No. _____

In The
Supreme Court of the United States

UNIÓN HERMANDAD DE EMPLEADOS DEL FONDO DEL SEGURO DEL ESTADO, ET AL.,

Petitioners,

v.

COMMONWEALTH OF PUERTO RICO, ET AL.,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The First Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

The last case that this Honorable Court struck down a law for impairing a government contract was *United States Trust Co. of New York v. New Jersey*, 431 U.S. 1 (1977) because the State failed to demonstrate that the impairment was reasonable and necessary. In that case, this Court applied a heightened scrutiny than what is employed when evaluating the impairment of a contract between private parties. This Court also established that when a law has impaired a public contract, less deference must be given to the legislature's assessment of reasonableness and necessity of the impairment because the State's self-interest is at stake. Nonetheless, the scope of this "heightened scrutiny" has not been clarified. Consequently, in this case, the Court of Appeals for the First Circuit placed the burden of proof on Petitioners regarding the reasonableness/necessity inquiry under the Contract Clause of the U.S. Constitution. However, the First, Second, Third, Sixth, Seventh, and Ninth Circuits are split on what party should have the burden of proof on this inquiry.

Thus, the questions presented are:

1. Whether placing the burden of proof on the plaintiffs regarding the reasonableness and necessity of a legislation that impaired a public contract conflicts with this Court's rule that less deference must be given to the State when it impaired a contract to which it is a party.

QUESTIONS PRESENTED – Continued

2. Whether an intermediate scrutiny applies to the evaluation of the constitutionality of a public contract's impairment.

3. Whether the severity of a fiscal crisis by itself justifies full deference to Puerto Rico's legislature's assessment of reasonableness and necessity of laws that impair public contracts.

PARTIES TO THE PROCEEDINGS

The parties to the proceedings below were as follows:

Petitioners here, Unión Hermandad de Empleados del Fondo del Seguro del Estado, Inc., and Unión de Médicos de la Corporación del Fondo del Seguro del Estado Corp. are parties in interest and filed an adversary complaint with the assigned case number Adv. Proc. No. 18-091, related to case No. 17 BK-3283, initiated by Respondent, the Financial Oversight and Management Board for Puerto Rico (hereinafter, the "FOMB"), in the district court for the District of Puerto Rico, on behalf of the Commonwealth of Puerto Rico (hereinafter, the "Commonwealth").

Respondents, the FOMB, the Commonwealth, the State Insurance Fund Corporation, Jesús Rodríguez Rosa, Ricardo Antonio Rosselló-Nevares, Gerardo Portela-Franco, Hon. Raúl Maldonado-Gautier, and José Iván Rosado,[1] were defendants in the above referenced adversary proceeding. Also, they were appellees before the Court of Appeals for the First Circuit in the Case No. 19-2028, which is directly related to this case.

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[1] Individual Co-respondents were sued in their official capacity.

CORPORATE DISCLOSURE STATEMENT

Counsel for Petitioners certifies as follows:

Petitioners, Unión Hermandad de Empleados del Fondo del Seguro del Estado, Inc., and Unión de Médicos de la Corporación del Fondo del Seguro del Estado Corp., are labor unions created as close corporations under the Laws of the Commonwealth of Puerto Rico. Their stocks are not traded, and they are not "nongovernmental corporate parties" for purposes of Rule 29.6, therefore, disclosures with respect to them are not required.

RELATED PROCEEDINGS

United States District Court for the District of Puerto Rico:

> *In re: Financial Oversight and Management Board for Puerto Rico*, Ad. Proc. No. 18-091 related to case, No. 17 BK-3283.

United States Court of Appeals for the First Circuit:

> *In re: Financial Oversight and Management Board for Puerto Rico*, No. 19-2028.

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PETITION FOR WRIT OF CERTIORARI

Petitioners, Unión Hermandad de Empleados del Fondo del Seguro del Estado, Inc. ("UECFSE"), and Unión de Médicos de la Corporación del Fondo del Seguro del Estado Corp. ("UMCFSE"), respectfully petition this Honorable Court for a writ of certiorari to review the judgement of the United States Court of Appeals for the First Circuit ("Court of Appeals" or "First Circuit") in the appeal No. 19-2028.

