Nos. 15-1218, 15-1221, 15-1271, 15-1272

United States Court of Appeals for the First Circuit

FRANKLIN CALIFORNIA TAX-FREE TRUST, *ET AL.*,
Plaintiffs-Appellees,
v.
THE COMMONWEALTH OF PUERTO RICO, *ET AL.*,
Defendants-Appellants.

BLUEMOUNTAIN CAPITAL MANAGEMENT, LLC, *ET AL.*,
Plaintiffs-Appellees,
v.
ALEJANDRO GARCIA-PADILLA, IN HIS OFFICIAL CAPACITY
AS GOVERNOR OF THE COMMONWEALTH OF PUERTO RICO, *ET AL.*,
Defendants-Appellants.

On Appeal from the United States District Court
for the District of Puerto Rico (Besosa, J.)
Civil Action Nos. 3:14-cv-1518 & 3:14-cv-1569

MOTION FOR LEAVE TO FILE BRIEF FOR PROFESSORS CLAYTON P. GILLETTE AND DAVID A. SKEEL, JR. AS *AMICI CURIAE* SUPPORTING APPEAL OF THE COMMONWEALTH OF PUERTO RICO DEFENDANTS-APPELLANTS AND URGING REVERSAL

Gabriel R. Avilés-Aponte
TAPIA & AVILÉS
Cond. First Federal, Suite 601
Ave. Muñoz Rivera #1056
San Juan, PR 00927
Tel.: (787) 764-1430/1530
Fax: (787) 767-1683
E-mail: gravileslaw@gmail.com

March 16, 2015

MOTION FOR LEAVE TO FILE BRIEF FOR PROFESSORS CLAYTON P. GILLETTE AND DAVID A. SKEEL, JR. AS *AMICI CURIAE* SUPPORTING APPEAL OF THE COMMONWEALTH OF PUERTO RICO DEFENDANTS-APPELLANTS AND URGING REVERSAL

To the Honorable Judges of the United States Court of Appeals for the First Circuit:

1. In accordance with Rule 29(b) of the Federal Rules of Appellate Procedure movants ask this Honorable Court for leave to file the adjoined Amici Curiae Brief.

2. Professors Clayton P. Gillette and David A. Skeel, Jr. are teachers and scholars who have written extensively in the areas of municipal fiscal distress and municipal bankruptcy, including scholarship on some of the issues raised by this case.

3. Professor Clayton Gillette, is the Max E. Greenberg Professor of Contract Law at NYU School of Law and the author of numerous books and articles concerning local government law, including *Municipal Debt Finance Law: Theory and Practice* (2d ed. 2013) (co-authored with Robert S. Amdursky and G. Allen Bass); *Local Government Law: Cases and Materials* (5th ed. 2014) (co-authored with Lynn A. Baker and David Schleicher); *Fiscal Federalism, Political Will, and Strategic Use of Municipal Bankruptcy*, 79 U. Chi. L. Rev. 281 (2012); and *Bondholders and Financially Stressed Municipalities*, 39 Ford. Urb. L. J. 639 (2012).

4. Professor David A. Skeel, Jr., is the Bruce W. Nichols Visiting Professor of Law at Harvard Law School, and the S. Samuel Arsht Professor of Corporate Law at the University of Pennsylvania Law School and a member of the American College of Bankruptcy. He has also served as a Scholar in Residence at the American Bankruptcy Institute and is the author of numerous articles on municipal bankruptcy and related issues. *See, e.g.*, David A. Skeel, Jr., *What is a Lien? Lessons from Municipal Bankruptcy*, 2015 Ill. L. Rev. (forthcoming 2015); David A. Skeel, Jr., *Is Bankruptcy the Answer for Troubled Cities and States?*, 50 Houston L. Rev. 1063 (2013); David E. Skeel, Jr., *States of Bankruptcy*, U. Chi. L. Rev. (2012). Professor Skeel has also testified in Congress on the question whether States should be permitted to file for bankruptcy and written on these issues in the popular media. *See, e.g.*, David Skeel, *A Puerto Rican Solution for Illinois*, Wall St. J., Aug. 4, 2014.

5. As written in their Brief, their interest in this case is as teachers and scholars in bankruptcy, local government law, and municipal bankruptcy law, to promote an accurate and thorough consideration of the legal principles that deal with municipal insolvency, including the interpretation and application of the Bankruptcy Code as it applies to municipalities.

6. Their reason for writing their Brief and joining the captioned as Amici Curiae is that they see a need to fully address some arguments that, to their

knowledge, have not been brought or discussed by the parties concerning the history and purpose of municipal insolvency law.

7. As mentioned in their Brief, Professors Gillette and Skeel have carefully studied the history of municipal bankruptcy, the details of Chapter 9, and the consequences of municipal financial distress. Their analysis of these issues will assist the Court in assessing the meaning and context of the key statutory provisions, and the consequences of interfering with Puerto Rico's exercise of its territorial police powers in enacting the "Recovery Act".

8. Professors Gillette and Skeel and their counsel are the sole authors of this brief. No counsel for a party authored this brief in whole or in part, and no person other than Professors Gillette and Skeel and their counsel made a monetary contribution to its preparation or submission. They write in their individual capacity and their views do not necessarily represent those of the law schools and organizations they are affiliated with.

THEREFORE, for the reasons stated above, Movants ask and pray that this Honorable Court grant them leave to file the adjoined Amici Curiae Brief.

RESPECTFULLY SUBMITTED.

In San Juan, Puerto Rico, on this 16th day of March, 2015.

