No. 15-233

In The
Supreme Court of the United States

COMMONWEALTH OF PUERTO RICO, et al.,

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

BRIEF OF *AMICUS CURIAE* EDUARDO BHATIA, PRESIDENT OF THE SENATE OF THE COMMONWEALTH OF PUERTO RICO, IN SUPPORT OF PETITIONERS

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INTEREST OF *AMICUS CURIAE*

Amicus curiae, Eduardo Bhatia, is the president of the Senate of the Commonwealth of Puerto Rico.[1] As such, he helped enact the Puerto Rico Recovery Act, at issue in the petition for *certiorari* filed by the Commonwealth of Puerto Rico before this Court. In addition, he has previously appeared as *Amicus* before the courts of the United States. See, e.g., *Ada M. Conde Vidal, et al. v. Ana Rius Armendariz, et al*., First Circuit, Appeal No. 2014-2184. As a citizen, statesman and legislator, he has a keen interest in promoting legislative solutions to the fiscal problems faced by the Commonwealth of Puerto Rico in a manner consonant with the laws and Constitution of the United States of America.

SUMMARY

The principal issue in the petitions for certiorari presented before this Court is whether the United States Bankruptcy Code, 11 U.S.C. §§ 101 *et seq.*,

[1] The Court has for consideration before it, two petitions for writ of certiorari in Nos. 15-233 and 15-255. In accordance with Supreme Court Rule 37, *amicus curiae* affirms that the position he takes in this brief has not been approved or financed by Petitioners, Respondents, or their counsel. Neither Petitioners, Respondents, nor their counsel had any role in authoring, nor made any monetary contribution to fund the preparation or submission of this brief. Pursuant to Supreme Court Rule 37, *amicus curiae* states that all parties via their attorneys received timely notice of *amicus curiae's* intent to file and have consented to the filing of this brief.

preempts the Puerto Rico Recovery Act. The Act seeks to provide public utilities an opportunity to restructure public debts that are overwhelming Puerto Rico as a political entity. Although the Bankruptcy Code excludes Puerto Rico from the safeguards of Chapter 9, and does not allow its municipalities the protection of the Code, the First Circuit found that the Commonwealth's Recovery Act, enacted to fill this void, was nonetheless preempted by the Bankruptcy Code.

Amicus does not seek to reiterate legal arguments concerning preemption already well-developed by the Petitioners. He comes instead as a lawmaker engaged in the affairs of the state, sharing with our forefathers the abhorrence of a political vacuum, and an aversion to the type of verdict that cripples government, and prevents it from addressing public ills or restoring the common wealth. The First Circuit decision here falls in this category: in the midst of a massive fiscal crisis, it has decreed a legislative limbo that wreaks political impotence, leaving Puerto Rico without either federal or Commonwealth debt relief, and rendering it even more powerless to face its fiscal problems than is countenanced by the Constitution itself.

Rather than examining the issue exclusively as a matter of preemption, the *Amicus* takes the clearing opened by Judge Torruella's concurrence in the decision below and focuses on the policy implications and constitutional dissonance of the First Circuit decision. Prior to 1984, the Bankruptcy Code allowed Puerto Rico to authorize its municipalities, including its

public utilities, to restructure its debts under Chapter 9 of the Code. See 11 U.S.C. § 101(40) ("municipality" means political subdivision or public agency or instrumentality of a State). In 1984, Congress amended the Code ostensibly to temper it to this Court's decision in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982). In so doing, however, Congress – without any supporting bills, hearings, discussions or deliberation ensconced in the legislative history – inserted a change in the definition of State that ended excluding Puerto Rico as an entity "who may be a debtor" under Chapter 9 of the Code. As a result of this amendment, the Commonwealth's municipalities and public corporations lost the right to restructure their debts under the Code. In the absence of any rationale for this clandestine change in the Code, the concurrence is justified in arguing that the 1984 amendments excluding Puerto Rico from even treatment under the Code do not meet rational scrutiny under the Equal Protection Clause.

A generation later, the result of this amendment has been catastrophic. Puerto Rico is undergoing its worst socio-economic crisis since the Commonwealth was enabled by Public Law 600 of 1950. The public debt, mostly the debt of public corporations excluded from bankruptcy safeguards, is effecting a financial chokehold on the island, such that the government is undergoing an extreme fiscal crisis. This, in turn, has prodded a significant evacuation of the island's population into the mainland. The Commonwealth faces this situation handcuffed, for it does not have available

federal or Commonwealth regulatory mechanisms for restructuring the debt of its public corporations.

