 9, there is no reason to suppose that Congress intended to preserve past bankruptcy practice by continuing to subject Puerto Rico to the burdens of Chapter 9. In short, if there is any "elephant" hidden in a "mousehole" here, *see Whitman v. American Trucking Ass'ns*, 531 U.S. 457, 468 (2001), it is the suggestion that Congress' decision to preclude Puerto Rico municipalities from restructuring their debts under Chapter 9 leaves those municipalities subject to limitations in Chapter 9 that preclude them from restructuring their debts under *any* legal regime.

The legislative history also provides no support for the decision below. As the First Circuit acknowledged, "[t]he legislative history is silent as to the reason for the exception set forth in the 1984 amendment." App. 28a. Thus, nothing in the legislative history suggests that Congress intended the 1984 amendment to deny Puerto Rico municipalities access not only to Chapter 9 but to any legal mechanism to restructure their debts.

Nor, contrary to the First Circuit's suggestion, *see* App. 24-28a, does the legislative history of Section 903(1)—which *predates* the 1984 amendment—support the decision below. The precursor to Section 903(1) was first added to the U.S. Code in 1946, in the wake of a decision by this Court holding that the enactment of Chapter 9 did not preempt state municipal-restructuring laws. *See Faitoute Iron & Steel Co. v. Asbury Park, N.J.*, 316 U.S. 502, 508-09 (1942). The legislative history of the 1946

amendment showed that Congress wanted to expand the preemptive scope of Chapter 9:

> State adjustment acts have been held to be valid, but a bankruptcy law under which bondholders of a municipality are required to surrender or cancel their obligations should be uniform throughout the 48 States, as the bonds of almost every municipality are widely held. Only under a Federal law should a creditor be forced to accept such an adjustment without his consent.

H.R. Rep. No. 79-2246, at 4 (1946). And, when Congress retained and recodified this provision as part of an overhaul of the Bankruptcy Code in 1978, it noted that "[d]eletion of the provision would permit all States to enact their own versions of Chapter IX, ... which would frustrate the constitutional mandate of uniform bankruptcy laws." S. Rep. No. 95-989, at 110 (1978) (internal quotation omitted).

But none of this legislative history says anything about what happens where, as here, *Congress itself* departs from the uniformity of federal bankruptcy law by excluding a jurisdiction, like Puerto Rico, from Chapter 9. To the contrary, the legislative history of Section 903(1) *presupposes* the availability of a federal mechanism for restructuring municipal debts. *See Hearings on H.R. 4307*, 79th Cong. 16 (1946) (statement of Millard Parkhurst) (precursor to Section 903(1) intended to prevent States from "hav[ing] their bankruptcy laws running right along at the same time as [Chapter 9]"). And that is perfectly understandable because, at the time the legislative history was written, no jurisdiction was

excluded from Chapter 9. Insofar as Section 903(1) was motivated by a concern that state municipal bankruptcy laws might "frustrate the constitutional mandate of uniform bankruptcy laws," S. Rep. No. 95-989, at 110 (1978), that concern sheds no light on the consequences of Congress' decision to *exclude* a jurisdiction from the scope of Chapter 9, which represents a departure from the uniformity of federal bankruptcy law. In short, the First Circuit vastly overread the legislative history of Section 903(1) to resolve an issue it did not address.

For that reason, the First Circuit's distinct "conflict preemption" argument also fails. *See* App. 41-43a. The First Circuit held that, quite apart from the text of Section 903(1), "[c]onflict preemption applies here because the Recovery Act frustrates Congress's undeniable purpose in enacting § 903(1)." App. 42a. The court based that holding on the premise that, in light of the legislative history quoted above, "Congress quite plainly wanted a single federal law to be the sole source of authority if municipal bondholders were to have their rights altered without their consent." *Id.* But that premise is baseless. As noted above, nothing in the legislative history suggests that Congress wanted Chapter 9 to be the sole recourse for debtors *excluded* from Chapter 9.

The Recovery Act represents Puerto Rico's considered decision to fill the gap left by the inapplicability of Chapter 9 to the Commonwealth's public utilities. *See* Lubben, *Puerto Rico & The Bankruptcy Clause*, 88 Am. Bankr. L.J. at 567 ("Puerto Rico's new Recovery Act is addressed to a class of debtors who are expressly excluded from

chapter 9 of the Bankruptcy Code by virtue of the exclusion of Puerto Rico from the definition of State 'for the purpose of defining who may be a debtor under chapter 9.' As such, there is no way for the Recovery Act to conflict with chapter 9 in violation of Congress' powers under the Bankruptcy Clause."); *id.* at 577 ("[I]t is emphatically possible to apply the Recovery Act and the Bankruptcy Code simultaneously, because the Bankruptcy Code has nothing to say about Puerto Rican municipal corporations. The two laws are mutually exclusive.").

