

PUERTO RICO AND THE NETHERWORLD OF SOVEREIGN DEBT RESTRUCTURING

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INTRODUCTION

Congress passed the Puerto Rico Oversight, Management, and Economic Stability Act (“PROMESA”) in an attempt to pull Puerto Rico back from the abyss.¹ The reason for this drastic action—a special insolvency regime available only for Puerto Rico—was plain: the Commonwealth had accumulated debts well beyond its ability to repay. Its economy was in such a dreadful state that even if one were to declare an indefinite moratorium on all of its debt payments, it would still be the case that the island could not make ends meet without a drastic overhaul of both

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1. See Stephen A. Nuño, *Congress Passes PROMESA Act for Puerto Rico Debt Crisis*, NBC NEWS (June 29, 2016, 8:33 P.M.), <http://www.nbcnews.com/news/latino/congress-passes-promesa-act-puerto-rico-debt-crisis-n601291>. See also Puerto Rico Oversight, Management, and Economic Stability Act, Pub. L. No. 114-187, 130 Stat. 549 (2016) (codified in scattered sections of 15, 29, and 48 U.S.C.).

its operations and its finances.² Yet prior to congressional action there was no moratorium. The island's creditors were demanding money, and the government's cash reserves were nearing depletion. Disaster seemed imminent.³

Congress provided a glimmer of hope to the American citizens of Puerto Rico. PROMESA, at least temporarily, put a halt to the creditors' collection efforts. It also created a proceeding that in essence replicates Chapter 9 of the Bankruptcy Code for the Commonwealth, as well as an alternative path relying on consensual restructuring coupled with the power to bind holdout creditors.⁴ Puerto Rico gained two options that it lacked prior to the legislation's passage. But the price for these protections was steep. A control board was put in place that effectively took over control of the territory's finances and the conduct of any insolvency proceedings.⁵ The members of this board were appointed by elected officials in Washington.⁶ The elected government of Puerto Rico had no right to appoint or veto any members. Given potential constitutional infirmities with the control board, it remains to be seen whether this last-minute action is sufficient to save the island from total financial collapse.⁷

2. For analyses of Puerto Rico's fiscal and operational problems, see generally Robert K. Rasmussen, *Puerto Rico: Of Capital Structures, Control Rights and Liquidity*, 11 CAP. MARKETS L.J. 228 (2016); ANNE O. KRUEGER, RANJIT TEJA & ANDREW WOLFE, *PUERTO RICO—A WAY FORWARD* (2015), <http://www.bgfpr.com/documents/PuertoRicoAWayForward.pdf>.

3. For an account of the evolution of the crisis, leading up to and including the passage of PROMESA, see Mary Williams Walsh, *How Puerto Rico Is Grappling with a Debt Crisis*, N.Y. TIMES (May 16, 2017), <https://nyti.ms/2ro6b37>.

4. Title III of PROMESA contains a judicially supervised restructuring mechanism, similar in many ways to Chapter 9. See Puerto Rico Oversight, Management, and Economic Stability Act, §§ 301–317. Title VI, in contrast, in effect inserts collective action clauses into Puerto Rico's sovereign bonds. See *id.* §§ 401–413. The granting of choice of which path to proceed under echoes the debates in the sovereign debt literature over whether sovereign distress is better handled through a sovereign debt restructuring mechanism or collective action clauses placed in the debt instruments. Compare ANNE O. KRUEGER, INT'L MONETARY FUND, *A NEW APPROACH TO SOVEREIGN DEBT RESTRUCTURING* 4–10 (2002), with John B. Taylor, Under Sec'y of Treasury for Int'l Aff., *Sovereign Debt Restructuring: A US Perspective*, Speech at the Conference "Sovereign Debt Workouts: Hopes and Hazards," Institute for International Economics (Apr. 2, 2002), <http://www.iese.com/publications/papers/Taylor0402.htm>.

5. Jackie Calmes, *Puerto Rico Relief Measure Clears Senate, Goes to Obama*, N.Y. TIMES (June 29, 2016), <https://nyti.ms/2oh1iaH>.

6. Creditor groups, seeking to enhance their chances for recovery on the bonds that they purchased, have argued that this method of filling the board violates the Appointments Clause. See Joseph Blocher & Mitu Gulati, *Puerto Rico's Colonial Status Hinges on a New York Hedge Fund's Greed*, HILL (Nov. 25, 2017, 10:00 A.M.), <http://thehill.com/opinion/finance/361775-puerto-ricos-colonial-status-hinges-on-a-new-york-hedge-funds-greed>; Mary Williams Walsh, *Hedge Fund Sues to Have Puerto Rico's Bankruptcy Case Thrown Out*, N.Y. TIMES: DEALBOOK (Aug. 7, 2017), <https://nyti.ms/2uAgQc4>.

7. See Blocher & Gualti, *supra* note 6.

We here are interested in a different type of abyss than the one that spurred Congress to act. Prior to the passage and signing of PROMESA, Puerto Rico inhabited a netherworld of debt adjustment. In *Puerto Rico v. Franklin California Tax-Free Trust*, the U.S. Supreme Court held that the Bankruptcy Code provided no relief for Puerto Rico or its municipalities and at the same time precluded Puerto Rico from enacting an insolvency regime of its own.⁸ The Commonwealth could neither repair to federal law to restructure some of the debts plaguing it nor could it enact legislation to address the fiscal crisis. In essence, Puerto Rico was faced with crushing debt and no mechanism to take action, other than attempts to have bondholders voluntarily agree to haircuts (something that bondholders are loath to do). Puerto Rico gamely undertook such efforts for some of its debt, but while these attempts may have shown glimmers of optimism to some, each of them eventually fell apart.⁹ Not a single group of creditors was willing to restructure its debt to a sustainable level. Puerto Rico was in fiscal purgatory.

While the issue was not before the Supreme Court in *Franklin*, we want to explore whether the Constitution allows Congress to put Puerto Rico into such a bind. Can it take away a government's power to enact a restructuring regime and put nothing in its place? Put in contractual terms, do the implicit terms of the deal struck between Puerto Rico and the U.S. federal government when Puerto Rico transitioned from the status of a colony to a "freely associated state" in 1952¹⁰ allow Congress to eliminate in full Puerto Rico's ability to restructure the debt of its municipalities? This question encompasses both the situation that existed in Puerto Rico prior to the enactment of PROMESA and the potential lacuna that could arise should a state enact a restructuring law for its own debts and Congress

8. *Puerto Rico v. Franklin Cal. Tax-Free Tr.*, 136 S. Ct. 1938, 1948–49 (2016).

9. See, e.g., Michael Corkery, *Let Us Help You, Hedge Funds Tell Puerto Rico*, N.Y. TIMES: DEALBOOK (Sept. 12, 2014, 11:05 A.M.), <https://nyti.ms/2m4CqBU>; Mary Williams Walsh, *Puerto Rico Postpones Debt Plan*, N.Y. TIMES: DEALBOOK (Aug. 30, 2015), <https://nyti.ms/2hHzAGd>.

10. See Chimène I. Keitner, *From Conquest to Consent: Puerto Rico and the Prospect of Genuine Free Association*, in RECONSIDERING THE INSULAR CASES: THE PAST AND FUTURE OF THE AMERICAN EMPIRE 77, 87–89 (Gerald L. Neuman & Tomiko Brown-Nagin eds., 2015). Some skeptics view Puerto Rico as still being essentially in a colonial vassal state, where Congress rules by fiat. See Mary Williams Walsh, *Puerto Rico Debt Relief Law Stirs Colonial Resentment*, N.Y. TIMES DEALBOOK (June 30, 2016), <https://nyti.ms/2jNQLSk>. But such a status would be fundamentally inconsistent with the modern state of international law, which no longer countenances empires and colonies. See Joseph Blocher & Mitu Gulati, *Forced Secessions*, 80 LAW & CONTEMP. PROBS. 215, 225–26 & n.60 (2017); Joseph Blocher & Mitu Gulati, *Puerto Rico and the Right of Accession*, YALE J. INT'L L. (forthcoming 2018) (manuscript at 7), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2988102.

seek to void such action.¹¹ We submit that the answer is no.

Our analysis proceeds in three parts. In the first, we describe the financial situation facing Puerto Rico, its attempts to address that situation, and the Supreme Court's recent decision in *Franklin*. This articulation of the problem highlights the ills that can occur when a sovereign entity has the power to issue debt but lacks a means for resolving financial distress. We then ask the question of whether, when it comes to states, the allocation of authority between them and the federal government would allow Congress to put *them* in such an untenable situation. States under our federal system retain core functions. The power to issue and restructure debts, we submit, resides in this core. Indeed, prior Supreme Court precedent holds that the power to issue debt necessarily includes the power to create a mechanism for restructuring that debt. We argue that while Congress can adjust this power by replacing a state's scheme with one of its own, it cannot, consistent with federalism, prohibit state action while putting nothing in its place.

