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2017

## Nothing Left to Tax or Cut, the Gate to Chapter 9 is Shut: The Puerto Rico Debt Crisis

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### Recommended Citation

Bianca Ko, Nothing Left to Tax or Cut, the Gate to Chapter 9 is Shut: The Puerto Rico Debt Crisis, 50 Loy. L.A. L. Rev. 313 (2017).

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### Cover Page Footnote

J.D. Candidate, May 2017, Loyola Law School, Los Angeles; B.A., Physics, Columbia University in the City of New York, 2014. Thanks to Professor Anne Wells, to Alisa Lalana for her invaluable feedback, to Professor Aimee Dudovitz for her unrelenting encouragement throughout the writing process, to the members of Loyola of Los Angeles Law Review for their hard work, and to family and friends for their support.

# NOTHING LEFT TO TAX OR CUT, THE GATE TO CHAPTER 9 IS SHUT:<sup>1</sup> THE PUERTO RICO DEBT CRISIS

*Bianca Ko\**

## I. INTRODUCTION

The Commonwealth of Puerto Rico is more than \$73 billion in debt, and United States citizens on the island are suffering.<sup>2</sup> Puerto Rico has a 45% poverty rate, and its biggest public pension is over 99% underfunded.<sup>3</sup> Although its unemployment rate has dipped, the decline is mainly due to Puerto Ricans traveling to mainland United States to look for jobs or dropping out of the workforce altogether.<sup>4</sup> As of 2015, sales taxes were higher in Puerto Rico than any other U.S. state or territory.<sup>5</sup> Moreover, schools and hospitals in Puerto Rico have suffered as a result of this financial crisis, as the crisis has led to cutoffs of power and water, leading to closures of various facilities.<sup>6</sup>

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\* J.D. Candidate, May 2017, Loyola Law School, Los Angeles; B.A., Physics, Columbia University in the City of New York, 2014. Thanks to Professor Anne Wells, to Alisa Lalana for her invaluable feedback, to Professor Aimee Dudovitz for her unrelenting encouragement throughout the writing process, to the members of *Loyola of Los Angeles Law Review* for their hard work, and to family and friends for their support.

1. Star and creator of the Broadway musical *Hamilton* Lin-Manuel Miranda performed a rap with the lyric “Nothing left to tax or cut” in LastWeekTonight. *Puerto Rico: Last Week Tonight with John Oliver*, YOUTUBE (Apr. 23, 2016), [https://www.youtube.com/watch?v=Tt-mpuR\\_QHQ](https://www.youtube.com/watch?v=Tt-mpuR_QHQ).

2. Lyle Denniston, *Court to Rule on Puerto Rico Debt-Relief Options*, SCOTUSBLOG (Dec. 4, 2015, 2:35 PM), <http://www.scotusblog.com/2015/12/court-to-rule-on-puerto-rico-debt-relief-options>.

3. Nick Brown, *Puerto Rico Authorizes Debt Payment Suspension; Obama Signs Rescue Bill*, REUTERS (June 30, 2016), <http://www.reuters.com/article/us-puertorico-debt-idUSKCN0ZG09Y>. “Promesa” is the Spanish word for “promise.”

4. About 80,000 people left Puerto Rico between 2014 and 2015. Brian Chappatta, *Puerto Rico Economy Worsens with Crisis, Most Anywhere You Look*, BLOOMBERG POLITICS (Apr. 25, 2016, 2:00 AM), <http://www.bloomberg.com/politics/articles/2016-04-25/puerto-rico-economy-worsens-with-crisis-most-anywhere-you-look>.

5. Scott Beyer, *Puerto Rico, at 11.5%, Has America’s Highest Sales Tax*, FORBES (Aug. 17, 2015), <http://www.forbes.com/sites/scottbeyer/2015/08/17/puerto-rico-at-11-5-has-americas-high-sales-tax/#85c633254245>.

6. See generally, Mary Williams Walsh, *Puerto Rico’s Fiscal Fiasco Is a Harbinger of Mainland Woes*, N.Y. TIMES (May 10, 2016), <http://www.nytimes.com/2016/05/11/business/dealbook/puerto-ricos-fiscal-fiasco-is-harbinger-of-mainland-woes.html>.

Under Chapter 9, the United States Bankruptcy Code allows almost any territory to file for bankruptcy relief to restructure its debts.<sup>7</sup> In such a scenario, the government's municipality, or "political subdivision or public agency or instrumentality of a State,"<sup>8</sup> would file a voluntary petition.<sup>9</sup> Then, the municipal debtor would file a list of creditors.<sup>10</sup> There would be an automatic stay, which would stop collection actions against the debtor and its property.<sup>11</sup> After negotiating with its creditors, the municipal debtor would write a plan with debt adjustments and an outline of its future spending.<sup>12</sup> The bankruptcy court to which the case is assigned would confirm the plan.<sup>13</sup> After the plan is carried out, the municipal debtor would receive a discharge, which relieves it of its debt.<sup>14</sup>