Indeed, the First Circuit's broad and non-textual "conflict preemption" theory works considerable collateral damage with respect to other possessions and territories. Only Puerto Rico and the District of Columbia are encompassed in any way by the Bankruptcy Code's current definition of "State," *see* 11 U.S.C. § 101(52), App. 273a—in sharp contrast to the Code's previous definition of "State," which (as noted above) included "the Territories and possessions to which this Act is or may hereafter be applicable, Alaska, and the District of Columbia," Act of June 22, 1938, Ch. 575 § 1(29), 75th Cong., 3d Sess., 52 Stat. 840, 842 (1938). The First Circuit's "conflict preemption" theory, however, prevents other possessions and territories (*e.g.*, the U.S. Virgin Islands, Guam, American Samoa, and the Commonwealth of the Northern Mariana Islands) from enacting legislation to allow their public utilities to restructure their debts, even though they are not even arguably covered by Section 903(1) in any way. *See* App. 16a n.12 (acknowledging that these other jurisdictions "are not expressly included for *any* purpose") (emphasis added). The decision

below, in short, unsettles municipal restructuring law in ways that go well beyond this case.

B. Background Preemption Principles Underscore That Section 903(1) Does Not Preempt The Recovery Act.

The decision below also flouts background preemption principles that apply with full force to Puerto Rico. In our federal system, "[i]t has long been settled ... that we presume federal statutes do not ... preempt state law." *Bond v. United States*, 134 S. Ct. 2077, 2088 (2014) (citing *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947)). Although Puerto Rico is not a State, this Court has long "agree[d]" that "the test for federal preemption of the law of Puerto Rico ... is the same as the test under the Supremacy Clause." *Puerto Rico Dep't of Consumer Affairs v. Isla Petroleum Corp.*, 485 U.S. 495, 499 (1988).

"Closely related" to the presumption against preemption "is the well-established principle that 'it is incumbent upon the federal courts to be certain of Congress' intent before finding that federal law overrides' the 'usual constitutional balance of federal and state powers.'" *Bond*, 134 S. Ct. at 2089 (quoting *Gregory v. Ashcroft*, 501 U.S. 452, 460 (1991)) (further internal quotation omitted). Thus, "if the Federal Government would 'radically readjust the balance of state and national authority, those charged with the duty of legislating must be reasonably explicit' about it." *Id.* (quoting *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 544 (1994)) (further internal quotation omitted).

Here, the First Circuit applied Section 903(1), a proviso to a clause that does not apply to Puerto

Rico, located in a Chapter of the Code that does not apply to Puerto Rico, to strip Puerto Rico of the ability to respond to "problems as peculiarly local as the fiscal management of its own household." *Faitoute*, 316 U.S. at 508-09. Yet far from ensuring that Congress was "reasonably explicit" about such a far-reaching choice, *Bond*, 134 S. Ct. at 2089 (internal quotation omitted), the First Circuit applied a provision that predates the exclusion of Puerto Rico from Chapter 9 and does not purport to preempt the restructuring laws of jurisdictions beyond the scope of Chapter 9.

Despite the First Circuit's protestations to the contrary, its decision places Puerto Rico in an anomalous "no man's land" in which its public utilities lack access to *any* legal mechanism to restructure their debts, and are thus left wholly at the mercy of their creditors. *See* App. 29-31a n.24. The First Circuit declared that Puerto Rico is not in such a "no man's land" because it can always ask Congress to change the law. *See id.* But Congress' power to free Puerto Rico from the current "no man's land" does not negate the existence of that "no man's land" in the first place: the point remains that, absent some future Act of Congress, the decision below leaves Puerto Rico powerless to authorize its public utilities to restructure their debts under any law. If Congress had intended to take so consequential a step, it surely could and would have said so.

Nor is there any support for the First Circuit's suggestion that Congress sought to reserve for itself the option of authorizing Puerto Rico's municipalities to restructure their debts, on the theory that "[i]f

Puerto Rico could determine the availability of Chapter 9 for Puerto Rico municipalities, that might undermine Congress's ability to do so." App. 29a; *see also id.* ("Congress's ability to exercise such other options would also be undermined if Puerto Rico could fashion its own municipal bankruptcy relief."). As Judge Torruella bluntly put it, these suggestions are "pure fiction" without any basis in fact or law. App. 53a. "There is absolutely nothing in the record of the 1984 Amendments to justify" the panel majority's statements regarding congressional intent. *Id.*; *see generally* Lubben, *Puerto Rico & The Bankruptcy Clause*, 88 Am. Bankr. L.J. at 578 ("[T]here seems to be no good reason why [the exclusion of Puerto Rico from Chapter 9] should leave Puerto Rico entirely helpless to address the plight of its public corporations. ... The bondholders are entitled to insist that that every effort be made to honor their contracts, but the citizens of Puerto Rico are also entitled to receive the basic services, like electricity, provided by these entities.").

