THE EXCLUSION OF PUERTO RICO'S MUNICIPALITIES FROM THE 1984 AMENDMENTS TO THE U.S. BANKRUPTCY CODE IS UNCONSTITUTIONAL BECAUSE THE AMENDMENTS VIOLATE THE BANKRUPTCY CLAUSE AND THE EQUAL PROTECTION COMPONENT OF THE U.S. CONSTITUTION

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Introduction

The amendments that strip Puerto Rico's power to seek federal bankruptcy protection for its municipalities are unconstitutional because they violate the uniformity requirement of the Bankruptcy Clause and the Equal Protection Component of the Fifth Amendment of the U.S. Constitution.

In 1978, Congress enacted § 421(j)(6) of the Bankruptcy Amendments and Federal Judgeship Act[1] (the "1984 Amendments") to, among other things, remove Puerto Rico's power to authorize its municipalities[2] to be eligible debtors under Chapter 9 of the U.S. Federal Bankruptcy Code (the "Bankruptcy Code").[3] Until 1984, federal bankruptcy laws included Puerto Rico under the definition of "State," thereby allowing its municipalities to access these mechanisms.[4]

Fast-forward to 2015 and Puerto Rico's financial situation was dire. The Island faced some tough calls: either decide to pay bondholders or keep the lights on. However, because of the 1984 Amendments, Puerto Rico's municipalities did not have access to the Bankruptcy Code. Even worse, in 2016 the U.S. Supreme Court decided *Puerto Rico v. Franklin California Tax-*

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[1] Pub. L. No. 98-353, § 421(j)(6), 98 Stat. 333, 368–69 (codified as amended at 11 U.S.C. § 101(52)).

[2] In this Note, the term "municipalities" refers to the 78 municipalities of Puerto Rico and the dozens of instrumentalities of the Government of Puerto Rico, including public corporations like the Puerto Rico Electric Power Authority, the Puerto Rico Aqueducts and Sewer Authority, among others.

[3] 11 U.S.C. §§ 901–946.

[4] Brief for Clayton P. Gillette & David A. Skeel, Jr. as Amici Curiae Supporting Petitioner at 6, Puerto Rico v. Franklin California Tax-Free Tr., 579 U.S. 115 (2016) (Nos.15-233), 2016 WL 355057, at *6.

Free Trust, striking down a local law that Puerto Rico enacted to restructure the obligations of its instrumentalities given the lack of access to federal bankruptcy relief.[5] In light of this worsening financial and political crisis, the Island's exclusion from the 1984 Amendments, and the U.S. Supreme Court's decision, Congress rushed to enact the Puerto Rico Oversight, Management, and Economic Stability Act ("PROMESA").[6] PROMESA established a mechanism for Puerto Rico to restructure its public debt obligations under a bankruptcy-like process, emulating Chapter 9 of the Bankruptcy Code.[7] Even though Puerto Rico would have needed Congressional action for a mechanism to restructure its state-wide obligations,[8] direct access to Chapter 9 would have given residents of Puerto Rico the same rights that residents across the 50 states have: the right to have a government that is able to allow its municipalities to access bankruptcy relief during troubling times.

This Note argues that another approach was (and is) possible and examines it in light of Judge Juan R. Torruella's concurrence in the First Circuit decision of *Franklin California Tax-Free Trust v. Puerto Rico*.[9] In the midst of Puerto Rico's crisis in 2015–2016, the Government of Puerto Rico never argued that the 1984 Amendments were unconstitutional. It could have. After briefly discussing the history of the Bankruptcy Code and Puerto Rico, this Note presents arguments as to why the 1984 Amendments violate the Bankruptcy Clause and the Equal Protection Component of the Fifth Amendment of the U.S. Constitution.

History of the Federal Bankruptcy Code and Puerto Rico

The year 1984 marked a drastic change in the United States' approach to extending bankruptcy protection to Puerto Rican municipalities. Prior to that, from the earliest days of municipal bankruptcy, Puerto Rico's municipalities always enjoyed access to bankruptcy relief.[10]

In response to municipal insolvencies during the Great Depression, Congress passed the first municipal bankruptcy statute in 1934 allowing municipalities access to bankruptcy relief.[11] However, in 1936 the U.S. Supreme Court invalidated the statute on constitutional grounds in Ashton v. Cameron County District as an improper interference with the sovereignty of

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[5] Puerto Rico v. Franklin California Tax-Free Tr., 579 U.S. 115 (2016).

[6] 48 U.S.C. §§ 2101–2241 (2016).

[7] *Id.*

[8] 11 U.S.C. § 101(40). States themselves do not have access to a bankruptcy mechanism. Much of Puerto Rico's outstanding debt obligations had been contracted by Puerto Rico's "state" government, so more than Chapter 9 would have been required.

[9] Franklin California Tax-Free Tr. v. Puerto Rico, 805 F.3d 322, 345 (1st Cir. 2015) (Torruella, J., concurring), *aff'd*, 579 U.S. 115 (2016).

[10] Brief for Gillette & Skeel, *supra* note 4, at 6.

