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Legal Sidebar

Puerto Rico's Financial Oversight and Management Board: The Supreme Court's Analysis and What It Means for Congress

November 23, 2020

The Supreme Court's recent decision in *Financial Oversight & Management Board for Puerto Rico v. Aurelius Investment, LLC* (*Aurelius*), in which the Court rejected an Appointments Clause challenge to Puerto Rico's Financial Oversight and Management Board's (Board) composition, is significant to Congress for several reasons. First, it allows Puerto Rico's debt adjustment proceedings under Title III of the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) to proceed. More generally, *Aurelius* reinforces Congress's authority to create offices that do not require Senate confirmation if the individuals filling those offices perform primarily local duties in the Territories (e.g., American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, and the U.S. Virgin Islands), or the District of Columbia. This Sidebar analyzes the Court's ruling and its potential import.

Background on PROMESA

Puerto Rico and many of its instrumentalities have experienced significant difficulties paying their debts. Under Chapter 9 of the Federal Bankruptcy Code, a "municipality" —defined as a "political subdivision or public agency or instrumentality of a State"—can sometimes obtain relief from debts it cannot repay by filing for bankruptcy. But the Bankruptcy Code excludes Puerto Rico from the definition of "State" for Chapter 9 eligibility purposes. (The Bankruptcy Code thus differs from its predecessor, the Bankruptcy Act, which included "the Territories" in its definition of "State.") Puerto Rico tried to surmount this obstacle by passing its own statute in 2014 to create a bankruptcy-like debt restructuring procedure for its public utilities. The Supreme Court ruled in 2016, however, that federal law preempted that statute, leaving Puerto Rico with no valid avenue for debt relief.

Congress responded in 2016 by invoking the Territorial Clause of Article IV of the U.S. Constitution (also known as the Territories Clause)—which empowers Congress to "make all needful Rules and Regulations respecting the Territory or other Property belonging to the United States"—to enact PROMESA and establish the Board. PROMESA grants the Board various powers and responsibilities "to provide a method for" Puerto Rico "to achieve fiscal responsibility and access to the capital markets." Title III of PROMESA also created a process by which certain U.S. Territories and their instrumentalities may adjust

Congressional Research Service
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LSB10555

their debts. Subject to various prerequisites, the Board may begin a Title III debt adjustment proceeding for the Commonwealth of Puerto Rico or one of its instrumentalities by filing a petition with the U.S. District Court for the District of Puerto Rico. The Board serves as the debtor's representative in that proceeding, and enjoys the exclusive authority to file a "plan of adjustment" that proposes to modify the territory's or instrumentality's debts and obligations. If that plan of adjustment satisfies various statutory requirements, the court may "confirm" it, which generally means that those modifications bind the debtor and its creditors. To date, the Board has filed Title III cases not only for the Commonwealth of Puerto Rico, but also for several of its instrumentalities, including the Puerto Rico Electric Power Authority. The court presiding over the Title III proceedings has confirmed a plan of adjustment in one of those cases, which is presently on appeal.

Under PROMESA, the Board qualifies as "an entity within the territorial government." Except for the Governor of Puerto Rico or her designee—who serves as a nonvoting, *ex officio* Board member—PROMESA specifies that the U.S. President shall appoint the Board's seven voting members. PROMESA does not, however, require the Senate to confirm those members before they take office, so long as the President selects six of those seven members from lists submitted by specified Members of Congress.

Aurelius, the Appointments Clause, and the Territorial Clause

The Constitution's Appointments Clause empowers the President to nominate principal "Officers of the United States," but only "by and with the Advice and Consent of the Senate"—that is, subject to Senate confirmation. The Appointments Clause also authorizes Congress to "vest the Appointment of . . . *inferior* Officers" in "the President alone," without Senate confirmation. While the Appointments Clause prescribes the method of appointment for federal *officers*, it does not govern the selection of "mere *employees*," who do not exercise "significant authority pursuant to the laws of the United States."

Aurelius required the Court to consider how the Appointments Clause interacts with the Territorial Clause. In *Aurelius*, several creditors facing a potential adjustment of their debts under Title III and a Puerto Rican labor organization argued that the Board's composition violated the Appointments Clause because its members were not Senate-confirmed. They contended that the Board's alleged constitutional infirmities made it unlawful for the Board to file the debt adjustment cases or otherwise exercise its putative powers under PROMESA.

The district court rejected the challengers' arguments. It reasoned that Congress created the Board as an Article IV territorial government body rather than a federal entity, making the Board members territorial officers instead of "Officers of the United States" subject to the Appointments Clause. On appeal, the U.S. Court of Appeals for the First Circuit (First Circuit) disagreed, holding that the Board members qualified as principal "Officers of the United States" who required Senate confirmation. To "reduce the disruption" that dismissing the pending Title III cases and invalidating all of the Board's prior actions would cause, however, the First Circuit applied a principle called the de facto officer doctrine—which, in limited circumstances, can validate certain actions taken by officials whose appointments were deficient—to uphold the actions the Board took prior to the First Circuit's decision. The Supreme Court granted certiorari to consider challenges to both aspects of the First Circuit's decision: (1) the applicability of the Appointments Clause to officers in the Territories, and (2) the use of the de facto officer doctrine.