/s/ Gabriel R. Avilés-Aponte
GABRIEL R. AVILÉS-APONTE
USCA-1st Cir. 76849
e-mail: gravileslaw@gmail.com

TAPIA & AVILÉS
Cond. First Federal, Suite 601
1056 Ave. Muñoz Rivera
San Juan, Puerto Rico 00927
Tel.: (787) 764-1430/1530
Fax: (787) 767-1683

CERTIFICATE OF SERVICE

I hereby certify that on March 16, 2015, I electronically filed the foregoing document with the United States Court of Appeals for the First Circuit by using the CM/ECF system. I certify that all parties and *amici* or their counsel of record are registered as ECF Filers and that they will be served by the CM/ECF system, including the following: Manuel Fernández-Bared, Jonathan Mark Wagner, Theodore B. Olson, Christopher Landau, Jorge R. Roig, Joanne Alexandra Tomasini-Muñiz, Matthew D. McGill, Janitza M. García-Marrero, David C. Indiano-Vicic, Leticia Casalduc-Rabell, Lawrence B. Friedman, Margarita Luisa Mercado-Echegaray, Joseph Gabriel Feldstein-Del Valle, Linette Figueroa-Torres, Zarel Joan Soto-Acaba, Scott Grant Stewart, Claire McCusker Murray, Lewis Jeffrey Liman, Richard James Cooper, Sean Aaron O'Neal, Matthew J. Williams, David Ellis Blabey, Jr., Andrea G. Miller, Philip Bentley, John E. Roberts, and Mark David Harris.

In San Juan, Puerto Rico, on this 16th day of March, 2015.

/s/ Gabriel R. Avilés-Aponte
GABRIEL R. AVILÉS-APONTE
USCA-1st Cir. 76849
e-mail: gravileslaw@gmail.com

TAPIA & AVILÉS
Cond. First Federal, Suite 601
1056 Ave. Muñoz Rivera
San Juan, Puerto Rico 00927
Tel.: (787) 764-1430/1530
Fax: (787) 767-1683

Nos. 15-1218, 15-1221, 15-1271, 15-1272

United States Court of Appeals for the First Circuit

FRANKLIN CALIFORNIA TAX-FREE TRUST, *ET AL.*,
Plaintiffs-Appellees,
v.
THE COMMONWEALTH OF PUERTO RICO, *ET AL.*,
Defendants-Appellants.

BLUEMOUNTAIN CAPITAL MANAGEMENT, LLC, *ET AL.*,
Plaintiffs-Appellees,
v.
ALEJANDRO GARCIA-PADILLA, IN HIS OFFICIAL CAPACITY AS GOVERNOR OF THE COMMONWEALTH OF PUERTO RICO, *ET AL.*,
Defendants-Appellants.

On Appeal from the United States District Court for the District of Puerto Rico (Besosa, J.) Civil Action Nos. 3:14-cv-1518 & 3:14-cv-1569

BRIEF FOR PROFESSORS CLAYTON P. GILLETTE AND DAVID A. SKEEL, JR. AS *AMICI CURIAE* SUPPORTING APPEAL OF THE COMMONWEALTH OF PUERTO RICO DEFENDANTS-APPELLANTS AND URGING REVERSAL

Gabriel R. Avilés-Aponte
TAPIA & AVILÉS
Cond. First Federal, Suite 601
Ave. Muñoz Rivera #1056
San Juan, PR 00927
Tel.: (787) 764-1430/1530
Fax: (787) 767-1683
E-mail: gravileslaw@gmail.com

March 16, 2015

TABLE OF CONTENTS

TABLE OF AUTHORITIES

JURISPRUDENCE

STATUTES AND REGULATIONS

Federal:

<u>States and Territories</u>:

OTHER AUTHORITIES

BOOKS AND PERIODICALS

INTEREST OF AMICI

Professors Clayton P. Gillette and David A. Skeel, Jr. are teachers and scholars of municipal bankruptcy, bankruptcy law, and local government law. They have written extensively in the areas of municipal fiscal distress and municipal bankruptcy, including scholarship on some of the issues raised by this case. As teachers and scholars, their interest in this litigation is to promote an accurate and thorough consideration of the legal principles that deal with municipal insolvency, including the interpretation and application of the Bankruptcy Code as it applies to municipalities. Both Professor Gillette and Professor Skeel are writing in their individual capacity and their views do not necessarily represent those of the law schools and organizations with which they are affiliated.

Clayton Gillette is the Max E. Greenberg Professor of Contract Law at NYU School of Law. Professor Gillette is the author of numerous books and articles concerning local government law, including *Municipal Debt Finance Law: Theory and Practice* (2d ed. 2013) (co-authored with Robert S. Amdursky and G. Allen Bass); *Local Government Law: Cases and Materials* (5th ed. 2014) (co-authored with Lynn A. Baker and David Schleicher); *Fiscal Federalism, Political Will, and Strategic Use of Municipal Bankruptcy*, 79 U. Chi. L. Rev. 281 (2012); *Bondholders and Financially Stressed Municipalities*, 39 Ford. Urb. L. J. 639 (2012).

David A. Skeel, Jr. is the Bruce W. Nichols Visiting Professor of Law at Harvard Law School, and the S. Samuel Arsht Professor of Corporate Law at the University of Pennsylvania Law School. Professor Skeel is a member of the American College of Bankruptcy, and he has served as a Scholar in Residence at the American Bankruptcy Institute. Professor Skeel is author of numerous articles on municipal bankruptcy and related issues. *See, e.g.*, David A. Skeel, Jr., *What is a Lien? Lessons from Municipal Bankruptcy*, 2015 U. Ill. L. Rev. (forthcoming, 2015); David A. Skeel, Jr., *Is Bankruptcy the Answer for Troubled Cities and States?*, 50 Houston L. Rev. 1063 (2013); David A. Skeel, Jr., *States of Bankruptcy*, 79 U. Chi. L. Rev. 677 (2012). Professor Skeel has also testified in Congress on the question whether States should be permitted to file for bankruptcy and written on these issues in the popular media. *See, e.g.*, David Skeel, *A Puerto Rican Solution for Illinois*, Wall St. J., Aug. 4, 2014.

Professors Gillette and Skeel have carefully studied the history of municipal bankruptcy, the details of Chapter 9, and the consequences of municipal financial distress. Their analysis of these issues will assist the Court in assessing the meaning and context of the key statutory provisions, and the consequences of interfering with Puerto Rico's exercise of its territorial police powers in enacting the Recovery Act.

Professors Gillette and Skeel seek to file this brief by leave of court, supporting the Appeal.