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 979 F.3d 10. App. 1. The opinion of the United States District Court in Adv. Pro. No. 18-091 (D.P.R.), is unreported. App. 25.

JURISDICTION

The judgment of the Court of Appeals was entered on October 28, 2020. App. 22. Petitioners timely petitioned for Panel Rehearing or Rehearing *en banc* on November 11, 2020. On December 11, 2020, the Court of Appeals denied the *Petition for Panel Rehearing or Rehearing En Banc*. App. 65. Therefore, Petitioners invoke the Jurisdiction of this Court under 28 U.S.C. § 1254(1). Due to the COVID-19 pandemic, on March 19, 2020 this Honorable Court issued an Order extending the deadline to file any petition for writ of certiorari for 150 days from the date of the lower court

judgment, order denying discretionary review, or order denying a timely petition rehearing. Such Order is still in effect.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Article I, Section 10, cl. 1 of the U.S. Constitution provides in its relevant part that "[n]o State shall [. . .] pass any [. . .] Law impairing the Obligation of Contracts [. . .]." U.S. Const. Art. I, § 10, cl. 1. The constitutionality of the following laws is being questioned under the Contract Clause: *Government of the Commonwealth of Puerto Rico Special Fiscal and Operational Sustainability Act*, Act No. 66, approved on June 17, 2014, the *Law to Address the Economic, Fiscal, and Budgetary Crisis to Guarantee the Operation of the Government of Puerto Rico*, Act No. 3, approved on January 23, 2017, the *Law for the Management and Transformation of Human Resources in the Government of Puerto Rico*, Act No. 8, approved on February 4, 2017, and the *Compliance with the Fiscal Plan Act*, Act No. 27, approved on April 29, 2017.

STATEMENT OF THE CASE

Petitioner UECFSE was founded in 1963. Its members are employees of the State Insurance Fund Corporation ("CFSE" for its Spanish acronym) and are responsible for the general operation of the services

that CFSE provides. UECFSE represents approximately one thousand and nine hundred (1,900) members in all matters related to their rights and wellbeing. UECFSE's latest collective bargaining agreement ("CBA") is from the 2011-2015 period. Even though it was enacted with a lifespan lasting from July 2011 through June 2015, the CBA states that it will continue dictating the labor relations between the CFSE and the UECFSE until a new collective bargaining agreement is negotiated and in effect. Since no new collective agreement has been negotiated and established, the CBA is still valid and in full force.

UMCFSE was founded in 1996 and incorporated in 2001. Its members are responsible for providing medical services to the injured workers served at the CFSE. UMCFSE represents approximately one hundred and nineteen (119) members in matters related to their rights and wellbeing.

UMCFSE's latest CBA is from the 2002-2006 period. Even though it was enacted with a lifespan lasting from July 2002 through June 2006, the CBA states that it will continue dictating the labor relations between the CFSE and the UMCFSE until a new CBA is negotiated and in effect. Since no new collective agreement has been negotiated and established, the CBA is still valid and in full force.

Respondent CFSE is a public corporation that is the exclusive provider of insurance coverage for work related accidents, deaths, and illness suffered by workers in the Commonwealth of Puerto Rico

("Commonwealth"). Additionally, CFSE is solvent, and by virtue of law, it is separate and independent from the Commonwealth's general fund. Thus, it is self-sufficient. Moreover, the expenses incurred to administer the CFSE are covered by the CFSE. App. 69. Therefore, Petitioners' salaries and benefits negotiated through their CBAs are funded only from CFSE.

However, Puerto Rico's legislature enacted four (4) unconstitutional laws to address the Central Government's economic crisis that impaired Petitioners' CBAs with CFSE. The first law is the *Government of the Commonwealth of Puerto Rico Special Fiscal and Operational Sustainability Act*, Act No. 66-2014. This Act required the Central Government, agencies, and public corporations, such as CFSE, to reduce their operating expenses, such as those related to payroll. This Act had a negative impact and impaired Petitioners' CBAs in sections pertaining to employee transfer, vacation days and pay, sick leave and pay, the monetary compensation for the lack of use of vacation and sick leave, and all other non-economic clauses that might have an economic impact on the corporation's budget.