In this context, Judge Torruella's concurrence makes a highly pertinent and timely argument. *Trailer Marine Transp. Corp. v. Rivera Vázquez*, 977 F.2d 1, 9 (1st Cir. 1992) suggest that Puerto Rico has been integrated wholly into the United States economic system in a manner akin to a State within a federalist structure. If Puerto Rico is treated like a State within the economic sphere of the Commerce Clause, it also befits that it be treated akin to a State under the fiscal scope of the Bankruptcy Clause. Under this scenario, *Califano v. Torres*, 435 U.S. 1 (1978) and *Harris v. Rosario*, 446 U.S. 651 (1980), would be limited to their facts. Congress may still restrict the benefits allowed to American citizens in Puerto Rico pursuant to federal programs that required the expenditures of federal monies to which Puerto Rico does not contribute its equal share. Said cases, however, would not control here, where the reason underlying the legislative exclusion is unrelated to federal spending and guards no independent rational interest of its own.

Given that the lawfulness of the Recovery Act is so intertwined with the prior removal of Puerto Rico from federal bankruptcy protection, *Amicus* submits that at this particular juncture, the question of preemption is best reviewed in its constitutional context, as part of an examination of Puerto Rico's disparate treatment under the Code. Taking his cue from Judge Torruella, *Amicus* posits that this crisis is

best resolved by reinserting Puerto Rico back in the Bankruptcy Code, on constitutional grounds.