We then turn our attention to Puerto Rico. The much-vilified *Insular Cases* seem to imply that Congress has substantial leeway in all matters regarding Puerto Rico.¹² We show, however, that the colonial conception of the relationship between Puerto Rico and the U.S. federal government, on which those cases rest, cannot form the basis for determining what the allocation of authority between Congress and Puerto Rico is *today*. Congress transferred sovereignty to Puerto Rico. It established and implemented a process by which the island became a commonwealth. As part of that transfer of sovereignty—something that was done in the post-Second World War era, when colonial outposts were to be phased out as a matter of the new international order—Congress authorized and then approved Puerto Rico's constitution, which expressly gave the Puerto Rican government the power to issue debt and impose taxes.¹³ This action,

11. For an argument, which we endorse, that Congress can enact a restructuring regimes for states, see generally David A. Skeel, Jr., *States of Bankruptcy*, 79 U. CHI. L. REV. 677 (2012).

12. The canonical *Insular Cases* comprise *Huus v. N.Y. & P.R. S.S. Co.*, 182 U.S. 392 (1901); *Downes v. Bidwell*, 182 U.S. 244 (1901); *Armstrong v. United States*, 182 U.S. 243 (1901); *Dooley v. United States*, 182 U.S. 222 (1901); *Goetze v. United States*, 182 U.S. 221 (1901); and *De Lima v. Bidwell*, 182 U.S. 1 (1901). See Juan R. Torruella, *One Hundred Years of Solitude: Puerto Rico's American Solitude*, in *FOREIGN IN A DOMESTIC SENSE: PUERTO RICO, THE AMERICAN EXPANSION, AND THE CONSTITUTION* 241, 248 n.14 (Christina Duffy Burnett & Burke Marshall eds., 2001).

13. For details, see Keitner, *supra* note 10, at 87–90. Some would argue further that to treat Puerto Rico's relationship to the rest of the United States through the lens of the *Insular Cases* (where Puerto Rico was explicitly conceptualized as U.S. "property") would also arguably violate the United States' international law obligations. See, e.g., Juan R. Torruella, *The Insular Cases: The Establishment of a Regime of Political Apartheid*, 29 U. PA. J. INT'L L. 283, 293, 332–34 (2007) (emphasizing, in

we submit, necessarily also gave Puerto Rico the power to enact a restructuring regime. Congress could negate Puerto Rico's right to put in place a restructuring regime, but only if it were to put in place some substitute mechanism. Prohibiting the enactment of any means of restructuring its obligations cannot pass constitutional muster.

I. THE PUERTO RICAN FISCAL CRISIS AND THE COMMONWEALTH'S ATTEMPT AT SELF-HELP

That Puerto Rico is facing a deep fiscal crisis is beyond doubt. Its problem consists both of the amount of debt that it owes and the varying and vague priorities among its various debt instruments. Unlike recently distressed sovereigns such as Greece and Argentina, which largely issued only one type of debt—unsecured sovereign bonds—Puerto Rico and its various instrumentalities issued many types of debt.¹⁴ Some of the debt came from various government agencies, such as the power company, the highway agency, and the water company. Some of this debt was guaranteed by the main government; some was not. The main government itself issued multiple flavors of obligations, with the relative priority of the various issues a current matter of dispute among the debt holders.¹⁵ When the bonds issued by the general government are added to the debt incurred by the various agencies, the total exceeds \$70 billion.¹⁶ This sum does not include Puerto Rico's unfunded pension obligations that it has promised to its employees. Throwing these promises to pay into the mix brings the total indebtedness to well over \$100 billion.¹⁷

The amount of Puerto Rico's debt is only half of the analysis. A

particular, the International Covenant on Civil and Political Rights that the United States became a party to in 1992).

14. There were differences among the Greek and Argentine sovereign bonds too, in that a small subset of Greek bonds were guaranteed by the state, and both Argentina and Greece had bonds governed by the laws of different jurisdictions (e.g., local, England, New York, Japan). However, the variation paled in comparison to what Puerto Rico had on offer. For details on the Greek and Argentine debts and their restructurings, see generally Juan J. Cruces & Tim R. Samples, *Settling Sovereign Debt's "Trial of the Century,"* 31 EMORY INT'L L. REV. 5 (2016); Jeromin Zettelmeyer et al., *The Greek Debt Restructuring: An Autopsy*, 28 ECON. POL'Y 513 (2013).

15. The holders of general obligation bonds assert that they have first priority to the revenues of the Commonwealth by virtue of Puerto Rico's Constitution. See Complaint at 2–3, *Jacana Holdings v. Commonwealth of Puerto Rico*, No. 1:16-cv-04702 (S.D.N.Y. June 21, 2016). The holders of CONFINA bonds, however, also argue that they have first dibs on half of the sales tax collected by the government.

16. See, e.g., Megan McArdle, *Debt Alone Won't Crush Puerto Rico. Depopulation is the Curse.*, BLOOMBERG (Oct. 6, 2017, 7:00 A.M.), <https://www.bloomberg.com/view/articles/2017-10-06/debt-alone-won-t-crush-puerto-rico-depopulation-is-the-curse>.

17. See *id.*

government's debt load can only be viewed as unsustainable when it is compared to its ability to raise funds through taxation. Sovereigns with larger economies can support larger debt loads. When we compare Puerto Rico's debt load with its prospects for generating future revenues, the results are bleak. Puerto Rico's economy has little hope of servicing its extant debt stock. The island's population is only around 3.4 million people.¹⁸ Its gross domestic product for 2013 was \$103 billion, which is roughly the same as, and indeed could well be less than, its debt obligations (with unfunded pension liabilities included).¹⁹ Yet it is even worse than this snapshot indicates. The Commonwealth's debt load and its GDP are moving in opposite directions.²⁰ The island's debt has been ballooning for years. Its economy, on the other hand, has been in decline for over a decade.²¹ Many of the island's citizens have decamped for the mainland. Indeed, Puerto Rico is losing population at an alarming rate.²² The gap between what Puerto Rico owes and what it can pay grows with each passing year.

The recent devastation wrought by Hurricane Maria has made things worse. The hurricane devastated the local economy and caused tens of thousands of Puerto Rico's citizens to flee to the continental United States.²³ The lawyers representing the PROMESA board have estimated that the government will not be able to make any payments on its debt for at least five years.²⁴

The Commonwealth's looming inability to meet its obligations has not gone unnoticed. Puerto Rico has spent the last few years looking for a

18. Patti Domm, *Puerto Rico's New Worry Is a Population Flight to the US Mainland that Could Slow Its Recovery*, CNBC (Sept. 28, 2017, 7:53 P.M.), <https://www.cnbc.com/2017/09/28/puerto-ricos-population-flight-could-slow-its-recovery.html>.

19. *Puerto Rico*, WORLD BANK: DATA, <https://data.worldbank.org/country/puerto-rico> (last visited Nov. 13, 2017).

20. See KRUEGER ET AL., *supra* note 2, at 24–25.

21. *Id.* at 3–4.

22. See Nick Timiraos, *Puerto Rico's Drastic Population Loss Deepens Its Economic Crisis*, WALL ST. J. (June 29, 2016, 7:35 P.M.), <https://www.wsj.com/articles/puerto-ricos-drastic-population-loss-deepens-its-economic-crisis-1467219467>.

23. See Ana Campoy, *Blown Away: Puerto Rico Is Set to Become the World's Worst Economy Next Year*, QUARTZ (Nov. 23, 2017), <https://qz.com/1137351> (noting that thousands of businesses have not reopened two months after the hurricane and that over 100,000 people have left the island). In theory, Congress could enact disaster relief sufficient to allow Puerto Rico to rebuild its economy. Given the structural relationship that we describe in this piece, we are skeptical that aid at such a level will be forthcoming.

24. Steven Church & Michelle Kaske, *Puerto Rico May Need to Skip Bond Payments for Five Years*, BLOOMBERG (Nov. 15, 2017, 7:43 A.M.), <https://www.bloomberg.com/news/articles/2017-11-15/puerto-rico-considering-suspending-debt-payments-for-five-years>.

mechanism by which it can address its financial distress. Chapter 9 of the Bankruptcy Code, which allows a state to authorize its municipal units to file for restructuring, was not an option.²⁵ To be sure, even had Puerto Rico been able to use Chapter 9 for its municipal entities, this would have not provided a comprehensive solution to the island's debt as it would not have offered a vehicle to restructure the debt issued by the Commonwealth itself. Chapter 9 is currently not available to the states, only to a state's municipalities.²⁶ Still, access to Chapter 9 would have allowed Puerto Rico to ameliorate the debt problem. Yet even such partial relief was not available.