The second law that impaired Petitioners' CBAs is the *Act to Attend to the Economic, Fiscal, and Budget Crisis and to Guarantee the Functioning of the Government of Puerto Rico*, Act No. 3-2017. This Act impaired, among other benefits and rights, the vacation and sick leave pay and its liquidation, and all non-economic clauses that are thought to have an adverse impact on the corporation's budget. Moreover, Act No. 3-2017 states that all collective bargaining agreement articles,

rulings, laws, or administrative dispositions that are contrary to or interfere with it are suspended during the lifespan of such law.

The third law that impaired Petitioners' CBAs is the *Administration and Transformation of the Human Resources of the Government of Puerto Rico Act*, Act No. 8-2017. Act No. 8-2017's purpose is to make the Government the sole employer of all public employees to consolidate services, eliminate those which it understands are no longer needed, create a unified system of job classifications, have a specific merit system applicable for all agencies, and facilitate the transfer or movement of employees between agencies and public corporations.

The fourth law that impaired Petitioners' CBAs is the *Fiscal Plan Compliance Act*, Act No. 26-2017. This Act standardized the fringe benefits of **all** public employees and eliminated the liquidation of excess accrued vacation and sick leave days.

These four laws (collectively the "challenged legislation") substantially impaired Petitioners' CBAs with CFSE. The challenged legislation impaired twenty-three (23) of the twenty-five (25) dispositions in UECFSE's CBA, and thirty-two (32) of the sixty-five (65) dispositions of UMCFSE's CBA. Therefore, Petitioners' CBAs are rendered useless. Indeed, in its *Opinion and Order Granting the Motions to Dismiss Plaintiffs' First Amended Adversary Complaint Pursuant to Fed. R. Civ. P. 12(B)(1) and (B)(6)*, the District Court established that "[Petitioners] have adequately

pleaded substantial impairment of the CBAs by the Challenged Legislation." App. 45. Additionally, considering the stage of the proceedings, the Court of Appeals stated that "[w]e may assume, as the District Court did, that each of these alleged impairments constitutes a substantial impairment of the unions' contracts with the CFSE." App. 13, 17.

In light of Petitioners' CBAs' impairment, they filed an *Adversary Complaint* on July 25, 2018, and a *First Amended Adversary Complaint* ("FAAC") on October 29, 2018, against the Commonwealth, the FOMB, CFSE, Jesús M. Rodríguez-Rosa, Ricardo Antonio Rosselló-Nevares, Gerardo Portela-Franco, Hon. Raúl Maldonado-Gautier, and José Iván Marrero-Rosado.[1] Petitioners sought a declaratory judgment decreeing that the challenged legislation violates the Contract Clause of the U.S. Constitution and the Collective Bargaining Clause of the Commonwealth's Constitution. Petitioners alleged repeatedly that the challenged legislation is unconstitutional since its purpose is to address the Central Government's fiscal crisis, and CFSE is fiscally self-sufficient, solvent, and independent from the Central Government's general fund by virtue of law. Also, Petitioners provided alternatives that the Central Government had to address its fiscal crisis, without impairing their CBAs. Finally, Petitioners requested full compensatory and punitive damages, costs, and attorney fees for the violation of the Contracts Clause and for the violation of the Right to

[1] Individual Co-Defendants were sued in their official capacity.

Collective Bargain guaranteed by the Commonwealth's Constitution.

Following respondents' motion to dismiss, on September 27, 2019, the District Court entered its *Opinion and Order* dismissing the FAAC. App. 25. The District Court erroneously concluded that Petitioners' claims under three (3) of the four (4) laws were moot, that the FAAC failed to state a claim for a Contract Clause violation, and that Petitioners' requested relief under the Collective Bargaining Clause of the Commonwealth's Constitution was time barred by the one-year statute of limitations established by article 1868 of the former Civil Code of Puerto Rico. App. 42, 52, 60.

Petitioners timely appealed the District Court's *Opinion and Order* and judgment to the Court of Appeals for the First Circuit, alleging that their claims under Acts No. 66-2014, 3-2017, and 8-2017 were not moot, and that the FAAC alleged sufficient facts that lead courts to infer that the CBAs' impairment by the challenged legislation is unreasonable and unnecessary because the laws' purpose is to address the Central Government's fiscal crisis, and CFSE is a public corporation that is fiscally self-sufficient, solvent, and independent from the Commonwealth's general fund. Moreover, that it is unreasonable to impair Petitioners' CBA since the financial responsibilities of the CBAs rely on CFSE's own fund. Also, that Petitioners' claims under the Collective Bargaining Clause of the Commonwealth's Constitution are timely.