[11] Michael W. McConnell & Randal C. Picker, *When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy*, 60 U. Chi. L. Rev. 425, 450 (1993).

the states.[12] Congress amended the statute in 1937, authorizing municipalities to access bankruptcy as long as a petitioning municipality showed that it "is authorized by law to take all action necessary to be taken by it to carry out the plan."[13] The U.S. Supreme Court upheld this statute in 1938.[14]

Much of the controversy around Puerto Rico and Chapter 9 involves the definition of the term "States." Since 1938, the definition of the term "States" in § 1(29) of the revised Municipal Bankruptcy Act of 1937 has included territories and possessions of the United States, thus including Puerto Rico.[15] In 1946, Congress amended the federal bankruptcy laws to prohibit states from enacting their own municipal bankruptcy schemes.[16]

In the 1970s, Congress reinstated a state-permission requirement, which has survived to this date.[17] Section § 109 (c)(2) of the Bankruptcy Reform Act of 1978 provided that a municipality could be an eligible debtor under Chapter 9 if it was "generally authorized to be a debtor under such chapter by State law, or by a governmental officer or organization empowered by State law to authorize."[18] This requirement was enacted to appease federalism concerns that federal bankruptcy without a type of "gateway" provision would infringe on the states' powers.[19]

The Bankruptcy Reform Act of 1978, which replaced the prior municipal bankruptcy laws, did not include a definition for the term "State."[20] In 1984, Congress added a new provision defining "State" as "include[ing] the District of Columbia and Puerto Rico, except for the purpose of defining who may be a debtor under chapter 9 of this title."[21] The reasons for this are unknown.[22] The effect: Congress removed Puerto Rico's power to seek federal bankruptcy protection for its municipalities.

For many decades and until the Great Recession, Puerto Rico enjoyed a booming economy. Concerns about lack of access to federal bankruptcy laws were not at the top of the policy priorities for Puerto Rican officials. But in 2015, reasons for the Government of Puerto Rico to seek bankruptcy relief were compelling. That same year, then-Governor García Padilla declared that the Government of Puerto Rico could not pay its debts.[23] It was

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[12] Ashton v. Cameron Cnty. Dist., 298 U.S. 513 (1936).

[13] Municipal Bankruptcy Act of 1937, Pub. L. No. 302, 50 Stat. 653.

[14] *See* United States v. Bekins, 304 U.S. 27 (1938).

[15] *See* Act of June 22, 1938, Pub. L. No. 75-696, ch. 575, § 1(29), 52 Stat. 840, 842 (codified as amended at 11 U.S.C. § 903).

[16] Act of July 1, 1946, Pub. L. No. 481, ch. 532, § 83(i), 60 Stat. 409, 415.

[17] Martin J. Bienenstock, Recent Developments Affecting Chapter 11 Cases, at 33 (Prepared for Task Force on Current Developments of Business Bankruptcy Subcommittee of the Section of Business Law of the American Bar Association Fall Meeting, October 30, 2020).

[18] Pub. L. No. 95-598, § 109(c)(2), 92 Stat. 2549, 2557. The current text requires "specific" authorization by State law rather than "general" authorization. 11 U.S.C. § 109(c)(2).

[19] *See* In re City of Vallejo, 403 B.R. 72, 75 (Bankr. E.D. Cal. 2009), *aff'd sub nom.* In re City of Vallejo, CA, 432 B.R. 262 (E.D. Cal. 2010).

[20] Brief for Gillette & Skeel, *supra* note 4, at 8.

[21] 11 U.S.C. § 101(52).

[22] *See* Brief for Gillette & Skeel, *supra* note 4, at 8.

[23] Michael Corkery & Mary Williams Walsh, *Puerto Rico's Governor Says Island's Debts Are 'Not Payable'*, N.Y. Times, June 28, 2015, *archived at* https://perma.cc/7YAB-RGQS.

the first time a municipality without access to bankruptcy under both state and federal law faced such a dire situation.[24] Facing unpayable debts and no mechanism to restructure them, Puerto Rico sought a local restructuring mechanism for its instrumentalities.[25] The Government of Puerto Rico enacted the Puerto Rico Public Corporation Debt Enforcement and Recovery Act (the "Recovery Act"), but it was short-lived.[26]

Franklin California Tax-Free Trust and BlueMountain Capital Management, LLC, among other investment funds, brought separate suits against Puerto Rico and various government officials to enjoin the enforcement of the Recovery Act.[27] They claimed that the Bankruptcy Code prohibited Puerto Rico from implementing its own municipal bankruptcy scheme. In *Franklin California*, the U.S. Supreme Court ultimately decided that Chapter 9 of the Bankruptcy Code preempted Puerto Rico's Recovery Act because Puerto Rico is a "State" for Chapter 9 purposes in general.[28] However, it held that Puerto Rico is not a "State" for purposes of the Bankruptcy Code's "gateway" provision governing who may be a debtor, denying it the right to authorize its municipalities to seek relief under Chapter 9 of the Code.[29]

Given the Court's decision, Congress and the Federal Government were essentially forced to respond. Puerto Rico had amassed over $72 billion in outstanding debt obligations plus over $50 billion in unfunded pension liabilities.[30] Moreover, the then-United States Secretary of the Treasury observed that the Government of Puerto Rico's ability to provide "basic healthcare, legal, and education services" was in serious doubt.[31] So, in 2016, Congress enacted, and President Obama signed PROMESA[32] into law providing a mechanism for Puerto Rico to restructure its debt and forge a path for its return to the capital markets.[33] PROMESA established a seven-member Financial Oversight and Management Board (the "Oversight Board") to represent Puerto Rico in its bankruptcy proceedings, in addition to approving fiscal plans and annual budgets for the Government of Puerto Rico and its instrumentalities. While the problems seemed daunting in 2015 for the then-Governor, Puerto Rico's fiscal and economic problems were much more complicated than anyone thought.[34]

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[24] Brief for Petitioners at 2, Puerto Rico v. Franklin California Tax-Free Tr., 579 U.S. 115 (2016) (Nos.15-233, 15-255), 2016 WL 355054, at *2.

[25] *See* Puerto Rico Public Corporation Debt Enforcement and Recovery Act. 2014 Laws P. R. at 371.

[26] Puerto Rico v. Franklin California Tax-Free Tr., 579 U.S. 115 (2016).

[27] *Id.* at 120.

[28] *Id.* at 116.

[29] *Id.*

[30] Fin. Oversight and Mgmt. Bd. for P.R., 2020 Fiscal Plan for the Commonwealth of Puerto Rico 21 (2020), *archived at* https://perma.cc/T2QF-GL2J.