Unfortunately, Puerto Rico does not have this safety net. In 1984, Congress amended the Bankruptcy Code to exclude the municipalities of Puerto Rico and the District of Columbia from bankruptcy eligibility.<sup>15</sup> Unable to restructure under the Bankruptcy Code, the Puerto Rican legislature designed and passed its own restructuring plan.<sup>16</sup> In response, Puerto Rico's creditors filed suit, alleging that, although Puerto Rico is excluded for the purposes of the definition of debtor in Chapter 9 of the Bankruptcy Code, 11 U.S.C. § 903(1) pre-empts the restructuring plan.<sup>17</sup>

*Puerto Rico v. Franklin California Tax-Free Trust*<sup>18</sup> asked the Supreme Court of the United States to determine whether Puerto Rico may pass its own Recovery Act to restructure its own debts.<sup>19</sup> The Supreme Court answered this question by examining three provisions

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7. See 11 U.S.C. § 109(c) (2012).

8. 11 U.S.C. § 101(40) (2012).

9. 11 U.S.C. § 301(a) (2012). A "voluntary petition" is in contrast with an "involuntary petition," where, in bankruptcies under Chapters 7 or 11, three creditors may file an involuntary petition for a debtor. See, e.g., 11 U.S.C. § 303(b)(1).

10. 11 U.S.C. § 924 (2012).

11. 11 U.S.C. §§ 362(a), 901(a) (2012).

12. 11 U.S.C. § 941 (2012).

13. 11 U.S.C. § 943 (2012).

14. 11 U.S.C. § 944 (2012).

15. 11 U.S.C. § 101(52) (2012).

16. Puerto Rico Public Corporation Debt Enforcement and Recovery Act ("Recovery Act"), 2014 P.R. LAWS 71, *invalidated by* Puerto Rico v. Franklin Cal. Tax-Free Trust, 136 S. Ct. 1938 (2016).

17. Amended Complaint at 11, *Franklin Cal. Tax-Free Trust v. Puerto Rico*, 85 F. Supp. 3d 577 (2015) (No. 14-1518).

18. 136 S. Ct. 1938 (2016).

19. See *id.* at 1943.

in Title 11 (Bankruptcy) of the United States Code: the gateway provision,<sup>20</sup> the pre-emption provision,<sup>21</sup> and the provision that defines the term “States.”<sup>22</sup> In a 5-2 decision, the Court held that Puerto Rico is a “State” for purposes of the pre-emption provision,<sup>23</sup> stopping Puerto Rican municipalities from being able to file for bankruptcy.<sup>24</sup>

Part II of this Comment examines the background of *Franklin*, with emphasis on some of Congress’s tax policies and their historical effect on Puerto Rico’s economy, providing explanations for Puerto Rico’s bankruptcy. Part III discusses the Court’s reasoning in *Franklin*, in both the majority opinion and Justice Sotomayor’s dissent. Part IV explains the aftermath of the decision, including other efforts to provide relief to Puerto Rico. Part V ties in the *Franklin* decision with Puerto Rico’s sovereignty and the purpose of bankruptcy law, and it argues for another look at the statute in context. Finally, Part VI provides a summary of the arguments put forward in this paper.

## II. BACKGROUND

In 1917, President Woodrow Wilson signed the Jones-Shafroth Act.<sup>25</sup> It granted birthright U.S. citizenship to Puerto Ricans and stated that Puerto Rico was a U.S. territory.<sup>26</sup> In addition, it gave triple tax exemptions<sup>27</sup> from bonds issued by the Puerto Rican government,

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20. 11 U.S.C. § 109(c)(2)(2012): “An entity may be a debtor under chapter 9 of this title if and only if such entity is specifically authorized . . . to be a debtor under such chapter by State law.” The Court dubs this statute the “gateway provision” because any municipality that does not fall under this category is not eligible for Chapter 9 relief. *Franklin Cal. Tax-Free Trust*, 136 S. Ct. at 1941.

21. 11 U.S.C. § 903(1) (2012): “[A] State law prescribing a method of composition of indebtedness of such municipality may not bind any creditor that does not consent to such composition . . . .” This statute is the “pre-emption provision” because it bars any state from preempting the Bankruptcy Code.

22. 11 U.S.C. § 101(52) (2012): “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.”

23. 11 U.S.C. § 903(1) (2012).

24. *Franklin Cal. Tax-Free Trust*, 136 S. Ct. at 1948–49. Justice Alito withdrew himself from the case; rumors indicate that he has personal interests as a result of his investments. Lyle Denniston, *Argument Analysis: If Only Congress Had Taken the Time to Explain*, SCOTUSBLOG (Mar. 22, 2016, 3:35 PM), <http://www.scotusblog.com/2016/03/argument-analysis-if-only-congress-had-taken-the-time-to-explain>.

25. Jones-Shafroth (Jones) Act of 1917, Pub. L. No. 64-348, 39 Stat. 951.

26. *Id.* at 953.

