GEORGETOWN LAW

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The Honorable Elizabeth Warren
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Washington, DC 20510

The Honorable Bernie Sanders
United States Senate
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Dear Senators Warren and Sanders:

We, the undersigned, are professors of law who specialize in bankruptcy and financial regulation. We write to express our support and appreciation for your introduction this week of the United States Territorial Relief Act of 2019 (the "U.S. Territorial Relief Act"), a bill that would provide desperately needed assistance for the Commonwealth of Puerto Rico and the U.S. Virgin Islands should they choose to avail themselves of the debt discharge option the bill provides. These territories have unsustainable debt burdens and cannot realistically repay their financial obligations absent extreme and undue hardship for their residents. The U.S. Territorial Relief Act provides a fair, efficient, and constitutional mechanism for helping long-neglected United States territories regain their economic footing.

The financial straits facing Puerto Rico and the U.S. Virgin Islands are the product of an unusual confluence of circumstances. The historical development of the territories' economies was shaped by deficient Federal administration that discriminated against many residents of the territories. The territories' tax bases are limited by large Federal land holdings, even as the territories must bear the cost of additional social services because the territories' residents lack full access to many Federal benefit programs, such as the Earned Income Tax Credit, Medicaid, and Supplemental Security income. The territories have also been challenged by calamitous hurricanes and grossly deficient federal responses. These factors have contributed to a long-term economic downturns and a steep decline in population that is further eroding the islands' tax bases. Additionally, there are serious, long-standing concerns about whether Puerto Rico assumed unauthorized obligations.

In 2016 Congress passed the Puerto Rico Oversight, Management, and Economic Stability Act ("PROMESA"), legislation intended to help Puerto Rico stabilize its finances. Circumstances have since changed that render PROMESA insufficient. PROMESA was enacted before the island was devastated by two hurricanes in the summer of 2017. These hurricanes knocked out the island's electric grid for months, shutting down substantial economic activity and furthering emigration from the Puerto Rico. PROMESA

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cannot sufficiently deleverage Puerto Rico, as the most recently certified Fiscal Plan for Puerto Rico shows. Instead, Puerto Rico and its instrumentalities will be left with a substantial debt overhang and will find themselves diverting funds to pay creditors when it is hard-pressed to provide adequate services for its residents. Moreover, PROMESA provides no assistance whatsoever for the heavily indebted U.S. Virgin Islands. All of these factors counsel for the need for additional assistance for the territories, which is precisely what the U.S. Territorial Relief Act would provide.

Title I of the U.S. Territorial Relief Act provides for the automatic discharge of the unsecured financial obligations of a territory (including its instrumentalities) that invokes the relief through an affirmative vote of its legislature and approval of its governor. This is bold stroke, the legislative equivalent of cutting through the Gordian Knot. It recognizes the dire financial situation of the territories and awards relief without the time-consuming and expensive process of a traditional bankruptcy proceeding.

As professors of law, we are sensitive to the limitations of federal legislative power under the Constitution. But we are also aware that Congress's power is at its high-tide when it acts under either the bankruptcy power or the territorial power. Based on our close examination of the U.S. Territorial Relief Act, we are satisfied that the legislation has been drafted to be consistent with Congress's authority under the bankruptcy power and territorial power.

The legislation has been carefully crafted to ensure that it complies with even an expansive interpretation of a Constitutional limitation on uncompensated, retroactive impairment of property rights – that is, takings through bankruptcy law. The U.S. Territorial Relief Act affects only unsecured financial obligations of the territories. It does not affect secured obligations. This distinction is important because secured obligations are property rights, as opposed to contractual rights, and the Supreme Court has distinguished between the ability of bankruptcy law to impair contractual obligations as opposed to property rights. *U.S. v. Security Industrial Bank*, 459 U.S. 70, 75, 80 (1982). Property rights are protected by the 5th Amendment of the Constitution against takings without just compensation. Contractual rights are not. An unsecured creditor has only contract rights; it lacks a claim against specific property. In contrast, a secured creditor has a property interest in its collateral. That property interest is limited to the value of the collateral. *Wright v. Union Central Life Ins. Co.*, 311 U.S. 273, 278 (1940). To the extent that the debt exceeds the collateral value or is not backed by collateral at all, however, the creditor's claim is merely a contractual right that may be impaired retroactively in bankruptcy. *See Wright v. Vinton Branch of Mountain Trust Bank of Roanoke*, 300 U.S. 440, 470 (1937). The U.S. Territorial Relief Act's impairment of existing unsecured financial obligations of the territories poses no Constitutional issue whatsoever. Indeed, all of the United States' various 19th century bankruptcy laws were responses to specific economic crises; their entire point was retroactivity in regard to unsecured debts, which raised no Constitutional problem.

The legislation also gives heed to the demands of due process. It contains a provision ensuring adequate notice to all affected creditors and creates a streamlined judicial mechanism for creditors to contest a discharge of their claims. In short, the bill is skillfully fashioned to comply with all relevant Constitutional requirements.

We also appreciate that the bill protects against abuse of the bankruptcy discharge by imposing important limitations on eligibility and the discharge. A territory could not simply invoke the legislation whenever it feels like it, but would instead have to first meet the stringent eligibility requirements, and then approve the invocation of relief through its own legislation process. Even so, a discharge is only permitted once every seven years. These provisions recognize the unusual nature of the territories' current economic distress and the need for a financial safety valve for territories in such dire and extraordinary circumstances.

Title I's discharge of the territories' unsecured financial obligations will inevitably discharge some obligations held by Puerto Rico's residents and institutions. Title II of the bill softens this blow by creating

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an appropriated fund for the compensation of certain qualified residents and institutions. We think this is a reasonable policy in part because a discharge that affects Puerto Rico's domestic creditors would also impair the Puerto Rico's tax base and the ability of residents to contribute to the island's economy. Finally, Title III of the bill would create a public commission to audit Puerto Rico's debt. Such a public audit commission is a critical step for providing transparency about Puerto Rico's past financial dealings and ensuring their legality and propriety.

In sum, the bill balances the need for immediate relief for the territories with protections for property interests, due process, and safeguards against abuse. We applaud you for your leadership in introducing bold, yet sensible, caring, and responsible legislation that would truly help the people of the Commonwealth of Puerto Rico and other U.S. territories ravaged by natural disasters and debt crises.

Yours,

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