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On the Discussion Draft of the “Puerto Rico Oversight, Management, and Economic Stability Act”

Chairman Bishop, Ranking Member Grijalva, and distinguished members of the Committee,

Thank you for inviting me to testify today. I am a professor of law at Fordham University School of Law, where I teach constitutional law and other topics.

As I understand the new draft legislation just released publicly, Title I creates a Financial Oversight and Management Board for Puerto Rico, and gives the legislatures of other U.S. territories the option to choose to have such an oversight board created for them. Title II sets out the responsibilities of any oversight board created under Title I. Title III, section 302, allows a U.S. territory or territorial instrumentality to be a debtor and follow specified debt adjustment procedures if it is subject to an oversight board created under Title I, that board has allowed the territory or territorial instrumentality to enter into a debt adjustment process, and the territory “desires to effect a plan to adjust its debts.”

I. The Uniformity Requirement of the Constitution’s Bankruptcy Clause

The Constitution’s Bankruptcy Clause provides that “The Congress shall have power to . . . establish . . . uniform laws on the subject of bankruptcies throughout the United States.” U.S. Const., art. I, § 8, cl. 4. Case law about this uniformity requirement establishes that, although it requires what the Supreme Court calls geographic uniformity, the clause nevertheless grants Congress great leeway. “The uniformity requirement is not a straitjacket . . . .” Railway Labor Executives’ Ass’n v. Gibbons, 455 U.S. 457, 469 (1982). Congress may treat different classes of debtors differently; may incorporate state law in ways that will lead to different results in different states; and may address geographically-isolated problems as long as the law operates uniformly on a given class of debtors and creditors. See id. at 465-69; Blanchette v. Connecticut General Ins. Corp., 419 U.S. 102, 156-61 (1974); Schultz v. United States, 529 F.3d 343, 350-52
(6th Cir. 2008). The Supreme Court has struck down a law as non-uniform, however, where it applied to only a single debtor, one named railroad company. See Railway Labor Executives’ Ass’n, 455 U.S. at 465-69.

In light of this case law, a question might be raised about whether the draft legislation could be subject to challenge for non-uniformity. The fact that legislation concerns debt adjustment for certain classes of debtors only—territories and territorial instrumentalities—is unlikely to be deemed objectionable under the Bankruptcy Clause uniformity provision. The Supreme Court has held that Congress may treat different classes of debtors differently. But to the extent that the legislation singles out Puerto Rico (and its instrumentalities), because only Puerto Rico has an oversight board created for it by the bill, uniformity questions might be raised.

Nevertheless, my view is that these constitutional concerns can be avoided in this case, because Congress may enact debt adjustment legislation for Puerto Rico under a different clause of the Constitution, a clause that does not require uniformity. That clause is the Territories or Territorial Clause of Article IV, as referenced in § 101(b)(3) of the new draft of the bill (setting out the “Constitutional Basis”).

II. The Territories Clause Allows Non-Uniform Legislation

The Constitution empowers Congress to “make all needful rules and regulations respecting the territory or other property belonging to the United States.” U.S. Const., art. IV, § 3. Congress’s power to use this clause to make rules for the territories has been called an “absolute and undisputed power,” by Chief Justice John Marshall. Sere v. Pitot, 10 U.S. 332, 336-37 (1810).

Congress has well-established and long-exercised power under this clause to treat territories differently from each other, and to treat territories differently than it treats U.S. States. In my judgment, this clause serves as an independent and sufficient basis on which Congress may enact the contemplated legislation. The remainder of my testimony will concern the Territorial Clause and the non-uniformity that it allows.