[31] Letter from Jacob L. Lew, Secretary of the Treasury, to Paul Ryan, Speaker, U.S. House of Representatives (Jan. 15, 2016).

[32] 48 U.S.C. §§ 2101–2241 (2016).

[33] *Id.* at § 2121.

[34] *See generally* Fin. Oversight and Mgmt. Bd. for P.R., *supra* note 30.

THE 1984 AMENDMENTS TO THE FEDERAL BANKRUPTCY LAWS ARE UNCONSTITUTIONAL BECAUSE THEY EXCLUDE PUERTO RICO FROM GRANTING ACCESS TO CHAPTER 9 RELIEF TO ITS MUNICIPALITIES

In *Franklin California* in 2016, the U.S. Supreme Court held that Puerto Rico's Recovery Act was unconstitutional, but it left unexamined the constitutionality of the 1984 Amendments.[35] This Note does not argue against the U.S. Supreme Court's holding that § 903(1) of Chapter 9 of the Bankruptcy Code preempts the Recovery Act because this section prohibits states from creating their own bankruptcy processes for insolvent municipalities.[36] The Court found the Recovery Act was preempted mainly because of two reasons. First, the exception [in §101(52)] "excludes Puerto Rico *only* for purposes of the gateway provision" and Puerto Rico is no less a "State" for the rest of the Bankruptcy Code.[37] Second, "[t]he Code's pre-emption provision has prohibited States and Territories defined as "States" from enacting their own municipal bankruptcy schemes for 70 years."[38] The Court presumably got to this narrow holding by following the constitutional avoidance canon that finds in favor of a party on statutory grounds so that the Court does not need to reach the constitutional question at all, even if properly presented in the record.[39] The parties to this suit debated the validity of the Recovery Act given Chapter 9 of the Bankruptcy Code,[40] but the Government of Puerto Rico did not challenge the constitutionality of the 1984 Amendments. It could have.

To challenge the constitutionality of the 1984 Amendments, Puerto Rico could have expanded on Judge Torruella's concurrence in the First Circuit decision of *Franklin California*. [41] This would have led Puerto Rico to make two claims: (1) Puerto Rico's exclusion from allowing its municipalities to access Chapter 9 of the Bankruptcy Code is unconstitutional, and (2) the 1984 Amendments violate the Equal Protection Component of the Fifth Amendment. The force of these potential claims is analyzed, respectively.

I. THE 1984 AMENDMENTS VIOLATE THE UNIFORMITY REQUIREMENT OF THE BANKRUPTCY CLAUSE OF THE U.S. CONSTITUTION

While Puerto Rico enacted its local bankruptcy law as the quickest way to grant relief to its instrumentalities, an alternative strategy would have

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[35] Puerto Rico v. Franklin California Tax-Free Tr., 579 U.S. 115, 116 (2016).
[36] *Id.* at 126–27.
[37] *Id.* at 126.
[38] *Id.* at 126–27.
[39] Ashwander v. Tennessee Valley Auth., 297 U.S. 288, 341 (1936) (Brandeis, J., concurring).
[40] *Franklin California Tax-Free Tr.*, 579 U.S. at 127.
[41] Franklin California Tax-Free Tr. v. Puerto Rico, 805 F.3d 322, 345 (1st Cir. 2015) (Torruella, J., concurring).

been to argue that the 1984 Amendments were unconstitutional as they establish bankruptcy legislation that is not uniform with regards to the rest of the United States.[42] These amendments violate the uniformity requirement of the Bankruptcy Clause of the U.S. Constitution.[43] The Bankruptcy Clause states that "Congress shall have the power. . . [t]o establish. . . uniform laws on the subject of bankruptcies throughout the United States."[44]

Judge Torruella correctly concludes that it would be absurd to argue that the exclusion of Puerto Rico in the 1984 Amendments is not prohibited by the uniformity requirement of the Bankruptcy Clause. To determine this, Judge Torruella starts where one should: the text of the constitutional provision. "Uniform" means that something is "always the same, as in character or degree"[45] and "[c]haracterized by a lack of variation; identical or consistent."[46] Judge Torruella, based on these definitions, stated:

> Prohibiting Puerto Rico from authorizing its municipalities to request Chapter 9 relief, while allowing all the states to benefit from such power, is hardly in keeping with these definitions. It would be absurd to argue that the exclusion of Puerto Rico from the protection of the Bankruptcy Code by the enactment of the 1984 Amendments is not prohibited by the unequivocal language of the Bankruptcy Clause of the Constitution.[47]

Given the definition of the term "uniform" is clear, "reliance on legislative history is unnecessary in light of the statute's unambiguous language."[48] However, an analysis of the history of the term "uniform" in the context of the Bankruptcy Clause also supports the proposition that the 1984 Amendments are unconstitutional. Looking to the Constitutional Convention as a source of understanding the uniformity requirement of the Bankruptcy Clause, there is little recorded debate on the subject.[49] James Madison, in the Federalist Papers, stated:

> The power of establishing uniform laws of bankruptcy is so intimately connected with the regulation of commerce, and will prevent many frauds where the parties or property may lie or be

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[42] *Id.*

[43] *Id.*

[44] U.S. Const. art. I, § 8, cl. 4.

[45] *Franklin California Tax-Free Tr.*, 805 F.3d at 346 (Torruella, J., concurring) (quoting The American Heritage Dictionary of the English Language 1881 (4th ed. 2000)).

[46] *Id.* (quoting Black's Law Dictionary, 1761 (10th ed. 2014)).

[47] *Id.*

[48] Mohamad v. Palestinian Auth., 566 U.S. 449, 458–59 (2012) (quoting Milavetz, Gallop & Milavetz, P.A. v. United States, 559 U.S. 229, 236 n.3 (2010)); *see also* Circuit City Stores, Inc. v. Adams, 532 U.S. 105, 119 (2001) ("[W]e do not resort to legislative history to cloud a statutory text that is clear.").