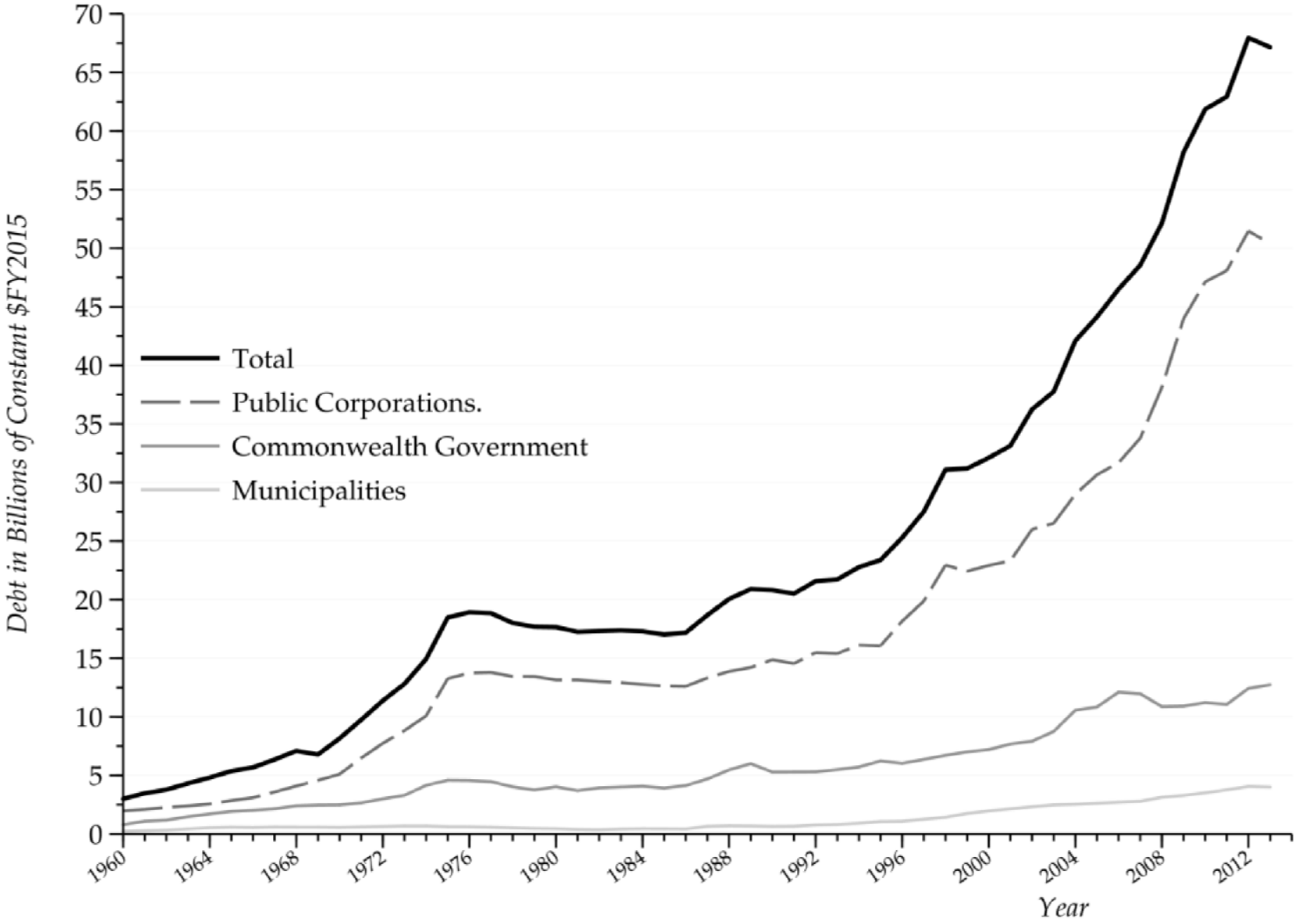
ARGUMENT

I. PUERTO RICO'S ECONOMIC CRISIS

"We are here in a very melancholy Situation: Continual Bankruptcies, universal Loss of Credit, and endless Suspicions," wrote David Hume in 1772 to his friend and fellow Scottish economist Adam Smith, close to two and a half centuries ago, in the depressing economic climate just prior to the publication of the *Wealth of Nations* in 1776.[2] Had it referred to Puerto Rico's fiscal situation, the letter could just as well have been written today.

The "melancholy situation" here concerns Puerto Rico's incapacity as a matter of law to address the grave domestic and fiscal crisis caused by its massive public debt. The 1984 amendments to the Code resulted in the exclusion of Puerto Rico from coverage under Chapter 9, and deprived its municipalities, including its public corporations, of their right to restructure their debt pursuant to federal law. According to empirical data collected by the Congressional Research Center, 1984 also marks the date at which the public debt in Puerto Rico started its meteoric rise, particularly the public debt issued by its public corporations.

[2] Hume, *Letters*, No. 476, June 27, 1772 to Adam Smith, p. 262.



Gross Public Debt of Puerto Rico in Billions of Constant Dollars, 1960-2014[3]

[3] See CRS Report R44095, *Puerto Rico's Current Fiscal Challenges: In Brief* (D. Andrew Austin, Aug. 18, 2015), Figure 2, p. 6, https://www.fas.org/sgp/crs/row/R44095.pdf.

Since 1984, Puerto Rico's public debt, particularly public corporate debt, has grown and grown and grown and is now – at $72.2 billion – slightly larger than the island's gross national product (GNP). The bulk of this debt is attributed to some 50 public corporations, since 1984 excluded from bankruptcy regulation, that serve a broad variety of purposes and activities, ranging from public infrastructure, banking, real estate, insurance, industrial development, health care, transportation, electric power, broadcasting, education, arts, and tourism, among others. This municipal public debt, and the incapacity to restructure the same, has generated a tsunami of collateral fiscal predicaments with respect to incoming revenues, governmental liquidity, debt service and the overall public function.[4]

On June 29, 2015, the Puerto Rican government released the Krueger Report, written by three former International Monetary Fund (IMF) economists, which described grave and threatening problems related to Puerto Rico's fiscal situation, budget execution, public administration, and tax structure.[5] According to the Krueger Report, the island is "now virtually shut off from normal [credit] market access" and its ability to

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[4] See CRS Report R44095, *Puerto Rico's Current Fiscal Challenges: In Brief* (D. Andrew Austin, Aug. 18, 2015), https://www.fas.org/sgp/crs/row/R44095.pdf.

[5] Anne O. Krueger, Ranjit Teja, and Andrew Wolfe, *Puerto Rico: A Way Forward*, June 29, 2015, http://recend.apextech.netdna-cdn.com/docs/editor/Informe%20Krueger.pdf.

meet debt service payments rested on the willingness of investors to roll over existing debt. The problem was succinctly summed up by Puerto Rico's governor, Alejandro García Padilla: "the debt is not payable."[6]

The government of Puerto Rico has not been lacking in its efforts to address the dire situation. Over the past years, Puerto Rico has engaged in extraordinary efforts to realign revenues and outlays by a series of legislative enactments meant to close the deficit. Those measures include tax increases and tax reforms, increasing the sales and use tax rate from 7% to 11.5%, cutbacks and modifications to public pension systems, 20% reduction in public sector employment, the cancellation or postponement of salary and benefit increases, the modification of collective bargaining agreements, the closing of public schools, and the reorganization of public school teaching staffs.[7] It has not been enough.