STATEMENT REGARDING AUTHORSHIP OF *AMICUS CURIAE* BRIEF

Professors Gillette and Skeel and their counsel are the sole authors of this brief. No party, party's counsel or other person has authored this brief in whole or in part, or contributed money that was intended to fund preparing or submitting this brief.

SUMMARY OF ARGUMENT

By striking down the Recovery Act, the District Court took the extraordinary step of overriding Puerto Rico's exercise of its territorial police powers. If Congress clearly intended to preempt a Puerto Rican restructuring law, it had the power to do so. But there is no evidence supporting the conclusion that it did so. The District Court relied almost entirely on the legislative history of section 83(i), the predecessor of section 903 of the Bankruptcy Code, which was enacted in 1946 and limits the effect of State law restructuring statutes. When the predecessor of section 83(i) was enacted, Puerto Rico was deemed to be a State for municipal bankruptcy purposes and thus permitted to allow its municipalities to make use of the federal bankruptcy laws. In 1984, Congress adopted a new definition of "State" that excluded Puerto Rico's municipalities from municipal bankruptcy. There is no evidence that Congress intended for the new definition of State to leave Puerto Rico municipalities without <u>any</u> restructuring options. Nor does the language of section 903, together with the 1984 definition of State, demand that result. Read literally, section 903 only limits State law compositions if a municipality has actually filed for municipal bankruptcy.

Since the provisions in question do not clearly preempt Puerto Rico's right to enact a limited municipal debt adjustment statute, and there is no evidence Congress intended to do so, the District Court's conclusion that Puerto Rico does not have any restructuring options for its troubled municipalities cannot be justified.

The District Court's ruling also has implications for Puerto Rico's municipalities inconsistent with their public functions. Municipal corporations, such as the corporations covered by the Recovery Act, play a unique role in the provision of public services. Unlike the customers of a private firm, the citizens who benefit from services provided by a municipal corporation may have no realistic alternative if a distressed municipality cannot adjust its debts and must either cease services or increase taxes and fees. The history of municipal insolvency law demonstrates attention to the need for debt adjustment in order to ensure the continued provision of municipal services without generating substantial increases in the cost of services or exit by residents. It is, therefore, implausible that Congress, by denying Puerto Rico municipalities access to Chapter 9, intended that they have no avenue by which to adjust their debts. The District Court paid insufficient attention to that issue. Moreover, the District Court failed properly to analyze the extent to which the result of leaving Puerto Rico without a debt adjustment opportunity under bankruptcy law or Puerto Rico law created an anomalous situation.

Given the long-settled rule against preemption of State or territorial legislation unless the preemption is unmistakably clear, and the absence of clear preemption here, this Court should reverse the District Court's ruling invalidating the Recovery Act.

ARGUMENT

I. Section 903 Was Not Intended to, and Does Not, Pre-empt Puerto Rico Legislation such as the Recovery Act.

Although Congress's reasons for excluding Puerto Rico municipalities from Chapter 9 as of 1984 are not altogether clear, there is substantial evidence that Congress did not intend to pre-empt Puerto Rico legislation such as the Recovery Act, and no evidence at all that Congress sought to leave Puerto Rico without any restructuring option. This is evident from the history of section 903 and related provisions; from the well-established presumption against federal pre-emption except where the pre-emption is absolutely clear; and from a literal reading of section 903. We take up each issue in turn.

A. The District Court Ruling Conflicts with the History of Section 903 and Related Provisions.

From the earliest municipal bankruptcy laws until 1984, Puerto Rico municipalities were authorized to file for municipal bankruptcy. The first municipal bankruptcy law, which was enacted in 1934 as amendments to the Bankruptcy Act of 1898 and which the Supreme Court invalidated in 1936, authorized "[a]ny municipality or other political subdivision of any State" to file for municipal bankruptcy. 11 U.S.C. § 303, 48 Stat. 798, 798 (1934). The Bankruptcy Act defined "State" to include territories such as Puerto Rico. The 1937 municipal bankruptcy statute, which the Supreme Court upheld in 1938, simply listed the types of municipalities that could file for bankruptcy, including "any city, town, village, borough, township, or other municipality." 11 U.S.C. § 401, 50 Stat. 654, 654 (1937). These municipal bankruptcy provisions, which governed until Congress enacted the current Bankruptcy Code in 1978, clearly encompassed municipalities in Puerto Rico as well as municipalities in the States.

In 1942, the Supreme Court upheld a New Jersey State law restructuring framework in *Faitoute Iron & Steel Co. v. City of Asbury Park, N.J.*, 316 U.S. 502 (1942). The Court held that the statute did not offend the Contract Clause prohibition against State impairment of contracts because it improved the likely recovery of the bonds that would be restructured and came in response to a financial emergency. After the *Faitoute* decision, a State or territory had two different restructuring options for its municipalities: If permitted by the State or territory, a fiscally distressed municipality could file for bankruptcy in Chapter IX, the predecessor to current Chapter 9, or the State or territory could enact its own restructuring statute.

In 1946, Congress amended the Bankruptcy Act to restrict State laws that facilitate restructuring by "composition" of municipal debt. The 1946 amendments appear to have been based on a set of proposals made by the American Bar Association. Both the House and Senate Reports, like the ABA proposals, described section 83(i), the predecessor to current section 903, as designed to ensure that a single, federal bankruptcy law would govern all municipal debt adjustments where municipalities were eligible to participate in the federal bankruptcy regime. "[A] bankruptcy law under which the bondholders of a municipality are required to surrender or cancel their obligations should be uniform throughout the 48 States," the House Report explained, "as the bonds of almost every municipality are widely held. Only under a Federal law should a creditor be forced to accept such an adjustment without his consent." H.R. Rep. No. 2246, 79th Cong., 2d Sess. 4 (1946). Section 83(i) was thus designed to standardize the options for municipal debt adjustments, and to ensure that the same federal bankruptcy option would apply in all forty-eight States. The federal bankruptcy laws apply to all States and territories and Section 83(j) did not leave any such State or territory without a restructuring option for its municipalities.