[49] Daniel A. Austin, *Bankruptcy and the Myth of "Uniform Laws"*, 42 Seton Hall L. Rev. 1081, 1151 (2012).

> removed into different States, that the expediency of it seems not likely to be drawn into question.[50]

The framers were concerned about a patchwork of bankruptcy laws throughout the states.[51] No further comment is found before the Bankruptcy Clause was incorporated into the U.S. Constitution as it presently appears.[52] The Framers did not put the Bankruptcy Clause immediately after the Commerce Clause by accident.[53] Congress's power to regulate commerce uniformly under the Commerce Clause, which has identical language to the Bankruptcy Clause, applies in full force to Puerto Rico.[54] In *Trailer Marine Transp. Corp. v. Rivera Vázquez*, the First Circuit held that:

> The central rationale of [the] dormant Commerce Clause doctrine . . . is to foster economic integration and prevent local interference with the flow of the nation's commerce. This rationale applies with equal force to official actions of Puerto Rico. Full economic integration is as important to Puerto Rico as to any state in the Union.[55]

This logic, put together, "gives added weight to the conclusion that the language in the Clause means what it unequivocally states: bankruptcy laws must be *uniform* throughout the United States or else are invalid."[56]

Federal bankruptcy laws cannot apply only to one regional debtor. Courts have analyzed uniformity under the Bankruptcy Code employing a "geographic uniformity" standard.[57] This standard "prohibits Congress from enacting a bankruptcy law that, by definition, applies only to one regional debtor. To survive scrutiny under the Bankruptcy Clause, a law must at least apply uniformly to a defined class of debtors."[58] For example, the Court struck down the Rock Island Railroad Transition and Employee Assistance Act because it was "inconsistent with the uniformity requirement in the bankruptcy clause."[59] The Court concluded that this law was "applicable to only one debtor, could be enforced only by one reorganization court presiding over that debtor, and [did] not address a class of similar debtors or a particular geographical problem."[60] For "[t]o hold otherwise would allow

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[50] *See* The Federalist No. 42, 237 (James Madison) (Robert A. Ferguson, ed., 2006).
[51] Austin, *supra* note 49, at 1152.
[52] *Franklin California Tax-Free Tr.*, 805 F.3d 322 at 346.
[53] *See generally* Charles Warren, Bankruptcy in United States History (1935).
[54] *See* Trailer Marine Transp. Corp. v. Rivera Vázquez, 977 F.2d 1, 8 (1st Cir. 1992).
[55] *Id.*
[56] *Franklin California Tax-Free Tr.*, 805 F.3d at 347.
[57] *See, e.g.*, Stellwagon v. Clum, 245 U.S. 605, 613 (1918) (noting that a bankruptcy law may be uniform and yet "recognize the laws of the state in certain particulars, although such recognition may lead to different results in different states"); Schultz v. United States, 529 F.3d 343, 351 (6th Cir. 2008) ("The Court . . . has consistently described the Bankruptcy Clause's uniformity requirement as 'geographical, and not personal.'" (quoting Hanover Nat. Bank v. Moyses, 186 U.S. 181, 188 (1902)).
[58] Ry. Lab. Executives' Ass'n v. Gibbons, 455 U.S. 457, 473 (1982).
[59] Bienenstock *supra* note 17, at 448 (citing *Gibbons*, 455 U.S. at 468–72).
[60] *Id.*

Congress to repeal the uniformity requirement from Art. I, § 8, cl. 4 of the Constitution."[61]

Lastly, applying the absurdity doctrine, courts could find that it does not make sense for Congress to completely strip Puerto Rico's municipalities from any access to bankruptcy. "[T]he [U.S.] Supreme Court has subscribed to the idea that judges may deviate from even the clearest statutory texts when a given application would otherwise produce 'absurd' results."[62] The Marshall Court held that "a court's obligation to the text ceased when 'the absurdity and injustice of applying the provision to the case, would be so monstrous, that all mankind would, without hesitation, unite in rejecting the application.'"[63] Congress designed Chapter 9 to provide municipalities throughout the United States with a "fresh start."[64] Many insolvent municipalities throughout the United States have invoked Chapter 9 to seek this "fresh start," including Detroit, Michigan; Jefferson Country, Alabama; and Orange County, California.[65] Special-purpose districts have also filed for bankruptcy, including entities dealing with fire protection, health care, and schools.[66] Like these entities, Puerto Rico, through its municipalities and instrumentalities, provides essential government services. The U.S. Supreme Court's decision in *Franklin California*, although it did not address the constitutionality of the 1984 Amendments, effectively led to an absurd result. It is well summarized in Puerto Rico's brief before the U.S. Supreme Court:

> Finally, the decision represents the first time in the history of the United States that an entity has been categorically barred from seeking bankruptcy protection under both federal and state law. Prior to the First Circuit's decision, every person, corporation, organization, and municipality in the country had been permitted to commence debt-relief proceedings under either federal or state law, provided that they met the criteria prescribed in an existing federal or state bankruptcy statute. The court below upended nearly two centuries of bankruptcy practice when it prohibited Puerto Rico's municipalities from availing themselves of both federal law and Commonwealth law.[67]

It is therefore an absurd and counterintuitive result that—because of the 1984 Amendments—municipalities serving as home to the over three million residents of Puerto Rico were left without any access to bankruptcy relief.

