No. 15-233

IN THE
Supreme Court of the United States

THE COMMONWEALTH OF PUERTO RICO,
ALEJANDRO GARCÍA PADILLA,
as Governor of the Commonwealth of Puerto Rico,
and CÉSAR MIRANDA RODRÍGUEZ, as Secretary of
Justice of the Commonwealth of Puerto Rico,

Petitioners,

v.

FRANKLIN CALIFORNIA TAX-FREE TRUST, *et al.,*

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the First Circuit

REPLY TO BRIEF IN OPPOSITION

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Respondents assert that this Court's review is unwarranted because (1) the decision below is "indisputably correct," BlueMountain Opp. 3; *see also* Franklin Opp. 11-28, and (2) the financial crisis facing Puerto Rico's public utilities is "imaginary," *id.* at 8; *see also* BlueMountain Opp. 2, 10, 12-17. As explained below, those assertions are baseless.

ARGUMENT

I. Respondents' Efforts To Defend The Decision Below Are Unavailing.

Like the courts below, respondents begin and end their textual analysis with the language of Section 903(1). According to respondents, the Recovery Act is a "'State law prescribing a method of composition of indebtedness,'" and is thus preempted insofar as it purports to "'bind any creditor that does not consent to such composition.'" Franklin Opp. 3-4 (quoting 11 U.S.C. § 903(1)); BlueMountain Opp. 7, 17-18 (same).

But that argument begs the question whether Section 903(1) applies to Puerto Rico in the first place. It does not. To the contrary, that Section is a proviso to a clause that does not apply to Puerto Rico, located within a chapter of the Bankruptcy Code that does not apply to Puerto Rico. Because the whole point of Chapter 9 is to create a mechanism for municipalities (including public utilities) to seek federal bankruptcy protection—a mechanism for which Puerto Rico's municipalities are categorically ineligible—it would be nonsensical to apply Section 903(1) to those municipalities. And because Section 903(1) does not apply to Puerto Rico, it follows that not only respondents' express-preemption argument, but also their conflict- and field-preemption arguments (both of which are also based on Section

903(1), *see, e.g.*, BlueMountain Opp. 29-32), fail as a matter of law.

Indeed, had Congress intended to take the unprecedented step of barring Puerto Rico's public utilities—which provide essential public services to the Commonwealth's citizens—from restructuring their debts under *any* law, it could hardly have done so in a more roundabout way. This Court should not lightly impute to Congress the decision to treat Puerto Rico and its 3.5 million American citizens in such a cavalier manner.

Unable to rebut the plain implication of the statute's structure, respondents double down on its legislative history. In particular, they insist that Section 903(1) was enacted in response to this Court's decision in *Faitoute Iron & Steel Co v. City of Asbury Park*, 316 U.S. 502 (1942), "which had sustained a New Jersey municipal debt restructuring statute in the face of a preemption challenge." Franklin Opp. 13; *see also* BlueMountain Opp. 6, 18, 23. The whole point of the provision, they argue, was to ensure that a municipal bankruptcy would occur "'only under a Federal law.'" Franklin Opp. 1 (quoting H.R. Rep. No. 79-2246, at 4 (1946)); *see also* BlueMountain Opp. 23.

Again, that argument begs the question whether Section 903(1) applies to a jurisdiction, like Puerto Rico, categorically excluded from federal municipal bankruptcy law in the first place. The legislative history cited by respondents dates from almost *forty years* before the exclusion of any jurisdiction from Chapter 9, and thus sheds no light on the legal consequences of such exclusion. It is one thing to say that Chapter 9 provides the exclusive mechanism for

municipal bankruptcy insofar as it applies; it is another thing altogether to say that Chapter 9 provides the exclusive mechanism for municipal bankruptcy *even for jurisdictions categorically ineligible for Chapter 9 relief*. Nothing in the text, structure, or history of Section 903(1) remotely suggests the latter interpretation.

Respondents similarly miss the mark by insisting that Section 903's principal clause—which provides that Chapter 9 "does not limit or impair the power of a State to control ... a municipality"—must apply to Puerto Rico because "the text of Section 903 did not change in 1984." BlueMountain Opp. 21; *see also* Franklin Opp. 1, 4-5. But Congress can alter the scope of a substantive statutory provision through a statutory definition, and that is just what happened here. Congress altered the scope of Section 903 in 1984 by defining the word "State" in 11 U.S.C. §101(52) to categorically preclude Puerto Rico's municipalities from seeking Chapter 9 relief.