The final key development came in 1984, after Congress had completely overhauled the bankruptcy laws in 1978. As originally enacted, the 1978 Bankruptcy Code had not included a definition for "State." As part of the 1984 amendments to the Code, Congress added a new provision defining "State" as "includ[ing] the District of Columbia and Puerto Rico, except for the purpose of who may be a debtor under chapter 9 of this title." 11 U.S.C. § 101(52). It is not clear why Congress excluded the District of Columbia and Puerto Rico from Chapter 9. Indeed, almost the only reference to the new definition in the legislative history came in testimony by Professor Frank Kennedy, one of the leading bankruptcy scholars of the era and executive director of the Commission on Bankruptcy Laws, who stated: "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, but the addition of the definition of 'State' is useful." Bankruptcy Improvements Act, Hearing on S. 333 & S. 445, before the Senate Comm. on the Judiciary, 98th Cong., 1st Sess. (April 6, 1983).

Given this history, the definition of "State," together with the restriction on composition in section 903, should not be viewed as being designed to preclude Puerto Rico both from authorizing its municipalities from filing for Chapter 9, and from enacting debt adjustment provisions for its municipalities. Either federal or local restructuring options, or both, had been available to Puerto Rico for fifty years, since the earliest municipal bankruptcy laws. Nothing in the legislative history, or in logic, reveals an intent to reverse that longstanding position in a way that leaves Puerto Rico without an option for resolving fiscal distress. Nor is this what section 903(1) says. As we demonstrate below, if read literally, section 903(1) does not preclude a Puerto Rico restructuring law.

B. Pre-emption of State Law Needs to be Extremely Clear.

Before we turn to the actual language of section 903, it bears emphasis that the Supreme Court has repeatedly held that State or territory law can only be pre-empted if the intent to pre-empt those laws is extraordinarily clear, particularly when, as here, a State's authority to provide for the health and welfare of its citizens through exercise of the State's police powers is at issue. *See, e.g.*, *Medtronic, Inc. v. Lohr*, 518 U.S. 470, 485 (1996); *CTS Corp. v. Waldburger*, 134 S. Ct. 2175, 2188 (2014). If a federal provision that might otherwise pre-empts State law is ambiguous, or can be interpreted in a way that avoids the pre-emption of a validly enacted State law, courts strongly favor the non-pre-emptive reading. Not only is it possible to interpret section 903 in this fashion; the non-pre-emptive reading is the most natural reading of actual language of the statute.

C. The District Court Misread Section 903

The District Court based its holding that section 903 pre-empts the Recovery Act on what it characterized as the unambiguous text of the Bankruptcy Code. Yet the court reads the key terms "creditor" and "debtor" out of section 903. If read literally, section 903 clearly does not pre-empt a State restructuring law such as the Recovery Act.

The District Court begins by pointing out that "[b]y its terms, section 903(1) applies to 'State' laws." *Franklin Cal. Tax Free Trust v. Puerto Rico*, Civil Nos. 14–1518 (FAB), 14–1569 (FAB) at 32 (D.P.R. Feb. 6, 2015) (hereinafter "District Court Opinion"). The court then turns to the definition of "State" in section 101(52), which states that "[t]he 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." *Id.* citing 11 U.S.C. § 101(52). This suggested to the District Court that Puerto Rico is a State in every context except with respect to the question whether a municipality qualifies as a proper Chapter 9 debtor under section 109 of the Bankruptcy Code, because a "municipality" means a "political subdivision or public agency or instrumentality of a State." 11 U.S.C. § 101(40). The court concluded the reference to State law in section 903 therefore includes Puerto Rico, because section 903 does not "fit[] into the narrow exception of 'defining who may be a debtor under chapter 9." District Court Opinion at 32. According to the District

Court, Puerto Rico's Recovery Act is therefore pre-empted by section 903(1), because section 903(1) states that a State law composition "may not bind any creditor that does not consent."

The District Court is reading section 903 creatively, not literally. The District Court's reading is in tension with what section 903 actually says.

Under section 903(1), a composition law "may not bind any creditor that does not consent," and section 903(2) says that "a judgment entered under such a law may not bind a creditor that does not consent to such composition." The key term here is "creditor," which is carefully defined by the Bankruptcy Code. A "creditor" is "an entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor," 11 U.S.C. § 101(10)(A), or an entity that has a claim under a handful of other sections of the Bankruptcy Code not relevant here. 11 U.S.C. § 101(10)(B) & (C). As this definition makes quite clear, "creditors" do not exist until a debtor has actually filed a bankruptcy case. The term "debtor" is defined quite similarly. Under 11 U.S.C. § 101(13), "[t]he term 'debtor' means person or municipality concerning which a case under this title has been commenced." By its literal terms, section 903 therefore does not apply unless a Chapter 9 case has actually been filed. Because Puerto Rico municipalities are not permitted to file for Chapter 9, section 903 cannot and does not apply to a Puerto Rico composition law such as the Recovery Act.

The District Court dismisses these readings in a footnote that relies principally on the legislative history to the predecessor of section 903, while ignoring both the language of section 903 and Congress's likely intent when it added a new definition of "State" to the Bankruptcy Code in 1984. "[R]eading section 903(1) as applying only when a Chapter 9 bankruptcy has commenced would deprive 903(1) of any practical effect," the court writes. District Court Opinion at 41. "More significantly," the District Court continues, "this reading is contrary to the legislative history of section 903(1) and its predecessor, which unequivocally indicates that Congress's intent in enacting the provision was to ensure that 'a bankruptcy law under which bondholders of a municipality are required to surrender or cancel their obligations [is] uniform throughout the [United] States' because '[o]nly under a Federal law should a creditor be forced to accept such an adjustment without his consent.'" *Id*. (citation omitted).

The problem with the District Court's analysis is that it simply ignores what the statute actually says. By its terms, section 903(1) only applies if a bankruptcy case has been filed. Nor is the literal interpretation absurd. Under the statute as written, section 903 makes clear that a State composition law could not be used to alter a creditor's claim against a municipality that has filed for Chapter 9. Any prior or concurrent State law composition proceeding would be superseded pursuant to section 903(1) once the municipality filed for Chapter 9, and any judgment previously obtained would be reopened under section 903(2). The Bankruptcy Code frequently achieves similar effects in other provisions. Under section 303(h)(2), for instance, the existence of a State law proceeding that has taken control of the debtor's assets serves as validation of an involuntary bankruptcy case, which then supersedes the State law proceeding.