When the predecessor to Chapter 9 was enacted, Puerto Rico was treated the same as a state and thus had the ability to authorize its municipalities to seek shelter in its provisions.²⁷ When Congress passed the Bankruptcy Code in 1978, Puerto Rico maintained its ability to use Chapter 9's provisions to restructure the debts of its municipalities.²⁸ Had that provision remained in place, Puerto Rico could have attempted to restructure the debt of its various agencies. In 1984, however, without comment or explanation, Congress, led by Senator Strom Thurmond of South Carolina, removed Puerto Rico's access to Chapter 9.²⁹

Attempting to deal with its financial predicament, Puerto Rico enacted the Puerto Rico Public Corporation Debt Enforcement and Recovery Act in 2014.³⁰ This Act contained a debt restructuring mechanism that drew its inspiration from Chapter 9. Chapter 9 allows for the instrumentalities of states, but not states themselves, to restructure their debts. Prior to its exclusion from Chapter 9, the same arrangement was available for Puerto Rico—it could place its instrumentalities into bankruptcy, but it could not use the provision for debts that it had issued. The law that Puerto Rico enacted followed this course; it would only be available to instrumentalities of the territory and not the territory itself. Puerto Rico in essence tried to

25. See 11 U.S.C. § 109(c) (2012).

26. See *id.*

27. See 11 U.S.C. § 401 (1970) (omitted 1976).

28. See, e.g., Stephen J. Lubben, *Puerto Rico and the Bankruptcy Clause*, 88 AM. BANKR. L.J. 553, 572–73 (2014).

29. *Id.* at 573–74. See also Bankruptcy Amendments and Federal Judgeship Act of 1984, tit. III, sec. 421, § 101, Pub. L. No. 98-353, 98 Stat. 333, 369 (“‘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”); Michal Kranz, *Here's How Puerto Rico Got into So Much Debt*, BUS. INSIDER (Oct. 9, 2017, 6:20 P.M.), <http://www.businessinsider.com/puerto-rico-debt-2017-10>.

30. 2014 P.R. Laws Act No. 71. For discussion, see Recent Legislation, *Puerto Rico Public Corporation Debt Enforcement and Recovery Act, 2014 P.R. Laws Act No. 71*, 128 HARV. L. REV. 1320, 1320–27 (2015).

restore what Congress had taken away.

Not so fast, claimed the holders of debt issued by Puerto Rico's public corporations. Chapter 9, they argued, contains a provision that preempts state restructuring regimes (and "states" in this case, according to the way the term had been defined, included Puerto Rico).³¹ The most relevant case in interpreting the predecessor of Chapter 9 was a famous wartime decision of the U.S. Supreme Court, *Faitoute Iron & Steel Co. v. City of Asbury Park*.³² At issue was a law passed by New Jersey to enable its municipalities to restructure their debts with the approval of 85% of their creditors (and judicial supervision and approval).³³ A subset of creditors, who were unwilling to allow the municipality to restructure its debts, sued, arguing that New Jersey was not entitled to take such an action.³⁴ The Court in *Asbury Park* upheld the New Jersey statute, ruling that the states' police power includes the ability to enact debt restructuring regimes for their municipalities.³⁵ To be sure, the Court said, the regimes could not run afoul of the Contracts Clause—in other words, the states could not put in place regimes that were aimed at simply expropriating value from investors and transferring that to the state.³⁶ However, so long as the regime that a state enacted respected this limit, the Court said, it could put a debt arrangement procedure in place.³⁷

Asbury Park thus left municipalities with two options: they could restructure either under federal bankruptcy law or under an appropriately enacted state law. Congress did not approve of having to share the field with the states. To the extent states wanted to allow their municipalities to have the option of restructuring their debts, Congress wanted to specify a uniform mechanism across the country. Reacting to *Asbury Park*, Congress decided that Chapter IX³⁸ was to be the only game in town. It placed in Chapter IX a new provision, expressly preempting state restructuring laws.³⁹ The price for having access to Chapter IX was that states could not set up alternative restructuring arrangements. The states could choose to not have a bankruptcy system for their municipalities, but if they chose to have one, it would be the uniform mechanism that Congress had designed.

31. See 11 U.S.C. § 903(1) (2012).

32. *Faitoute Iron & Steel Co. v. City of Asbury Park*, 316 U.S. 502 (1942).

33. *Id.* at 502–03.

34. *Id.* at 507.

35. *Id.* at 513–16.

36. *Id.* at 512–13.

37. *Id.* at 513–16.

38. At the time, bankruptcy chapters were denominated with Roman numerals.

39. See 11 U.S.C. § 903(1) (2012).

That tradeoff continues to this day. No one disputes that Illinois, or any other state for that matter, cannot enact its own debt restructuring regime for its municipalities. The holders of Puerto Rican debt argued that this provision preempts the Puerto Rican effort on this score as well.⁴⁰

Puerto Rico's response to the argument from the creditors was that, when Congress took away Puerto Rico's access to Chapter 9, it also took Puerto Rico out of the ambit of Chapter 9's preemption provision.⁴¹ In other words, preempting a state's bankruptcy law for purposes of ensuring a uniform municipal bankruptcy system around the country was fine, but only if the federal government was going to put something in its place (which is what Congress did for the states). Absent any federal mechanism to substitute for a state mechanism, the state (or state-type entity) was allowed to substitute its own mechanism—that seemed to be the clear teaching of *Asbury Park*.

A divided Supreme Court disagreed with this reading of the Bankruptcy Code and, in an opinion by Justice Thomas, struck down Puerto Rico's efforts to put in place its own municipal bankruptcy system.⁴² The Court sided with the lenders and held that Chapter 9 preempted Puerto Rico's restructuring law.⁴³ The effect of this ruling was to leave Puerto Rico with no federal law to help it restructure its debts and the inability to pass such a law on its own. It found itself in a position where it could take no action to address the existential financial challenge that it faced. Any future attempts to repair Puerto Rico's unsustainable debt stock could only come through congressional action.

II. THE POWER OF STATES TO ENACT RESTRUCTURING REGIMES

Before examining the situation that Congress created when it left Puerto Rico in the netherworld of debt restructuring, we begin our analysis with the question of whether Congress could do the same thing to a state. As a starting point, one might think, if Congress could constitutionally enact such a law for the fifty states, it surely could do so for Puerto Rico. Puerto Rico may have fewer protections against incursions from Congress than the states do, but, at least as an initial matter, one would think that it

40. See *Franklin Cal. Tax-Free Tr. v. Puerto Rico*, 805 F.3d 322, 326 (1st Cir. 2015), *aff'd*, 136 S. Ct. 1938 (2016).

41. *Franklin*, 136 S. Ct. at 1946.

42. *Id.* at 1949. Not surprisingly, Justice Thomas used textualism in reaching this result. See *id.* at 1946 (“The plain text of the Bankruptcy Code begins and ends our analysis.”).

43. *Id.* at 1949.

does not have more.⁴⁴

To begin, consider the following hypothetical. Congress, in order to promote efficiency and lessen the burden on interstate commerce caused by fires, creates a national fire department, and, in order to prevent needless duplication of effort, forbids the states and their instrumentalities from creating their own fire units. Assume that at least one state is fond of its own fire departments and seeks to have the new law struck down as transgressing the limits on federal interference with state authority. To determine whether the new law would comport with constitutional limitations on congressional inroads on state regulation of the state's internal affairs, it is necessary to delve into the Supreme Court's federalism cases.

At one time, the Court used to strike down with some regularity regulations that interfered with a state's "traditional" functions. Our hypothetical law would have likely been found to be unconstitutional under this analysis, as establishing a fire department has been a function of states and their municipalities for decades. The Court, however, in *Garcia v. San Antonio Metropolitan Transit Authority*, abandoned the project of demarcating which government functions were "traditional" and hence subject to constitutional protection.⁴⁵

The Court later made clear, in *New York v. United States*, that *Garcia* addressed federal laws that applied to states and private actors alike.⁴⁶ When the federal government regulates the states as states, a different analysis now takes hold. The federal government is allowed, within limits, to encourage states to take actions—for example, setting speed limits below seventy miles per hour on interstate highways within a state—through financial incentives.⁴⁷ Alternatively, the federal government can regulate the activity itself and forbid the state from regulating through preemption. What it cannot do, however, is require that the states regulate in a prescribed manner.

44. We argue *infra* in Part III that one can articulate a reason for greater protection for Puerto Rico from congressional intervention, though the position that we put forward in this article does not hinge on this argument.

45. *Garcia v. San Antonio Metro. Transit Auth.*, 469 U.S. 528, 546–47 (1985) (“We therefore now reject, as unsound in principle and unworkable in practice, a rule of state immunity from federal regulation that turns on a judicial appraisal of whether a particular governmental function is ‘integral’ or ‘traditional.’”).

46. *New York v. United States*, 505 U.S. 144, 160 (1992).

47. *South Dakota v. Dole*, 483 U.S. 203, 210–12 (1987). *But see Nat’l Fed’n of Indep. Bus. v. Sebelius*, 567 U.S. 519, 580–82 (2012) (holding that Congress went too far with its incentives when it went from encouragement to compulsion).

Based on this framework, it seems that Congress's creation of a national fire department would be upheld. To be sure, Congress could not take over the extant local fire departments and run them—that would be commandeering and would run afoul of *New York*.⁴⁸ Having established a national fire force, however, Congress could then preempt all local efforts in this space. The federal government can bar duplication of effort.