The power of Congress over the territories is vastly different than its power over the States of the Union. Congress’s power is limited in legislating for the States to certain enumerated or implied topics of national concern. But when legislating for the territories, Congress is given additional power by the Territorial Clause—broad, general legislative power that the Supreme Court analogizes to that of a State legislature. See, e.g., First Nat. Bank v. Yankton Cty., 101 U.S. 129, 133 (1879); Benner v. Porter, 50 U.S. 235, 242 (1850). Over a territory or dependency “the nation possesses the sovereign powers of the general government plus the powers of a local or a state government in all cases where legislation is possible.” Cincinnati Soap Co. v. United States, 301 U.S. 308, 317 (1937). Thus, “[t]he powers vested in Congress by” the Territorial Clause “to govern Territories are broad,” Examining Bd. of Engineers, Architects, & Surveyors v. Flores de

The Supreme Court has many times emphasized that interpretation of Congress’ ability to legislate for the territories under the Constitution must be marked by “flexibility,” Cincinnati Soap Co., 301 U.S. at 318, and concern for Congress’s practical ability to govern, see Torres v. Commonwealth of Puerto Rico, 442 U.S. 465, 470 (1979).

Puerto Rico, though it is now formally a commonwealth, is still a territory of the United States within the meaning of the Territorial Clause. See Torres, 442 U.S. at 468-70; Dávila-Pérez v. Lockheed Martin Corp., 202 F.3d 464, 468-69 (1st Cir. 2000); Americana of Puerto Rico, Inc. v. Kaplus, 368 F.2d 431, 435 (3d Cir. 1966). In other words, Congress may still today legislate for Puerto Rico pursuant to it plenary power over territorial legislation.1

The history of congressional regulation of the territories has been one of tailoring legislation to the specific historical, geographic, economic, legal, and political conditions of each particular territory. The history has also shown Congress using the Territorial Clause to enact a wide array of legislation that it could not enact for the States under its Article I powers.

Congress’s first territorial legislation—enacted in 1787 by the Confederation Congress, and re-enacted in 1789 by the first Congress organized under the new Constitution—shows this pattern. See Act of Aug. 7, 1789, ch. 8, 1 Stat. 50. This law, the famous Northwest Ordinance, announced many rules that would apply only in the Northwest Territory. For example, it announced rules concerning intestate succession and conveyance of real estate, but then also provided that “the French and Canadian inhabitants” of the territory could continue to be governed by their own “laws and customs now in force among them.” An Ordinance for the Government of the Territory of the United States Northwest of the River Ohio § 2 (July 13, 1787).

Many other examples could be given of congressional legislation that (1) could not have been enacted under Article I to apply in the States and (2) applied to one territory only and provided specifically tailored rules for that territory. After the Louisiana Purchase, Congress’s legislation under the Territorial Clause provided special rules for that territory concerning the port of New Orleans. See Act of Feb. 24, 1804, ch. 13, §§ 6 & 8, 2 Stat. 251, 253. After the United States acquired Florida from Spain, Congress enacted specific rules regarding revenue collection for Spanish vessels trading with Florida. See Act of March 3, 1821, ch. 39, § 2, 3 Stat. 637, 639. When Congress organized the Territory of Oklahoma, it provided that certain specified chapters of the laws of the State of Nebraska would apply there, concerning mortgages, corporations, railroads, real

1 See also Cincinnati Soap Co., 301 U.S. at 319 (holding that Congress’ legislative power over the Philippines under the Territorial Clause had not changed as a result of “the adoption and approval of a constitution for the Commonwealth of the Philippine Islands”).

Early on Congress recognized the utility of extending many general laws of the United States over the territories, but also recognized that not all laws applicable in the States would work well in some or all territories. As a result, Congress developed a practice of providing in the organic acts for territories that “all laws of the United States which are not locally inapplicable” shall apply in the territory. Act of Sept. 9, 1850, ch. 49, § 17, 9 Stat. 446, 452 (Territory of New Mexico). See also Act of March 3, 1863, ch. 117, § 13, 12 Stat. 808, 813 (Territory of Idaho); Act of May 26, 1864, ch. 95, § 13, 13 Stat. 85, 91 (Territory of Montana). This statutory provision was, in effect, a delegation from Congress to the courts to tailor the legislation of the United States to the specific local requirements of each organized territory. The ubiquity of these provisions, and the lack of successful constitutional challenges to them, evidences Congress’ plenary authority to tailor legislation to the needs and circumstances of an individual territory.

