

# **Bond Case Briefs**

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## **Supreme Court Validates PR Financial Oversight Board, but Challenges Remain: Skadden**

Since PROMESA was enacted in 2016 to pave the way for a comprehensive restructuring of Puerto Rico's mounting municipal debt obligations, the U.S. District Court for the District of Puerto Rico (District Court) has become a haven for litigious groups of creditors and other constituencies. Undoubtedly frustrated with the progress and trajectory of the cases of the commonwealth and its subsidiaries, these groups have mounted a number of complex legal attacks to the efficacy and validity of PROMESA. However, the debtors recently secured a significant win in *Fin. Oversight & Mgmt. Bd. for P.R. v. Aurelius Investment, LLC, No. 18-1334*, when the U.S. Supreme Court, reversing a decision of the U.S. Court of Appeals for the First Circuit, concluded that the appointment of the members of the Financial Oversight and Management Board (Oversight Board) — the debtors' statutory representative under PROMESA — passed constitutional muster.

### **Background**

In 2016, Puerto Rico faced a dilemma: It was burdened by a seemingly insurmountable debt load, yet because Chapter 9 of Title 11 of the United States Bankruptcy Code only permits municipalities of states to declare bankruptcy, it was unable to restructure that debt under the traditional avenue for municipal bankruptcy relief. In response, Congress enacted the Puerto Rico Oversight, Management and Economic Stability Act (PROMESA). PROMESA created the Oversight Board and authorized it to, among other things, commence bankruptcy proceedings under the statute on behalf of the commonwealth and its instrumentalities. PROMESA also vests the Oversight Board with significant, sometimes final, authority over the various debtor entities. For example, the Oversight Board — and not the municipal debtors themselves — is the statutory representative of the debtor entities in bankruptcy. Pursuant to the statute, the members of the Oversight Board were appointed by President Obama, without subsequent confirmation of those appointees by the Senate. The Oversight Board commenced restructuring proceedings on behalf of the commonwealth and five of its instrumentalities (PROMESA Cases) in the District Court.

Shortly thereafter, a group of creditors filed a motion to dismiss the PROMESA Cases, contending that President Obama's appointment of the members of the Oversight Board violated Article II, Section 2, Clause 2 of the United States Constitution (Appointments Clause), which provides that the president "shall nominate, and by and with the Advice and Consent of the Senate, shall appoint Ambassadors, other public Ministers and Consuls, Judges of the supreme Court, and all other Officers of the United States ... ." The District Court denied the motion. The First Circuit subsequently reversed, concluding that the appointment process did violate the Appointments Clause. However, the court ultimately found that the actions of the Oversight Board taken to that point were valid under the de facto officer doctrine.<sup>1</sup>

### **Opinion**

Writing for a unanimous court, Justice Stephen G. Breyer<sup>2</sup> began by concluding that the Appointments Clause, by its plain language, directly applied to the appointment of all "Officers of

the United States,” including those exercising power in, or in relation to, Puerto Rico. *See* Slip Op. at 8-9. However, the Court explained that this conclusion was not dispositive, next addressing whether or not the members of the Oversight Board fell within the purview of the “Officers of the United States” covered by the Appointments Clause. *See id.* at 9. Justice Breyer read the text to suggest a distinction between “federal officers” exercising powers on behalf of the national government, and officers exercising authority on behalf of “some other government” — which, based on the federalist structure envisioned by the Constitution, included local (usually state) governments. *See id.* at 9. Noting the unique way that territories such as Puerto Rico fit into this federalist structure, the Court explained that Congress had in fact been given the power to establish localized governance constructs on behalf of territories that were unable to do so on their own (i.e., non-states). *See id.* at 9-10 (citing Const. Art. I, § 8, cl. 17; Const. Art. IV, § 3, cl. 2).<sup>3</sup> Justice Breyer explained that this clearly contemplated a distinct, localized exercise of authority. *See id.* at 10. And indeed, the Court noted that these powers had long been used to create and fill government offices on behalf of U.S. territories without resort to the process contemplated by the Appointments Clause, and that even Puerto Rico itself had a long-standing history of doing so. *See id.* at 10-13. Justice Breyer explained that this reflected an underlying trend of permitting such actions to be taken outside of the strict constitutional appointment construct for “federal officers” where the officers and their corresponding duties were “primarily local” in nature. *See id.* at 14.