But what if Congress passed a law that did not create a national fire department, but rather, seeking to spur the development of privately owned fire departments, Congress simply forbade states and municipalities from creating their own? Congress, in our hypothetical, has determined that the private market is the best way to provide for efficient fire protection. The Supreme Court has not addressed such a situation. Here, Congress is regulating the state as a state and is ousting the state from a traditional state power. It is not, however, putting a federal scheme in its place.

Such a law, we submit, would be unconstitutional. The Court is clearly worried more about the relationship between the federal and state governments when Congress attempts to regulate the states qua states. The Court in *New York* distinguished *Garcia* and its predecessors on precisely this ground.⁴⁹ The Court got back into the Tenth Amendment game in *New York* because the federal government was attempting to regulate the states as states. Thus, while *Garcia* abandons the project of articulating traditional state functions as to regulations that apply to a range of private and public parties, it would be over-reading that case to suggest that the Court would not act to protect core government functions when Congress seeks to divest them from the state yet put nothing in their place.

To be sure, Congress can exercise its power under the Commerce Clause to regulate this space for itself, but it would violate basic federalism principles were it to remove this area from the states and leave nothing in its place.⁵⁰ Put differently, the implicit deal among the states to delegate certain powers to a central government and maintain others for themselves is violated when the central government takes away the power of the state to protect its citizens in certain ways without stepping in to do the job itself. The rationale for allowing Congress to step in here is that there are going to

48. *New York*, 505 U.S. at 160, 175.

49. *Id.* at 160.

50. Of course, there are times when federal power restricts state power, even if there is nothing put in place. The clearest example is the Dormant Commerce Clause. There, states are prevented from enacting laws even though there is no conflict with federal action. In such a setting, however, there is no interference with a core state function. See Martin H. Redish & Shane V. Nugent, *The Dormant Commerce Clause and the Constitutional Balance of Federalism*, 1987 DUKE L.J. 569, 570.

be some instances where the assumption that regulation is best designed and applied at the local level does not hold. In economic terms, these are the contexts where domestic regulation of an activity by the individual states will either under- or over-produce the levels of that activity in a way that causes harm to the system: negative externalities, in economic parlance. Here it serves the interests of everyone to have the regulation centralized.⁵¹ Congress would be within its zone of power if it were to conclude that local control of firefighting efforts has produced too little protection for the nation's citizens, and thus central regulation is preferable. It cannot, however, prevent the state from fulfilling a core function and fail to provide an alternative.

The same analysis applies in the area of debt restructuring regimes. We begin with the Supreme Court's jurisprudence in the area of municipal bankruptcies. Originally, the Court struck down Congress's first attempt to enact a bankruptcy regime for municipalities, stating a concern that the provision at issue intruded too much on a state's sovereignty.⁵² In *United States v. Bekins*, though, the Court upheld a new federal effort,⁵³ pointing to the fact that under the revised Chapter IX only a "voluntary" petition could be filed.⁵⁴ In other words, the state's municipalities could not be hauled into court over their objections. That the state had consented to have its municipalities subject to the federal regime was sufficient for the Court to quiet earlier concerns that the law intruded too much on state prerogatives. So long as the states themselves could choose to authorize their municipalities to file for bankruptcy under Chapter IX, the new regime did not run afoul of the Constitution.⁵⁵

For our purposes, the most important case is the next in the lineage, *Asbury Park*. In that case, as described earlier, New Jersey had enacted a

51. For the basic economic logic, see generally Robert P. Inman & Daniel L. Rubinfeld, *Economics of Federalism*, in 3 OXFORD HANDBOOK OF LAW AND ECONOMICS: PUBLIC LAW AND LEGAL INSTITUTIONS 84 (Francesco Parisi ed., 2016).

52. *Ashton v. Cameron Cty. Water Improvement Dist.*, 298 U.S. 513, 530–32 (1936).

53. *United States v. Bekins*, 304 U.S. 27, 50–54 (1938). While the Court treated the new regime as different from the one it struck down, today most commentators view the two regimes as virtually identical. The reason for the difference in outcome is now attributed to the Court's famous "switch in time." See Clayton P. Gillette & David A. Skeel, Jr., *Governance Reform and the Judicial Role in Municipal Bankruptcy*, 125 YALE L.J. 1150, 1174, 1175 n.108 (2016).

54. *Bekins*, 304 U.S. at 38–39. This requirement existed in the prior law as well. Indeed, most commentators find few if any significant differences in the law that the Court struck down in *Ashton* and the one that it upheld in *Bekins*. See Gillette & Skeel, *supra* note 53, at 1175–76.

55. Some have said that similar concerns would render congressional efforts to enact a debt adjustment law for states unconstitutional. For an argument to the contrary, see Skeel, *supra* note 11, at 707–11.

restructuring regime for its municipalities. The city of Asbury Park, hopelessly insolvent, sought to take advantage of this state-provided provision that allowed for a restructuring of its debt with the approval of 85% of the holders in principal amount. A subset of unhappy debtholders invoked the Court's preemption jurisprudence. They argued that when Congress enacted the regime that was validated in *Bekins*, it occupied the field and left no room for a state to enact its own restructuring regime.

The Supreme Court, in an opinion by Justice Frankfurter, turned back the challenge. The Court held that the power to enact a restructuring regime is part and parcel of the power to tax and to issue debt in the first instance. The insight here is that issuing debt necessarily creates the risk that the municipality will issue more debt than it can service. It is not that the municipality is necessarily feckless when it defaults; rather, unforeseen events can well create a situation where the municipality simply does not have the financial wherewithal to service its debts. Regardless of why the government finds itself in financial distress, the financial distress can make it impossible for the government to fulfill its core mission. If the municipality were powerless to restructure its debt, it would be unable to provide the basic infrastructure for its citizens. Justice Frankfurter wrote:

But if taxes can only be protected by the authority of the State and the State can withdraw that authority, the authority to levy a tax is imported into an obligation to pay an unsecured municipal claim, and there is also imported the power of the State to modify the means for exercising the taxing power effectively in order to discharge such obligation, in view of conditions not contemplated when the claims arose. . . . The necessity compelled by unexpected financial conditions to modify an original arrangement for discharging a city's debt is implied in every such obligation for the very reason that thereby the obligation is discharged, not impaired.⁵⁶

The import of the passage seems to be that those who buy a municipality's bonds are relying primarily on the municipality's power to tax in order to have the bond serviced. The power to tax, after all, is almost always going to be a municipality's primary source of income. The bondholders know this going into the transaction. The state has the ability to constrain a municipality's taxing power, and it can deem how the taxes that a municipality receives are spent. To the extent that the government cannot both meet its basic needs and service the debt on the terms that it was issued, the state can create a procedure for the adjustment of the debt. As the Court said:

56. *Asbury Park*, 316 U.S. at 511.

The intervention of the State in the fiscal affairs of its cities is plainly an exercise of its essential reserve power to protect the vital interests of its people by sustaining the public credit and maintaining local government. The payment of the creditors was the end to be obtained, but it could be maintained only by saving the resources of the municipality—the goose which lays its golden eggs, namely, the taxes which alone can meet the outstanding claims.⁵⁷

Put differently, the bondholders' primary expectation is to get paid back via taxes, and the state can ensure, via a restructuring regime, that a city maintains sufficient funds to run its operations and service the debt. Allowing the city to restructure its debt creates the possibility that the bondholders, while not receiving as much as they were promised, will receive more than if the city were to not maintain its operations.

The notion that a restructuring of extant debt can enhance the overall welfare of the bondholders was also crucial in rejecting the dissenting bondholders' argument that the restructuring regime at issue violated the Contracts Clause. In rejecting the notion that the bondholders had their contracts impaired, the Court pointed out that the restructuring made the creditors as a group better off.⁵⁸ The bonds held by the holdouts were worth more after the restructuring than before.⁵⁹

This observation implies that there are limits on the extent to which a state can restructure municipal debt. In the extreme, a state could not enact a law that took away the value of the bondholders' instruments. In terms of whether a bondholder was better off, the Court seems to be willing to say that if 85% (which, as noted, was the requirement in New Jersey law)⁶⁰ were in favor of the new terms, that was good enough. Of course, no such limitation exists on Congress's power to restructure municipal debts.⁶¹

The argument is that the power to tax is essential to the running of a state. It would be fanciful to propose that a modern state could finance itself without resorting to this power. The power to restructure debt is linked to the taxing power. Once the state allows a municipality to issue debt, the primary (if not the only) way that the debt will be serviced is through the exercise of the taxing power. There are, as the Court noted,

57. *Id.* at 512.

58. *Id.* at 513–14.

59. *Id.* at 513. Courts have articulated this logic in other restructuring cases as well. *See, e.g., Katz v. Oak Industries, Inc.*, 508 A.2d 873, 876–77 (Del. Ch. 1986).

60. *Asbury Park*, 316 U.S. at 504.