Finally, the First Circuit erred by declaring that the presumption against preemption is "weak, if present at all" in this case. App. 36a. Although the Bankruptcy Clause of the federal Constitution gives Congress "the power ... [t]o establish ... uniform Laws on the subject of Bankruptcies throughout the United States," U.S. Const. art. I, § 8, cl. 4, it has long been settled that this power does not prevent States and Territories from enacting their own laws governing the restructuring of debts, *see, e.g.*, *Ogden v. Saunders*, 12 Wheat. (25 U.S.) 213, 368 (1827); *Sturges v. Crowninshield*, 4 Wheat. (17 U.S.) 122, 193-97 (1819); *see generally* Lubben, *Puerto Rico & The Bankruptcy Clause*, 88 Am. Bankr. L.J. at 563-

68. Indeed, during the first century under the Constitution, a federal bankruptcy law was in effect for a total of only 16 years; it was not until 1898 that the precursor of the modern Bankruptcy Code was enacted. *See* Bankruptcy Act of 1898, Ch. 541, 55th Cong., 2d Sess., 30 Stat. 544 (1898); *see generally Hanover Nat'l Bank v. Moyses*, 186 U.S. 181, 184 (1902) (describing history). During that time, States and Territories routinely enacted their own legislation governing restructuring of debts. *See, e.g.*, Laws of the Territory of Michigan 333 (1827) ("An Act for the Relief of Insolvent Debtors"); 1 General Law of Pennsylvania 710 (1836) ("An Act Relating to Insolvent Debtors"); 1 Statutes of the State of Ohio of a General Nature, ch. 57, at 456 (1854) ("Insolvent Debtors").

Thus, there is no "dormant Bankruptcy Clause" akin to the "dormant Commerce Clause" that precludes States and Territories from adopting restructuring legislation absent authorization by Congress. *See, e.g.*, Lubben, *Puerto Rico & The Bankruptcy Clause*, 88 Am. Bankr. L.J. at 554, 578. It follows, as this Court has explained, that state and territorial laws in this area are "suspended *only* to the extent of actual conflict with the system provided by the Bankruptcy Act of Congress." *Stellwagen v. Clum*, 245 U.S. 605, 613 (1918) (emphasis added). That explains why this Court has long upheld state restructuring or liquidation laws applicable to entities—like banks or insurance companies—excluded from the scope of the federal Bankruptcy Code. *See, e.g.*, *Neblett v. Carpenter*, 305 U.S. 297, 303-05 (1938) (upholding state statute governing rehabilitation of an insurance company); *Doty v.*

Love, 295 U.S. 64, 70-74 (1935) (upholding state statute governing reorganization of a bank).

Indeed, States and Territories have an especially compelling interest in safeguarding the fiscal health of their *own* public corporations, agencies, and instrumentalities. Thus, it was not until 1934 that Congress first extended the federal Bankruptcy Code to encompass such entities at all. *See* Act of May 24, 1934, Ch. 345, 73rd Cong., 2d Sess., 48 Stat. 798 (1934). And that legislation did not survive judicial scrutiny: in light of background principles of federalism, this Court struck down the law on the ground that Congress' constitutional power over bankruptcy did not extend to this context. *See Ashton v. Cameron Cty. Water Imp. Dist. No. 1*, 298 U.S. 513, 529-32 (1936). Were the 1934 Act permitted to stand, the Court declared, States would be "no longer free to manage their own affairs," and "the sovereignty of the state, so often declared necessary to the federal system, [would] not exist." *Id.* at 531.

It was not until 1938 that this Court first interpreted the Bankruptcy Clause to allow Congress to enact a federal municipal bankruptcy law. *See United States v. Bekins*, 304 U.S. 27, 51-52 (1938). And even then, the Court did not overrule its earlier precedents, but simply held that the statute in question (a precursor to Chapter 9) was "carefully drawn so as not to impinge on the sovereignty of the State." *Id.* at 50-51. The Court emphasized that the redrawn statute allowed "[t]he State [to] retain[] control of its fiscal affairs" by permitting municipal restructuring under federal law "only in a case where

[the federal restructuring] is authorized by state law." *Id.* at 51.

