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Supreme Court Rejects Puerto Rico Law in Debt Restructuring Case.

WASHINGTON — The Supreme Court on Monday rejected an effort in Puerto Rico to allow public utilities there to restructure \$20 billion in debt, striking down a 2014 Puerto Rico law.

Justice Clarence Thomas, writing for the majority in the 5-to-2 decision, said the law was at odds with the federal bankruptcy code, which bars states and lower units of government from enacting their own versions of bankruptcy law.

Puerto Rico is struggling with \$72 billion in debt and has argued that it needs to restructure at least some of it under Chapter 9, the part of the bankruptcy code for insolvent local governments. But Puerto Rico is not permitted to do so, because Chapter 9 specifically excludes it, although it is unclear why.

In 2014, the island tried to get around that exclusion by enacting its own version of a bankruptcy law, intended for its big public utilities, which account for about \$26 billion of the total debt. But that attempt, called the Recovery Act, ran afoul of the part of the code that says only Congress may enact bankruptcy laws.

Puerto Rican officials had argued that the Recovery Act addressed a gap in the way its debts are treated. Under the bankruptcy code, they said, states may authorize their cities, counties, public utilities and other branches of government to restructure their debts under Chapter 9 of the code. But that law excludes Puerto Rico and all branches of its government, including its public utilities.

Utility creditors challenged the Recovery Act in federal court, arguing that the bankruptcy code displaced, or pre-empted, it. The justices agreed.

The federal law, Justice Thomas wrote, “bars Puerto Rico from enacting its own municipal bankruptcy scheme to restructure the debt of its insolvent public utilities.” Chief Justice John G. Roberts Jr. and Justices Anthony M. Kennedy, Stephen G. Breyer and Elena Kagan joined him.

Justice Thomas wrote that the decision was compelled by a straightforward reading of the federal law.

In dissent, Justice Sonia Sotomayor, joined by Justice Ruth Bader Ginsburg, said the majority’s approach was too mechanical and failed to take into account the purpose of the bankruptcy law and the impact of its decision. The Recovery Act, she wrote, “is the only existing legal option for Puerto Rico to restructure debts that could cripple its citizens.”

“The Commonwealth of Puerto Rico and its municipalities are in the middle of a fiscal crisis,” she wrote. “The combined debt of Puerto Rico’s three main public utilities exceeds \$20 billion. These utilities provide power, water, sewer and transportation to residents of the island.”

“With rising interest rates and limited access to capital markets, their debts are proving

unserviceable. Soon, Puerto Rico and the utilities contend, they will be unable to pay for things like fuel to generate electricity, which will lead to rolling blackouts,” Justice Sotomayor added. “Other vital public services will be imperiled, including the utilities’ ability to provide safe drinking water, maintain roads and operate public transportation.”

The majority’s approach ignores those realities, she wrote, “rejects contextual analysis in favor of a syllogism” and leaves Puerto Rico “powerless and with no legal process to help” its citizens.

Pedro Pierluisi, Puerto Rico’s nonvoting member of Congress, said: “The practical significance of the court’s holding is crystal clear. Only Congress can provide the Puerto Rico government with the authority to restructure its debts.” He said action by Congress “is essential if the territory is going to overcome its severe — and worsening — economic, fiscal and demographic crisis.”

The case has been vexing for all parties because when Congress amended the bankruptcy code to exclude Puerto Rico, in 1984, it left no written record explaining why. Yet the rule barred the island from the only way under United States law that a debtor can legally reduce debt over the objections of creditors.

Besides passing its own bankruptcy law in 2014, Puerto Rico tried to persuade Congress to delete the 1984 exclusion. It said the provision was inexplicable and may have been inserted by mistake.

Those arguments did not sway Congress. But last year lawmakers realized the United States Constitution gave them the power to “make all needful rules and regulations” for territories, including Puerto Rico. Using that approach, the House of Representatives passed a quasi-bankruptcy bill this month that would apply to all territories (though only Puerto Rico is in dire need at the moment).

Obama administration officials have expressed hope that the Senate will take up the measure quickly and enact it before July 1, when Puerto Rico is supposed to make debt payments totaling nearly \$2 billion. It is expected to default, which would normally prompt creditors to sue. As now drafted, the bill would stay such lawsuits, put Puerto Rico under federal oversight and give it other legal powers similar to those found in bankruptcy.

In the majority opinion, Justice Thomas noted that Puerto Rico had also been seeking help from Congress. “After the parties briefed and argued these cases,” he wrote, “members of Congress introduced a bill in the House of Representatives to establish an oversight board to assist Puerto Rico and its instrumentalities,” adding that “the bill does not amend the federal bankruptcy code.”

Justice Sotomayor responded that “the government and people of Puerto Rico should not have to wait for possible congressional action to avert the consequences of unreliable electricity, transportation and safe water — consequences that members of the executive and legislature have described as a looming ‘humanitarian crisis.’”

Justice Samuel A. Alito Jr. recused himself from the cases, *Puerto Rico v. Franklin California Tax-Free Trust*, No. 15-233, and *Acosta-Febo v. Franklin California Tax-Free Trust*, No. 15-255. As is the court’s custom, he did not explain why.

THE NEW YORK TIMES

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JUNE 13, 2016