27. Transactions involving Puerto Rican bonds are exempt from federal, state and local taxes. *Id.*

regardless of the bond holder's residence.<sup>28</sup> Moreover, the Constitution of the Commonwealth of Puerto Rico states that public debt is paid before any other government spending.<sup>29</sup> In summary, Puerto Rican bonds were a tax-free, low-risk investment with a fixed interest. Naturally, these bonds attracted many investors.

In 1976, Congress enacted a law exempting United States corporations in Puerto Rico from federal taxes.<sup>30</sup> As a result, Puerto Rico became a United States multinational tax haven, especially for pharmaceutical companies.<sup>31</sup> However, starting in 1996, Congress incrementally rolled back these tax breaks to offset some debt in mainland United States, and by 2006, the tax breaks were completely removed.<sup>32</sup>

Consequently, companies started to leave Puerto Rico, which hit recession as people followed their jobs off the island and tax revenue went down.<sup>33</sup> Municipalities in Puerto Rico began to accumulate a lot of debt; by 2015, accumulative debt totaled more than \$72 billion.<sup>34</sup> As tax revenues were low and Puerto Rico had no other means of earning money, the Puerto Rican government turned back to selling bonds—this time, to anyone who would buy them.<sup>35</sup> The surge in sales downgraded the bonds to junk status.<sup>36</sup> In 2015, Puerto Rican governor

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28. *Id.* Bonds are an investment bought from the government: someone becomes a bond holder by buying the bonds and the government owes money to its bond holders on an interest, which it repays after a certain period. *Investor Resources: Commonwealth of Puerto Rico*, GOV'T DEV. BANK FOR P.R., [http://www.gdbpr.com/investors\\_resources/commonwealth.html](http://www.gdbpr.com/investors_resources/commonwealth.html) (last visited July 31, 2016).

29. Jones-Shafroth (Jones) Act of 1917, Pub. L. No. 64-348, 39 Stat. 951, 963.

30. 26 U.S.C. § 936 (2012).

31. Ezra Fieser, *The Town Viagra Built Tries to Move On*, BLOOMBERG (Nov. 19, 2015), <http://www.bloomberg.com/news/articles/2015-11-19/the-town-viagra-built-tries-to-move-on>. In fact, because Pfizer once produced Viagra there, the mayor of Barceloneta once bragged that “[w]e’re responsible for a lot of good moments.” *Id.*

32. Mary Williams Walsh & Liz Moyer, *How Puerto Rico Debt is Grappling with a Debt Crisis*, N.Y. TIMES (July 1, 2016), <http://www.nytimes.com/interactive/2016/business/dealbook/puerto-rico-debt-crisis-explained.html>.

33. *Id.*; see Jens Manuel Krogstad, *Puerto Ricans Leave in Record Numbers for Mainland U.S.*, PEW RES. CTR. (Oct. 14, 2015), <http://www.pewresearch.org/fact-tank/2015/10/14/puerto-ricans-leave-in-record-numbers-for-mainland-u-s/>, for detailed analysis of Puerto Rican expatriation numbers.

34. Walsh & Moyer, *supra* note 32.

35. A former governor of Puerto Rico compared this situation to a drug addiction. *Puerto Rico: Last Week Tonight with John Oliver*, *supra* note 1.

36. *Id.*

Alejandro Garcia Padilla formally announced that Puerto Rico could not pay its debt.<sup>37</sup>

The United States Bankruptcy Code provides that municipalities in Puerto Rico cannot file Chapter 9 bankruptcy, as Puerto Rico lacks the power to determine whether a municipality can be a debtor under Chapter 9.<sup>38</sup> If Puerto Rican municipalities could file Chapter 9 bankruptcy, then the process would have directly provided relief for about \$20 billion of Puerto Rico's debt.<sup>39</sup> Without the ability to file for bankruptcy under existing federal law, Puerto Rico opted to enact the Recovery Act.<sup>40</sup> The Recovery Act allows Puerto Rico's municipalities to negotiate debt with its creditors,<sup>41</sup> much like a debtor would in case of bankruptcy.<sup>42</sup> These municipalities include the Electric Power Authority (PREPA), the Aqueduct and Sewer Authority (PRASA), and the Highways and Transport Authority (PRHTA).<sup>43</sup>

In part because of the urgency of the issue,<sup>44</sup> other government officials are also attempting to address this problem. As of the date of this writing, President Obama has signed, and members of Congress are hoping to pass, the Puerto Rico Oversight, Management, and Economic Stability Act (hereinafter "Promesa").<sup>45</sup> Promesa is a bill that temporarily bars Puerto Rico's creditors from suing it for payment<sup>46</sup> and allows Puerto Rico to enter district court-supervised

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37. He said, "This is not politics, this is math." Michael Corkery & Mary Williams Welsh, *Puerto Rico's Governor Says Island's Debts Are 'Not Payable'*, N.Y. TIMES, (June 28, 2015), <http://www.nytimes.com/2015/06/29/business/dealbook/puerto-ricos-governor-says-islands-debts-are-not-payable.html>.