61. The Contracts Clause applies only to states, not to the federal government. *See* U.S. CONST. art. 1, § 10, cl. 1 (“No State shall . . . pass any Bill of Attainder, ex post facto Law, or Law impairing the Obligation of Contracts . . .”).

practical limits on how much revenue taxes can raise. Moreover, the municipality has to be able to meet the basic needs for which it exists in the first instance. When feasible revenues cannot cover both the basic needs and the debt obligations, the state needs to have the power to orchestrate an adjustment in the debt burden.

Indeed, a moment's reflection reveals that a debt restructuring regime is part and parcel of issuing debt, at least where a sovereign is concerned. Despite the best efforts of those charged with running the municipality, it is inevitably the case that a debtor will, on occasion, find itself in a position where it cannot satisfy all its obligations. Even putting aside the public choice dynamics that induce governments to worry more about the near term than the long term,⁶² foresight is not perfect. Anticipated growth in revenues does not always materialize. Investments in new infrastructure may not yield the expected return. There may be an economic downturn that causes tax revenue to decline well below previous projections. A city can see its tax base erode with the loss of a major employer. A government utility can be whipsawed by rising commodity prices. There are countless ways in which things may go awry, and the municipality may be left with a debt stock that it cannot service. If, in such a situation, there is no restructuring mechanism to which the municipality can turn, then what one ends up with is chaos. At some point the municipality stops paying, and then the creditors begin fighting amongst themselves and with the debtor to grab assets—at least to the extent that the municipality does not enjoy sovereign immunity. Such a system has little to commend it. It thus is not surprising that the Supreme Court held that a government's power to issue debt includes the power to restructure that debt when necessary.

Now, with private firms, we could imagine a world without a debt restructuring mechanism. If the parties cannot reach an agreement to restructure the debt, and the business can no longer service it, the firm can be liquidated. Indeed, liquidation is the most common outcome when a business cannot make ends meet. Alternatively, the firm can have a capital structure that itself is designed to deal with future financial distress. One can imagine a system where the default on a debt payment leads to the wiping out of old equity and conversion of the junior-most debt into new equity.⁶³

Such options do not exist with a municipality. Liquidation is by and

62. See Gillette & Skeel, *supra* note 53, at 1198–99.

63. See generally Barry E. Adler, *Financial and Political Theories of American Corporate Bankruptcy*, 45 STAN. L. REV. 311 (1993).

large out of the question. To be sure, states have at times terminated municipalities in order for the state to take over regulation of the affected citizenry.⁶⁴ Yet there has never been a case where the body that issued the debt was liquidated for the benefit of the creditors. Taking over an operation is one thing; shutting down and selling off its assets and leaving the affected citizens without services is quite another. At a fundamental level, the municipal corporation needs to continue in existence so as to fulfill its public purpose. In this respect, a government is better analogized to an individual than to a corporation.⁶⁵

Revamping the capital structure of the distressed municipality so as to transfer control rights over its operations is also not an available option. Proposals in the private sector that call for the elimination of the interests of equity holders and a conversion of junior debt into new equity when financial distress hits in effect cede control of the company to the creditors. Such is not feasible in the case of a government. We have no objections when one group of financial investors—equity holders—is replaced by another group—debt holders. One cannot imagine, however, voters losing their ability to run the government and having the operations taken over by bondholders.⁶⁶ Hedge funds can run companies; our democratic system does not countenance them running cities.

That a state has the inherent power to put a restructuring regime for municipal debt in place does not imply that it has an obligation to do so. In theory, one could articulate a cogent reason as to why a state, when it establishes a municipal entity, may bar that entity from restructuring its debts. One could posit that those creating a new entity could decide that they want to ensure that the new public entity keeps its borrowing extremely low and funds almost all of its expenditures out of current income (taxes). For example, a state may be concerned about maintaining the creditworthiness of the state as a whole, and therefore want to constrain any individual entity from over-borrowing and therefore putting the credit

64. See generally Michelle Wilde Anderson, *Dissolving Cities*, 121 YALE L.J. 1364 (2012).

65. See generally Robert K. Rasmussen, *Integrating a Theory of the State into Sovereign Debt Restructuring*, 53 EMORY L.J. 1159 (2004).

66. Of course, we do see voters losing control when a financial control is put in place, as was done in Detroit, New York City, Washington, D.C. and now Puerto Rico. These boards were always put in place by governmental officials, with a mandate to steer the finances back on track. They were not charged with looking after the interests of the bondholders first and foremost. See, e.g., Hazel Bradford, *Detroit, D.C. Offer Clues to the Future of Puerto Rico's Public Pension Funds*, PENSIONS & INV. (July 8, 2016, 11:50 A.M.), <http://www.pionline.com/article/20160708/ONLINE/160709915/detroit-dc-offer-clues-to-the-future-of-puerto-ricos-public-pension-funds>; Janell Ross & Matt Sledge, *Detroit Financial Advisory Board Finds Model in New York City, Washington D.C.*, HUFFINGTON POST (Apr. 9, 2012, 8:17 A.M.), https://www.huffingtonpost.com/2012/04/09/detroit-financial-rescue_n_1409112.html.

of the other constituent units at risk. The state, in other words, may be concerned about moral hazard. This decision though, the Supreme Court has made clear, is a matter for the states—it is a matter of state sovereignty. To be sure, the federal government has preempted states' power to create a restructuring regime, but it has put an adequate substitute in its place. The federal government provides a mechanism, Chapter 9, and the states get to decide whether they want to use it for their municipalities and, if so, whether there are conditions they wish to attach to its use.

Consistent with the foregoing, *Asbury Park* established that it is the states that have the inherent power to enact a restructuring regime. Congress, however, reacted to the decision by amending the federal municipal bankruptcy law so that it preempted state restructuring regimes such as the one at issue in the case. But Congress did so by saying that it was giving states the basic mechanism to use, should they wish to use it. The option—whether or not to have a restructuring mechanism at all—still rested squarely with the state.

To the extent that the power to establish a restructuring regime is an integral part of the power to tax, the question becomes whether Congress can take away this power and put nothing in its place. For the reasons that articulated above, the answer is no.

III. PUERTO RICO

The above section argued that the power to enact a debt adjustment scheme is an integral part of a state's sovereign power, and that Congress cannot take that power away and put nothing in its place.⁶⁷ But Puerto Rico is not a state; rather, it has a unique and convoluted relationship with the United States. The question necessarily arises whether Congress has greater latitude with respect to the Commonwealth than it does with the states.

If one considers Puerto Rico a territory, as that term is used in the United States Constitution, it follows that Congress has plenary power over the island. The much-discussed *Insular Cases* made the point clear.⁶⁸ There

67. A somewhat related question is raised by the Court's decision in *Franklin*. In order to be eligible for Chapter 9, a state has to authorize its municipalities to file for bankruptcy. Recall that the consent of the state was a key factor in *Bekins*. Can a state decline the offer of Chapter 9 and instead enact its own debt restructuring regime? We know from *Franklin* that § 903 would apply to such an attempt. The difference in this case and the one we are considering is that, as to the states, Congress has provided the option of using Chapter 9, something that it did not provide for Puerto Rico. In other words, Congress did not take away the states' power to enact a restructuring regime and give it nothing; rather, it took away the states' power and said that the only route was the federal one. We think that this would be within Congress's power.

68. See generally RECONSIDERING THE *INSULAR CASES*, *supra* note 10. See also *supra* note 12.

is much to criticize in these cases—particularly the thinly veiled undercurrents of racism and colonialism.⁶⁹ However, they stand for the proposition that Congress has plenary power with respect to territories, including (at that time) Puerto Rico. Territories, in short, do not enjoy the structural protections that federalism grants the states. If the relationship between the United States and Puerto Rico remained as it was in 1922, there would be no plausible argument that Congress transgressed the Constitution when it forbade Puerto Rico from enacting an insolvency regime while at the same time offering no alternative. Of course, if that relationship had not been altered, it is unclear that there would even be an issue—territories by and large do not have the power to issue debt.

But the relationship between the United States and Puerto Rico has undergone significant changes since the time of the *Insular Cases*—to quote the title of Chimène Keitner’s article, it has moved “From Conquest to Consent.”⁷⁰ Most importantly, Congress in 1950 enacted Public Law 600.⁷¹ This law provided “[t]hat, fully recognizing the principle of government by consent, this Act is now adopted in the nature of a compact so that the people of Puerto Rico may organize a government pursuant to a constitution of their own adoption.”⁷² Puerto Rico, however, did not have *carte blanche*. First, the law required that any constitution approved by the Puerto Rican people had to create a “republican form of government” and had to contain a bill of rights.⁷³ Moreover, Congress retained a veto over any constitution that Puerto Rico might put forth.⁷⁴ The constitution would become effective only with congressional approval. Congress had the power to reject the proposed constitution in full or to approve it subject to whatever amendments it deemed necessary.⁷⁵

Following the passage of Public Law 600 in 1950, Puerto Rican officials drafted a constitution. It was approved by the citizens of Puerto Rico on March 3, 1952, with 82% voting in favor.⁷⁶ President Truman then, on April 22, 1952, submitted the draft constitution to Congress for its

69. See, e.g., Juan R. Torruella, *Ruling America's Colonies: The Insular Cases*, 32 YALE L. & POL'Y REV. 57, 71 (2013).

70. Keitner, *supra* note 10.

71. Act to Provide for the Organization of a Constitutional Government by the People of Puerto Rico, Pub. L. No. 81-600, 64 Stat. 319 (1950) (codified as amended in scattered sections of 48 U.S.C.).