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[61] *Gibbons*, 455 U.S. at 473.
[62] John F. Manning, *The Absurdity Doctrine*, 116 Harv. L. Rev. 2387, 2388 (2003).
[63] *Id.* (quoting Sturges v. Crowinshield, 17 U.S. (4 Wheat.) 122, 203 (1819)).
[64] *See* McConnell & Picker, *supra* note 11, at 470.
[65] *See* Michelle Wilde Anderson, *The New Minimal Cities*, 123 Yale L. J. 1118, 1120 n.1 (2014).
[66] Jeff Chapman, Adrienne Lu & Logan Timmerhoff, *By the Numbers: A Look at Municipal Bankruptcies Over the Past 20 Years*, The PEW Charitable Trusts (July 6, 2020), *archived at* https://perma.cc/RP9J-YQ4G.
[67] Brief for Petitioners, *supra* note 24, at 3.

In light of the framework discussed above, excluding Puerto Rico from deciding who may be a debtor under Chapter 9 of the Bankruptcy Code is unconstitutional and in violation of the uniformity principle of the Bankruptcy Clause of the U.S. Constitution.

II. The 1984 Amendments violate the Equal Protection Component of the Fifth Amendment of the U.S. Constitution

"Discrimination by the federal government violates the Fifth Amendment when it constitutes 'a denial of due process of law.'"[68] This denial of due process of law by the Federal Government is considered the Equal Protection Component of the Fifth Amendment.[69] "Equal protection analysis in the Fifth Amendment area is the same as that under the Fourteenth Amendment."[70]

The Federal Government argues in *United States v. Vaello-Madero* that the Territorial Clause allows Congress to "pass economic and social welfare legislation for the territories where there is a rational basis for such actions," relying on the U.S. Supreme Court's prior interpretation of the clause.[71] Supporters of the constitutionality of the 1984 Amendments argue that they are constitutional because the uniformity clause does not apply to Puerto Rico. They use the Territorial Clause to argue that Congress can treat Puerto Rico differently. But the District Court for the District of Puerto Rico summed it up nicely when it said that the Federal Government cannot use the Territorial Clause as a "blank check" to violate the constitutional rights of residents of Puerto Rico.[72] Considering the Equal Protection Component of the Fifth Amendment of the U.S. Constitution, the 1984 Amendments are unconstitutional because they cannot withstand a rational-basis test.

The Territorial Clause provides some leeway for the Federal Government's treatment of Puerto Rico, but not in all cases. The U.S. Supreme Court cases of *Califano v. Gautier-Torres* and *Harris v. Rosario* allowed Congress to legislate differently for Puerto Rico as long as it had a rational basis for the disparate treatment.[73]

In *Califano*, the U.S. Supreme Court held that the denial of Supplemental Security Income ("SSI") benefits to a recipient who acquired them while a resident of one of the 50 states—but then moved to Puerto Rico—was constitutional.[74] Congress amended the Social Security Act in 1972 and ex-

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[68] United States v. Vaello-Madero, 956 F.3d 12, 18 (1st Cir. 2020) (quoting *Bolling v. Sharpe*, 347 U.S. 497, 499 (1954)).
[69] *Id.* (citing U.S. Dep't of Agric. v. Moreno, 413 U.S. 528, 533 (1973)).
[70] *Id.* (quoting Adarand Constructors, Inc. v. Pena, 515 U.S. 200, 224 (1995)).
[71] United States v. Vaello Madero, 356 F. Supp. 3d 208, 212 (D.P.R. 2019).
[72] *Id.*
[73] *See* Califano v. Gautier-Torres, 435 U.S. 1, 5 (1978); Harris v. Rosario, 446 U.S. 651, 651–52 (1980).
[74] *Id.*

cluded Puerto Rico from SSI, a program meant to provide support to qualified aged, blind, and disabled persons.[75] Based on the text of the statute, persons in Puerto Rico are not eligible to receive SSI benefits, but are eligible to receive benefits under the pre-existing programs that applied to Puerto Rico.[76] In addition to Puerto Rico, Guam and the U.S. Virgin Islands are excluded from SSI payments, while the residents of the 50 states, the District of Columbia, and the Commonwealth of the Northern Mariana Islands are eligible.[77]

Appellees Torres, Colon, and Vega received SSI benefits while residing in Connecticut, Massachusetts, and New Jersey, respectively, but lost them upon moving to Puerto Rico.[78] The appellees filed different suits in the District Court for the District of Puerto Rico, which held that the Constitution requires that a person who travels to Puerto Rico must be given the same benefits they were receiving before.[79] The U.S. Supreme Court reversed, stating that it has never held that the constitutional right to travel embraces the doctrine "that a person who travels to Puerto Rico is entitled to benefits superior to those enjoyed by other residents of Puerto Rico if the newcomer enjoyed those benefits in the State from which he came."[80] It cautioned that such doctrine would open the door to benefits a state might provide for its residents, and then would require that state to continue providing them should a resident move to another state.[81] The Court held that "the broader implications of such a doctrine in other areas of substantive law would bid fair to destroy the independent power of each State under our Constitution to enact laws uniformly applicable to all of its residents."[82] *Califano*, however, "is an opinion in which the footnotes are almost as important as its main text."[83] The Court decided *Califano* on issues related to the right to travel, not on equal protection grounds.[84] Two years later, in *Harris*, Justice Mar-

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[75] *Id.* at 3.

[76] *Id.* at 4. The SSI program replaced the federal-state programs of: Old Age Assistance, 42 U.S.C. § 301 et seq.; Aid to the Blind, 42 U.S.C. § 1201 et seq.; Aid to the Disabled, 42 U.S.C. § 1351 et seq.; and Aid to the Aged, Blind, and Disabled, 42 U.S.C. § 1381 et seq. Puerto Rico had access to these old programs, but not SSI.

[77] 42 U.S.C. § 1381 et seq.

[78] *Califano*, 435 U.S. at 3.

[79] *Id.*

[80] *Id.* at 4.

[81] *Id.*

[82] *Id.* at 5.

