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PERSPECTIVE

Puerto Rico's last stand extinguished

By Robbin L. Itkin and Alexandra Kelly

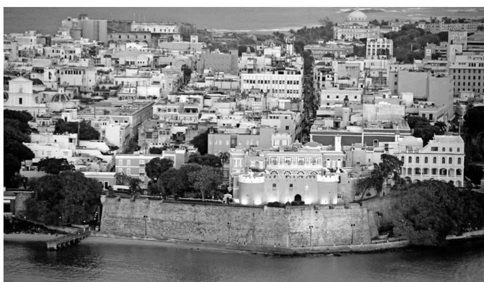
Puerto Rico's last opportunity to navigate a self-determined path out of financial distress was all but extinguished by the U.S. Supreme Court on Monday in its rulings on The Commonwealth of *Puerto Rico v. Franklin California Tax-Free Trust* and *Melba Acosta-Febo v. Franklin California Tax-Free Trust cases*. 2016 DJDAR 5671. In these cases, the Supreme Court invalidated the Puerto Rico Corporate Debt Enforcement and Recovery Act, which was enacted by Puerto Rico in 2014 to address the nearly $70 billion in outstanding municipal debt crippling the territory's economy. Puerto Rico formulated and passed the act because the federal Bankruptcy Code explicitly excludes Puerto Rico from seeking relief under Chapter 9, the section dedicated to municipal restructurings.

The Recovery Act was Puerto Rico's answer to Chapter 9, and was in essence a Puerto Rico-specific statute that mimicked to a large degree the framework set forth in Chapters 9 and 11 of the Bankruptcy Code to restructure debt. In striking down the statute, the Supreme Court found that Puerto Rico was bound by the preemption provision of Chapter 9 of the Bankruptcy Code, which prohibits states from enacting their own municipal bankruptcy schemes.

Statutory Analysis

Justice Clarence Thomas's opinion in *Puerto Rico* required a detailed analysis of three separate provisions of the Bankruptcy Code: Section 109(c), the "who may be a debtor" provision which requires certain state pre-authorization before a municipality may access Chapter 9 relief; Section 903(1), the preemption provision of Chapter 9 which prohibits states from enacting their own insolvency regimes; and Section 101(52), which defines "State" to include Puerto Rico, "except for the purpose of defining who may be a debtor under Chapter 9." In turn, Section 109(c) provides, in pertinent part, that an entity may be a debtor under Chapter 9 if, among other things, it is a municipality, *and* "is specifically authorized … to be a debtor under such chapter by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor."

Puerto Rico argued that its exemption from the definition of "State" for purposes of "defining who may be a debtor under Chapter 9" should be read to exclude Puerto Rico from the provisions of Chapter 9 altogether, including the preemption provision. The Supreme Court, in a 5-2 decision, found otherwise, and held that by a clear reading of the statute, Puerto Rico should only be excluded from the definition of "State" in 101(52) for purposes of Section 109(c)(the "who may be a debtor" provision described above), but is otherwise subject in all respects to Chapter 9. The court further opined that no public policy considerations could alter its precise reading of the statute and the clear congressional intent attendant thereto. Thus, the Recovery Act is pre-empted by the Bankruptcy Code and, because it is void, cannot be utilized by Puerto Rico to address its unsustainable debt load.


New York Times
Old San Juan, Puerto Rico

What Now?

The Recovery Act likely represented Puerto Rico's final attempt to independently deleverage and effect a capital restructure free of federal government meddling. Without the act, Puerto Rico's fragile economy rests solely in Congress' hands and immediate action by the legislature must be taken. In addition to general mounting instability in Puerto Rico's economy, specific threats of hospital closures and utility shutdowns loom and Puerto Rico faces a July 1 deadline for a nearly $2 billion payment under its bonds.

The U.S. House of Representatives overwhelmingly passed the Puerto Rico Oversight, Management and Economic Stability Act (PROMESA) last week, through broad bipartisan effort, which would provide an independent board appointed by Congress to manage Puerto Rico's finances and oversee any proposed debt restructuring. Under PROMESA, Puerto Rico would be granted a grace period under its existing debts through at least February 2017, during which time creditors could not sue to enforce their claims. PROMESA would further authorize Puerto Rico to pursue a court-monitored restructuring so long as the independent board determines that good faith negotiations with creditors precipitated any proposed restructuring. The board will also wield significant advisory power over the territory's finances and budgets, with a view towards implementation of a stringent austerity agenda. In connection with the austerity plan, PROMESA will effect a hefty reduction in the minimum wage for workers under the age of 25.

Proponents of PROMESA view it as necessary means to address an imminent disaster with no easy fix; critics view it as poorly cloaked colonialism which further erodes the territory's sovereignty and the Puerto Rican people's status and dignity. As stated by Pedro Pierluisis, Puerto Rico's non-voting resident commissioner in Congress, "so long as my constituents are treated like second-class citizens, Puerto Rico will never have a first-class economy." Certain Puerto Rican advocacy groups and Puerto Rican elected officials have joined forces to seek stronger protections for the territory under PROMESA, including the ability to require that certain members of the independent board be appointed by Puerto Rico. Although the exact framework specified by PROMESA may be in flux, in light of the approaching bond payment deadline, the Senate is likely to act quickly to review and vote on PROMESA so that, if passed, President Barack Obama can sign it into law before July 1.

PROMESA is ambitious in its reach — by design, it is intended to be both retrospective in providing a framework to address existing debt, as well as prospective in mandating rigorous oversight of the Puerto Rican economy to prevent recidivistic conduct that could lead to future financial distress. Whether it can achieve its lofty goals remains to be seen.

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