On October 28, 2020, the Court of Appeals entered its *Opinion* reversing in part and affirming in part the District Court's *Opinion and Order*. It concluded that Petitioners' claims under Acts No. 66-2014, 3-2017, and 8-2017 were not moot. However, it erroneously decided that despite that Petitioners' CBAs were substantially impaired, the FAAC failed to state a claim for a Contract Clause violation, **because they did not meet their burden of alleging that such impairment is unnecessary and unreasonable to address the Commonwealth's fiscal crisis**. App. 13, 17. Despite that CFSE's solvency and independence from the Central Government's general fund has been Petitioners' main argument regarding the unreasonableness of the challenged legislation, the Court of Appeals disposed of it by vaguely stating that "[t]here is no basis, however, for the unions' contention that the benefit cuts implemented by the challenged laws are unrelated to Puerto Rico's interest in addressing the fiscal challenges faced by its central government." App. 14. Additionally, notwithstanding that CFSE is not facing a fiscal problem that it must resolve, and that Petitioners proposed several alternatives for the Commonwealth to address its fiscal crisis, the First Circuit concluded that Petitioners' proffered alternatives "are not adequate to support the Plaintiffs' claims that the cutting of CFSE benefits caused by the challenged legislation were unreasonable or unnecessary." App. 15-16.

Also, granting full deference to the Commonwealth, the Court of Appeals concluded that Petitioners failed

to explain why the justification offered by Puerto Rico's legislature when it enacted the challenged legislation was legally inadequate. Likewise, it stated that:

> The unions do not dispute that Puerto Rico's goal of resolving its budgetary crisis while minimizing service disruption and layoffs was a legitimate one [citations omitted], nor do they argue that the legislature's acknowledged alternative of simply terminating large numbers of public employees would have been an adequate substitute for the Commonwealth's course of action. They likewise do not voice any disagreement with the Commonwealth's apparent conclusion that it was necessary to apply the mobility provision to workers at CFSE to achieve this goal. App. 18.

As it will be explained further, the Court of Appeals misapplied the standard established by this Court for Contract Clause claims, because it overvalued the Commonwealth's economic situation by concluding, without any evidence – since the case is currently in the pleading stage – and granting complete deference to Puerto Rico's legislature, that the austerity measures imposed through the challenged legislation addresses the Central Government's fiscal crisis reasonably and necessarily. Furthermore, the Court of Appeals implied that if the Commonwealth is facing a fiscal crisis, any measure to address it is reasonable and necessary. However, Petitioners alleged repeatedly that CFSE is fiscally self-sufficient, solvent, and independent from the Commonwealth's general

fund. Therefore, the obligations of the CFSE under the CBAs do not affect the Central Government's economic crisis. Therefore, the Court of Appeals ignored the fact that CFSE's employees have CBAs that are protected by the Contract Clause and that the financial responsibility to cover them rely uniquely upon the CFSE, not the general fund.[2]

After the First Circuit entered its *Opinion*, Petitioners filed a *Petition for Panel Rehearing or Rehearing En Banc* on November 11, 2020. However, on December 11, 2020, the Court of Appeals denied the *Petition for Panel Rehearing or Rehearing En Banc*. App. 65.

The Court of Appeals erred by placing the burden on Petitioners on the reasonableness/necessity inquiry for Contract Clause claims, despite that there exists conflict between the Circuit Courts of Appeals on this issue, and notwithstanding that this Court established that less deference must be accorded to the State when it has impaired a public contract. Additionally, the Court of Appeals erred in the application of the standard for Contract Clause claims by granting full deference to Puerto Rico's legislature and failing to correctly apply the reasonableness/necessity standard to the challenged legislation. Thus, Petitioners respectfully request for this Honorable Supreme Court to grant the petition for writ of certiorari and reverse the Court of

[2] The First Circuit also determined that Petitioners' claims under the Collective Bargaining Clause of the Commonwealth's Constitution were time barred. App. 19-21. However, Petitioners are not seeking review of this conclusion.