38. 11 U.S.C. 101(52) (2012).

39. Greg Stohr & Michelle Kaske, *Puerto Rico Debt Law Struck Down, Leaving Congress in Charge*, BLOOMBERG POL. (June 13, 2016), <http://www.bloomberg.com/politics/articles/2016-06-13/puerto-rico-debt-restructuring-law-voided-by-u-s-supreme-court>.

40. Franklin Cal. Tax-Free Trust, 136 S. Ct. at 1942-43.

41. 2014 P.R. LAWS 71, section 318(b).

42. In fact, this is very similar to a Chapter 9 bankruptcy. See *Chapter 9—Bankruptcy Basics*, U.S. CTS., <http://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-9-bankruptcy-basics> (last visited Aug. 29, 2016).

43. 2014 P.R. LAWS 71, section A.

44. Puerto Rico missed a payment on May 1, 2016, before the Supreme Court opinion was even handed down. Michelle Kaske, Jonathan Levin & Brian Chappatta, *Puerto Rico Warns of More Defaults After Missing May Payment*, BLOOMBERG, (May 1, 2016), <http://www.bloomberg.com/news/articles/2016-05-01/puerto-rico-will-default-on-government-development-bank-debt>.

45. Brown, *supra* note 3. "Promesa" is the Spanish word for "promise."

46. This mechanism is used in nearly all bankruptcy cases, and is termed an "automatic stay." 11 U.S.C. § 362 (2012).

debt restructuring.<sup>47</sup> It includes measures such as cuts in Puerto Rico's healthcare and education systems as well as government agencies.<sup>48</sup> Most notably, it cuts the minimum wage for youths under 25 to \$4.25 an hour.<sup>49</sup> Unsurprisingly, many Puerto Ricans have expressed concerns about this bill.<sup>50</sup>

### III. THE COURT'S REASONING

In *Puerto Rico v. Franklin California Tax-Free Trust*<sup>51</sup> (*Franklin*), with a 5-2 decision, the majority opinion, written by Justice Clarence Thomas, ruled that Puerto Rico was barred from enacting the Recovery Act.<sup>52</sup> The dissent was written by Justice Sotomayor and joined by Justice Ginsburg. Justice Alito excused himself from the case.<sup>53</sup>

The case addresses whether Puerto Rico may pass its own law permitting its municipalities to file for bankruptcy. The Court did this by looking at three different statutes.<sup>54</sup> Despite the structure of the Bankruptcy Code and the obvious practical considerations, the Court held that the plain language of the statutes forbade Puerto Rico from enacting the law.<sup>55</sup>

#### A. The Majority Opinion

The Court's opinion indicates that the Code pre-empted Puerto Rico's bankruptcy plan.<sup>56</sup> Justice Thomas begins the opinion by stating that, although the Constitution allows Congress to "establish uniform Laws on the subject of Bankruptcies throughout the United States,"<sup>57</sup> Congress's bankruptcy laws may have "infringed the States'

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47. H.R. 5278, 114th Cong. (2d Sess. 2016). The Court in *Franklin* notes that Congress is proposing to add a chapter to Title 48, governing the Territories, rather than amending the Bankruptcy Code. 136 S. Ct. 1938, 1943 n. 1 (2016).

48. H.R. 5278, 114th Cong. (2d Sess. 2016).

49. Juan C. Dávila, *PROMESA: Puerto Rico's "Restructure" at \$4.25 an Hour*, THE HUFFINGTON POST (June 29, 2016), [http://www.huffingtonpost.com/juan-c-davila/promesa-puerto-ricos-rest\\_b\\_10615610.html](http://www.huffingtonpost.com/juan-c-davila/promesa-puerto-ricos-rest_b_10615610.html).

50. E.g., Lin-Manuel Miranda, *Making Lemonade from Lemons*, EL DIARIO (May 31, 2016), <http://www.eldiariory.com/2016/05/31/making-lemonade-from-lemons>.

51. 136 S. Ct. 1938 (2016).

52. *Id.* at 1940–41.

53. *Id.* at 1941.

54. *See supra* notes 19–21.

55. *Franklin Cal. Tax-Free Trust*, 136 S. Ct. at 1942.

56. *Id.* at 1946.

57. *Id.* at 1944 (citing U.S. CONST. art. I, § 8, cl. 4; *Hanover Nat. Bank v. Moyses*, 186 U.S. 181, 184 (1902)).



powers to ‘manage their own affairs.’”<sup>58</sup> He points out that Congress’s federal municipal bankruptcy laws preserve “the States’ reserved powers over their municipalities.”<sup>59</sup> Justice Thomas then defends his method of interpretation by asserting that the language of the statutes is plain.<sup>60</sup>