The Supreme Court took up Congress’ s direction to determine which general laws were locally applicable or inapplicable in specific territories. When Congress specified in a statute that it would apply to “territories” as well as States, the Supreme Court examined “the character and aim of the act” to determine if a particular territory was covered. People of Puerto Rico v. Shell Co., 302 U.S. 253, 258 (1937).

The Foraker Act, the organic act for Puerto Rico passed in 1900, contained this same “not locally inapplicable” tailoring provision, and specified also that Congress’ internal revenue laws would not apply. See Act of April 12, 1900, ch. 191, § 14, 31 Stat. 77, 80.2 Congress further tailored legislation specifically for Puerto Rico by also specifying in the Foraker Act that preexisting laws from the period of Spanish rule would continue in force unless they were repealed by the United States, in conflict with U.S. statutes, or determined to be “locally inapplicable.” Id. § 8.

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2 Today 48 U.S.C. § 734 provides:

“The statutory laws of the United States not locally inapplicable, except as hereinbefore or hereinafter otherwise provided, shall have the same force and effect in Puerto Rico as in the United States, except the internal revenue laws other than those contained in the Philippine Trade Act of 1946 [22 U.S.C.A. § 1251 et seq.] or the Philippine Trade Agreement Revision Act of 1955 [22 U.S.C.A. § 1371 et seq.]: Provided, however, That after May 1, 1946, all taxes collected under the internal revenue laws of the United States on articles produced in Puerto Rico and transported to the United States, or consumed in the island shall be covered into the Treasury of Puerto Rico.”
Congress enacted the “not locally inapplicable” provision only for so-called organized territories, see Revised Statutes § 1891 (1878), in which Congress had created a local territorial government. Thus, Congress allowed even greater dis-uniformity in unorganized territories, where general rules of the United States were not extended by any such provision. Even within organized territories, Congress drew distinctions. When Congress organized a government for the Philippines, it provided that § 1891 did not apply, see Act of July 1, 1902, ch. 1369, § 1, 31 Stat. 691, 692, indicating an intent that generally applicable U.S. laws would not automatically extend to the Philippines.

In the Insular Cases, the Supreme Court held that the Constitution does not apply in full in so-called unincorporated territories, among which the Court included Puerto Rico and the Philippines. There are “inherent practical difficulties” with “enforcing all constitutional provisions ‘always and everywhere.’” Boumediene v. Bush, 553 U.S. 723, 759 (2008). Thus under the Insular Cases, not all structural limitations on congressional power apply to territorial legislation, see Torres, 442 U.S. at 468-69, and “[o]nly ‘fundamental’ constitutional rights are guaranteed to inhabitants of those [unincorporated] territories,” United States v. Verdugo-Urquidez, 494 U.S. 259, 268 (1990). Congressional legislation for an “unincorporated territory” like Puerto Rico is “not subject to all the provisions of the Constitution.” Torres, 442 U.S. at 469. “In exercising this power [under the Territories Clause], Congress is not subject to the same constitutional limitations as when it is legislating for the United States.” Hooven & Allison Co. v. Evatt, 324 U.S. 652, 674 (1945).

In contrast to its allowance of flexibility and heterogeneity with territorial legislation, the Constitution prescribes a certain amount of uniformity when Congress is legislating for the States of the Union. Territorial legislation has sometimes been challenged on the grounds that it is dis-uniform and hence unconstitutional, but these challenges have not succeeded.

The Constitution specifies that three kinds of legislation should be “uniform” “throughout the United States”: naturalization legislation, bankruptcy legislation, and certain taxes ("duties, imposts and excises"). Notwithstanding these clauses, it is well-established that naturalization and tax legislation for the territories need not be

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3 This statute provides: “The Constitution and all laws of the United States which are not locally inapplicable shall have the same force and effect within all the organized Territories, and in every Territory hereafter organized as elsewhere within the United States.”