[83] United States v. Vaello-Madero, 956 F.3d 12, 19 (1st Cir. 2020) (citing *Califano*, 435 U.S. at 3 n.4). Footnote 3 reads:

> The complaint had also relied on the equal protection component of the Due Process Clause of the Fifth Amendment in attacking the exclusion of Puerto Rico from the SSI program. Acceptance of that claim would have meant that all otherwise qualified persons in Puerto Rico are entitled to SSI benefits, not just those who received such benefits before moving to Puerto Rico. But the District Court apparently acknowledged that Congress has the power to treat Puerto Rico differently, and that every federal program does not have to be extended to it. Puerto Rico has a relationship to the United States "that has no parallel in our history."

[84] *Id.* at 20.

shall confirmed that there was no equal protection question before the court in *Califano*.[85]

In *Harris*, the Court held that a lower level of Aid to Families with Dependent Children ("AFDC") program reimbursement provided to Puerto Rico did not violate the Fifth Amendment's equal protection guarantee.[86] Ultimately, the Court decided this case based on the Territorial Clause of the U.S. Constitution stating that Congress is empowered "to 'make all needful Rules and Regulations respecting the Territory . . . belonging to the United States,' [and] may treat Puerto Rico differently from States so long as there is a rational basis for its actions."[87] The Court listed three factors as a basis to justify the rational basis test: "Puerto Rican residents do not contribute to the federal treasury; the cost of treating Puerto Rico as a State under the statute would be high; and greater benefits could disrupt the Puerto Rican economy."[88]

Califano and *Harris*, put together, held that "pursuant to Congress's powers under the Territorial Clause, only rational basis review is warranted when considering the validity of a statute that treats Puerto Rico differently."[89] But *Califano* and *Harris* are not a carte blanche to discriminate against Puerto Rico residents in all cases,[90] and the First Circuit declined to read the cases so broadly when deciding *Vaello-Madero*.[91] Judge Torruella's concurrence in *Franklin California* also points to this distinction.[92] The rulings in *Califano* and *Harris* did not address discriminatory treatment of Puerto Rico residents, specifically because the U.S. Supreme Court decided *Califano* on the basis of the right to travel[93] and *Harris* on the basis of block grants received by the territory under the AFDC program.[94]

The Bankruptcy Code is a statute that treats Puerto Rico differently, and thus a rational-basis test is warranted. It is well established that "[a] legislative classification . . . be sustained, if the classification itself is rationally related to a legitimate government interest."[95] The 1984 Amendments, insofar as they exclude Puerto Rico, could have been constitutional had there been a conceivable government interest in stripping the municipalities of

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[85] *See* Harris v. Rosario, 446 U.S. 651, 651–52 (1980), 446 U.S. at 654–655 (Marshall, J., dissenting) ("[T]he District Court relied entirely on the right to travel, and therefore no equal protection question was before this Court. The Court merely referred to the equal protection claim briefly in a footnote . . . At most, [this is] reading[ ] more into that single footnote of dictum [in *Califano*] than it deserves.").

[86] *Id.* at 651–52.

[87] *Id.* (quoting U.S. Const. art. IV, § 3, cl. 2).

[88] *Id.* at 652 (citing *Califano*, 435 U.S. at 5 n.7).

[89] Franklin California Tax-Free Tr. v. Puerto Rico, 805 F.3d 322, 348 (1st Cir. 2015) (Torruella, J., concurring).

[90] United States v. Vaello-Madero, 956 F.3d 12, 19 (1st Cir. 2020).

[91] *Id.*

[92] *Franklin California Tax-Free Tr.*, 805 F.3d at 348 (Torruella, J., concurring).

[93] Califano v. Gautier-Torres, 435 U.S. 1, 4–5 (1978).

[94] Harris v. Rosario, 446 U.S. 651, 651–52 (1980).

[95] *Vaello-Madero*, 956 F.3d at 18 (quoting U.S. Dep't of Agric. v. Moreno, 413 U.S. 528, 533 (1973)).

Puerto Rico from access to Chapter 9.[96] But there are no conceivable reasons that withstand the rational-basis test to remove Puerto Rico's power to authorize its municipalities to access bankruptcy. Congress's decision to treat Puerto Rico—and its residents—differently is arbitrary because it is not rationally related to any conceivable legitimate purpose. In essence, the 1984 Amendments benefited creditors at the expense of the residents of the Island. Puerto Rico was unreasonably and arbitrarily barred from accessing a remedy it had previously been afforded access to for four decades. The following are the five key reasons for making the case that the 1984 Amendments violate the Equal Protection Component of the Fifth Amendment.

First, "[t]here is absolutely nothing in the record of the 1984 Amendments to justify [the majority's statement that Congress sought to preserve to itself the power to authorize Puerto Rican municipalities to seek Chapter 9 relief] or Congress's legitimate purpose in adopting them."[97] In *Franklin California*, Judge Torruella's concurrence is an eloquent walk through the scant information available as to how the 1984 Amendments came to fruition.[98] The U.S. House of Representatives originally passed H.R. 5174—which eventually became law after amendments—without the Chapter 9 debtor eligibility exclusion for Puerto Rico. However, then-Senator Strom Thurmond, a Republican from South Carolina, introduced the amendment during the Senate's review of H.R. 5174 to exclude Puerto Rico and the District of Columbia from this provision.[99] The U.S. Senate's original bill also did not have a provision excluding Puerto Rico and the District of Columbia.[100] Then-Senators Dole, Thurmond, and Hefflin, without giving any explanation, introduced an amendment to incorporate the Chapter 9 exclusion.[101]

Second, courts are required to carefully examine Congress's statutory text and justifications when interpreting changes to bankruptcy statutes.[102] "There is hermetic silence regarding all of the issues or questions that would normally arise and be discussed when a provision that was part of the Bankruptcy Code for close to half a century, and whose elimination would affect

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[96] *Franklin California Tax-Free Tr.*, 805 F.3d at 348 (Torruella, J., concurring); *see* FCC v. Beach Commc'ns, Inc., 508 U.S. 307, 313 (1993) ("[A] statutory classification that neither proceeds along suspect lines nor infringes fundamental constitutional rights must be upheld against equal protection challenges if there is any reasonably conceivable state of facts that could provide a rational basis for the classification.").