Justice Thomas first focuses on the “express pre-emption clause” of the gateway provision and points out that its purpose was to “pre-empt[] state municipal bankruptcy laws.”<sup>61</sup> He notes that the Bankruptcy Code includes the District of Columbia and Puerto Rico as States “except for the purpose of defining *who may be a debtor* under [C]hapter 9.”<sup>62</sup> He declares that the exception “unmistakably refers to the gateway provision.”<sup>63</sup> Thus, Puerto Rico’s municipalities “cannot satisfy the requirements of Chapter 9’s gateway provision.”<sup>64</sup>

Then, the Court turns to the “gateway provision,” which determines who may be a debtor under Chapter 9.<sup>65</sup> It states that a Chapter 9 debtor “is a municipality [and] is specifically authorized . . . to be a debtor under such chapter by State law.”<sup>66</sup> In other words, if Puerto Rico is a “State” under this definition, PREPA, PRASA, and PRHTA must all obtain Puerto Rico’s permission before they file for Chapter 9 bankruptcy.<sup>67</sup> However, the Court holds that the amended definition supplied by the pre-emption clause excludes Puerto Rico from the definition of “State” here.<sup>68</sup> As previously stated, the Code specifies that Puerto Rico is “not a State . . . for the purposes of *defining* who may be a debtor.”<sup>69</sup> Justice Thomas writes that to “define” is “to decide upon,”<sup>70</sup> or “to establish or prescribe authoritatively.”<sup>71</sup> As

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58. *Id.* (citing *Ashton v. Cameron Cty. Water Improvement Dist. No. One*, 298 U.S. 513, 531 (1936)).

59. *Id.* at 1944.

60. *Id.* at 1947.

61. *Id.* at 1946 (quoting 11 U.S.C. § 903 (2012)). *See supra* note 21.

62. *Id.* (quoting 11 U.S.C. § 101(52) (2012)) (emphasis in opinion). *See supra* note 22.

63. *Id.*

64. *Id.*

65. 11 U.S.C. § 109(c) (2012).

66. *Id.*

67. *Id.*

68. *Franklin Cal. Tax-Free Trust*, 136 S. Ct. at 1946–47.

69. *Id.*

70. *Id.* at 1947 (citing *define*, OXFORD ENGLISH DICTIONARY 383 (2d ed. 1989)).

71. *Id.* (citing *define*, BLACK’S LAW DICTIONARY 380 (5th ed. 1979)).

such, Puerto Rico cannot “specifically authorize which municipalities may file Chapter 9 petitions.”<sup>72</sup>

Finally, the Court grapples with the pre-emption provision, which bars States from enacting municipal bankruptcy laws.<sup>73</sup> Congress has prohibited States and Territories defined as “States” from enacting their own municipal bankruptcy schemes for 70 years.<sup>74</sup> The Bankruptcy Code should not impede on “the political or governmental powers of [a] municipality, including expenditures,” but “a State law prescribing a method of composition of indebtedness of such municipality may not bind any creditor that does not consent to such composition.”<sup>75</sup>

Justice Thomas then argues that the structure of the Bankruptcy Code needs not be taken into account.<sup>76</sup> First, he argues that the gateway provision determines whether the debtors themselves—in this case, the municipalities, and *not* the State—can file for bankruptcy.<sup>77</sup> The pre-emption provision ensures that any State that chooses not to authorize its municipalities to file for bankruptcy cannot enact its own municipal bankruptcy scheme.<sup>78</sup> Even though the Code prohibits Puerto Rico from authorizing municipalities to seek Chapter 9 relief, Justice Thomas believes that Congress would have expressly excluded Puerto Rico as a “State” for purposes of the pre-emption provision if it had meant to do so.<sup>79</sup>

Moreover, Justice Thomas acknowledges that this decision left Puerto Rico with no choice but to wait for congressional action to avert further crises.<sup>80</sup> However, this reality does not allow the Court to redraft Congress’s legislation.<sup>81</sup>

### *B. The Dissenting Opinion*

Justice Sotomayor, joined by Justice Ginsburg, authored the dissent.<sup>82</sup> Justice Sotomayor argues that the Bankruptcy Code should

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72. *Id.* (referring to 11 U.S.C. § 903(1) (2012)).

73. *Id.*

74. *Id.* (citing 60 Stat. 415).

75. 11 U.S.C. § 903(1).

76. *Franklin Cal. Tax-Free Trust*, 136 S. Ct. at 1947–49.

77. *Id.* at 1947.

78. *Id.* at 1948.

79. *Id.*

80. *Id.* at 1949.