Nor is there any basis for respondents' conclusory assertion that Section 903(1) is the rare proviso that operates independently of its principal clause. *See* BlueMountain Opp. 22-23; Franklin Opp. 20-21. As explained in the petition, the general rule is that a proviso serves "as a *limitation* upon the principal clause," *Republic of Iraq v. Beaty*, 556 U.S. 848, 858 (2009) (emphasis added), and thus by definition can extend no *further* than the principle clause. There is no reason to conclude that Section 903(1) is an exception to that general rule. Indeed, long before this litigation was contemplated, counsel of record for the Franklin respondents recognized that "[Section 903(1)] appears as an exception to § 903's

respect for state law in chapter 9 and thus appears to apply *only* in a chapter 9 bankruptcy." Thomas Moers Mayer, *State Sovereignty, State Bankruptcy, & a Reconsideration of Chapter 9*, 85 Am. Bankr. L.J. 363, 379 n.84 (2011) (emphasis added).

Finally, respondents err by asserting that petitioners' structural argument proves too much. Accepting that argument, they contend, would require this Court to hold Section 903(1) inapplicable to municipalities eligible to seek Chapter 9 protection but not authorized by their States to do so, thereby undermining the uniformity of federal municipal-bankruptcy law. *See*, *e.g.*, BlueMountain Opp. 20, 23-25; Franklin Opp. 21-22.

But that argument is a *non sequitur*. To conclude that Section 903(1) is legally and logically inapplicable to a jurisdiction (like Puerto Rico) categorically ineligible to authorize its municipalities to seek Chapter 9 relief is not to conclude that Section 903(1) is similarly inapplicable to jurisdictions that *are* eligible to authorize their municipalities to seek Chapter 9 relief, but (for whatever reason) have not done so. Indeed, Congress itself necessarily *rejected* the uniformity of federal municipal-bankruptcy law by barring Puerto Rico from authorizing its municipalities to seek Chapter 9 relief in the first place.

II. Respondents' Efforts To Minimize The Importance Of This Case Are Unavailing.

Apart from their unavailing efforts to defend the decision below on the merits, respondents insist that this case is insufficiently important to warrant this Court's review. According to respondents, petitioners are merely crying wolf, and the "supposed

emergency" that drove the Commonwealth to enact the Recovery Act is "largely invented." Franklin Opp. 28; *see also* BlueMountain Opp. 12. Again, their arguments are unavailing.

Ironically, respondents filed their opposition briefs just two days after the Administration submitted a report to Congress on Puerto Rico's economic and fiscal crisis. *See* President Barack Obama, *Addressing Puerto Rico's Economic & Fiscal Crisis and Creating a Path to Recovery* (Oct. 21, 2015) (*White House Report*), *available at* http://tinyurl.com/nbulohb (last visited Nov. 9, 2015). That report details the severity of the economic crisis, and warns that it may soon become "a humanitarian crisis." *Id.* at 1.

Respondents insist that the crisis relates to the financial situation of the Commonwealth, not of its public utilities. *See* BlueMountain Opp. 12-13; Franklin Opp. 30 n.19. But that alleged distinction is illusory; the financial situations of the Commonwealth and its public utilities are inextricably intertwined. *See, e.g.*, Commonwealth of Puerto Rico, *Financial Information & Operating Data Report* (Oct. 30, 2014), at 8, *available at* http://tinyurl.com/olwcxxw (last visited Nov. 9, 2015) (noting that the Commonwealth has been forced to subsidize certain essential public utilities, like the highway authority, to keep them afloat). The Commonwealth did not go to the trouble of enacting the Recovery Act—and is not now calling upon this Court to revive that Act—for sport. And presumably respondents would not have gone to the trouble of filing their suits for declaratory and injunctive relief

before the Act was ever invoked, and securing its invalidation, if it were no big deal.

Indeed, the Administration's recent report to Congress describes relief for Puerto Rico's public utilities as "an important first step" in containing the Commonwealth's financial meltdown. *White House Report*, at 3; *see also id.* at 6. Similarly, a report by Dr. Anne Krueger, former World Bank Chief Economist, emphasizes that the Commonwealth's crippling public debt burden is driven in part by the public utilities' "precarious" financial situation. Anne O. Krueger *et al.*, *Puerto Rico—A Way Forward* (June 29, 2015), at ¶ 16, *available at* http://tinyurl.com/obt843a (last visited Nov. 9, 2015); *see also id.* ¶ 7. The report explains that resolution of the Commonwealth's financial problems "should be coordinated with" resolution of the public utilities' financial problems—"not least because creditors too, like the government, will look at the overall resource envelope and investment needs in public enterprises." *Id.* ¶ 34.