5 See U.S. Const., art. I, § 8, cl. 1 (“The Congress shall have power to lay and collect taxes, duties, imposts and excises, to pay the debts and provide for the common defense and general welfare of the United States; but all duties, imposts and excises shall be uniform throughout the United States.”); id. § 8, cl. 4 (“The Congress shall have power to ... establish a uniform rule of naturalization, and uniform laws on the subject of bankruptcies throughout the United States.”).
uniform—either with respect to legislation for States of the Union or with respect to legislation for other territories. It stands to reason that the Bankruptcy Clause, employing identical language about uniformity, also does not bind Congress when it legislates for the territories.

**Tax uniformity not required for the territories:** The Supreme Court held, in the Insular Cases, that Congress was not bound by the uniformity provision with regard to taxation when it enacted special revenue laws applying only to Puerto Rico. As the Court later summarized the rule:

“In *Downes v. Bidwell*, 182 U.S. 244 (1901), we held that Congress could establish a special tariff on goods imported from Puerto Rico to the United States, and that the requirement that all taxes and duties imposed by Congress be uniform throughout the United States, Art. I, § 8, cl. 1, was not applicable to the island.” *Torres*, 442 U.S. at 468-69.

As *Torres* indicates, *Downes* is still good law on this point.

The tax uniformity requirement has also been held inapplicable with regard to incorporated territories. In organizing and incorporating the Alaska Territory, Congress “created no legislative body” for the territory and so “established a revenue system of its own, applicable alone to that territory.” *Binns*, 194 U.S. at 492. The Supreme Court rejected a claim that these Alaska-specific license and excise taxes enacted by Congress were required to be “uniform” with those “throughout the United States.” *Id.* at 487, 494-96. As the Court noted:

“It must be remembered that Congress, in the government of the territories . . . has plenary power, save as controlled by the provisions of the Constitution; that the form of government it shall establish is not prescribed, and may not necessarily be the same in all the territories.” *Id.* at 491.

**Naturalization uniformity not required for the territories:** The Supreme Court has held that under the Territorial Clause or the clause allowing Congress to admit new states into the union Congress can accomplish the naturalization of aliens located in certain territories and adjust their status to that of U.S. citizens. See *Boyd v. Nebraska ex rel. Thayer*, 143 U.S. 135, 164-66, 168-70 (1892). The Court quoted with approval a lower court decision that “denied that the only constitutional mode of becoming a citizen of the United States is naturalization by compliance with the uniform rules established by congress.” *Id.* at 165-66. The “plenary power of Congress over the territories” can be used to collectively naturalize specific groups of people on the terms that Congress determines. *Id.* at 169.

Congress has long exercised plenary authority to determine whether residents of insular territories should be made citizens or not, and has made distinctions between different territories. Hawaii, Puerto Rico, Guam, and the Philippines were all acquired by
the United States in 1898, but Congress treated residents of the territories very
differently for citizenship purposes. In 1900, citizenship was granted to essentially all
Congress confer U.S. citizenship on many residents of Puerto Rico. See Act of March 2,
1917, ch. 145, § 5, 39 Stat. 951, 953. Congress waited until 1940 to comprehensively
grant citizenship to residents of Puerto Rico. See Nationality Act of 1940, ch. 876, § 202,
54 Stat. 1137, 1139. Not until 1950 did Congress extend citizenship to Guamanians. See
citizenship to residents of the Philippines en masse, see Valmonte v. INS, 136 F.3d 914,
916-17 (2d Cir. 1998), though they were eligible for naturalization if they came within
the terms of generally applicable statutes, see, e.g., Balzac v. Porto Rico, 258 U.S. 298, 308
(1922). Samoa, which was acquired by the United States in 1900, has also seen its
residents excluded from automatic U.S. citizenship. See Tuaua v. United States, 788 F.3d
300, 302 (D.C. Cir. 2015).

Recently the Ninth Circuit confirmed that the uniformity provision of the
Naturalization Clause cannot be invoked by residents of unincorporated territories to
challenge non-uniform congressional rules. See Eche v. Holder, 694 F.3d 1026, 1031 (9th
Cir. 2012).