81. *Id.*

82. *Id.* (Sotomayor, J., dissenting).

be read in context: for instance, what applies to a Chapter 9 plan (for municipalities) should not be read to apply to any plan filed under Chapter 13 (restructuring).<sup>83</sup> Therefore, when Justices Sotomayor and Ginsburg look at the purpose that the pre-emption provision serves, they find no reason that the word “States” should apply to Puerto Rico.<sup>84</sup>

Justice Sotomayor argues that the purpose of the pre-emption provision is to “delineate the balance of power between the States that can authorize their municipalities to access Chapter 9 protection and the bankruptcy court that would preside over any municipal bankruptcy commenced under Chapter 9.”<sup>85</sup> In other words, the pre-emption provision ensures that any State with the power to grant Chapter 9 protection to its municipality may not decline to do so in favor of some other bankruptcy mechanism. The statute is a restriction of the States’ power to invoke municipal bankruptcy.<sup>86</sup> The dissent thus argues that this restriction of power does not apply to Puerto Rico because Puerto Rico does not have the power to invoke Chapter 9 protection.<sup>87</sup>

In defense of this conclusion, Justice Sotomayor points to the structure of the Bankruptcy Code.<sup>88</sup> She argues that the Bankruptcy Code sets out a formal structure; for example, “Chapter 1 is the starting point. It sets out how to read the Code” by setting out what kind of debtors should look at which chapters.<sup>89</sup> The dissent argues that the gateway provision excludes Puerto Rico from Chapter 9 bankruptcy for all purposes.<sup>90</sup>

Finally, the dissent embraces practicality, as without the plan, Puerto Rico had no choice but to rely on Congress to construct and pass a bankruptcy plan that could save it.<sup>91</sup> From an equitable standpoint, the dissent argues that “[s]tatutes should not easily be read as removing the power of a government to protect its citizens.”<sup>92</sup>

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83. *Id.* at 1951.

84. *Id.* at 1953.

85. *Id.* at 1952.

86. *Id.*

87. *Id.*

88. *Id.* at 1951–52.

89. *Id.* at 1951.

90. *Id.* at 1953.

91. *Id.* at 1954.

92. *Id.*

IV. IMPACT AND SIGNIFICANCE OF *PUERTO RICO V. CALIFORNIA FRANKLIN TAX-FREE TRUST*

It is important to acknowledge that the outcome of this case is counterintuitive.<sup>93</sup> After all, it is difficult to believe that the Court would make a decision leaving United States citizens “unable to pay for things like fuel to generate electricity, which will lead to rolling blackouts.”<sup>94</sup> To be sure, some commentators have said that Puerto Rico drowns in debt out of its own making.<sup>95</sup> However, this does not mean at all that Puerto Ricans should continue to endure this crisis any more than they have to.

The immediate effect of *Franklin* is that Puerto Rico was left to rely on Congress and President Obama for a way out.<sup>96</sup> On June 30, 2016, President Obama signed Promesa.<sup>97</sup> Promesa gives authority to a fiscal oversight board (the “Board”) to oversee Puerto Rico’s finances.<sup>98</sup> The Board will primarily develop and approve budgets for Puerto Rico and its many municipalities.<sup>99</sup> It will also approve voluntary debt restructurings for Puerto Rico and its municipalities, or use the federal district court system to impose restructurings where the parties are unable to agree.<sup>100</sup>

In addition, much like any other bankruptcy law, Promesa provides an automatic stay of all litigation against Puerto Rico and its municipalities.<sup>101</sup> It also proposes to lower the minimum wage for

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93. As one commentator wrote, “[y]our profligate uncle can obtain relief through bankruptcy, but the people of Puerto Rico must suffer.” Ian Millhiser, *Supreme Court Rules Against Puerto Rican Bankruptcy*, THINKPROGRESS (June 13, 2016, 12:08 PM), <http://thinkprogress.org/justice/2016/06/13/3787665/supreme-court-puerto-rico-youre-screwed/>. See Ted Folkman, *Case of the Day: Puerto Rico v. Franklin Cal. Tax-Free Trust*, LETTERS BLOGATORY (June 21, 2016), <https://lettersblogatory.com/2016/06/21/case-day-puerto-rico-v-franklin-california-tax-free-trust/>.

94. *Franklin Cal. Tax-Free Trust*, 136 S. Ct. at 1950 (Sotomayor, J., dissenting).

95. Scott Shackford, *It’s Not Hedge Funds That Caused Puerto Rico to Fail to Manage Its Debts*, REASON.COM (May 3, 2016, 1:35 PM), <http://reason.com/blog/2016/05/03/its-not-hedge-funds-that-caused-puerto-r>.

96. Greg Stohr & Michele Kaske, *Puerto Rico Debt Law Struck Down, Leaving Congress in Charge*, BLOOMBERG (June 12, 2016, 4:10 PM), <https://www.bloomberg.com/politics/articles/2016-06-13/puerto-rico-debt-restructuring-law-voided-by-u-s-supreme-court>.

97. Brown, *supra* note 3.

98. Stephen Selbst, *Puerto Rico Financial Oversight Law Enacted*, BLOOMBERG BNA (Aug. 11, 2016), <http://www.bna.com/puerto-rico-financial-n73014446226/>.

