

# Chapman Client Alert

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Current Issues Relevant to Our Clients

## Missed Appointment: First Circuit Finds That Puerto Rico Oversight Board Needs Advice and Consent of the Senate

The Puerto Rico bankruptcy-like proceeding will live to see another day, but in a case of constitutional importance, the U.S. Court of Appeals for the First Circuit (the “*First Circuit*” or the “*Court*”) addressed whether members of the Financial Oversight and Management Board created by PROMESA<sup>1</sup> are “Officers of the United States” subject to the U.S. Constitution’s Appointments Clause. The Court held that the appointment of the members of the Oversight Board violated the Appointments Clause because the members were not appointed with the “advice and consent” of the Senate. The Court applied the ancient canon of interpretation that the “specific governs the general,” and found that while the Territorial Clause provided broad power to Congress to govern territories like Puerto Rico, the specific nature of the Appointments Clause meant that it governs the appointment of federal officers in the territories.<sup>2</sup>

However, the Court refused to strike down the entirety of PROMESA because the statute itself used a severability clause to remove any constitutionally infirm provisions. As to the actions taken by the improperly appointed board, the Court instead applied the *de facto* officer doctrine, an ancient tool of equity, which allowed the Court to deem the Oversight Board’s past actions valid notwithstanding the illegality of the board’s appointment. The Court then stayed its ruling for 90 days to give Congress the opportunity to either validate the existing Oversight Board or reconstitute a new one that complies with the Appointments Clause. This deadline could potentially be altered in a further appeal to the U.S. Supreme Court.

This ruling likely injects a further round of uncertainty into Puerto Rico’s restructuring and opens the door to a new board that could change the course of the current restructuring. However, the ruling will be welcomed by those advocating for broader application of constitutional rights in Puerto Rico.

### Background

The case involved the interplay between two important provisions of the Constitution. The first is Article II, Section 2, Clause 2, commonly referred to as the “Appointments Clause,” which requires that the appointment of certain federal officers needs the “advice and consent” of the Senate. The intent of the Appointments Clause is to strike a balance between the President’s appointment power and curbing executive abuses by requiring Senate confirmation.

The second provision at issue is Article IV, Section 3, Clause 2, or the “Territorial Clause,” which provides Congress with the “power to dispose of and make all needful Rules and

Regulations respecting the Territory ... belonging to the United States.” U.S. Const. art. IV, § 3, cl. 2. Congress’s power under the Territorial Clause is generally considered to be “plenary”—that is, absolute power, with no limitations.<sup>3</sup>

### The District Court’s Ruling

The District Court, in separate decisions, rejected the motions of various parties to dismiss the Oversight Board’s Title III petitions.<sup>4</sup> The District Court determined that the Oversight Board is an instrumentality of the Commonwealth government established pursuant to Congress’s plenary powers under the Territorial Clause.

The District Court went on to find that the Oversight Board members are not “Officers of the United States” and therefore there was no constitutional defect in the method of their appointment. The District Court based its ruling on the premise that “the Supreme Court has long held that Congress’s power under [the Territorial Clause] is both ‘general and plenary.’”

### The Ruling

The First Circuit reversed the District Court. First, in determining the primacy of the Territorial Clause and the Appointments Clause in this case, the First Circuit used the doctrine *generalia specialibus non derogant*—the specific governs the general—to reject the District Court’s determination that the expanded Article IV powers under the Territorial Clause enabled Congress to ignore the structural limitations on the manner in which the federal government chooses federal officers. To reach this conclusion, the Court

examined a wide body of case law and determined that the Territorial Clause is a provision of general authority and rulemaking for the territories.<sup>5</sup> However, the First Circuit noted, the Territorial Clause does not deal with the appointment of federal officers.<sup>6</sup>

Conversely, the First Circuit noted that the Appointments Clause deals with the specific subject matter of the appointment of federal officers, and nothing suggests that it does not apply in the territories. The Court drew an analogy to the Presentment Clause in Article I, which requires that bills be presented to the President for signature. The Court noted that no one would suggest that the “plenary power” under the Territorial Clause would have permitted Congress to enact PROMESA without the President’s signature.<sup>7</sup>

The First Circuit held that for the Appointments Clause to be implicated the Oversight Board members must be “Officers of the United States,” meaning they are principal, and not inferior, officers. This determination was important because if the Oversight Board members were “inferior” officers, Congress would be permitted to vest appointment in the President alone, but “principal” officers must be appointed by the President upon the advice and consent of the Senate. The Court went on to determine that the Board Members are “principal” officers and thus qualify as “Officers of the United States,” covered by the Appointments Clause, because they occupy “continuing positions” under PROMESA and exercise significant authority “pursuant to the laws of the United States.”<sup>8</sup>