At least one bankruptcy scholar has suggested a somewhat narrower interpretation of the language of section 903. Stephen J. Lubben, *Puerto Rico and the Bankruptcy Clause*, 88 Am. Bankr. L.J. 553, 576 (2014). According to this reading, section 903 prohibits composition laws altogether in States that have the option of permitting their municipalities to file for bankruptcy, but does not apply to Puerto Rico municipalities or to the District of Columbia. This reading has the virtue of taking the actual language of section 903 seriously, while permitting section 903 to operate more fully in the States for which it arguably was intended to apply. It thus accords both with Congress's intent in enacting section 83(i) in 1946, and Congress's intent when it added a new definition of State in 1984. In our view, Professor Lubben's is not the most natural reading of the literal language of section 903, but it is preferable to simply ignoring the language of the statute, as the District Court did. This reading also is consistent with the longstanding history of ensuring that every State and territory has at least some debt adjustment option available for its municipalities. By contrast, the District Court's ruling that the new 1984 definition of State left Puerto Rico without any restructuring option conflicts with the well-settled rule that courts should be very hesitant to interpret the Bankruptcy Code to dramatically alter pre-Code practice absent unmistakably clear evidence that a provision is intended to achieve this effect. *See, e.g., United Savings Assn. of Texas v. Timbers of Inwood Forest Associates, Ltd.*, 484 U.S. 365, 380 (1988).

Our principal point here is that the Bankruptcy Code does not dictate the conclusion reached by the District Court. To the contrary, under the most natural interpretation of section 903, the Bankruptcy Code does not pre-empt Puerto Rico's Recovery Act. At the very least, if one engages in the type of technical analysis of the Bankruptcy Code's language that the District Court purported to undertake, one is left with the conclusion that the statute is ambiguous rather than that the statute supports a finding Congressional intent to pre-empt.

II. Ambiguity Concerning Congressional Intent Should be Resolved Against the Unreasonable Result of Prohibiting Debt Adjustment that Assures Provision of Vital Municipal Services.

A. The Failure to Allow Debt Adjustment Drastically Diminishes the Capacity of Municipalities to Fulfill Their Role as Providers of Public Goods.

We have demonstrated above that careful analysis of the relevant statutes and legislative history reveals that Congress did not, by excluding Puerto Rico municipalities from the category of eligible "debtors" under Chapter 9, intend to pre-empt Puerto Rico from creating its own mechanism for adjusting the debts of distressed municipalities. At the very least, the above analysis demonstrates ambiguity concerning Congressional intent. Any such ambiguity should be resolved by the application of well-established canons of interpretation. Those canons require courts to interpret statutes to avoid preemption and unreasonable, unequitable, or even odd results. *See, e.g.*, *Comm'r v. Asphalt Prods. Co.*, 482 U.S. 117 (1987); In re *WTC Disaster Site*, 414 F.3d 352, 372 (2d Cir. 2005); *Hughey v. JMS Dev. Corp.*, 78 F.3d 1523, 1529 (11th Cir.1996) (quoting *Green v. Bock Laundry Mach. Co.*, 490 U.S. 504, 509 (1989)). Indeed, the Supreme Court has concluded that "[f]requently . . . even when the plain meaning did not produce absurd results but merely an unreasonable one 'plainly at variance with the policy of the legislation as a whole' this Court has followed that purpose, rather than the literal words." *United States v. Am. Trucking Assns*, 310 U.S. 534, 543 (1940) (internal citations omitted). On that standard, there is no doubt that any ambiguity about pre-emptive intent in this case should be resolved in favor of allowing Puerto Rico to create a debt adjustment plan for its municipalities because a contrary conclusion would produce the highly unreasonable consequence of interfering with the orderly and efficient delivery of the very services that those municipalities were created to provide and that Congress has recognized as a core objective of municipal bankruptcy.

As the District Court recognized, invalidation of the Recovery Act on pre-emption grounds means that Puerto Rico municipalities have no mechanism for adjusting debts in the event of severe fiscal distress. As discussed above, Puerto Rico municipalities are explicitly excluded from filing for debt adjustment under Chapter 9 of the Bankruptcy Code. *See* 11 U.S.C. § 101(52) ("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."). A finding of pre-emption would mean that Puerto Rico itself is also precluded from creating a mechanism for debt adjustment. In order to evaluate whether Congress should be deemed to have intended such a result, therefore, it is necessary to consider the consequences of such a conclusion. We conclude that an understanding of those consequences demonstrates that Congress could not have intended that Puerto Rico be left without a mechanism for adjusting onerous debts that would prevent its municipalities from fulfilling the very public objectives for which they were created.

Municipal corporations, such as the municipalities covered by the Recovery Act, play a unique role in the provision of services. As is the case with private firms, municipal corporations provide goods and services to "customers" (residents). But the goods and services that municipal corporations provide have characteristics that distinguish them from the goods and services provided by private firms operating in a well-functioning market. The goods and services provided by municipal corporations, which typically include police, fire, street maintenance, parks, and utility delivery, are typically referred to as "public goods" or goods that have characteristics of "natural monopolies." The latter category involves goods that have continually decreasing average costs – "the greater the level of output, the lower the cost per unit." Harvey S. Rosen and Ted Gayer, *Public Finance* 358 (9th ed. 2010). Typically this occurs when the initial costs of entry are so high that a potential private producer of the good will refuse to incur the necessary capital costs without some assurance of monopoly power, because the producer cannot otherwise be confident that it will recover its initial investment. Common examples include water or sewer systems or electrical service. Thus, the government itself may produce the good as a monopolist. Goods and services are "public" when they have characteristics that deter private firms from supplying them, notwithstanding that there is substantial demand for them. Goods have characteristics of "publicness" if they are "nonrival," in the sense that multiple consumers can utilize them simultaneously. Under those circumstances, potential users are able to obtain the benefits of the good without contributing anything to the costs of providing it if someone else pays for the production of the good. Examples include policing or mosquito spraying. Thus, private providers cannot be confident that consumers will pay for goods rather than wait for others to pay for their production. Or, public goods may be "nonexcludable," in the sense that it would be inefficient to attempt to recover from users the minimal marginal cost of providing the good. Examples include street paving or uncongested roads. *Id*. at 54-56.

