

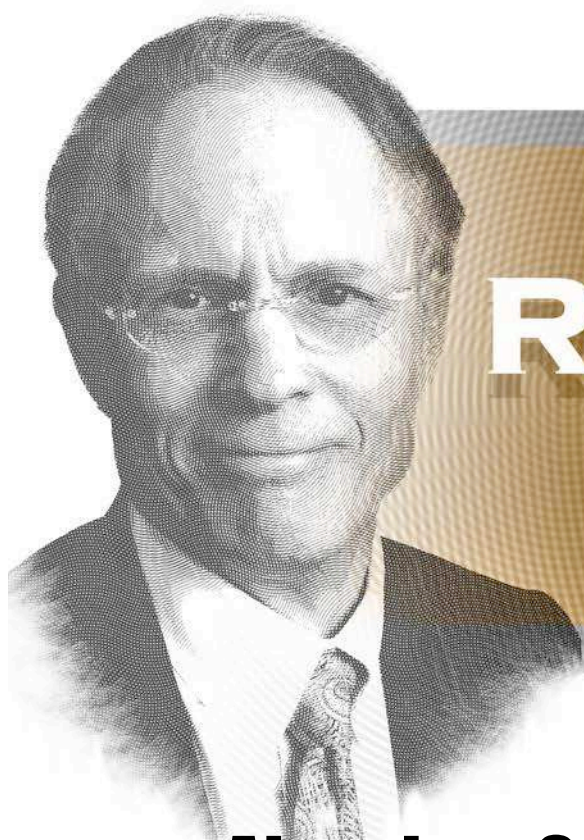
PRESENTED AT

35th Annual Jay L. Westbrook Bankruptcy Conference

November 17-18, 2016
Austin, Texas

Abundant Splits and Other Significant Bankruptcy Decisions

Bill Rochelle



ROCHELLE'S DAILY WIRE

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**35th Annual Jay L. Westbrook
Bankruptcy Conference
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Supreme Court



Last Term



Congress is the last resort for Puerto Rico to deal with looming debt default.

Supreme Court Invalidates Puerto Rico's Local Law for Municipal Debt Adjustment

The Supreme Court ruled by a vote of 5-2 that Congress both excluded Puerto Rico from chapter 9 municipal bankruptcy and precluded the island commonwealth from adopting local laws to deal with the insolvencies of its instrumentalities, such as municipal power and water companies.

The two dissenters said that “preemption here means that a government is left powerless and with no legal process to help its 3.5 million citizens.” They concluded their dissent by saying, “Statutes should not easily be read as removing the power of a government to protect its citizens.”

What the Opinion Means

In practical terms, Justice Clarence Thomas' June 13 majority opinion means that legislation by Congress is the last and only hope for Puerto Rico to avert a debt crisis. It is questionable whether Puerto Rico could even use some form of an equity receivership to keep the lights on and the water flowing.

To the dissenters' argument that Puerto Rico and its people “should not have to wait for possible congressional action,” Justice Thomas said that “our constitutional structure does not permit this Court to ‘rewrite the statute that Congress has enacted.’”

Two weeks in a row, the Supreme Court has handed down opinions allowing Puerto Rico's government to exercise less power than the states. Last week, the high court ruled in *Commonwealth of Puerto Rico v. Sanchez Valle* that the island does not have sovereign power like the states.

In the 6-2 opinion on June 9, Justice Elena Kagan held that Congress was the source of the island's sovereign powers to enact criminal laws, unlike the states, whose sovereign powers antedate the adoption of the Constitution. Consequently, the Court last week ruled that the Double Jeopardy Clause of the federal Constitution prohibits Puerto Rico, unlike a state, from prosecuting someone who had already pleaded guilty in federal court.



How Puerto Rico Was Excluded from Bankruptcy

Puerto Rico could have authorized its municipalities to use chapter 9 until the 1984 amendments to the Bankruptcy Code. For reasons it did not explain, Congress in that year prohibited Puerto Rico's instrumentalities from filing under chapter 9 when it wrote Section 101(52) of the Code to define "States" as including Puerto Rico, except for the purpose of deciding who is eligible for chapter 9. In turn, Section 109(c), referred to as the "gateway," provides that only a "municipality" can be a debtor in chapter 9. "Municipality" is defined in Section 101(40) as an instrumentality of a "State."

The definitions and cross-references mean that Puerto Rico's municipalities are ineligible for chapter 9, and the commonwealth has not argued otherwise.

No longer having access to federal bankruptcy courts, Puerto Rico still faces Section 903(1) of the Code, which says "State law" cannot bind non-consenting creditors to a debt adjustment.

Puerto Rico's Solution

Puerto Rico's governor admitted that the island is saddled with debts that are "not payable." Ineligible for chapter 9 municipal bankruptcy, Puerto Rico adopted its Public Corporation Debt Enforcement and Recovery Act in June 2014. The statute was structured so the island's public corporations could restructure debt in a manner akin to a chapter 9 debt adjustment.

That same month, bond funds affiliated with Franklin Resources Inc. and others sued the commonwealth in federal district court in Puerto Rico. In February 2015, a district judge in San Juan held that the Recovery Act was preempted by Section 903(1) of the Bankruptcy Code and therefore violated the Supremacy Clause of the U.S. Constitution on its face.

In what amounted to a 2-1 opinion in July 2015, the First Circuit held that the preemption of Puerto Rico's law was evident from the "plain meaning" of the Bankruptcy Code.

The Supreme Court granted *certiorari* at Puerto Rico's request, even though there was no split of circuits. The case was argued on March 22.

Justice Thomas' Majority Opinion

Puerto Rico presented the case to the Supreme Court as a question of statutory interpretation. The commonwealth did not contend there were residual sovereign or constitutional powers justifying the adoption of the Recovery Act. Consequently, the majority opinion does not address any theories other than statutory interpretation, while the dissenters only hint that the result could or should have been different under some notion of Puerto Rico's sovereignty or the equal protection rights of the island's residents.

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