72. *Id.*

73. 48 U.S.C. § 731(c) (2012).

74. See *id.* § 731(d).

75. See *id.*

76. Dieter Nolen, *Puerto Rico*, in 1 ELECTIONS IN THE AMERICAS: A DATA HANDBOOK 543, 556 tbl. 2.5b (Dieter Nolen ed., 2005).

approval,⁷⁷ which occurred by joint resolution (subject to minor changes) on July 3 of the same year.⁷⁸

The precise meaning of the creation of Puerto Rico's constitution in terms of the relationship between Congress and Puerto Rico has been contested ever since, and we still do not have a definitive determination. Shortly after Congress blessed Puerto Rico's constitution, many government officials represented to the United Nations and elsewhere that any future changes to Puerto Rico's constitution could only take place with the consent of the citizens of Puerto Rico.⁷⁹ And this makes sense, because after the Second World War the United States was a key player in the creation of a new world order that explicitly disavowed colonialism. For example, U.N. General Assembly Resolution 1514 (XV) on the Granting of Independence to Colonial Countries and Peoples, and associated resolutions, set forth the right of self-determination of "[a]ll peoples;" a right by which those peoples were to be able to "freely determine their political status and freely pursue their economic, social and cultural development."⁸⁰ In 1945, Puerto Rico was on the United Nations' list of non-self-governing territories under the control of the United States (that is, the list of imperial colonies). In 1952, based on U.S. representations to the United Nations about the change in Puerto Rico's status vis-à-vis the United States, it was taken off that list.⁸¹ In other words, Puerto Rico was part of the United States, and its status could no longer be that of a vassal state (to remind ourselves, 1950 was when Public Law 600, which established the "compact" between the United States and Puerto Rico, was passed⁸²).

The following pronouncements from key congressional committees are illustrative of the rationale behind Public Law 600. The House Committee on Public Lands explained that Public Law 600 would "fulfill in a most exemplary fashion our obligations with respect to Puerto Rico under chapter XI of the charter of the United Nations, relating to the

77. See 98 CONG. REC. 4228 (1952) (message from Pres. Truman).

78. See Joint Resolution Approving the Constitution of the Commonwealth of Puerto Rico, Pub. L. No. 82-447, 66 Stat. 327 (1952).

79. See, e.g., T. Alexander Aleinikoff, *Puerto Rico and the Constitution: Conundrums and Prospects*, 11 CONST. COMMENT. 15, 19, 33 n.76, 41 n.105 (1994).

80. G.A. Res. 1514 (XV), at 66 (Dec. 14, 1960). See also G.A. Res. 2878 (XXVI), at 16 (Dec. 20, 1971); G.A. Res. 2621 (XXV), at 2 (Oct. 13, 1970).

81. See Keitner, *supra* note 10, at 90-91.

82. We have drawn on Keitner's superb article, for the sources and substance described here. See generally *id.*

administration of non-self-governing territories.”⁸³

The Senate Committee on Interior and Insular Affairs, for its part, in its report on Public Law 600 explained that:

[Public Law 600] is designed to complete the full measure of local self-government in the island by enabling the 2¼ million American citizens there to express their will and to create their own territorial government. . . . [thereby] giv[ing] further concrete expression to our fundamental principles of government of, by, and for the people.⁸⁴

The report cited the obligation to develop self-government contained in Article 73 of the U.N. Charter and expressed the view that the United States’ Charter obligations towards Puerto Rico “already have been fulfilled to an extent that is almost without parallel.”⁸⁵

The foregoing is bolstered by the statement made by Frances Bolton, a U.S. congressional representative to the U.N. General Assembly’s eighth regular session, who said that “[t]he previous status of Puerto Rico was that of a territory subject to the full authority of the Congress of the United States [but that a new status has been created by] a compact of a bilateral nature whose terms may be changed only by common consent.”⁸⁶

In addition, as Judge Juan Torruella of the First Circuit has emphasized, there exist international human rights treaties to which the United States is party that would be flatly inconsistent with a colony-type relationship between Congress and Puerto Rico.⁸⁷

Putting the foregoing actions and statements together leads to the conclusion that Congress vested Puerto Rico with sovereignty somewhat on par with that of the states. Congress could override the Puerto Rican constitution by passing an inconsistent law, just as it could override a state’s duly enacted law. But it lacks the power to unilaterally amend the

83. See H.R. REP. NO. 81-2275, at 2 (1950).

84. See S. REP. NO. 81-1779, at 2 (1950).

85. *Id.* at 3.

86. See November 3 Statement by Mrs. Bolton, 29 DEP’T ST. BULL. 802, 804 (1953). See also October 30 Statement by Mrs. Bolton, 29 DEP’T ST. BULL. 797, 798 (1953); Memorandum by the Government of the United States of America Concerning the Cessation of Transmission of Information Under Article 73(e) of the Charter with Regard to the Commonwealth of Puerto Rico, 28 DEP’T ST. BULL. 585, 586–88 (1953) [hereinafter 1953 Memorandum].

87. See *Igartua-De La Rosa v. United States*, 417 F.3d 145, 173–75 (1st Cir. 2005) (Torruella, J., dissenting); Torruella, *supra* note 13, at 333–35. See generally Joseph Blocher & Mitu Gulati, *Forced Secessions*, 80 LAW & CONTEMP. PROBS. 215 (2017) (describing the anti-colonial move in international law); Cesar A. Lopez Morales, *A Political Solution to Puerto Rico’s Disenfranchisement: Reconsidering Congress’s Role in Bringing Equality to America’s Long-Forgotten Citizens*, 32 B.U. INT’L L.J. 185, 194–95 (2014).

Puerto Rican constitution. The Puerto Rican constitution provided a mechanism for amendment—a mechanism that involved actions only by Puerto Rico itself.

If anything, though not essential to our argument here, Puerto Rico should have greater protection from congressional inroads than do the states. When the Supreme Court got out of the “core function” game in *Garcia*, part of its articulated reason was that the states, through their representation in Congress, had structural measures by which they could protect themselves.⁸⁸ Each state has at least one representative. While the power of a lone representative is not great (though Puerto Rico, were it a state, would be entitled to four representatives), each state also receives two senators. As with every small state, even the senators and representatives working together cannot ensure that a state gets its way. Rather, it is the case that these congressional officials offer some guarantee that the interests of the state will be considered in the legislative process. They can join with others and form coalitions that ensure that they have a voice in the process.⁸⁹ They are not guaranteed to succeed, but they are guaranteed a seat at the table. Not so for Puerto Rico. It has no representatives that can look out for its affairs in the political rough-and-tumble in the halls of Congress. It has to rely on grace, not allies.⁹⁰ This lack of structural protection should, if anything, nudge the Court towards intervening to protect the sovereignty of the Commonwealth when a federal law seeks to remove power from the island.

The treatment of Puerto Rico’s access to Chapter 9 proves the point. Congress removed Puerto Rico and the District of Columbia from the ambit

88. See *Garcia v. San Antonio Metro. Transit Auth.*, 469 U.S. 528, 546–47, 555 (1985).

89. Constitutional law scholars have long debated whether the ability of states to defend their interests in the political realm implies that there is no need for judicial review to protect the interest of states. See generally, e.g., Larry D. Kramer, *Putting the Politics Back into the Political Safeguards of Federalism*, 100 COLUM. L. REV. 215 (2000); John C. Yoo, *The Judicial Safeguards of Federalism*, 70 S. CAL. L. REV. 1311 (1997); William W. Van Alstyne, Comment, *The Second Death of Federalism*, 83 MICH. L. REV. 1709 (1985); Jesse H. Choper, *The Scope of National Power Vis-à-Vis the States: The Dispensability of Judicial Review*, 86 YALE L.J. 1552 (1977); Herbert Wechsler, *The Political Safeguards of Federalism: The Role of the States in the Composition and Selection of the National Government*, 54 COLUM. L. REV. 543 (1954). While the participants in this debate disagree over the extent to which state interests are protected in the legislative process, and whether this protection means that there is no need for judicial review, they all acknowledge that states have some protection in the process—something that Puerto Rico does not have at all.