If goods with these characteristics are to be efficiently provided, it may be that governmental provision is necessary, since private actors don't have incentives to produce them at levels consistent with demand. The typical solution to the failure of the market to provide goods susceptible to natural monopoly or public goods that have a limited geographic effect is to create a local government that undertakes to provide them and then to allow that government to impose mandatory taxes or fees to pay for their provision. Indeed, the provision of public goods is arguably the most important function of a municipal corporation because, in their absence, the failure of the private market to provide them means that the services simply will not exist at an efficient level.

The potential consequences of not allowing a fiscally distressed municipality to adjust its debts are clear from a comparison with the failure of a private firm. If a private firm becomes distressed and cannot adjust its debts, it must charge noncompetitive prices that ultimately induce customers to seek substitutes elsewhere. As a result, the firm may be liquidated, but its customers continue to satisfy their needs through marketplace transactions with the failed firm's competitors. But the "customers" (residents) of a distressed municipality have no such option. Governments typically provide the public services they offer on a monopoly basis. Residents who cannot obtain the goods and services from their local governments at something close to marginal cost must either move to a different jurisdiction, pay inordinately high prices (taxes and fees) for services, or do without. Obviously, this has distributive effects as the relatively wealthy leave the jurisdiction to escape higher taxes and fees and the relatively poor are unable to do so, leaving the municipality with a smaller and smaller tax base to provide services to a poorer population, and as a larger share of municipal revenues is used to pay for past debts rather than to pay for current services. *See, e.g.*, In re *Sullivan Cnty. Reg'l Refuse Disposal Dist.*, 165 B.R. 60, 66 (Bankr. D.N.H. 1994) (discussing how a disposal district's tipping fees led to a "'death spiral' . . . whereby increased fees result in lower total dollar collections by driving away customers because of the higher fees."); In re *Pub. Serv. Co. of N.H.*, 114 B.R. 820, 831 (Bankr. D.N.H. 1990) (discussing how electricity rates set "too high" can trigger a "death spiral" of diminishing returns due to an exodus of customers).

Congress and the courts have recognized this unique position of municipalities and have required creditors to accept debt adjustment in order to ensure the efficient provision of services to residents through the enactment and implementation of Chapter 9. Implicitly, the enactment of Chapter 9 recognizes that creditors are in a far superior position to bear the risk of municipal fiscal distress than are residents, because creditors can spread the risk of default over a diversified portfolio of investments, while residents have no alternative source of service. This balance of interests pervades Chapter 9. Thus, bankruptcy courts have interpreted the requirement that a municipality be "insolvent" before filing a petition under Chapter 9 to mean "service delivery insolvency." *See* In re *City of Stockton*, 493 B.R. 772, 781 (Bankr. E.D. Cal. 2013); In re *City of Detroit*, 504 B.R. 97, 169-70 (Bankr. E.D. Mich. 2013). A proposed plan to exit Chapter 9 can be confirmed only if it is "feasible," 11 U.S.C. § 943(b)(7), and courts have interpreted feasibility to mean "whether the debtor can accomplish what the plan proposes and provide governmental services." In re *Mount Carbon Metro. Dist*., 242 B.R. 18, 35 (Bankr. D. Colo.1999). Notably, the court in the City of Detroit bankruptcy recently adopted a standard of "feasibility" that considered whether the city "will be able to sustainably provide basic municipal services to the citizens of Detroit and to meet the obligations contemplated in the Plan without the significant probability of a default." In re *City of Detroit*, 524 B.R. 147, 222 (Bankr. E.D. Mich. 2014). Indeed, the entire structure of Chapter 9 is commonly recognized as providing a municipality with a "fresh start," analogous to an individual bankruptcy, rather than a mechanism purely for the collection of assets to maximize the benefit of creditors, as in the case of corporate bankruptcy. *See* Michael W. McConnell & Randal C. Picker, *When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy*, 60 U. Chi. L. Rev. 425, 470 (1993) ("[M]unicipal bankruptcy is based on the idea of the fresh start rather than the efficient reconfiguration of assets. The theory of Chapter 9 is that the burden of debt service, if sufficiently high, will affect the taxpayers of a city as it would a debt-ridden individual: it will sap initiative and depress money-generating activity"); Omer Kimhi, *Reviving Cities: Legal Remedies to Municipal Fiscal Crises*, 88 B.U. L. Rev. 633, 654 (2008) ("The underlying assumption [of municipal bankruptcy] is that mitigating the city's financial hardship provides the locality with a fresh start and enables its rehabilitation, to the benefit of both residents and creditors").

Even outside of municipal bankruptcy, courts have historically recognized that the crucial role of municipalities in providing public goods requires creditors to bear the risk of fiscal distress. Justice Frankfurter noted in *Faitoute Iron & Steel Co. v. City of Asbury Park*, 316 U.S. 502, 510 (1942), that failure to adjust debts had historically generated an "empty right to litigate," as creditors armed with a writ of mandamus to collect taxes from an insolvent municipality were met with resignations of tax-collecting officers, and courts systematically refused to force municipalities to pay where the result was the further deterioration of municipal services. *See* Robert S. Amdursky, Clayton P. Gillette, & G. Allen Bass, *Municipal Debt Finance Law: Theory and Practice* 334-38 (2d ed. 2013) (discussing the reluctance by courts to order a remedy that would push the municipality further into fiscal distress). Even courts that agreed that creditors of a municipality were entitled to a writ of mandamus to collect taxes sufficient to pay debts ultimately observed that if payment would prevent the debtor from performing its "essential functions" the writ would not issue. *See, e.g., Cromartie v. Commr's of Bladen,* 85 N.C. 211, 216 (1881) ("[I]f the entire fund which can be raised by taxation is required to meet the necessary expenses of an economical administration of the county government, and none can be diverted to pay its indebtedness without serious detriment to the public, none ought to be thus appropriated"); *Defoe v. Town of Rutherfordton*, 122 F.2d 342, 345 (4th Cir. 1941) ("We agree that the court may modify an order in the nature of a writ of mandamus, where in the light of subsequent events its commands have become improper, as where . . . [it] would interfere with the support of necessary governmental functions."). Alternatively, courts effectively compromised debts by structuring the terms of payment in a manner that balanced "the orderly administration of municipal government and the duty owing to the [creditor]." *United States ex rel. Metzger v. City of Vero Beach*, 90 F.2d 70, 72 (5th Cir. 1937).

