

# Legislative Update

BY REP. PEDRO R. PIERLUISI

## A Lifeline for Puerto Rico

**Editor's Note:** *In this month's Update, Puerto Rico's representative in Congress, Resident Commissioner Pedro R. Pierluisi, makes the case for his legislation to authorize chapter 9 for the territory.*

Puerto Rico, a U.S. territory home to approximately 3.5 million American citizens that I represent in Congress, is mired in an economic crisis that has generated considerable attention in recent months. The chronicle of how Puerto Rico got into this situation is complex and contains many chapters, but a single theme — inequality — runs throughout the narrative.

Even though federal law is supreme in Puerto Rico, the territory lacks meaningful representation at the federal level. My constituents cannot vote for their president, are not represented in the Senate (where every member wields tremendous power), and have a single non-voting delegate in the House. In this position, I can introduce bills and vote in committee, but I cannot vote on the House floor. Accordingly, Puerto Rico has limited capacity to use the political process to protect and promote its interests, which is the essence of our democratic system of government. If Puerto Rico were a state, it would have seven votes in the electoral college, two senators and five voting representatives in the House.

Moreover, the U.S. Supreme Court has held that Congress can treat territories differently than states as long as it has a rational basis for doing so — the lowest level of constitutional scrutiny. Congress regularly enacts legislation that treats Puerto Rico worse than the states, and no federal court in the modern era has invalidated such a law on the grounds that it fails the rational-basis test. Think of any federal social safety-net program, from Medicaid to the earned income tax credit program, and Puerto Rico is either treated unfairly or excluded entirely.

In order to compensate for this shortfall in economic support from Washington, D.C., Puerto Rico has borrowed heavily in the capital market, and local officials have not always put this money to productive use. Historically, there has been a high demand for bonds issued by U.S. territories because the yields are relatively high, plus Congress has decreed that the interest income generated on those bonds is not taxable at the federal, state or local level — regardless of where the investor resides.

Puerto Rico currently has about \$72 billion in public debt, which is roughly equal to the territory's gross national product (GNP). (The size of Puerto

Rico's economy is typically measured on the basis of GNP rather than gross domestic product.) It bears emphasizing that the debt structure is not monolithic, and about 17 entities in Puerto Rico have bonds outstanding. These include general obligation bonds issued by the central government, bonds backed by sales tax revenue, and bonds issued by the territory's public corporations, such as the electric power authority (PREPA), the water and sewer authority (PRASA), and the highway and transportation authority (PRHTA). These three public corporations are in different stages of financial distress and together have about \$20 billion in debt.

As readers might be aware, through chapter 9 of the U.S. Bankruptcy Code, Congress has empowered each state government to authorize a "municipality" within its borders to adjust its debts, with the term "municipality" defined as a "political subdivision or public agency or instrumentality of a State."<sup>1</sup> A state government may authorize — or decline to authorize — its insolvent municipalities to file for chapter 9 protection. The power to decide rests with the state government.<sup>2</sup>

Puerto Rico is treated like a state in every chapter of the Bankruptcy Code except for chapter 9. There is a general consensus that between 1938-84, Puerto Rico had the power to authorize its municipalities to adjust their debts.<sup>3</sup> However, in 1984, in the Bankruptcy Amendments and Federal Judgeship Act, Congress expressly excluded Puerto Rico from the ability to file for chapter 9.<sup>4</sup> As the First Circuit Court of Appeals observed in a recent decision, the legislative history does not reveal why Puerto Rico was excluded. One of the judges described it rather poetically: "[T]here is no legislative record on which to rely for determining Congress's reasons behind the 1984 Amendments. A tracing of its travels through the halls of Congress sheds less light than a piece of coal on a moonless night regarding the reason for its enactment."<sup>5</sup>



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<sup>1</sup> See 11 U.S.C. §§ 101(52) and 109(c) (emphasis added).

<sup>2</sup> See Daniel G. Egan, Emily J. Tidmore, George B. South III, H. Slayton Dabney Jr., Marc A. Levinson and Patrick Darby, *Municipalities in Peril: The ABI Guide to Chapter 9* (ABI, 2d ed. 2012) (appendix describes each state's current approach to chapter 9). This publication is available for purchase in the ABI Bookstore at [abi.org/bookstore](http://abi.org/bookstore).

<sup>3</sup> See *Franklin California Tax-Free Trust v. Commonwealth of Puerto Rico*, Docket No. 15-1218 (1st Circuit 2015) (concluding that "at least from 1938 until the modern Bankruptcy Code was introduced in 1978, Puerto Rico, like the states, could authorize its municipalities to obtain federal municipal bankruptcy relief," further concluding that "although the modern Code omitted a definition of the term 'State' from its enactment in 1978 until it was re-introduced in 1984, most commentators agree that this did not affect Puerto Rico's ability during that time to provide its municipalities authorization"). This opinion is available at [media.ca1.uscourts.gov/pdf/opinions/15-1218P-01A.pdf](http://media.ca1.uscourts.gov/pdf/opinions/15-1218P-01A.pdf).

<sup>4</sup> The relevant language added by Congress in 1984 is as follows: "The term 'State' includes the District of Columbia and Puerto Rico, except for the purpose of defining who may be a debtor under chapter 9 of this title." 11 U.S.C. § 101(52).

<sup>5</sup> See *Franklin California Tax-Free Trust v. Commonwealth of Puerto Rico*, Docket No. 15-1218 (1st Circuit, 2015) (Torruella, J., concurring).