As to be expected, economics affects demographics. The overall economic situation of high unemployment, stagnant business development, global competition, corporate flight and an economic structure shaped more by tax than comparative advantages, has provoked a significant exodus of Puerto Ricans to the continental United States, particularly Florida. This population shift drains labor and capital resources,

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[6] See CRS Report R44095, *id.*, at p. 1.

[7] Center for a New Economy, *Fiscal Situation Update: Analysis of the Governor's Budget Request for FY2015*, pp. 9-10.

and dries up business productivity, tax revenues and economic growth. In sum, it is estimated that in the last decade, Puerto Rico has lost 1% of its total population *yearly* and that, overall, a third of those born in Puerto Rico now reside on the mainland.[8]

In addition, benefit caps under federal programs spurs the movement towards more beneficial jurisdictions in the States. Under the incorporation doctrine, Congress can apply federal entitlement programs in Puerto Rico unevenly as compared to the States. See *Downes v. Bidwell*, 182 U.S. 244 (1901) (Uniformity clause of Art. I, § 8 does not apply to non-incorporated territories); *Harris v. Rosario*, 446 U.S. 651, 651-52 (1980) ("Congress, which is empowered under the Territory Clause of the Constitution . . . to 'make all needful Rules and Regulations respecting the Territory . . . belonging to the United States,' may treat Puerto Rico differently from States so long as there is a rational basis for its actions." (per curiam); *Califano*

[8] Overall, see: Barry Bosworth and Susan M. Collins, "Economic Growth," in Susan M. Collins, Barry P. Bosworth, and Miguel A. Soto-Class, eds., *The Economy of Puerto Rico: Restoring Growth* (Brookings: Washington, DC, 2006), pp. 17-81; Federal Reserve Bank of New York, *Report on the Competitiveness of Puerto Rico's Economy*, 2012, available in English at http://www.newyorkfed.org/regional/puertorico/index.html; Abek, Jaison R. and Deitz, Richard, "*Puerto Rico's population exodus is all about jobs*," USA Today. March 11, 2012; "Population Lost: Puerto Rico's Troubling Out-Migration," Liberty Street Economics, New York Federal Reserve Bank, April 13, 2015, http://libertystreeteconomics.newyorkfed.org/2015/04/population-lost-puerto-ricos-troubling-out-igration.html.

v. Torres, 435 U.S. 1, 5 (1978) (per curiam) (same). This allows Congress, for example, to cap funding for the federal portion of Medicaid applicable to territories such as Puerto Rico, but leave it open-ended for the States.[9]

Puerto Rico's Recovery Act of 2014 represents a local, legislative escape hatch to this implosion. While the relationship cannot be ascertained as causal, the correlation of facts is there: it shows that once Congress removed Puerto Rico from bankruptcy protection in 1984, the innate balances between debtors and creditors in-built into the Code disappeared, and municipal debt increasingly bloated and is now dragging the government down. While the Act is not a total panacea, it was intended to ameliorate the fiscal situations of several distressed Puerto Rican public corporations whose combined deficit in 2013 totaled $800 million, and whose combined debt reached $20 billion. Recovery Act, Stmt. of Motives, § A.

The First Circuit found, nonetheless, that said effort was precluded by § 903(1) of the Code. The decision is *sui generis*, since States, unlike Puerto Rico, can avail themselves of Chapter 9 of the Code, and can authorize municipalities and public corporations to restructure their debt under it: they do not

[9] The maximum statutory matching rate for Medicaid is 83%. Mississippi has the highest matching rate (74.17%), while the matching rate for Puerto Rico is capped at 55%. CRS Report R43847, *Medicaid's Federal Medical Assistance Percentage (FMAP), FY2016*, by Alison Mitchell.

need a Recovery Act. As a result, the Commonwealth is now precluded not only from authorizing its municipalities to restructure their debts under Chapter 9, but from enacting any law allowing it to restructure its public debt as a matter of state law.