The Court then had no trouble finding that the PROMESA board members were “principal” officers for whom the only constitutional method of appointment is by the President, by and with the advice and consent of the Senate. For example, the Court noted that the Oversight Board members had significant federal authority, including the power to veto and the power to rescind or revise Commonwealth laws and regulations that the Oversight Board deems inconsistent with the provisions of PROMESA or the fiscal plans developed pursuant to it. In fact, the Court likened the Oversight Board to

“Roman proconsuls” and concluded that its members were “principal officers of the United States” that needed the advice and consent of the Senate to hold office.<sup>9</sup>

However, the Court stopped short of invalidating PROMESA and the actions taken by the Oversight Board thereunder, and fashioned a remedy that will permit the Senate to either confirm the existing members or constitute a new board. The Court applied the *de facto* officer doctrine to validate the Oversight Board’s past actions, noting that it was acting with the color of authority—PROMESA—when it decided to file the Title III petitions behalf of the Commonwealth.<sup>10</sup> The Court went on to note that perhaps thousands of innocent parties have relied on the Oversight Board’s actions, and vacating its actions would cancel out all of the progress that has been made so far in the restructuring.<sup>11</sup>

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## Conclusion

The ruling introduces a new round of uncertainty into Puerto Rico’s restructuring. The ultimate effect of the ruling will not be known until the new Oversight Board is constituted.<sup>12</sup>

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## For More Information

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1 As discussed in prior Client Alerts, due to a serious and ongoing fiscal emergency in the Commonwealth, in 2016, Congress enacted the Puerto Rico Oversight, Management, and Economic Stability Act (“PROMESA”). In addition to establishing the Title III proceeding for the Commonwealth and its instrumentalities, PROMESA also required that an oversight board (the “Oversight Board”) be established to develop a method for the Commonwealth to achieve fiscal responsibility and regain access to the capital markets. Among other things, PROMESA requires the Oversight Board to certify a fiscal plan for the Commonwealth and its instrumentalities. On May 3, 2017, the Oversight Board commenced a debt-restructuring proceeding on behalf of the Commonwealth by filing a petition in the District Court under Title III of PROMESA. Shortly thereafter, the Oversight Board commenced Title III proceedings on behalf of certain Puerto Rican government instrumentalities.

2 *Aurelius Inv., LLC v. P.R.*, \_\_\_ F.3d \_\_\_, 2019 WL 642328 (1st Cir. Feb. 15, 2019).

3 Historically, the Territorial Clause has been a source of controversy with respect to Puerto Rico, as it has been interpreted to give the federal government broad power in Puerto Rico that many argue is undemocratic. The Territorial Clause also spawned a much-maligned line of cases commonly referred to as the “Insular Cases,” which gave rise to the unincorporated territories doctrine—something that in

several ways limited the reach of the Constitution in Puerto Rico and consequently the rights of people in Puerto Rico and the other territories. *De Lima v. Bidwell*, 182 U.S. 1 (1901); *Goetze v. U.S.*, 182 U.S. 221 (1901); *Dooley v. U.S.*, 182 U.S. 222 (1901); *Armstrong v. United States*, 182 U.S. 243 (1901); *Downes v. Bidwell*, 182 U.S. 244 (1901); *Huus v. N.Y. & Porto Rico Steamship Co.*, 182 U.S. 392 (1901).

- 4 *In re Commonwealth of P.R.*, Bankruptcy Case No. 17-BK-3283 (LTS) (D.P.R. July 3, 2018); *Assured Guar. Mun. Corp. v. Fin. Oversight and Mgmt. Bd. for P.R.*, No. 18-87 (LTS) (D.P.R. Aug. 3, 2018); *UTIER v. PREPA*, No. 17-228 (LTS).
- 5 *Aurelius Inv., LLC*, at \*8.
- 6 *Id.*
- 7 *Aurelius Inv., LLC*, at \*8.
- 8 *Id.* at \*11.
- 9 *Id.* at \*14–15.
- 10 *Id.* at \*16.
- 11 *Id.*
- 12 On March 7, 2019, the First Circuit denied a petition to rehear the matter *en banc*. The potential exists that one or more of the parties will petition the U.S. Supreme Court to hear the case.

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