Thus, Justice Breyer proceeded to examine whether the statutory mandate and authority of the Oversight Board were primarily local in nature; the Court held that they were. *See id.* The Court reasoned that the Oversight Board was the statutory representative of the commonwealth and its instrumentalities, effectively all of its powers and responsibilities were circumscribed by Puerto Rican — not federal — law, and it carried out its duties in conjunction with existing commonwealth government officials. *See id.* at 15-17. That the Oversight Board’s actions in the realm of PROMESA might have broader, national consequences was irrelevant. *See id.* at 16. In light of the Oversight Board’s “primarily local duties,” the Court held that the selection of the board’s members “is not subject to the constraints of the Appointments Clause.” *See id.* at 17.<sup>4</sup>

## Conclusion

PROMESA is a unique response to a unique event in modern American history — the solution to crippling municipal debts of an American territory. As such, the statute and structure of the PROMESA process, such as the validity of the Oversight Board appointments, have been subject to numerous legal challenges. While the Supreme Court upheld the validity of the Oversight Board and its appointments, other challenges remain. Indeed, only several weeks ago an insurer of certain Puerto Rican bonds filed a complaint contesting the constitutionality of the PROMESA statute itself.<sup>5</sup> This challenge, brought by bond insurer Ambac Assurance, asserts that the PROMESA statute violates the Constitution’s uniformity requirements with respect to bankruptcy legislation. The complaint argues that while the Constitution gives Congress plenary power to legislate on the subject of bankruptcy, such legislation must be uniform and not favor a specific debtor, such as the PROMESA debtors. Whether this latest attack will gain any traction with District Court Judge Laura Taylor Swain remains to be seen, but practitioners and interested parties are wise to continue to pay close attention to the continuing proceedings challenging the PROMESA process and structure.

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<sup>1</sup> As the First Circuit explained, the doctrine “‘confers validity upon acts performed by a person acting under the color of official title even though it is later discovered that the legality of that person’s appointment ... to office is deficient.’” *See Aurelius Inv., LLC v. Puerto Rico*, 915 F.3d 838, 862 (1st Cir. 2019) (citation omitted). The court applied the doctrine based on its conclusion that (1) the Oversight Board members acted in the good faith belief that they had the requisite authority

under PROMESA and (2) unwinding the PROMESA Cases would jeopardize the substantial progress made by the commonwealth and its instrumentalities to date, along with the livelihood of Puerto Rican citizens.

2 The Court's decision was unanimous, but Justices Clarence Thomas and Sonia Sotomayor wrote separate concurring opinions.

3 The latter is known as the Territorial Clause, which provides in full: "The Congress shall have Power to dispose of and make all needful Rules and Regulations respecting the Territory or other Property belonging to the United States; and nothing in this Constitution shall be so construed as to Prejudice any Claims of the United States, or of any particular State." *See* Const. Art. IV, § 3, cl. 2. The First Circuit's decision rested largely on its conclusion that the Territorial Clause did not trump the Appointments Clause. *See Aurelius*, 915 F.3d at 855.

4 In doing so, the Court rejected the First Circuit's analysis as dependent on case law examining the clause's role in the appointment of officers exercising primarily federal duties. *See id.* at 18. The Court seemed to reject an approach that emphasized the legal source of those duties — *i.e.*, state or federal law — instead focusing on the level at which those duties are exercised — *i.e.*, "primarily local" in nature. *See id.*

5 *See* Complaint, *Ambac Assurance Corp. v. Fin. Oversight & Mgmt. Bd. for P.R. (In re Fin. Oversight & Mgmt. Bd. for P.R.)*, Case No. 17-03283 (LTS), Adv. Proc. No. 20-00068 (LTS) (D.P.R. May 26, 2020), ECF No. 1.

**Skadden Arps Slate Meagher & Flom LLP** – Julie E. Cohen, Joseph O. Larkin, Stephen J. Della Penna and Steve Walsh

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