[97] *Franklin California Tax-Free Tr.*, 805 F.3d at 349 (Torruella, J., concurring).

[98] *Id.* at 345–50.

[99] *Id.* at 349.

[100] *Id.*

[101] *Id.* at 349–50.

[102] *Id.* at 350 ("We . . . 'will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure.'") (citing Cohen v. de la Cruz, 523 U.S. 213, 221 (1998); United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., 484 U.S. 365, 380 (1980) ("Such a major change in the existing rules would not likely have been made without specific provision in the text of the statute; it is most improbable that it would have been made without even any mention in the legislative history."); *See* Dewsnup v. Timm, 502 U.S. 410, 419 (1992) ("When Congress amends the bankruptcy laws, it does not write 'on a clean slate.'").

millions of U.S. citizens, is deleted."[103] There is nothing in the text and legislative history regarding why there should be changes to a part of the Bankruptcy Code that had been in place for nearly 50 years, and whose elimination would impact millions of U.S. citizens. Courts must find this silence alarming, as courts are required to examine these justifications.

Third, the 1984 Amendments stripped Puerto Rico of an important component of state-like functions that it formerly had the right to exercise. The Court held in 1976 that Puerto Rico has "[t]he degree of autonomy and independence normally associated with States of the Union."[104] In that vein, the Third Circuit held in 2009 that "Puerto Rico has the same level of authority over its municipalities" as compared to the states.[105] Moreover, in 1928 the First Circuit held that "[i]n the matter of local regulations and the exercise of police power Porto Rico possesses all the sovereign powers of a state, and any exercise of this power which is reasonable and is exercised for the health, safety, morals, or welfare of the public is not in contravention of the Organic Act nor of any provision of the Federal Constitution."[106] The First Circuit has also found that "there would have to be specific evidence or clear policy reasons embedded in a particular statute to demonstrate a statutory intent to intervene more extensively into the local affairs of post-Constitutional Puerto Rico than into the local affairs of a state."[107] There is no such evidence nor specific policy reasons for the differential treatment of Puerto Rico in this instance.

Fourth, the lack of access of Puerto Rico's municipalities to Chapter 9 violates the Equal Protection Component of the Fifth Amendment because—absent PROMESA—creditors would be treated preferentially in Puerto Rico as opposed to the 50 states. A municipal bondholder in the 50 states would have been in a significantly riskier position as compared to Puerto Rico (where there was no access to bankruptcy pre-PROMESA) and the District of Columbia. Because Congress's power to regulate commerce uniformly under the Commerce Clause applies in full force to Puerto Rico,[108] it would not make sense to provide unequal treatment to bondholders who invest in Puerto Rico. The fact that Puerto Rican bonds are triple tax exempt from federal, state, and local taxes is not a sufficient reason to sustain the unequal treatment because "Puerto Rico's status in this respect is not entirely remark-

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[103] *Franklin California Tax-Free Tr.*, 805 F.3d at 350 (Torruella, J., concurring).

[104] Examining Bd. of Eng'rs, Architects & Surveyors v. Flores de Otero, 426 U.S. 572, 594 (1976).

[105] *See* United States v. Laboy-Torres, 553 F.3d 715, 722– 23 (3d Cir. 2009) (O'Connor, J., sitting by designation) ("[C]ongress has accorded the Commonwealth of Puerto Rico 'the degree of autonomy and independence normally associated with States of the Union.'") (quoting United States v. Cirino, 419 F.3d 1001, 1003-04 (9th Cir. 2005) (per curiam)).

[106] *Franklin California Tax-Free Tr.*, 805 F.3d at 351(Torruella, J., concurring) (citing Armstrong v. Goyco, 29 F.2d 900, 902 (1st Cir. 1928)).

[107] Córdova & Simonpietri Ins. Agency, Inc. v. Chase Manhattan Bank N.A., 649 F.2d 36, 41–42 (1st Cir. 1981).

[108] *See* Trailer Marine Transp. Corp. v. Rivera Vázquez, 977 F.2d 1, 8 (1st Cir. 1992).

able. State and local bonds have enjoyed federal tax-exempt status 'since the modern income tax system was enacted in 1913.'"[109]

Fifth, this differential treatment of Puerto Rico specifically targeted a minority group for discriminatory treatment. In such cases, the rational-basis test standard does not warrant judicial deference.[110]

For similar reasons, the First Circuit recently decided in *Vaello-Madero* excluding Puerto Rico residents from SSI benefits violates the Due Process Clause of the Fifth Amendment.[111] The *Vaello-Madero* case originated when New York resident José Luis Vaello-Madero moved to Puerto Rico and was stripped of his SSI benefits.[112] Like in *Califano* and *Harris*,[113] Vaello-Madero could no longer access the SSI program due to being domiciled in Puerto Rico.[114] Instead, he was entitled to a separate, Puerto Rico-specific program with far fewer benefits.[115] The First Circuit, upholding a decision from the District Court for the District of Puerto Rico, stated that "the Fifth Amendment does not permit the arbitrary treatment of individuals who would otherwise qualify for SSI but for their residency in Puerto Rico (those plausibly considered least able to 'bear the hardships of an inadequate standard of living')."[116] The future of this case, however, remains to be seen.[117]

Similar to the logic of *Vaello-Madero*, residents of Puerto Rico who relocate to one of the 50 states would live in a municipality and receive services from entities with access to Chapter 9 relief. This unequal treatment would certainly be barred by the Fifth Amendment. Again, "here the situation is different than in *Califano* and *Harris* because, contrary to the Supreme Court's statements in those two cases, [here there is not a] single plausible explanation as to why Congress opted for the disparate treatment of Puerto Rico."[118] In response to this argument, the Federal Government might recycle its logic from *Vaello-Madero* to argue that Puerto Rico's municipalities should not get access to Chapter 9 protections because its residents do not pay federal taxes.[119] While most residents of Puerto Rico do

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[109] *Franklin California Tax-Free Tr.*, 805 F.3d at 330 n.8 (citing Nat'l Assoc. of Bond Lawyers, *Tax–Exempt Bonds: Their Importance to the National Economy and to State and Local Governments* 5 (Sept. 2012) ("*Tax–Exempt Bonds*"); *see also* 26 U.S.C. § 103).