**Other uniformity cases:** When litigants from the territories have used individual
rights provisions of the Constitution to challenge congressional legislation under the
Territorial Clause for lack of uniformity, the Supreme Court has rejected these claims.
For instance, when individual rights challenges have been raised to social benefits
legislation that treated residents of Puerto Rico differently than residents of the States,
the Supreme Court has held that Congress “may treat Puerto Rico differently from States
so long as there is a rational basis for its actions.” Harris v. Rosario, 446 U.S. 651, 651-52
(1980) (AFDC program, Fifth Amendment Due Process Clause challenge); see also
Califano v. Torres, 435 U.S. 1, (1978) (per curiam) (SSI program) (holding that Congress
could treat Puerto Rico differently without violating the constitutional right to travel
“[s]o long as its judgments are rational, and not invidious”). This kind of rational basis
review is exceedingly deferential to the government. See, e.g., FCC v. Beach Commc’ns,

**III. Conclusions**

As a general matter, Congress needs only one constitutional grant of power upon
which to enact legislation. And if the legislation meets the requirements of one grant, it
does not matter if other possibly applicable grants do not support the legislation. See,

It is true that the Supreme Court has held that, although general principles governing
the reach of the Commerce Clause would allow Congress to enact bankruptcy legislation
on that basis, Congress should not be allowed to use the Commerce Clause “to enact
nonuniform bankruptcy laws,” because that “would eradicate from the Constitution a

The Supreme Court was not addressing and did not consider legislation governing the territories when it made that statement, and the case law and legal principles discussed above suggest that the Court’s concerns about an end run around limitations on congressional power should not apply to the situation at hand, where Congress could act under the Territorial Clause.

The Territorial Clause is not an end run around anything. It is a specially crafted constitutional power designed to allow Congress to flexibly address the myriad practical problems of governing the territories, and to tailor its legislation to the unique circumstances of each territory. In many ways, the entire point of the Territorial Clause is to allow Congress to do things that it cannot otherwise do under Article I. That is how the clause has been consistently used by Congress and interpreted by the Supreme Court over the centuries.

In my judgment, the newly-released draft legislation is within Congress's power under the Territorial Clause, which is not limited by the uniformity requirement of the Bankruptcy Clause.

That conclusion is supported by the recent decision in *Franklin California Tax-Free Trust v. Puerto Rico*, 805 F.3d 322 (1st Cir. 2015), in which two judges of the First Circuit opined that Congress could enact debt adjustment legislation specifically for Puerto Rico under its plenary power under the Territorial Clause. See id. at 337. One judge disagreed with this conclusion, however. See id. at 346-48 (Torruella, J., concurring in judgment). The Supreme Court has granted cert in this case, see *Acosta-Febo v. Franklin California Tax-Free Trust*, 136 S. Ct. 582 (2015), but it is not generally thought that the Court’s decision is likely to address Bankruptcy Clause uniformity issues.

Thank you again for the opportunity to testify about this bill.
April 20, 2016

The Honorable Rob Bishop, Chairman
U.S. House of Representatives, Committee on Natural Resources
1324 Longworth House Office Building
Washington, D.C. 20515

Re: H.R. 4900, the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA)

Dear Chairman Bishop and Members of the Committee,

Thank you for inviting me to testify on April 13, 2016 on the constitutionality of the new draft of the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA). As you know, current federal bankruptcy law does not provide either a voluntary or involuntary debt adjustment process for U.S. states or territories. PROMESA would create such a process for territories. At the hearing, questions were asked about whether a debt adjustment bill similar to PROMESA could be enacted for U.S. state governments. I was asked to submit a letter amplifying my testimony about that topic, in particular focusing on the Contracts Clause of the U.S. Constitution.