99. *Id.*

100. *Id.*

101. *Id.*

workers under the age of 25 years to only \$4.25 per hour for up to four years.<sup>102</sup>

Promesa is actually very similar to a Chapter 9 bankruptcy.<sup>103</sup> Members of Congress have decided to draft and enact a separate law for Puerto Rico to file bankruptcy in district court rather than simply amend the Bankruptcy Code so that Puerto Rico can allow its own municipalities to file for bankruptcy like states do.<sup>104</sup> One reason for this is politics: bondholders lobbied for Puerto Rico's bankruptcy to be heard in district courts rather than bankruptcy courts, as they felt that bankruptcy courts were in favor of employee and pension claims.<sup>105</sup>

## V. ANALYSIS

*Franklin* is closely related to *Puerto Rico v. Sanchez Valle*,<sup>106</sup> another case that was argued during the October Term of 2015. In a 6-2 decision, the Court held that the Double Jeopardy Clause barred Puerto Rico and the United States from successively prosecuting one person for the same conduct under equivalent criminal laws.<sup>107</sup> According to the Double Jeopardy Clause, two entities may bring successive prosecutions only if the entities derive their power to punish from independent sources.<sup>108</sup> The majority reasoned that “the oldest roots of Puerto Rico’s power to prosecute lie in federal soil”: Puerto Rico’s authority to govern itself came from its Constitution, which in turn came from the U.S. Congress.<sup>109</sup> Since Puerto Rico and the rest of the United States derived their power from the same source, Puerto Rico was barred by the Double Jeopardy clause from prosecuting someone whom the United States federal government had already prosecuted. The results of the two cases are consistent with one another: in both cases, the Court recognizes the special status of Puerto Rico, and restricts its power to govern itself.

In the case of *Franklin*, the competing views of how statutes should be interpreted is not new; the Court has used both methods of

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102. *Id.*

103. *Id.*

104. *Id.*

105. *Id.*

106. 136 S. Ct. 1863 (2016).

107. *Id.* at 1876.

108. *Id.* at 1871.

109. *See id.* at 1868, 1874–77.

interpretation—by its plain meaning and by incorporating statutory structure—in prior cases. While the majority, citing *United States v. Ron Pair Enterprises, Inc.*,<sup>110</sup> argues that the statute should be read on its plain meaning,<sup>111</sup> the dissent, citing *Utility Air Regulatory Group v. EPA*,<sup>112</sup> argues that the structure of the code should be taken account of as context.<sup>113</sup> When the Court applies definitions so narrowly, it permits Congress to pick and choose when it controls Puerto Rico’s finances and when it does not. Perhaps more troublingly, the Court finds that Congress’s freedom of choice in this matter is completely logical. In oral arguments, when Puerto Rico municipalities pointed out that creditors’ interpretation of the pre-emption statute left no choice for Puerto Ricans but to appeal to Congress to change the law, Chief Justice Roberts asked why it would be irrational for Congress to want Puerto Rico to approach it for bankruptcy protection separately from Chapter 9.<sup>114</sup>

One argument for Justice Sotomayor’s interpretation is in the pre-emption provision itself, but in the first clause: “[t]his chapter does not limit or impair the power of a State to control, by legislation or otherwise, a municipality of or in such State in the exercise of the political or governmental powers of such municipality, including expenditures for such exercise.”<sup>115</sup> As a U.S. territory, Puerto Rico should be given the right to control its own municipalities and their expenditures.<sup>116</sup> This clause of the statute is not violated by the bankruptcy filing of almost any other municipality because in the case of almost any other municipality bankruptcy, the municipality would still control its own finances.<sup>117</sup> By denying Puerto Rico both the

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110. 489 U.S. 235, 241 (1989).

111. *Puerto Rico v. Franklin Cal. Tax-Free Trust*, 136 S. Ct. 1938, 1946 (2016) (Interpretation “begins ‘with the language of the statute itself,’ and that ‘is also where the inquiry should end,’ for ‘the statute’s language is plain.’”).

112. 134 S. Ct. 2427, 2441 (2014).

113. *Franklin Cal. Tax-Free Trust*, 136 S. Ct. at 1953 (“Words of a statute must be read in their context and with a view to their place in the overall statutory scheme.” (quoting *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 133 (2000))).

114. Transcript of Oral Argument at 24, *Puerto Rico v. Franklin Cal. Tax-Free Trust*, 136 S. Ct. 1938 (2016) (No. 15-233).

115. 11 U.S.C. § 903 (2012).

116. See P.R. CONST. art. VI, § 1 (allowing the Puerto Rico legislature to “create, abolish, consolidate, and reorganize municipalities . . . [and] to determine their organization and functions”).

117. See *Chapter 9—Bankruptcy Basics*, *supra* note 42 (“The provision makes it clear that the [municipality’s] day-to-day activities are not subject to court approval.” (citing 11 U.S.C. § 904 (2012))).

power to file for Chapter 9 bankruptcy *and* its power to enact its own bankruptcy laws, the Code would “impair the power of a State to control” its municipalities.

Justice Thomas points out that States’ powers over their municipalities are not unlimited because the pre-emption provision was enacted after *Faitoute Iron & Steel Co. v. Asbury Park*<sup>118</sup> in which the Court held that states could require their municipalities to file for bankruptcy under state law before resorting to federal bankruptcy schemes.<sup>119</sup> However, this case can and should be distinguished from *Faitoute* because Congress likely enacted the pre-emption provision so that states would not enact their own bankruptcy schemes when a federal bankruptcy scheme was available. In this case, Puerto Rico’s alternative to a state bankruptcy scheme is *no* bankruptcy scheme, and it is difficult to imagine that Congress meant to leave Puerto Rico with no safety net.