[110] *See* United States v. Windsor, 570 U.S. 744, 827 (2013) ("The Constitution's guarantee of equality 'must at the very least mean that a bare congressional desire to harm a politically unpopular group cannot' justify disparate treatment of that group.").

[111] United States v. Vaello-Madero, 956 F.3d 12 (1st Cir. 2020).

[112] *Id.*

[113] *See* Califano v. Gautier-Torres, 435 U.S. 1 (1978); Harris v. Rosario, 446 U.S. 651 (1980).

[114] *Vaello-Madero*, 956 F.3d at 12.

[115] *See id.*

[116] *Id.* at 30 (citing Jefferson v. Hackney, 406 U.S. 535, 549 (1972)).

[117] Recently, the U.S. Supreme Court granted certiorari to review *Vaello-Madero*. Sebastián Negrón-Reichard, *President Biden is Not Living Up to His Promise to Treat All Puerto Ricans Equally*, Miami Herald (Apr. 5, 2021), https://www.miamiherald.com/opinion/op-ed/article250447586.html, *archived at* https://perma.cc/2K25-B4JG.

[118] Franklin California Tax-Free Tr. v. Puerto Rico, 805 F.3d 322, 354 (1st Cir. 2015) (Torruella, J., concurring).

[119] *Vaello-Madero*, 956 F.3d at 12.

not pay federal income taxes, Puerto Rico taxpayers paid over $3.5 billion into the federal treasury in 2019.[120] This sum includes "the payment of federal income taxes by residents of Puerto Rico on income from sources outside Puerto Rico for which they are liable under the Internal Revenue Code, the regular payment of federal income taxes by all federal employees in Puerto Rico,[121] as well as the full Social Security, Medicare, and Unemployment Compensation taxes that are paid in the rest of the United States."[122] Moreover, this argument would fall on its face because the District of Columbia is also excluded from the Chapter 9 provision,[123] but its residents do pay federal taxes.

The Court, in *Carolene Products*, established that "prejudice against discrete and insular minorities may be a special condition, which tends seriously to curtail the operation of those political processes ordinarily to be relied upon to protect minorities, and which may call for a correspondingly more searching judicial inquiry."[124] Courts have held that judicial deference is warranted "absent some reason to infer antipathy" because "even improvident decisions will eventually be rectified by the democratic process."[125] But in this case, there is reason to infer antipathy. Puerto Rico is excluded from the political process in Congress and this "is asking it to play with a deck of cards stacked against it."[126] All in all, a case about the constitutionality of the 1984 Amendments is certainly one that would call for more searching judicial inquiry.

PROMESA and the path forward

The passage and existence of PROMESA does not obviate the need for this discussion. First, PROMESA would have been needed regardless of mere access to Chapter 9 of the Bankruptcy Code. Even if Puerto Rico's municipalities could access Chapter 9, Puerto Rico's "state" government issued a great chunk of Puerto Rico's debt—and states themselves do not have access to a bankruptcy mechanism.[127]

Second, PROMESA exists for now, but what happens after its expiration date? When the Oversight Board established by PROMESA certifies that Puerto Rico has met the termination requirements established in the law,[128] it is unclear what would happen in a subsequent case where a Puerto Rico municipality needs bankruptcy relief.

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[120] *See* Internal Revenue Service, SOI Tax Stats - Gross Collections, by Type of Tax and State - IRS Data Book Table 5, *archived at* https://perma.cc/84P5-AWM3.

[121] 26 U.S.C. 933.

[122] *See* 26 U.S.C. §§ 3101, 3111, 3121(e), 3301, 3306(j).

[123] Brief for Gillette & Skeel, *supra* note 4, at 8.

[124] *See* United States v. Carolene Prod. Co., 304 U.S. 144, 152 n.4 (1938).

[125] Franklin California Tax-Free Tr. v. Puerto Rico, 805 F.3d 322, 354 (1st Cir. 2015) (Torruella, J., concurring) (citing Beach Commc'ns, 508 U.S. at 314).

[126] *Id.* at 355.

[127] 11 U.S.C. § 101(40).

[128] 48 U.S.C. § 2149 (2016).

Even though the Oversight Board has sought to do a "once and done" approach to Puerto Rico's restructuring, it is evident that Puerto Rico's politicians have not proven to be effective financial managers. Thus, if ever in need of bankruptcy relief for Puerto Rican municipalities, and absent Congressional action to amend Chapter 9, Puerto Rico could bring suit regarding the constitutionality of the 1984 Amendments to right a wrong that has been inflicted upon it.

While it remains to be seen whether the U.S. Supreme Court will uphold *Vaello-Madero* in the near future, there are strong arguments coming out of the First Circuit that point to Congress's unequal treatment of Puerto Rico. The violation of both the Bankruptcy Clause and the Fifth Amendment's Equal Protection Component of the U.S. Constitution through the exclusion of Puerto Rico from the 1984 Amendments is just one example of this unequal treatment, but a very powerful one with far-reaching consequences.