As I understood the thrust of several questions, there might be concern about whether a debt adjustment law for territories, such as the current draft of PROMESA, could create a precedent for a bankruptcy bill for states. The constitutional considerations regarding congressionally-authorized debt adjustment for territories, like Puerto Rico, and debt adjustment for U.S. states are starkly different. So different that, in my view, PROMESA would not create constitutional precedent for a debt adjustment statute for states.

Territories and states are fundamentally distinct in our constitutional system. “[U]nder our federal system, the States possess sovereignty concurrent with that of the Federal Government, subject only to limitations imposed by the Supremacy Clause.” Gregory v. Ashcroft, 501 U.S. 452, 457 (1991) (quotation marks omitted). “[T]he preservation of the States, and the maintenance of their governments, are as much within the design and care of the Constitution as the preservation of the Union and the maintenance of the National government. The Constitution, in all its provisions, looks to an indestructible Union, composed of indestructible States.” Id. (quoting Texas v. White, 7 Wall. 700, 725 (1869)).
State sovereignty limits federal power in a variety of important ways. See, e.g., U.S. Const., art. X (“The powers not delegated to the United States by the Constitution, nor prohibited by it to the states, are reserved to the states respectively, or to the people.”); id. art. XI (“The judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by citizens of another state, or by citizens or subjects of any foreign state.”). Congressional power, when legislating for the states of the union, is limited to certain enumerated and implied topics of national concern.

By contrast, the Constitution empowers Congress to “make all needful rules and regulations respecting the territory or other property belonging to the United States.” U.S. Const., art. IV, § 3. Unlike U.S. states, territories are not constitutional sovereigns whose existence, structure, and powers are protected from federal infringement by the Constitution. Over a territory or dependency “the nation possesses the sovereign powers of the general government plus the powers of a local or a state government in all cases where legislation is possible.” Cincinnati Soap Co. v. United States, 301 U.S. 308, 317 (1937). Thus, “[t]he powers vested in Congress by” the Territorial Clause “to govern Territories are broad,” Examining Bd. of Engineers, Architects, & Surveyors v. Flores de Otero, 426 U.S. 572, 586 n.16 (1976), “plenary,” Binns v. United States, 194 U.S. 486, 491 (1904), and even “practically unlimited,” Cincinnati Soap Co., 301 U.S. at 317.

As my written testimony for the April 13, 2016 hearing indicates, I believe that Congress has authority under Territorial Clause of Article IV to enact the PROMESA bill. But if Congress acting under Article I powers were to amend the bankruptcy code to allow either voluntary or involuntary debt adjustment for U.S. states, very serious questions would be raised about constitutionality. I cannot say definitively that such a statutory scheme would be found unconstitutional—extant Supreme Court case law does not allow that kind of precision, and the membership of the Court will likely be changing in the next year or so—but there is certainly a great risk of unconstitutionality.

The first question would be whether Congress has enumerated or implied power to enact bankruptcy legislation for state governments. The Constitution’s Bankruptcy Clause provides that “The Congress shall have power to . . . establish . . . uniform laws on the subject of bankruptcies throughout the United States.” U.S. Const., art. I, § 8, cl. 4. The Supreme Court has never been squarely confronted with the question whether this power allows bankruptcy legislation for state governments. Certainly we can say, though, that the members of the Founding generation who drafted and voted to adopt this language did not contemplate that Congress would be legislating with regard to state governments. See Emily D. Johnson & Ernest A. Young, The Constitutional Law of State Debt, 7 Duke J. Const. L. & Pub. Pol’y 117, 155-56 (2012); Thomas Moers Mayer, State Sovereignty, State Bankruptcy, and a Reconsideration of Chapter 9, 85 Am. Bankr. L.J. 363, 367 (2011). But even if the Bankruptcy Clause could not support such legislation, Congress arguably would find sufficient power under the Interstate Commerce and Necessary and Proper Clauses of Article I of the Constitution. But cf. Railway Labor Executives’ Ass’n v. Gibbons, 455 U.S. 457
(1982) (holding that Congress cannot do an end run around the uniformity requirement of the Bankruptcy Clause by legislating under the Commerce Clause).