Appeals' determination regarding Petitioners' claims under the Contract Clause. Also, upon the Courts of Appeals' split, Petitioners request for this Court to establish that once a plaintiff has alleged a substantial impairment of a public contract, the burden is on the State/Commonwealth on the reasonableness/necessity prong for Contract Clause claims.

REASONS FOR GRANTING THE PETITION FOR WRIT OF CERTIORARI

The First Circuit affirmed the District Court's dismissal of the FAAC based on *United Auto. Aerospace, Agr. Implement Workers of America International Union v. Luis Fortuño*, 633 F.3d 37 (1st Cir. 2011) (hereinafter "*United Auto*"), where it established that plaintiffs bear the burden of proof on the reasonableness/necessity inquiry when evaluating an impairment of a public contract under the Contract Clause. Thus, according to such burden, the legal sufficiency of a complaint under Rule 12(b)(6) of the Federal Rules of Civil Procedure would be evaluated. Nevertheless, establishing the burden on the plaintiffs conflicts with this Court's rule that when a public contract has been impaired, less deference must be given to the State's assessment of reasonableness and necessity of the challenged legislation, because the State's self-interest is at stake. Still, Petitioners complied with Fed. R. Civ. Proc. 12(b)(6), its progeny, and with *United Auto* since they pleaded sufficient facts that lead courts to infer that

the challenged legislation is unconstitutional under the Contract Clause.

Likewise, the First Circuit departed from the applicable standard for Contract Clause claims, since it implied that if the Commonwealth is facing a fiscal crisis, any measure to address it is reasonable. Nonetheless, for an impairment of a contract to be constitutional under the Contract Clause, besides having a legitimate public purpose, it must be reasonable and necessary to address such purpose. Consequently, the First Circuit departed from the applicable standard for Contract Clause claims.

Thus, for the reasons set forth herein, the petition for writ of certiorari should be granted, and the First Circuit's *Opinion* must be summarily reversed, since it contradicts controlling precedent of this Court. *See*, *e.g.*, *Moore v. Texas*, 139 S.Ct. 666 (2019); *Pavan v. Smith*, 137 S.Ct. 2075 (2017). In the alternative, this Court should grant plenary review.

1. This case represents the first opportunity for this Court to establish that the State/Commonwealth has the burden on the reasonableness/necessity inquiry for Contract Clause claims when a public contract has been substantially impaired.

In the last ten (10) years, this Honorable Court has only reviewed one Contract Clause claim, which was *Sveen v. Melin*, 138 S.Ct. 1815 (2018), which concerned the impairment of a private contract, and its

constitutionality was upheld by this Court. The last case that this Court struck down a state law for impairing a **public contract** in violation of the Contract Clause of the U.S. Constitution was 44 years ago: *United States Trust Co. of New York v. New Jersey*, 431 U.S. 1 (1977).

In *United States Trust Co. of New York*, this Court stated that despite that "the Contract Clause appears literally to proscribe 'any' impairment, [. . .] 'the prohibition is not an absolute one and is not to be read with literal exactness like a mathematical formula.'" *Id*. (*citing Home Building & Loan Assn. v. Blaidsell*, 290 U.S. 398, 428 (1934)). However, "private contracts are not subject to unlimited modification under the police power" of the State. *Id*. at 22. After being established that there was a substantial impairment, to be constitutional, the law impairing contract must have a legitimate public purpose. *Id*. Additionally, such legislation must be tailored upon reasonable conditions and of character appropriate to the public purpose justifying its adoption. *Id*. Furthermore, "[a]s is customary in reviewing economic and social regulation, however, courts properly defer to legislative judgment as to the necessity and reasonableness of a particular measure. *Id*. Nonetheless, this Court established that a **heightened scrutiny must be applied when the State is a party to the impaired contract because**:

> [. . .] **complete deference to a legislative assessment of reasonableness and necessity is not appropriate because the State's self-interest is at stake.** If the State could reduce its financial obligations

> whenever it wanted to spend the money for what it regarded as an important public purpose, the Contract Clause would provide no protection at all. *Id*. (emphasis added).