II. AN ALTERNATIVE APPROACH

A. The 1984 Amendments to the Code

Judge Torruella's concurrence, however, would not have left Puerto Rico helpless to deal with its hapless fiscal crisis. The concurring opinion thought the preemption rationale inappropriate because prior to deciding the preemption issue, the Judge would have first deemed unconstitutional Puerto Rico's exclusion from the Bankruptcy Code. If so, recourse to the Recovery Act would be moot, because public corporations would have direct access to Chapter 9 of the Code. Judge Torruella would have found the Code unconstitutional on two grounds. First, because the 1984 exclusion of Puerto Rico breached the uniformity requirement of the Bankruptcy Clause of the Constitution.[10] Second, because the 1984 amendment did not meet rational scrutiny under the Equal Protection Clause.

Amicus wishes to supplement Judge Torruella's reading. He underscores, first, the absence of reasons

[10] U.S. Const. art. I, § 8, cl. 4: "The Congress shall have Power To . . . establish . . . uniform Laws on the subject of Bankruptcies throughout the United States . . ."

justifying the change of law. All parties agree that prior to 1984, Congress had granted Puerto Rico the statutory right enjoyed by all States to authorize its municipalities to file for Chapter 9 relief pursuant to Section 109(c). 11 U.S.C. § 109(c). To correct an unintended omission in the 1978 version of the Code, in 1984, Congress re-introduced a definition of "State" to the Code. See Bankruptcy Amendments and Federal Judgeship Act of 1984, codified at 11 U.S.C. § 101(52)). The reinstated definition of § 101(52) defines "State" to "include . . . Puerto Rico" but unlike previous versions of the definition of "State," the 1984 version added the language "except for the purpose of defining who may be a debtor under chapter 9 of [the Bankruptcy Code]." *Id*. This amendment was itself unrelated to the primary purpose of the Bankruptcy Amendments and Federal Judgeship Act of 1984, which principally aimed to respond to the Court's decision in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co*., 458 U.S. 50 (1982), which had held unconstitutional the Code's new system of bankruptcy courts and judges. The end result was that the Commonwealth ceased having the legal capacity to authorize its municipalities to seek federal bankruptcy relief under Chapter 9 and municipalities and public utilities were deprived of their prior right to restructure their debt. 11 U.S.C. §§ 101(40), 101(52), 109(c).

B. Puerto Rico's Removal from the Code Does Not Meet Rational Scrutiny

In a series of cases known collectively as the *Insular Cases*, the Supreme Court determined that Puerto Rico was an unincorporated territory, as opposed to an incorporated territory, and as such, "only fundamental constitutional rights extend to unincorporated United States territories," *Balzac v. Puerto Rico*, 258 U.S. 298 (1922). Under the non-incorporation doctrine, Congress can discriminate against the territory and its citizens so long as there exists a rational basis for such disparate treatment. See *Califano v. Torres*, 435 U.S. 1 (1978); *Harris v. Rosario*, 446 U.S. 651 (1980).

Following Puerto Rico's adoption of its own Constitution in 1952, however, the judiciary has questioned whether the non-incorporation doctrine requires the same wooden application of rational scrutiny to all socio-economic legislation affecting the island. As noted in *Examining Board v. Flores de Otero*, 426 U.S. 572, 594 (1976), "[The] purpose of Congress in the 1950 and 1952 legislation was to accord to Puerto Rico the degree of autonomy and independence normally associated with a State of the Union." Later, in 1981, then First Circuit Judge Breyer observed that while "prior to 1950 Puerto Rico's legal status was closer to that of a 'territory' than that of a 'state'," after 1952 "Puerto Rico's status changed from that of a mere territory to the unique status of Commonwealth." *Cordova & Simonpietri Ins. Agency Inc. v. Chase Manhattan Bank*, 649 F.2d

36, 40-41 (1st Cir. 1981). As a result of said change, "the federal government's relations with Puerto Rico changed from being bounded merely by the territorial clause, and the rights of the people of Puerto Rico as United States citizens, to being bounded by the United States and Puerto Rico Constitutions, Public Law 600, the Puerto Rican Federal Relations Act and the rights of the people of Puerto Rico as United States citizens." *Id.*

Amicus notes that unlike the public welfare cases, *Torres* and *Harris*, the instant case does not involve the distribution of benefits under federal programs, but the application of the bankruptcy safeguards to Puerto Rico. In *Torres* and *Harri*s, the Court focused on three economic factors as justifying the uneven application of the Aid to Families with Dependent Children program (AFDC), 42 U.S.C. §§ 601 *et seq*. These factors were that residents of Puerto Rico did not contribute to the federal treasury; that the cost of treating Puerto Rico as a State under the statute would be high; and that greater benefits could disrupt the Puerto Rican economy. *Harris*, 446 U.S. at 652; *Torres*, 435 U.S. at 5, n. 7. At present, however, the Court is not faced with a factual scenario requiring the application of rational scrutiny to differences in social expenditures. Insofar as the elimination of Puerto Rico from the Code in 1984 is not grounded on any of these economic considerations, their absence here signals to the lack of rationality motivating the removal of Puerto Rico from the Code.