Congress certainly was aware of this history when it enacted the predecessor to section 903 in 1946. *See* McConnell & Picker, *supra* at 462 (describing the legislative underpinnings of the predecessor of section 903). The creation of a federal bankruptcy law eliminated both the need for uncoordinated, case-by-case adjudication of municipal circumstances by judges and the presence of potentially conflicting State procedures. But given that Congress was reacting to the need to bring order to the process of debt adjustment, rather than to forestall or limit it, it would be unreasonable to believe that Congress was doing anything more than substituting a federal bankruptcy remedy for a State-provided one.

The negative implication of that Congressional intervention, however, is that where no federal bankruptcy was available to municipalities of a sovereign such as Puerto Rico, that sovereign's ability to restructure the debt of its municipalities remained intact. In short, debt adjustment for municipalities recognizes the central role that they play in efficiently providing public goods and services not otherwise available in the market and ensures the continued availability of those services notwithstanding that some creditors will be disadvantaged.

Puerto Rico municipalities today face the very consequences of debt overhang that Congress sought to avoid. A 2014 report from the Federal Reserve Bank of New York ("Report") illustrates that the "death spiral" of high rates of exit followed by high taxes and fees for those who remain followed by higher rates of exit has indeed materialized. *See generally* Federal Reserve Bank of New York, *An Update on the Competitiveness of Puerto Rico's Economy* (July 31, 2014), *available at* http://newyorkfed.org/outreach-and-education/puerto-rico/2014/Puerto-Rico-Report-2014.pdf. That Report concluded that "[a]mong the fifty states plus the District of Columbia, Puerto Rico would rank second in terms of total tax burden, behind only Alaska with its unusually large severance taxes." *Id.* at 14. One consequence of this has been sustained depopulation. The Report noted that:

> [T]he Island's rate of outmigration has increased significantly, contributing to an acceleration in the population decline. Puerto Rico's population fell from its peak of 3.8 million in 2004 to about 3.6 million in 2013, a decline of 212,000 residents, or 5.5 percent, over this nine-year period . . . . Moreover, the Island's population is projected to fall by 0.65 percent in 2014—one of the steepest projected population declines among countries around the globe.

Id. at 4 (footnotes omitted).

It is implausible that Congress, by denying Puerto Rico municipalities access to Chapter 9, intended that they have no avenue by which to adjust debts. History shows that the previous "debt adjustment" procedure of circumventing mandamus orders was untenable. But to believe that Congress would have wanted thereby to deny Puerto Rico's municipalities any avenue for relief is to entertain the implausible conclusion that Congress was indifferent to the plight of Puerto Rico's municipalities that were ineligible for Chapter 9, thereby locking them into service delivery insolvency with its inherent death spiral, or that Congress preferred that Puerto Rico's municipalities have no systematic avenue to ensure the provision of municipal goods rather than have such a systematic scheme.

B. States That Have Failed To Specifically Authorize Their Municipalities To File For Chapter 9 Are Not Analogous To Puerto Rico.

The District Court implicitly rejects the claim that Puerto Rico's inability to restructure debts is problematic when it denies that it is "anomalous" to read the Bankruptcy Code as both precluding Puerto Rico municipalities from participating in Chapter 9 proceedings and pre-empting Puerto Rico laws that govern debt restructuring for Puerto Rico municipalities. *See* District Court Opinion at 38-39. The District Court reached this conclusion on the theory that municipalities otherwise eligible for Chapter 9 must receive specific authorization from their State, and several States have failed to provide that authorization. The District Court thereby implies that States eschewing Chapter 9 have made a deliberate decision to avoid Chapter 9, notwithstanding that they cannot adopt their own debt adjustment legislation, and that the resulting absence of any debt adjustment mechanism for the municipalities of such States places them in the same position as Puerto Rico.

The District Court's rationale, however, is seriously flawed. In the first instance, unlike the situation in which the District Court places Puerto Rico, States are not disabled from both enacting debt adjustment regimes and filing for Chapter 9. Instead, some States have failed to exercise the option that they clearly possess of specifically authorizing their municipalities to seek debt adjustment under Chapter 9. There is a crucial difference between the failure to exercise an option and the absence of having that option in the first instance. States that have not authorized their municipalities to file petitions under Chapter 9 can clearly change their mind should circumstances warrant it. Puerto Rico possesses no such option.

Second, the District Court's opinion fails to understand why many States may not have enacted the necessary legislation to permit their municipalities to file for Chapter 9. The District Court thereby implies that non-authorizing States have affirmatively determined that the inability to file under Chapter 9 is not problematic. There is little reason to conclude that State inaction is predicated on such a calculation. The requirement of "specific authorization" has existed only since 1994. Prior to that time, a municipality could be a debtor under 11 U.S.C. § 109(c)(2) 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 such entity to be a debtor under such chapter." Courts were divided as to whether the relevant language allowed municipalities to file on the basis of legislation such as home rule grants or the grant to municipalities of the power to sue and be sued rather than on the basis of legislation that explicitly invoked the authority to file under Chapter 9. The majority position allowed broad authorization, largely on the theory that "that financially distressed municipalities should be able to efficiently and expeditiously reorganize their economic affairs." *See* In re *Pleasant View Util. Dist. of Cheatham Cnty.*, 24 B.R. 632, 638 (Bankr. M.D. Tenn.