In applying this less deference scrutiny, the Courts of Appeals have had disparate approaches and interpretations of *United States Trust Co.* regarding the burden of proof on the reasonableness/necessity of the impairment of a public contract that merits this Court's intervention. For instance, in *United Auto*, 633 F.3d 37, 44 (1st Cir. 2011), the First Circuit recognized that this Court has not settled which party bears the burden on the reasonableness/necessity prong for Contract Clause claims. *Id.* at 43. The First Circuit stated that "**[a]lthough neither party must prove anything at [the pleading stage], determining who bears the burden of proof informs the inquiry into whether the plaintiffs' complaint was appropriately dismissed under Rule 12(b)(6)**." *Id*. at 42. (emphasis added). Then, the First Circuit established that when a public contract has been impaired, the plaintiffs bear the burden on the reasonableness/necessity inquiry of the Contract Clause analysis. 633 F.3d 37 at 42 (1st Cir. 2011). Like Petitioners' FAAC, in *United Auto* the complaint was dismissed on the pleading stage for failure to state a Contract Clause violation. The First Circuit affirmed because it established that, since plaintiffs (and Petitioners in this case) have the burden of proof, the complaint failed to allege that the challenged legislation was unreasonable and unnecessary despite that there was a substantial impairment, and notwithstanding that less deference must be

given to the Commonwealth when a public contract has been impaired.

Acknowledging this contradiction, in *United Auto* the First Circuit stated that "[s]addling a plaintiff with the burden of proving a lack of reasonableness or necessity **is in some tension with the Supreme Court's instruction** that complete deference to a legislative assessment of reasonableness and necessity is not appropriate." *Id*. at 43 (emphasis added). However, the First Circuit asserted that both prongs of the Contract Clause analysis – substantial impairment and lack of reasonableness or necessity to serve an important governmental purpose – "must be plead by plaintiffs seeking to invalidate a state action." *Id*. at 43. The First Circuit added that:

> To demand that the state prove reasonableness and necessity would force governments to endure costly discovery each time a plaintiff advances a plausible allegation of substantial impairment, even where that plaintiff cannot allege a single fact to question the reasonableness or necessity of the impairment. This would not only financially burden states, it would likely discourage legislative action impacting public contracts**. Such a result is particularly undesirable in today's fiscal environment, where many states face daunting budget deficits that**

> **may necessitate decisive and dramatic action.** *Id*. at 43 (emphasis added).[3]

This First Circuit's interpretation undermines the protection of the Contract Clause, since it suggests that if a Government is facing a financial crisis, it can impair a contract to which it is a party and it would be valid unless the other party proves otherwise. "If the State could reduce its financial obligations whenever it wanted to spend the money for what it regarded as an important public purpose, the Contract Clause would provide no protection at all." *United States Trust Co. of New York*, 431 U.S. at 29. Also, the First Circuit's rule destroys the very essence of the Contracts Clause of the U.S. Constitution, as laws that impair "the obligation of contracts are contrary to the first principles of the social compact, and to every principle of sound legislation."[4] *See also*, *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 242 (1978). Additionally, the

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[3] It should be noted that, **unlike *United Auto*, Petitioners pleaded facts that questioned the reasonableness and necessity of the challenged legislation**. Specifically, Petitioners alleged that the challenged legislation is unreasonable since its purpose is to address the Central Government's fiscal crisis, and CFSE is a public corporation that is solvent, and by virtue of law, it is separate from the Commonwealth's general fund, and therefore, the money to cover the CBAs' expenses are covered with the CFSE's own fund. Also, Petitioners provided alternatives to the Central Government to address its fiscal crisis, without impairing their CBAs. **Therefore, even if the First Circuit's rule of placing the burden of proof on the plaintiffs is correct, Petitioners complied with it.**

[4] James Madison, THE FEDERALIST PAPERS: NO. 44. Available at https://avalon.law.yale.edu/18th_century/fed44.asp (last visit: Feb. 16, 2021).

First Circuit equaled the analysis of the impairment of a private contract with the impairment of a public contract. Nevertheless, this Court stated that a "stricter scrutiny" must be applied when a public contract has been impaired than when the State impaired a private contract. *Energy Reserves Group, Inc. v. Kansas Power and Light Co.*, 459 U.S. 400, 412 n. 14 (1983).