Puerto Rico's exclusion from chapter 9 led the territory's government to enact local legislation called the "Puerto Rico Public Corporation Debt Enforcement and Recovery Act" in July 2014. The Recovery Act sought to authorize certain Puerto Rico municipalities to adjust their debts, including PREPA, PRASA and PRHTA.

Multiple investment firms that own PREPA bonds sued the Puerto Rico government, arguing that the Recovery Act, which differs from chapter 9 in multiple respects, violates the U.S. Constitution. On Feb. 6, 2015, a U.S. district court judge in Puerto Rico held that the Recovery Act is pre-empted by the U.S. Bankruptcy Code and is therefore invalid under the Supremacy Clause of the Constitution. In addition, the district court declined to dismiss the investment firms' claims that the Recovery Act violates the Contracts Clause and the Takings Clause of the Constitution. On July 6, 2015, the First Circuit affirmed the district court's decision invalidating the Recovery Act. The federal appeals court concluded that "Congress preserved to itself that power to authorize Puerto Rican municipalities to seek Chapter 9 relief." According to the court, Puerto Rico has only one option: To "turn to Congress for recourse."<sup>6</sup>

In July 2014 (after the Puerto Rico government enacted the Recovery Act) and again in February 2015 (after the federal district court invalidated the Recovery Act), I introduced the Puerto Rico Chapter 9 Uniformity Act in the House. On July 15, 2015, an identical bill was introduced in the U.S. Senate that would simply grant Puerto Rico a power that every state has and that Puerto Rico itself had for nearly half a century until Congress inexplicably removed it — namely, the power to authorize its municipalities to seek chapter 9 protection. Under the bill, Puerto Rico could seek to restructure the debts of its insolvent public corporations, not its central government.

The bill is supported by virtually all bankruptcy experts, including the National Bankruptcy Conference. It has been endorsed by major editorial boards and by individuals and organizations across the political spectrum. The vast majority of Puerto Rico's creditors support the bill or are agnostic toward it, while market participants without a direct financial stake in the outcome — such as credit-rating agencies and municipal bond research firms — generally view the bill in a positive light.<sup>7</sup>

However, the bill is opposed by a handful of investment firms who own bonds issued by PREPA. By and large, these are the same firms that sued the Puerto Rico government for

enacting the Recovery Act, insisting (correctly, as it turned out) that the only path for Puerto Rico to permit its municipalities to restructure debt is to seek inclusion in chapter 9. Yet these firms are now trying to block that solitary path. They may believe that such obstructionism is in their narrow self-interest, but it is clearly not in the broader public interest.

Opponents make two arguments against the bill, but neither withstands scrutiny. The first claim is that the bill constitutes a "bailout." Nothing could be further from the truth. The Congressional Budget Office confirms that the bill does not require the federal government to expend one cent. All the bill does is empower Puerto Rico, like the states, to authorize its municipalities to utilize an existing legal forum and legal framework.<sup>8</sup>

The second argument made by opponents is that the bill would apply to pre-existing debt and that such "retroactive" application would be unfair. This claim is extraordinarily weak. Numerous states do not authorize their municipalities to seek chapter 9 relief, but those states could provide authorization at any point in the future. Consider Georgia, which expressly prohibits its municipalities from filing a chapter 9 petition. If an investor purchases Atlanta bonds today, Atlanta does not have the option to file for chapter 9 protection if it becomes insolvent. However, if the city encounters financial difficulties, the Georgia legislature can authorize Atlanta to file for chapter 9, and pre-existing debt issued by the municipality would be subject to adjustment.

The same analysis obtains in the case of Puerto Rico. A bondholder who purchased a Puerto Rico municipal bond after 1984 should have known that Congress could (again) act to empower the Puerto Rico government to authorize its municipalities to file for chapter 9 — and that Puerto Rico could avail itself of this power. Any expectation to the contrary is objectively unreasonable. As sophisticated investors should know better than anyone, the governing law — whether federal or state — is not cast in stone.

Congress should enact the Puerto Rico Chapter 9 Uniformity Act into law. It is the right thing to do from a moral perspective and the prudent thing to do from a policy perspective. Passage of this bill would not resolve all of Puerto Rico's economic problems, but instead must be complemented by other reforms in both Washington, D.C., and San Juan. State-like treatment under chapter 9 is necessary but not sufficient. Ultimately, to reach its full potential, Puerto Rico must receive equal treatment in all respects by becoming a state of the Union. **abi**

<sup>8</sup> It is worth noting that conservative organizations and periodicals strongly supported chapter 9 for Detroit as an alternative to a "bailout" of the city. For example, a *National Review* editorial dated July 22, 2013, entitled "No Bailout for Detroit," concluded as follows: "All that is required of Washington is to let the federal courts work.... There will be plenty of pain to go around, and the agency best suited to divvying it up is a federal bankruptcy court." See [www.nationalreview.com/article/354045/no-bailout-detroit-editors](http://www.nationalreview.com/article/354045/no-bailout-detroit-editors).

<sup>6</sup> *Id.*

<sup>7</sup> For a list of statements in support of the bill, see [pierluisi.house.gov/media-center/press-releases/running-list-of-editorials-letters-and-statements-in-support-of-hr-870](http://pierluisi.house.gov/media-center/press-releases/running-list-of-editorials-letters-and-statements-in-support-of-hr-870).

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