1982) (concluding from legislative history that Congress intended to impose minimal barriers for municipalities to file under Chapter 9); Nicholas B. Malito, *Municipal Bankruptcy: An Overview of Chapter 9 and a Critique of the "Specifically Authorized" and "Insolvent" Eligibility Requirements of 11 U.S.C.A. § 109(c)*, 17 J. Bankr. L. & Prac. 4 Art. 2 (2008) (providing an overview of how courts historically construed general authorization under Chapter 9).

Congress ultimately adopted the minority view and, in 1994, required that a municipality be "specifically authorized" by the State to be a debtor under Chapter 9. *See* 11 U.S.C. § 109(c)(2) (requiring that a municipality be "specifically authorized" by State law to be a debtor under Chapter 9). But few States that might previously have concluded that their municipalities qualified for debt adjustment through general authorization have enacted the legislation made necessary by the statutory change. This is not a surprising result. Notwithstanding the recent fiscal crisis, there do not appear to have been substantial threats of default by municipalities in States have not adopted specific authorization. Thus, there has been little impetus for State legislatures to adopt the necessary authorizing statutes. Even those States that have enacted statutes that specifically authorize the filing of Chapter 9 petitions tend to have enacted those statutes prior to 1994. *See, e.g.*, Conn. Gen. Stat. Ann. § 7-566 (added by P.A. 93-421, § 7, eff. July 1, 1993); N.Y. Local Fin. L. § 85.80 (added by L.1975, c. 868, §19, eff. Sept. 9, 1975); Neb. Rev. Stat. §

13-402 (added by Laws 1981, LB 327, § 2); Ohio Rev. Code Ann. § 133.36 (1989 H 230, eff. 10-30-89). In short, an earlier belief that general statutes provide adequate protection, combined with inertia that has interfered with post-1994 statutory amendments, rather than a deliberative decision to avoid the benefits of Chapter 9, may explain the uneven enactment of the necessary legislation.

If a municipality in one of the States that has not specifically authorized a Chapter 9 filing faces immediate insolvency, that State can quickly respond with the necessary legislation. Its municipalities are not foreclosed from achieving the debt relief necessary to ensure the continued delivery of essential public goods or from forestalling the exodus of population and revenue that inevitably accompanies distress. On the District Court's interpretation of Congressional intent, however, Puerto Rico cannot. On that interpretation, Puerto Rico alone is helpless to assist its municipalities to achieve the debt relief that would staunch the flow of human and financial capital that results from fiscal distress. Leaving Puerto Rico without the option of formulating its own regime for debt adjustment, therefore, does indeed create an anomaly that can be avoided through an interpretation of Congressional intent more consistent with the well-recognized objective of preserving municipal services.

CONCLUSION

For all the foregoing reasons, and as previously stated given the long-settled rule against preemption of State or territorial legislation unless the preemption is unmistakably clear, and the absence of clear preemption here, this court should reverse the District Court's ruling invalidating the Recovery Act.

RESPECTFULLY SUBMITTED.

In San Juan, Puerto Rico, on this 16th day of March, 2015.

Amici Curiae:

s/ Clayton P. Gillette
CLAYTON P. GILLETTE
40 Washington Square South
New York, NY 10012
212-998-6749
clayton.gillette@nyu.edu

s/ David A. Skeel, Jr.
DAVID A. SKEEL, JR.
3501 Sansom Street
Philadelphia, PA 19104
215-573-9859
dskeel@law.upenn.edu

s/ Gabriel R. Avilés-Aponte
GABRIEL R. AVILÉS-APONTE
USCA-1st Cir. 76849
e-mail: gravileslaw@gmail.com

TAPIA & AVILÉS
Cond. First Federal, Suite 601
1056 Ave. Muñoz Rivera
San Juan, Puerto Rico 00927
Tel.: (787) 764-1430/1530
Fax: (787) 767-1683

Counsel for Amici Curiae

CERTIFICATE OF SERVICE WITH RULE 32(a)

Certificate of Compliance With Type-Volume Limitation, Typeface Requirements, and Type Style Requirements

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains **6,880 words**, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using **Microsoft Office Word 2013** in **Times New Roman, size 14**.

In San Juan, Puerto Rico, on this 16th day of March, 2015.

/s/ Gabriel R. Avilés-Aponte
GABRIEL R. AVILÉS-APONTE
USCA-1st Cir. 76849
e-mail: graviles law@gmail.com

TAPIA & AVILÉS
Cond. First Federal, Suite 601
1056 Ave. Muñoz Rivera
San Juan, Puerto Rico 00927
Tel.: (787) 764-1430/1530
Fax: (787) 767-1683

CERTIFICATE OF SERVICE

I hereby certify that on March 16, 2015, I electronically filed the foregoing document with the United States Court of Appeals for the First Circuit by using the CM/ECF system. I certify that all parties and *amici* or their counsel of record are registered as ECF Filers and that they will be served by the CM/ECF system, including the following: Manuel Fernández-Bared, Jonathan Mark Wagner, Theodore B. Olson, Christopher Landau, Jorge R. Roig, Joanne Alexandra Tomasini-Muñiz, Matthew D. McGill, Janitza M. García-Marrero, David C. Indiano-Vicic, Leticia Casalduc-Rabell, Lawrence B. Friedman, Margarita Luisa Mercado-Echegaray, Joseph Gabriel Feldstein-Del Valle, Linette Figueroa-Torres, Zarel Joan Soto-Acaba, Scott Grant Stewart, Claire McCusker Murray, Lewis Jeffrey Liman, Richard James Cooper, Sean Aaron O'Neal, Matthew J. Williams, David Ellis Blabey, Jr., Andrea G. Miller, Philip Bentley, John E. Roberts, and Mark David Harris.

In San Juan, Puerto Rico, on this 16th day of March, 2015.

/s/ Gabriel R. Avilés-Aponte
GABRIEL R. AVILÉS-APONTE
USCA-1st Cir. 76849
e-mail: gravileslaw@gmail.com

TAPIA & AVILÉS
Cond. First Federal, Suite 601
1056 Ave. Muñoz Rivera
San Juan, Puerto Rico 00927
Tel.: (787) 764-1430/1530
Fax: (787) 767-1683