Another argument is that this decision defeats the principles of bankruptcy. It is often said that the bankruptcy court is a court of equity.<sup>120</sup> “Equity” impresses upon the average person sentiments such as “fairness, justness, right dealing, inclusion, and flexibility.”<sup>121</sup> This was first held in *Local Loan Co. v. Hunt*.<sup>122</sup> However, bankruptcy judges have argued against this principle, writing instead that bankruptcy is a statutory practice.<sup>123</sup> This is due to the fact that bankruptcy courts are limited to the power they are given by Congress through the Bankruptcy Code. In fact, one judge has written that the bankruptcy court is in the nice, cozy middle.<sup>124</sup>

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118. 316 U.S. 502, 507–09 (1942).

119. *Puerto Rico v. Franklin Cal. Tax-Free Trust*, 136 S. Ct. 1938, 1944–45 (2016).

120. *See* *Local Loan Co. v. Hunt*, 292 U.S. 234, 240 (1934); *see also* Michael W. McConnell & Randal C. Picker, *When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy*, 60 U. CHI. L. REV. 425, 426 (1993) (describing the problem that bankruptcy is supposed to solve as a balance between a borrower’s ability to make “legally-enforceable promise to repay” and the importance of an accommodation where creditors get paid); *but see*, Alan M. Ahart, J., *The Limited Scope of Implied Powers of a Bankruptcy Judge: A Statutory Court of Bankruptcy, Not a Court of Equity*, 79 AM. BANKR. L.J. 1 (2005).

121. *See* Marcia S. Krieger, J., *The Bankruptcy Court Is a Court of Equity: What Does That Mean?*, 50 S.C. L. REV. 275, 297 (1999); *see also* 1 JOHN NORTON POMEROY, EQUITY JURISPRUDENCE § 363 (4th ed. 1918) (for a list of the maxims of equity).

122. 292 U.S. 234, 240 (1934).

123. *See, e.g.*, Ahart, *supra* note20; Krieger, *supra* note21, at 310.

124. *See* Krieger, *supra* note 121, at 310 (identifying the bankruptcy court as a “specialized court of limited jurisdiction applying statutory law that embodies a particular, often changing, social objective”).

Given that Puerto Ricans are in crisis, the *Franklin* decision seems hardly equitable at all. It is not unreasonable to ask why Congress amended this statute. One cannot ignore that there is no justification provided by Congress for why the District of Columbia and Puerto Rico have to wait for Congress to negotiate and pass a law on how they would conduct their bankruptcy proceedings.<sup>125</sup> Promesa is almost identical to Chapter 9 bankruptcy, with the exception that it is overseen by a federal district court rather than a bankruptcy court.<sup>126</sup> There seems to be little reason for Puerto Rico to wait for Congress to appoint a fiscal oversight board that would effectively perform a Chapter 9 bankruptcy proceeding when it is in horrific crisis. Moreover, this threatens the underlying assumption that different courts administering the same law should yield similar results.

There is no doubt that Chief Justice Roberts is correct in claiming Congress is free: (1) to determine that the District of Columbia and Puerto Rico should not be able to file for Chapter 9 bankruptcy, and (2) to exercise its control over the bankruptcy laws of these two places. However, if there are concerns that bankruptcy cases should be decided with principles of equity in mind, then perhaps the Court should take into account Congressional intent and the purpose of bankruptcy before assuming from the plain words of the statute that some U.S. citizens are simply stripped of their livelihoods through rolling blackouts, restricted access to water and transportation, high taxes, and a low minimum wage.

## VI. CONCLUSION

Although the government of Puerto Rico is not entirely blameless in its financial crisis, it was Congress that passed many of the laws leading it there. *Franklin* is one case in the ongoing debate about the principles of bankruptcy and the bankruptcy court as a court of equity. The Court's interpretation of the Bankruptcy Code is problematic as it is simply impractical. Bankruptcy should be a law that balances

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125. "The only comment on excluding Puerto Rico from Chapter 9 came from Professor Frank Kennedy, former Executive Director of the Commission on Bankruptcy Laws, who said: 'I do not understand why the municipal corporations of Puerto Rico are denied by the proposed definition of 'State' of the right to seek relief under Chapter 9.'" *Puerto Rico v. Franklin Cal. Tax-Free Trust*, 136 S. Ct. 1938, 1953 n.2 (2016) (Sotomayor, J., dissenting) (quoting Bankruptcy Improvements Act, Hearing on S. 333 et al. before the Senate Committee on the Judiciary, 98th Cong., 1st Sess., 326 (1983)).

126. See *supra* Section II.



equitable and statutory doctrines, and the Court should not render a decision that delays help for millions of United States citizens.