And, just four years after upholding the constitutionality of the federal municipal bankruptcy regime, this Court squarely rejected the suggestion that the enactment of that regime divested States and Territories of the power to enact their own municipal restructuring laws. *See Faitoute*, 316 U.S. at 508-09. As the Court explained, "[n]ot until April 25, 1938, was the power of Congress to afford relief similar to that given by New Jersey for its municipalities clearly established." *Id.* at 508 (citing the date on which *Bekins* upheld the municipal restructuring provisions of the federal Bankruptcy Code against a constitutional challenge). "Can it be that a power that was not recognized until 1938, and when so recognized, was carefully circumscribed to reserve full freedom to the states, has now been completely absorbed by the federal government—that a state which ... has ... devised elaborate machinery for the autonomous regulation of problems as peculiarly local as the fiscal management of its own household, is powerless in this field? We think not." *Id.* at 508-09.

Accordingly, there is no basis for the First Circuit's suggestion that the presumption against preemption is "weak, if present at all," App. 36a, in this case. To the contrary, as noted above, a State or Territory's ability to address "problems as peculiarly local as the fiscal management of its own household" lies at the very core of its autonomy. *Faitoute*, 316 U.S. at 508-09; *see also id.* at 512 ("The intervention of the State in the fiscal affairs of its cities is plainly an exercise of its essential reserve power to protect the vital

interests of its people by sustaining the public credit and maintaining local government."). That is why, as this Court has emphasized, Congress lacks plenary power to enact bankruptcy legislation applicable to the States' political subdivisions or instrumentalities, and why such legislation must be "carefully" tailored to permit States to "retain[] control of [their] fiscal affairs." *Bekins*, 304 U.S. at 51; *see also Ashton*, 298 U.S. at 528-32.

II. This Court Should Review This Important Question Of Federal Law.

As Judge Torruella noted in his separate opinion below, "[t]his is an extraordinary case involving extraordinary circumstances, in which the economic life of Puerto Rico's three-and-a-half million U.S. citizens hangs in the balance." App. 63a (opinion concurring in the judgment). The First Circuit's decision leaves Puerto Rico powerless to restructure the debts of its public utilities under *any* law. The question whether the federal Bankruptcy Code requires this unprecedented and anomalous result is "an important question of federal law that has not been, but should be, settled by this Court." S. Ct. R. 10(c).

As a practical matter, there is no realistic prospect of further percolation of this issue among the lower courts. None of the other jurisdictions outside the scope of Chapter 9 has enacted its own municipal restructuring law, so the issue is not presented elsewhere. Nor is there any prospect of further litigation with respect to the validity of Puerto Rico's Recovery Act: unless and until this Court overturns the decision below, the Act is a nullity. Because no circuit split is realistically possible here, there is no

basis for this Court to defer review pending the development of such a split.

And it is hard to overstate the importance of this issue to the future of Puerto Rico and its people. As the Governor recently explained, the island now finds itself caught in a "death spiral" where it can neither pay nor restructure its debts. Michael Corkery & Mary Williams Walsh, *Puerto Rico's Governor Says Island's Debts Are "Not Payable,"* N.Y. TIMES, June 28, 2015, at A1. In the absence of a restructuring regime, individual creditors have every incentive to "hold out" on any prospective agreement in an effort to obtain more favorable terms, even though creditors as a whole may have an interest in working out a restructuring plan that would enhance their collective recovery. *See generally* App. 10a n.6. The Recovery Act created such a restructuring regime, and the question whether it is preempted by the federal Bankruptcy Code—which offers Puerto Rico no alternative restructuring regime—warrants this Court's review.

Nor is it a practical answer to say that Puerto Rico can seek relief from Congress. Puerto Rico would certainly welcome legislative relief from its inexplicable (and unexplained) exclusion from Chapter 9, and has sought legislation to that end. But those long ongoing efforts have thus far proven fruitless—in part because of the furious opposition of certain bondholders (especially hedge funds that purchased the bonds at a substantial discount and now seek to make windfall profits in the absence of a restructuring regime). Indeed, Judge Torruella went out of his way to "take issue with the majority's proposal that Puerto Rico simply ask Congress for

relief; such a suggestion is preposterous given Puerto Rico's exclusion from the federal political process." App. 48a; *see also* App. 65a ("[W]hen Puerto Rico is effectively excluded from the political process in Congress, this is asking it to play with a deck of cards stacked against it.").

At the end of the day, Congress treated Puerto Rico without the dignity due the millions of American citizens who live there by arbitrarily excluding the Commonwealth from Chapter 9, and the lower courts in this case were equally dismissive of the Commonwealth's compelling interest in providing an alternative means for its public utilities to restructure their debts. Before the Commonwealth and its people are left at the mercy of their creditors, they deserve a definitive answer from this Court as to whether the Recovery Act is preempted by federal law.

CONCLUSION

For the foregoing reasons, the Court should grant this petition for writ of certiorari.

Respectfully submitted,

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