90. We have argued elsewhere that this lack of political representation explains the lack of urgency from the federal government in assisting Puerto Rico after the devastation wrought by Hurricane Maria in 2017. See Mitu Gulati & Robert K. Rasmussen, *Puerto Rico: Devastation Without Representation*, HILL (Oct. 22, 2017, 8:00 A.M.), <http://thehill.com/blogs/congress-blog/politics/356455-puerto-rico-devastation-without-representation>.

of Chapter 9 in 1984.⁹¹ It is difficult to imagine such action being taken if Puerto Rico had voting representation in Congress. Its representatives could have lobbied their fellow representatives and could well have put together a coalition to block the measure. There does not seem to have been a great groundswell of enthusiasm for removing the availability of Chapter 9 for Puerto Rico's municipalities; a small bit of organized resistance might well have stopped the effort.

One can find other statements around the creation of the Puerto Rican constitution, however, suggesting that at least some thought that Congress retained plenary power over Puerto Rico, undiminished in any way.⁹² These statements, if credited, suggest that the act of creating the constitution was simply a way to put a process in place by which Puerto Rico could govern itself, though it would always be subject to overrule by the federal government.⁹³ One reason why this debate remains unresolved is that Congress has not made any attempt to unilaterally alter the Puerto Rican constitution since giving its consent in 1952.

Moreover, as Gary Lawson and Robert Sloane have pointed out, if Puerto Rico remains a territory, many features of the current arrangement would likely be unconstitutional.⁹⁴ Most prominently, the official in charge of Puerto Rico would seem to be an officer of the United States.⁹⁵ As such, he would have to be appointed by the President and confirmed by the Senate.⁹⁶ In fact, the governor of Puerto Rico, like the governor of every state in the Union, is elected by the citizenry.⁹⁷

In 2016, a few weeks before its decision in *Franklin*, the Supreme Court reaffirmed that Puerto Rico is not the same for all constitutional purposes as a state. In *Puerto Rico v. Sánchez Valle*, Puerto Rico had filed a criminal action against Luiz Sánchez Valle for illegally selling firearms in violation of the Puerto Rico Arms Act of 2000.⁹⁸ The federal government then brought federal charges against him based on the same conduct. The

91. See *supra* note 29 and accompanying text.

92. See, e.g., S. REP. NO. 81-1779, at 3 (1950) ("The measure [Pub. L. 600] would not change Puerto Rico's fundamental political, social, and economic relationship to the United States."); H.R. Rep. No. 81-2275, at 3.

93. See Keitner, *supra* note 10, at 85 ("Because Congress would always have the last word on Puerto Rico's status, the legacy of conquest circumscribed the principle of consent both structurally and symbolically.")

94. See generally Gary Lawson & Robert D. Sloane, *The Constitutionality of Decolonization by Associated Statehood: Puerto Rico's Legal Status Reconsidered*, 50 B.C. L. REV. 1123 (2009).

95. *Id.* at 1167-68.

96. *Id.* at 1172.

97. *Id.* at 1147.

98. *Puerto Rico v. Sánchez Valle*, 136 S. Ct. 1863, 1865 (2016).

defendant reached a plea agreement with the federal authorities while the case brought by Puerto Rican officials was still pending.⁹⁹ Sánchez Valle then moved to dismiss the case brought by the Puerto Rican authorities, arguing that convicting him would expose him to double jeopardy, in violation of the Fifth Amendment.¹⁰⁰

Puerto Rico attempted to continue its prosecution by invoking the dual sovereign doctrine.¹⁰¹ Under the dual sovereign doctrine, the federal government and the appropriate state government can prosecute an individual for the same activity and not run afoul of the Double Jeopardy Clause.¹⁰² The theory is that while the act is the same, the crimes are distinct—one is against the federal sovereign, and one is against the state sovereign. Puerto Rico argued here that one crime was against the federal sovereign, and one was against Puerto Rico. The Court rejected this argument and held that the Commonwealth could not maintain a separate prosecution.¹⁰³

The Court recognized that, in the dual sovereign context, “‘sovereignty’ . . . does not bear its ordinary meaning.”¹⁰⁴ Rather, the Court’s jurisprudence on the dual sovereign issue requires it to look to the source of the power to criminalize. To the extent that the power to criminalize comes from distinct sources, the two prosecutions can go forward.¹⁰⁵ With states and Indian tribes, they have that power apart from the federal government.¹⁰⁶ Their sovereignty preexists that of the federal government. In Puerto Rico’s case, however, the power to enact criminal laws was given to it by the federal government. Congress authorized Puerto Rico to adopt its constitution, and the prosecution at issue derives its legitimacy from that constitution. Since the *ultimate* source of the power was the federal government, such power could not originate from Puerto Rico.¹⁰⁷

The Court’s analysis supports our argument. The Court went out of its way to emphasize that the Commonwealth enjoyed many if not all

99. *Id.*

100. *Id.* at 1869.

101. *Id.* at 1869.

102. *Id.* at 1871.

103. *Id.* at 1876–77.

104. *Id.* at 1870.

105. *Id.* at 1871.

106. *Id.* at 1872.

107. *Id.* at 1875.

attributes of sovereignty.¹⁰⁸ What was critical to the double jeopardy analysis was the historical source of that sovereignty: from where did Puerto Rico get the power to enact its criminal laws? After the *Insular Cases*, it was clear that all power lay with Congress. Whatever power Congress transferred to Puerto Rico, even if this power was a one-way transfer of sovereignty, it remained the case that this power originated with the federal government. That being the case, the dual sovereign doctrine did not apply, and Puerto Rico could not maintain its action against Sánchez Valle. This analysis is consistent with an understanding of Puerto Rico's current sovereignty as—once transferred by Congress—including the attributes of state sovereignty involving the power to issue and restructure debt.

The real question, left untouched by *Sánchez Valle*, is whether, having transferred sovereignty to Puerto Rico by authorizing its constitution, Congress may subsequently diminish or retract specific aspects of the conferred sovereignty in ways that it cannot for the states. One can infer that the Supreme Court is aware of this issue from its repeated efforts at ducking it. For example, in *Examining Board of Engineers, Architects and Surveyors v. Flores de Otero*, the issue was whether a Puerto Rico law violated the Constitution's guarantee of Equal Protection (it did).¹⁰⁹ But there are two routes by which the Equal Protection Clause can apply. Under the Fourteenth Amendment, the Equal Protection Clause by its terms applies to states.¹¹⁰ To the extent that one views the Commonwealth as a new type of entity, somewhere between a territory and a state, it may well be akin to a state for Fourteenth Amendment purposes. On the other hand, for territories like the District of Columbia, the Equal Protection constraint on government action applies via the Fifth Amendment's Due Process Clause. The Court expressly declined to identify which clause was at issue, noting that the law in question would run afoul of either.¹¹¹

108. *Id.* at 1874 (“Puerto Rico today has a distinctive, indeed exceptional, status as a self-governing Commonwealth.”); *id.* (“[The drafting and passage of Puerto Rico’s constitution] were of great significance – and, indeed, made Puerto Rico ‘sovereign’ in one commonly understood sense of that term. As this Court has recognized, Congress in 1952 ‘relinquished its control over [the Commonwealth’s] local affairs[,] granting Puerto Rico a measure of autonomy comparable to that possessed by the States.’”) (quoting *Examining Bd. of Eng’rs, Architects & Surveyors v. Flores de Otero*, 426 U.S. 572, 597 (1976)). See also *Rodriguez v. Popular Democratic Party*, 457 U.S. 1, 8 (1982) (“Puerto Rico, like a state, is an autonomous political entity, ‘sovereign over matters not ruled by the Constitution’”) (quoting *Calero-Toledo v. Pearson Yacht Leasing Co.*, 416 U.S. 663, 673 (1974)).

109. *Flores de Otero*, 426 U.S. at 600–01.

110. U.S. CONST. amend. XIV, § 1.

111. *Flores de Otero*, 426 U.S. 572 at 600.

Similarly, the Court has never addressed whether the Contracts Clause, which applies only to states, applies to Puerto Rico as well.¹¹² In *Sánchez Valle*, the Court noted that since both parties agreed that the Double Jeopardy Clause applied to Puerto Rico, it was not going to consider the question.¹¹³ Indeed, if Puerto Rico were to be treated as a state for part of the Constitution other than the idiosyncratic dual sovereign doctrine, it would appear that treating Puerto Rico differently than states would be unconstitutional. The Bankruptcy Clause of the Constitution provides that “[t]he Congress shall have Power To . . . establish . . . uniform Laws on the subject of Bankruptcies throughout the United States.”¹¹⁴ Congress cannot pass one set of bankruptcy laws for municipalities in Illinois and a different set for those in California. By the same token, to the extent that Puerto Rico is part of the United States, the exclusion of Puerto Rico from the protections of Chapter 9 runs afoul of the uniformity requirement.

We want to emphasize that our analysis does not rest solely on the fact that Puerto Rico’s citizens voted for a constitution. In the nineteenth century, many United States territories enacted constitutions.¹¹⁵ While these constitutions may have held sway over the local citizens, no one thought that they altered the territory’s relationship with the federal government. Indeed, it would be odd to argue that any political entity could act unilaterally and in so doing claim for itself power that otherwise rests in Congress.