The Court, in an opinion written by Justice Breyer and joined by six other Justices, reversed the First Circuit's judgment. After surveying the Constitution's structure, text, and history, the Court first explained that "the Appointments Clause restricts the appointment of *all* officers of the United States, including those who carry out their powers and duties in or in relation to Puerto Rico." The Court then determined that the Board members were not officers *of the United States*, but were instead officers *of Puerto Rico* to whom the Appointments Clause did not apply. To support its conclusion, the Court emphasized:

- PROMESA defined the Board as "an entity within the *territorial* government," not "a department, agency, establishment, or instrumentality of the Federal Government";
- By statute, Puerto Rico's government—not the federal government—paid the Board's expenses;
- The Board's investigatory powers—such as the ability to administer oaths, issue subpoenas, and take evidence—were "backed by Puerto Rican, not federal, law";
- The Board's fiscal and budgetary responsibilities concerned "the finances of the Commonwealth, not of the United States"; and
- The Board served as the representative of Puerto Rico and its instrumentalities in the Title III debt adjustment proceedings—not the representative of the United States.

Accordingly, the Court concluded that the Appointments Clause did not apply to the Board's voting members because the Board's duties were primarily *local*, not primarily *federal* in nature. Because these appointments did not violate the Constitution, the Court did not proceed to address the de facto officer doctrine.

Considerations for Congress

Aurelius may be of interest to Congress for several reasons. For one, the Supreme Court's ruling means that the Appointments Clause does not render the ongoing Title III proceedings or the Board's past restructuring efforts constitutionally infirm, and Puerto Rico's attempts to adjust its debts under PROMESA may therefore proceed. Relatedly, the Board may continue exercising its other powers and duties under PROMESA so long as those powers and duties concern matters primarily local in nature.

The Appointment of Territorial Officers

Aurelius also reinforces Congress's authority to establish offices to perform primarily local duties in Puerto Rico and other U.S. Territories without mandating Senate advice and consent, even if exercising those primarily local duties may at times have nationwide consequences. To the extent that Article IV also authorizes Congress to create local offices for the District of Columbia, *Aurelius* likewise affirms Congress's power to forgo Senate advice and consent when the officials filling those offices perform primarily local duties.

At the same time, *Aurelius* leaves several questions open. The Court's opinion does not exhaustively demarcate "local" versus "federal" duties, or explain how courts should apply that test when an officer performs both. For that reason, Justice Clarence Thomas, in an opinion concurring in the judgment, criticized the "primarily local" test as too "amorphous." Future cases may provide further guidance. Until then, Congress can reduce the risk that the creation of any particular territorial office falls on the unconstitutional side of the line either by requiring presidential nomination and Senate confirmation or by excluding duties that appear federal in nature.

Aurelius also raised a related question regarding the appointment of territorial officers. Though concurring in the judgment, Justice Sonia Sotomayor wrote separately to discuss whether Puerto Rico's adoption of its (congressionally approved) constitution in the early 1950s might change the analysis of federal officer appointments there. In her view, by ratifying Puerto Rico's constitution, "Congress explicitly left the authority to choose Puerto Rico's governmental officers to the people of Puerto Rico." According to Justice Sotomayor, that action could constitute a "voluntary concession by the Federal Government," giving Puerto Rico "the exclusive right to establish [its] own territorial officers." Noting that Puerto Rico does not have a role in selecting the Board's voting members, Justice Sotomayor questioned whether Board members could truly be considered territorial officers. Nonetheless, she agreed with the majority that the parties had not properly presented this question, so the Court did not consider it.

To the extent this challenge may find traction in future litigation, Congress may consider whether Territories with a degree of home rule should be given formal roles in the appointment of territorial officers. Alternatively, Congress could explicitly amend PROMESA or enact similar legislation to indicate it has not conceded its ability to appoint territorial officers other than those contemplated by the relevant home rule statutes and related provisions. Such a statement might be challenged in litigation, but could eventually lead to further clarification in a legal area that remains unsettled.

The *Insular Cases*

Finally, Congress could address unresolved issues related to the *Insular Cases.* The *Aurelius* Court described this line of Territorial Clause cases from the turn of the 20th century as "much-criticized," but "whatever their continued validity," declined to consider whether they should be formally overruled. (One party had claimed that these cases implicitly undergirded the argument that the Appointments Clause did not apply to territorial officers.) The *Insular Cases* stand generally for the proposition that residents of the "unincorporated" Territories (i.e., those Territories not clearly on the pathway to U.S. statehood) are not entitled to the full range of constitutional protections enjoyed by residents of U.S. states. For example, *Downes v. Bidwell* held in 1901 that Puerto Rico was not part of the United States for certain constitutional purposes, and could thus be taxed differently. Much of the criticism leveled at the *Insular Cases* and their progeny has been based on assertions of "racially motivated biases" and "colonial governance theories" that critics claim have led to "second-class treatment" of territorial inhabitants. However, some modern commentators point to instances where some Territories have "reclaimed" the *Insular Cases* to serve as "bulwarks for cultural preservation," and there is disagreement among territorial inhabitants themselves on whether the Constitution should apply fully in those locations.

Although Congress cannot change the Supreme Court's constitutional interpretations, it could elect not to exercise the power affirmed by the *Insular Cases*. For example, Congress could alter or eliminate specific legislative provisions that treat the Territories differently. For example, 42 U.S.C. § 1382c(e) excludes residents of Puerto Rico and other Territories from Supplemental Social Security benefits eligibility; federal law caps the Territories' Medicaid funding; and 42 U.S.C. § 1308 limits other types of federal financial assistance for Territories. Recently, plaintiffs have successfully challenged some of these distinctions on equal protection grounds in federal court, although those cases have not reached the Supreme Court. Several bills in the 116th Congress, such as H.R. 947 and S. 3029, aim to eliminate some of these differences.

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