Equally unavailing is respondents' suggestion that this Court's review is unwarranted because this case is "unique" insofar as it applies only to Puerto Rico. Franklin Opp. 28-29; *see also* BlueMountain Opp. 2. As an initial matter, that suggestion is plainly incorrect, because the First Circuit's conflict-preemption analysis implicates *all* jurisdictions (including the District of Columbia and the territories) excluded from Chapter 9. *See* Pet. 20-21. In any event, even a decision applicable "only" to Puerto Rico still impacts the lives and livelihoods of more than 3.5 million American citizens. *Cf. Puerto Rico v. Sánchez Valle*, No. 15-108, 136 S. Ct. __, 2015

WL 4505083 (Oct. 1, 2015) (granting certiorari to review issue applicable only to Puerto Rico). Indeed, the importance of this dispute should hardly be a matter of controversy; it involves the validity of a duly enacted statute of the Commonwealth of Puerto Rico seeking to respond to an "economic emergency" in the Commonwealth. Pet. App. 138a.

Finally, respondents contend that this Court's review is unwarranted in light of various contingencies that have the potential to render adjudication of the petition unnecessary. But that is nothing more than an exercise in conjecture.

Precisely because the crisis facing Puerto Rico's public utilities is so acute, it would be irresponsible for the Commonwealth to respond to the vacuum left by the lower courts' invalidation of the Recovery Act by simply kicking back and crossing its fingers pending this Court's consideration of this petition. Instead, the Commonwealth and its public utilities have explored every potential avenue to fill that gap, including federal legislation and consensual deals with creditors. But the Commonwealth's diligence in exploring such avenues provides no reason to insulate the lower courts' invalidation of the Recovery Act from this Court's review.

Thus, it is certainly true that the Commonwealth has been seeking federal legislation that would allow Puerto Rico to authorize its municipalities to avail themselves of Chapter 9. *See, e.g.*, Franklin Opp. 2, 31-32; BlueMountain Opp. 16 n.5. As explained in the petition, the Commonwealth "would certainly welcome legislative relief" in this regard. Pet. 28. But the fate of such legislative efforts is unknown and unknowable. Respondents' speculation about

possible developments on the legislative front thus provides no basis for this Court to deny review of the important legal issue presented here.

Such federal legislation, after all, is necessary precisely because the lower courts in this case invalidated the Recovery Act. The Administration's recent report to Congress highlights this point:

> Puerto Rico does not have access to the federal bankruptcy courts to restructure its financial obligations. Puerto Rico's officials tried to address this shortfall on their own by passing a law to provide a bankruptcy-like process, but a federal appeals court held that federal law preempts the local legislation.

White House Report, at 5. If federal law indeed strips Puerto Rico of its sovereign right and responsibility to respond to "problems as peculiarly local as the fiscal management of its own household," *Faitoute*, 316 U.S. at 508-09, it should be because *this* Court, not "a federal appeals court," *White House Report*, at 5, has so concluded.

Indeed, there is irony in respondents' invocation of the pending federal legislative proposals as a ground to deny review, because respondents themselves are fiercely opposing those very proposals. Counsel of record for the Franklin respondents testified against the pending legislation, *see* Testimony of Thomas Moers Mayer, Feb. 26, 2015, *available at* http://tinyurl.com/p9vv5mu (last visited Nov. 9, 2015), and the BlueMountain respondents have hired no fewer than three firms to lobby against it, *see*, *e.g.*, Gibson, Dunn & Crutcher LLP, Lobbying Reports (Apr. 21, July 20, & Oct. 22, 2015), *available*

at http://tinyurl.com/nkcfpxq; http://tinyurl.com/nuoapct; and http://tinyurl.com/oph7hla (last visited Nov. 9, 2015); Liberty International Group LLC, Lobbying Reports (Apr. 20, July 20, & Oct. 20, 2015), *available at* http://tinyurl.com/oa2h7ja; http://tinyurl.com/odpwdex; and http://tinyurl.com/of644nd (last visited Nov. 9, 2015); and Venable LLP, Lobbying Reports (Apr. 17, July 16, & Oct. 14, 2015), *available at* http://tinyurl.com/ov4lozv; http://tinyurl.com/ns42whf; and http://tinyurl.com/nqgjna4 (last visited Nov. 9, 2015).

Similarly unavailing is respondents' invocation of a recent deal among the Puerto Rico Electric Power Authority (PREPA), bondholders holding about 35% of PREPA's uninsured bonds, and certain PREPA lenders. *See* Franklin Opp. 1-2, 30-32; BlueMountain Opp. 2, 10 & n.2, 14-15 & n.4. As an initial matter, the Recovery Act applies not only to PREPA, but also to the Commonwealth's other public corporations, which hold approximately $17 billion in debt. *See* Commonwealth of Puerto Rico, *Quarterly Report* (May 7, 2015), at 64, *available at* http://tinyurl.com/nc33844 (last visited Nov. 9, 2015); Pet. App. 176-77a, 186-87a.