A second question is whether state bankruptcy legislation would violate the Tenth Amendment and related principles protecting state sovereignty. In the 1930s, the Supreme Court held that a 1934 federal bankruptcy law for municipalities that allowed bankruptcy courts to impair the control of state governments over the fiscal affairs of their municipal subdivisions was not constitutional, see Ashton v. Cameron County Water Improvement Dist. No. 1, 298 U.S. 513, 528-29 (1936); id. at 539 (Cardozo, J., dissenting), while the 1937 amendment that both required state consent and sufficiently protected state sovereignty was constitutional, see United States v. Bekins, 304 U.S. 27, 49-51 (1938).

These two decisions are widely understood to have suggested that, to pass constitutional muster, any federal bankruptcy regime that would apply to states would need to meet two requirements: states would need to consent (the process would need to be entirely voluntary), and the statute would need to prevent federal bankruptcy courts from undermining state autonomy and sovereignty over taxing, spending, and other core sovereign matters. See, e.g., Michael E. McConnell, Extending Bankruptcy Law to States, in When States Go Broke: The Origins, Context, and Solutions for the American States in Fiscal Crisis 229, 230 (Peter Conti-Brown & David A. Skeel, Jr., eds., Cambridge Univ. Press 2012); Mayer, supra, at 374-75.1

Ashton and Bekins thus suggest that a mandatory oversight authority for states—akin to that found in PROMESA—could be subject to fatal constitutional objections. See David A. Skeel, Jr., States of Bankruptcy, 79 U. Chi. L. Rev. 677, 731 (2012). But even a purely voluntary bankruptcy process that attempted to respect state sovereignty could run into constitutional problems under the Tenth Amendment and principles of state sovereignty articulated in Ashton and Bekins. First, “viewed realistically, state bankruptcy would cut deeply into the inherently sovereign powers of the statute over taxation and expenditure,” transferring at least some control over those matters to a bankruptcy court. See McConnell, supra, at 233-34. In other words, it would be hard to design a process that in fact avoided all interference with a state’s core fiscal functions.

Second, more recent Supreme Court case law raises questions about whether state consent could cure Tenth Amendment concerns about federal impairments of state sovereignty via a bankruptcy regime. The “anti-commandeering” case law bars Congress from “require[ing] the States to govern according to Congress’ instructions,” New York v.1

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1 Federal bankruptcy for states without state consent might also be unconstitutional under the Eleventh Amendment and principles of state sovereign immunity. The Supreme Court has not directly answered this question, and its case law has given inconsistent signals. Compare Seminole Tribe v. Florida, 517 U.S. 44 (1996) (holding that Congress may not abrogate state sovereign immunity under Article I powers) and Central Virginia Community College v. Katz, 546 U.S. 356 (2006) (holding that state sovereign immunity did not bar a bankruptcy court from voiding a preferential transfer from a private debtor to a state instrumentality). See generally Johnson & Young, supra, at 159-60; Mayer, supra, at 368.
United States, 505 U.S. 144, 162 (1992), even if the state consents, see id. at 180-82. Federal legislation that commands state legislatures to regulate according to federal instructions disrupts the accountability of local officials to their local electorates and hence undermines the constitutional plan. See id. at 168-69. The Supreme Court has also reiterated that constitutional limits on federal action arising from federalism concerns and the Tenth Amendment protect structural interests and individual liberty, not just state sovereignty, see, e.g., id. at 181-82; Bond v. United States, 131 S. Ct. 2355, 2364 (2011), casting further doubt on whether state consent could cure an otherwise unwarranted invasion of state sovereignty. See McConnell, supra, at 234-35. If state consent is not effective, it is possible that even purely voluntary state bankruptcy would be unconstitutional, to the extent that it impaired the sovereignty and autonomy of state governments.