If anything, recent judicial developments point to the inclusion of Puerto Rico into the full economic orbit of the United States. In *Trailer Marine Transp. Corp. v. Rivera Vázquez*, 977 F.2d 1, 9 (1st Cir. 1992) ("*TMT*"), the First Circuit for the first time decreed the application of the dormant Commerce Clause to Puerto Rico, finding that "certainly since 1952 Puerto Rico has had sufficient effective autonomy to classify it as something more than the mere agent of Congress and thus bring it within the dormant Commerce Clause doctrine." According to the First Circuit, the central rationale of the dormant Commerce Clause doctrine is "to foster economic integration and prevent local interference with the flow of the nation's commerce. . . . Full economic integration is as important to Puerto Rico as to any state in the Union." (citations omitted). 977 F.2d at 8.

A recent federal District Court decision in Puerto Rico has expressly gone farther than *TMT*. After a detailed chronicle of the judicial pronouncements and legislative enactments pointing to the integration of the Puerto Rican society into the full social, cultural and economic orbit of the United States, it found that "a monumental constitutional evolution based on continued and repeated congressional annexation has taken place." It then held that Puerto Rico had moved from an unincorporated to an incorporated status, to which the Constitution applies in full force, except as to federal elections to the Presidency and Congress. See *Consejo de Playa de Ponce v. Rullán*, 586 F.Supp. 2d 22, 42-43 (D.P.R. 2008). Under this precedent, the

exclusion of Puerto Rico from the Bankruptcy Code would be both a Uniformity Clause and Equal Protection violation.

The latest indication that this Court may be willing to provide a closer scrutiny to legislation excluding Puerto Rico from its coverage was stated in *Boumediene v. Bush*, 553 U.S. 723, 128 S. Ct. 2229 (2008). The Court there made four crucial pronouncements regarding the *Insular Cases*. First, it recognized that the *Insular Cases* involved territories "*with wholly dissimilar traditions and institutions*" that Congress intended to govern only "*temporarily*". 128 S. Ct. at 2255. Second, the Court, citing Justice Brennan's concurrence in *Torres*, *supra*, held that "*[i]t may well be that over time the ties between the United States and any of its unincorporated territories strengthen in ways that are of constitutional significance.*" *Id.* at 2255 (emphasis added). Third, the Court recognized that fundamental constitutional rights apply to detained enemy combatant aliens in Guantanamo Bay, an unincorporated territory over which the United States has exercised jurisdiction or control for over 100 years. *Id.* at 2258-59. Finally, and most important, the Court held that:

> "Our basic charter cannot be contracted away like this. The Constitution grants Congress and the President the power to acquire, dispose of and govern territory, *not the power to decide when and where its terms apply.* Even when the United States acts outside its borders, its powers are not absolute and

> unlimited but are subject to such restrictions as are expressed in the Constitution. Abstaining from questions involving forward sovereignty and territorial governance is one thing. *To hold the political branches have the power to switch the Constitution on or off at will is quite another.*" *Id.* at 2259 (citation omitted) (emphasis added).

CONCLUSIONS

The foregoing discussion raises two distinctive points. It shows first that the 1984 amendments to the Bankruptcy Code were not the object of parliamentary deliberations nor even reflected in the legislative history of the measure excluding Puerto Rico from coverage under the Code. Accordingly, the exclusion of Puerto Rico from the benefits of Chapter 9 of the Code does not satisfy even rational scrutiny under the Equal Protection Clause. It argues, then, that the case law following Public Law 600 of 1950 and the enactment of the Commonwealth in 1952 suggests that there may have been a change of constitutional significance in the relationship of Puerto Rico to the United States that may warrant a closer look to the 1984 amendments excluding Puerto Rico from the Bankruptcy Act. On these grounds, *Amicus* submits that Judge Torruella's concurrence below

raises constitutional issues related to an adjudication of the question presented that merit closer attention by this Honorable Court.

In San Juan, Puerto Rico, this September 23, 2015.

Respectfully submitted,

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