And whether the PREPA deal, like the proposed federal legislation, will ever take effect is both unknown and unknowable. As most recently signed on November 5, 2015, it requires the satisfaction of numerous "Conditions Precedent" by June 30, 2016. *See* PREPA Public Disclosure, Annex D at 3, Annex A § 13(a) (Nov. 5, 2015), *available at* http://tinyurl.com/nh7v46y (last visited Nov. 9, 2015). Those conditions include, among other things: (1) the assent of the remaining uninsured bondholders

holding all but $700 million of the remaining uninsured PREPA bonds, *see id.* Annex D at 3; (2) the assent of monoline insurers holding $2.5 billion in PREPA bonds, *see id.* Annex A § 13(b)(i); (3) the enactment of a "Legislative Reform Package," which would authorize issuance of new bonds, and the successful resolution of any and all lawsuits—and "any appeals therefrom"—challenging the validity of any such legislation and bonds, *see id.* Annex A § 13(b)(iv); Annex D at 3; Schedule I-A § 5(c),(d); Schedule I-B at 12; (4) the receipt of an "investment grade rating" for the new bonds, *see* Schedule I-B at 3, 11; (5) hearings on, and approval of, several of the deal's proposed changes by the Puerto Rico Energy Commission, *see id.* Annex A § 13(b)(v)-(vii), Annex D at 3.

Let there be no mistake—the Commonwealth would like nothing better than for PREPA and other public utilities to reach consensual deals with their creditors that would restore those utilities to fiscal health and allow them to fulfill their obligations to their creditors as well as to Puerto Rico's citizens. But reaching a consensual deal with all creditors is no easy task; indeed, the bankruptcy laws exist precisely because of the "collective action" problems inherent in this situation. *See, e.g.*, Pet. App. 10a & n.6. Particularly in the anomalous circumstances presented here, where—in light of the decisions below—Puerto Rico's public utilities uniquely lack access to *any* legal mechanism to force creditors to the table and restructure their debts, those utilities are truly negotiating at their creditors' sufferance. The mere possibility of a consummated PREPA deal by next summer is no substitute for a legal framework in which all of Puerto Rico's public

utilities can restructure their debts in a "fair and orderly" manner. *White House Report*, at 3, 6.

Nor is it any answer to assert, as respondents do, that the fiscal problems of Puerto Rico's public utilities can be addressed through "a Puerto Rico court's appointment of a receiver—who can and will keep the lights on, and who also can increase revenues, cut costs and collect debts." Franklin Opp. 8-9. As respondents acknowledge, a receiver can exercise all "the rights and powers of the Authority," *id.* at 9 (internal quotation omitted), but no more. In particular, a receiver (like the utility itself) cannot unilaterally restructure the utility's debts. Thus, a receiver is no substitute for a restructuring regime.

Nor can a receiver "keep the lights on" in Puerto Rico, *id.* at 8, if there is no money to do so. As the U.S. Treasury has explained, "[i]n the past year, the Commonwealth has completely lost access to market funding; it no longer can raise even short-term financing." U.S. Treasury, *Puerto Rico's Economic & Fiscal Crisis* (attached to *White House Report*), at 3. Without access to capital markets, Puerto Rico's public utilities cannot ensure that they can keep up operations, much less repay their debts. Respondents' assertion that "[n]o bondholder lawsuits have been brought against PREPA," Franklin Opp. 29, is thus disingenuous; as respondents are well aware, PREPA has been living from one short-term forbearance agreement (in which creditors temporarily agree to forbear from taking legal action) to the next. Time is of the essence; this Court should grant the petition forthwith in order to review the First Circuit's decision invalidating the Recovery Act this Term.

Finally, respondents err by arguing that the First Circuit's decision invalidating the Recovery Act on preemption grounds does not warrant this Court's review because they have also "alleged" that the Act violates the Contract Clause, and the district court declined to dismiss that claim on the pleadings. Franklin Opp. 9; *see also* BlueMountain Opp. 16-17. But *alleging* a violation of the Contract Clause is a far cry from *proving* a violation of the Contract Clause, and indeed successful invocations of the Contract Clause in the modern era are vanishingly rare. *See, e.g.*, *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470, 502-06 (1987). If this Court were to reverse the dispositive preemption ruling below, respondents would of course be free to pursue their Contract Clause claims, but those claims provide no basis for this Court to deny review of that ruling in the first place.

CONCLUSION

For the foregoing reasons, and those set forth in the petition, this Court should grant review.

Respectfully submitted,

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