A third and final question is whether the Constitution would prohibit the impairment of state government contracts—for example, with bondholders—through a federal debt adjustment process overseen by a bankruptcy court. The Contracts Clause provides that “No State shall . . . pass any . . . law impairing the obligation of contracts.” U.S. Const., art. I, § 10, cl. 1. It might be said that no Contracts Clause problem would be posed by a congressional statute authorizing state bankruptcy, see Steven L. Schwarcz, A Minimalist Approach to State “Bankruptcy,” 59 U.C.L.A. L. Rev. 322, 337 (2011), because the federal government is not covered by the Contracts Clause, which expressly applies to “State[s]” only, see Hanover Nat’l Bank v. Moyses, 186 U.S. 181, 188 (1902). But if Tenth Amendment concerns, discussed above, require that the state consent to the federal bankruptcy process and to any court orders stemming from it, then it would not only be Congress but arguably the state also that would be choosing and authorizing actions that impaired state contracts. Thus the Contracts Clause could come into play.

The Supreme Court’s 1930s cases about municipal bankruptcy and state sovereignty do not answer all questions about the Contracts Clause as applied to a hypothetical statute authorizing state bankruptcy. The Ashton decision, about the 1934 law, suggested that states would violate the Contracts Clause by consenting to a congressional bankruptcy scheme that impaired state contractual obligations. See 298 U.S. at 531. But Bekins, the subsequent decision about a very similar statute, the 1937 amendment, did not discuss any Contracts Clause issues, perhaps suggesting that the Supreme Court had sub silentio reversed itself on the issue.

Under modern Contracts Clause jurisprudence, “impairment of a State’s own contracts would face more stringent examination . . . than would laws regulating contractual relationships between private parties.” Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 244 n.15 (1978). State laws regulating existing contractual relations must have “a legitimate public purpose. A State could not adopt as its policy the repudiation of debts . . . .” United States Trust Co. of New York v. New Jersey, 431 U.S. 1, 22 (1977) (quotation marks omitted). The courts must guard against “the State’s self-interest” leading it to abuse contracting partners. Id. at 26. Impairments of contract rights must be “reasonable and necessary to serve an important public purpose.” Id. at 25. The greater and more
permanent the impairment to contract rights, the less likely it is to be constitutional. See, e.g., Home Building & Loan Ass’n v. Blaisdell, 290 U.S. 398, 425, 430, 433, 441 (1934). Similarly, if contract rights were more theoretical than real to begin with, a subsequent impairment by the state is less likely to be proscribed by the Constitution. See Faitoute Iron & Steel Co. v. City of Asbury Park, 316 U.S. 502, 510-13 (1942) (holding that bondholders’ ability to sue defaulting municipalities under preexisting law was an empty “right to pursue a sterile litigation” and the challenged state law allowing municipal debt restructuring did not violate the Contracts Clause).

It cannot be predicted with certainty how voluntary state bankruptcy allowed by a congressional statute would be treated under the Contracts Clause by the Supreme Court applying the doctrines described above. A lot could depend on details—for instance, did the bankruptcy process impose significant “haircuts” on the principal owed to bondholders, or did it merely extend the payment period by a reasonably short amount of time. The former would be more likely unconstitutional than the latter.

The Supreme Court’s case law under the Fifth Amendment also protects against impairment of contract rights. “The Supreme Court has made clear that retroactive legislation that affects valid property interests raises problems under both” the Takings Clause and the Due Process Clause of the Fifth Amendment. Johnson & Young, supra, at 144 (discussing Eastern Enterprises v. Apfel, 524 U.S. 498 (1998)). As with the Contracts Clause, it is uncertain how a hypothetical congressional statute for state bankruptcy would fare under the Fifth Amendment, and the outcome of judicial review would depend significantly on the particular details of the legislation and any challenged court orders issued pursuant to it.

In sum, a congressional statute allowing state government bankruptcy would raise a number of serious constitutional issues, implicating unsettled areas of Supreme Court doctrine. In my judgment, there is a real risk that either the legislation itself or particular applications of it by bankruptcy courts would be found unconstitutional. By contrast, as my April 13 testimony indicated, I believe that PROMESA rests on a firm constitutional foundation.

Sincerely,

Andrew Kent
Professor of Law
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