Rather, our argument focuses on the role of Congress in the creation. Puerto Rico was invited by Congress to draft a constitution. Indeed, Congress required that the Puerto Rican constitution guarantee a republican form of government. The U.S. Constitution, of course, requires the United States (interpreted by the Court to mean Congress)¹¹⁶ to guarantee that all states have such a form of government. There is no such requirement that Congress ensure republican government in the territories.¹¹⁷ Congress’s

112. The First Circuit applied the Contracts Clause to Puerto Rico in *United Automobile, Aerospace, Agricultural Implement Workers of America International Union v. Fortuno*, 633 F.3d 37, 41 (2011), but a footnote states that the Puerto Rican government conceded that the Contracts Clause applied to it. *Id.* at n.3.

113. *Puerto Rico v. Sánchez Valle*, 136 S. Ct. at 1870 n.1.

114. U.S. CONST. art. I, § 8.

115. See, e.g., GARY LAWSON & GUY SEIDMAN, *THE CONSTITUTION OF EMPIRE: TERRITORIAL EXPANSION AND AMERICAN LEGAL HISTORY* 154 (2004).

116. See *Luther v. Borden*, 48 U.S. 1, 42 (1849).

117. *Baker v. Carr*, 369 U.S. 186, 226 (1962) (“[The Court] has pointed out that Congress is not required to establish republican government in the territories before they become States, and before they

insistence on that requirement in the constitution that it was authorizing Puerto Rico to adopt is consistent with an investiture of sovereignty similar to statehood. We view the act “in the nature of a compact,” by which Congress brought the Puerto Rican constitution into being, as the transfer of sovereignty over the island from Congress to Puerto Rico.¹¹⁸

International law supports this interpretation. As noted earlier, among the United States’ commitments to the United Nations was that it was going to divest itself of its colonies. Indeed, as the House and Senate reports cited earlier suggest, the United States committed to setting an example for other colonial powers in terms of willingness to grant self-governance rights to former colonies such as Puerto Rico.¹¹⁹ (Beginning in 1946, the United Nations had viewed the U.S.-Puerto Rico relationship as one in which the latter was a colony.¹²⁰) The United States government, however, represented to the United Nations that the creation of the Puerto Rican constitution decolonized Puerto Rico.¹²¹ These statements would be inconsistent with the assertion that the United States retained plenary power over the island.¹²²

To be sure, some have argued that Congress could not give away any of its power. For these scholars, the Constitution, when it comes to relationships with the federal government, contemplates only a limited number of possibilities.¹²³ It is similar to the *numerus clausus* principle in property law.¹²⁴ For these scholars, the Constitution identifies and limits the type of relationships other political units can have vis-à-vis the federal government. A political unit can be a state, it can be a territory, it can be an

have attained a sufficient population to warrant a popularly elected legislature.”) (citing *Downes v. Bidwell*, 182 U.S. 244, 278–79 (1901) (dictum)).

118. Act to Provide for the Organization of a Constitutional Government by the People of Puerto Rico, Pub. L. No. 81-600, 64 Stat. 319 (1950) (codified as amended in scattered sections of 48 U.S.C.). The only other territory that has received an equivalent transfer of sovereignty is the Northern Mariana Islands. See H.R. REP. 104-856, at 2–3 (1996).

119. See *supra* text accompanying notes 83–85.

120. See G.A. Res. 66 (I), at 124–25 (Dec. 14, 1946).

121. See, e.g., 1953 Memorandum, *supra* note 86, at 585 (stating that Puerto Rico has achieved “the full measure of self-government”); *id.* at 587 (“Congress has agreed that Puerto Rico shall have, under [its] Constitution, freedom from control or interference by the Congress in respect of internal government and administration.”).

122. These representations to the international community, others have argued, have legal implications. See Lawson & Sloane, *supra* note 94, at 1155 (“[I]t is well established that a State may, by repeated, public representations intended to induce reliance on the part of other States . . . bind itself unilaterally”).

123. See T. ALEXANDER ALEINIKOFF, *SEMBLANCES OF SOVEREIGNTY: THE CONSTITUTION, THE STATE, AND AMERICAN CITIZENSHIP* 89–90 (2002); Lawson & Sloane, *supra* note 94, at 1127.

124. Thomas W. Merrill & Henry E. Smith, *Optimal Standardization in the Law of Property: The Numerus Clausus Principle*, 110 YALE L.J. 1, 3–4 (2000).

Indian tribe, or it can be a foreign nation. That is all that the Constitution mentions, and that is all that there is. All agree that Puerto Rico is not a state, an Indian tribe, or a foreign nation; ergo, it must be a territory. To the extent that one finds this argument persuasive—and we do not—it ends the inquiry. Congress would have plenary power over Puerto Rico, and it could not object to Congress both barring it from enacting an insolvency regime and at the same time putting nothing in its place.

Yet another reading of the United States Constitution, however, is possible—and we think more plausible in the modern era. Congress began with plenary power over the territory. The act of working with the citizens of Puerto Rico to create a constitution was akin to an Ackermanian constitutional moment.¹²⁵ It was a fundamental alteration in the relationship between the United States and Puerto Rico. By putting in place a mechanism, in the nature of a compact, that led to the establishment of the Constitution, Congress ceded part of its former plenary power to the citizens of Puerto Rico. Consistent with the commitment of the United States to a world that had put the legacy of colonialism behind it, there were to be no more colonies with second-class status. The original states began with total sovereignty and ceded some of that to create the federal government. Here, the process is the converse. Congress started with total sovereignty and then transferred some to Puerto Rico.

The Constitution directs that Congress may add new states into the Union,¹²⁶ and when those new states arise from former territories, then Congress is in effect transferring sovereignty that it once held to the new states. Those new states then gain new status under the Constitution, including the protection of their sovereignty from incursion by Congress under the Tenth Amendment. What happened to Puerto Rico in 1952 represents a portion of that process having occurred. While not ending in full statehood, it involved a constitutional change in status and a profound alteration of relationship between the federal government and Puerto Rico. Sovereignty once yielded, particularly though an agreement to share governance, cannot be clawed back through unilateral action.

Since 1952, Congress has maintained a relationship with Puerto Rico

125. See generally Bruce A. Ackerman, *The Storrs Lectures: Discovering the Constitution*, 93 YALE L.J. 1013 (1984). Of course, one does not have to ascribe to this particular vision of constitutional law to endorse the proposition that Congress is free to create types of entities in addition to those expressly mentioned in the Constitution. Any version of a living Constitution will suffice. Indeed, even an originalist could agree with our point, so long as she did not find in the Constitution an intent to limit congressional flexibility on this score.

126. U.S. CONST. art. IV, § 3.

similar to what it has with the states. Federal laws applicable to the nation can override local laws, as with all states. But Congress has not used its powers to legislate for Puerto Rico specifically. That power was ceded to the Puerto Rican government.

To the extent that Congress did irrevocably transfer sovereignty to Puerto Rico, it is beyond peradventure that part of what was transferred was the ability to tax its own citizens. Article six of the Puerto Rican constitution, which, again, was approved by Congress, expressly provides that the legislature can levy taxes. As per *Asbury Park*, the power to tax contains the power to create a debt restructuring scheme. If Congress cannot prevent a state from enacting a restructuring regime without offering an alternative, the same is true in the case of Puerto Rico.¹²⁷

CONCLUSION

Puerto Rico has operated since 1952 in an uncomfortable place in our federal system. It is not a state, yet to call it a territory would be to ignore the combined efforts of Puerto Rico and the United States to remove its colonial status. Puerto Rico, it seems to us, may not have the structural protections of the fifty states, but it does have a degree of sovereignty unlike that of a colony or a territory. To quote President Truman's message to Congress on the new relationship between Puerto Rico and the United States, issued while submitting the Puerto Rican draft constitution for congressional approval:

The Commonwealth of Puerto Rico will be a government which is truly by the consent of the governed. No government can be invested with a higher dignity and greater worth than one based upon the principle of consent. The people of the United States and the people of Puerto Rico are entering into a new relationship that will serve as an inspiration to all who love freedom and hate tyranny.¹²⁸

That modicum of inherent power that was granted to Puerto Rico includes the power to tax and, with that, the power to enact its own restructuring scheme for its municipalities. Congress can take that power away so long as it provides an alternative. It cannot, however, consign

127. At a minimum, this implies that when Congress created the netherworld, it should have done so with greater clarity. It clearly was not inadvertent that Congress removed Puerto Rico from the definitional section. Given that there is no evidence whatsoever behind this action, it is impossible to know whether Congress thought that it was leaving Puerto Rico defenseless. At a minimum, given the quasi-state-like status that Puerto Rico has today, the Court should require Congress to speak clearly when it wants to treat Puerto Rico worse than a state. It should not be allowed to invade the traditional government functions without a clear indication that that was its intent.

128. See 98 CONG. REC. 4228 (1952) (message from Pres. Truman).

Puerto Rico to the netherworld.

Indeed, to the extent that states can enact their own restructuring regimes, Puerto Rico is free to do so as well.

