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BANKRUPTCY - PUERTO RICO

Franklin California Tax-Free Trust v. Puerto Rico

United States Court of Appeals, First Circuit - July 6, 2015 - F.3d - 2015 WL 4079422

Investors commenced action against Commonwealth of Puerto Rico, its Governor, its Secretary of Justice, and Government Development Bank to challenge validity of Puerto Rico Public Corporation Debt Enforcement and Recovery Act, Puerto Rico's own municipal bankruptcy law, and enjoin its implementation. The United States District Court permanently enjoined Recovery Act on ground that it was preempted. Defendants appealed.

The Court of Appeals held that:

- Recovery Act was preempted;
- Presumption against preemption was overcome; and
- Conflict preemption principles preempted Recovery Act.

Puerto Rico Public Corporation Debt Enforcement and Recovery Act, which was Puerto Rico's own municipal bankruptcy law, was preempted by provision in Bankruptcy Code stating that state law prescribing a method of composition of indebtedness of a municipality may not bind any creditor that does not consent to such composition. All municipalities seeking reorganization had to do so under federal law.

Presumption against preemption of Puerto Rico Public Corporation Debt Enforcement and Recovery Act, which was Puerto Rico's own municipal bankruptcy law, to the extent it applied, was overcome by provision in Bankruptcy Code stating that Puerto Rico was to be treated like a state, except for the power to authorize its municipalities to file under Chapter 9.

Conflict preemption principles preempted Puerto Rico Public Corporation Debt Enforcement and Recovery Act, which was Puerto Rico's own municipal bankruptcy law, since Congress wanted single federal law to be the sole source of authority if municipal bondholders were to have their rights altered without their consent, but Recovery Act frustrated that purpose.