In *United Auto*, the First Circuit found support in *Buffalo Teachers Federation v. Tobe*, 464 F.3d 362 (2d Cir. 2006) to establish the burden on plaintiffs regarding the reasonableness/necessity inquiry under the Contract Clause. However, *Buffalo Teachers* was not on the pleading stage since it was decided through summary judgment. There, the plaintiffs were several Unions that sued the Buffalo Fiscal Authority, its members, and New York's Governor for their members' wage freeze, which was imposed to address Buffalo's fiscal crisis. *See id*. at 365-66. In that case, the Second Circuit held that:

> When a state is sued for allegedly impairing the contractual obligations of one of its political subdivisions even though it is not a signatory to the contract, the state will not be held liable for violating the Contracts Clause of the United States Constitution unless plaintiffs produce evidence that the state's self-interest rather than the general welfare of the public motivated the state's conduct. On this issue, plaintiffs have the burden of proof because the record of what and why the state has acted is laid out in committee hearings, public reports, and legislation, making what motivated the

> state not difficult to discern. In the appeal before us, the record of why the state acted is available, and plaintiffs have not met their burden.

However, fourteen years later, in *Sullivan v. Nassau*, 959 F.3d 54, 66 (2d Cir. 2020), which was decided also through summary judgment, the Second Circuit stated that the question of the burden on the reasonableness/necessity prong for the impairment of a government contract was not squarely addressed in *Buffalo Teachers*. Moreover, it clarified that it "**take[s] no position** on whether the plaintiffs or the government bears the burden of proving the reasonableness and necessity of the government's contract-impairing actions." *Id*. (emphasis added). Thus, the Second Circuit's decisions on this matter are now inconsistent. The Second Circuit even acknowledged that this issue has split the circuits. *Sullivan*, 959 F.3d at 66. The First Circuit's ruling in *United Auto*, and in this case as well, relied on *Buffalo Teachers* of the Second Circuit. Therefore, the First Circuit's ruling of placing the burden on the plaintiffs is now unsupported.

Despite that the Third Circuit has not addressed the issue of the burden of proof explicitly, its opinions reflect inconsistency on this matter. For instance, in *Mabey Bridge & Shore, Inc. v. Schoch*, 666 F.3d 862 (3d Cir. 2012), the Court established that the plaintiffs had to prove that its contracts, which are public contracts, were substantially impaired. *Id*. at 874-75. Notwithstanding, it did not decide upon which party bears the burden on the reasonableness/necessity prong of the

Contract Clause. Also, in *Watters v. Board of School Directors of the City of Scranton*, 975 F.3d 406 (3d Cir. 2020), which was on the pleading stage, the Third Circuit concluded that based on the complaint and the exhibits, the defendants' application of the challenged statute in that case to the plaintiffs was necessary and reasonable for defendants to alleviate its budget shortage. *Id*. at 414-16. Moreover, that the plaintiffs **failed to state** a § 1983 claim premised on a Contract Clause violation because the statute was reasonable and necessary to alleviate the State's budgetary crisis. Therefore, the Court implicitly allocated the burden on the plaintiffs on the reasonableness/necessity inquiry of the Contract Clause.

Notwithstanding that the Third Circuit has not expressly established which party has the burden, its language reflects that there is a gap on this issue. The Second and First Circuits, as mentioned, have placed the burden on plaintiffs. On the other hand, as it will be further discussed, the Ninth, Sixth, and Seventh Circuits have placed the burden on the government. As such, this Court's intervention is necessary and urgent.

In *United States Trust Co. of New York v. New Jersey*, this Court stated that in such case, "**the State ha[d] failed to demonstrate that the repeal of the 1962 covenant was similarly necessary**." 431 U.S. 1, 31 (1977) (emphasis added). This implies that the burden of proof is on the State. Also, Chief Justice Burger, in his concurring opinion, stated that:

> [. . .] to repeal the 1962 covenant without running afoul of the constitutional prohibition against the impairment of contracts, **the State must demonstrate that the impairment was essential to the achievement of an important state purpose**. Furthermore, the State **must show that it did not know and could not have known the impact of the contract on that state interest at the time that the contract was made**. *Id*. at 32 (J. Burger, concurring) (emphasis added).

Unlike the instant case and *United Auto*, which were dismissed in the pleading stage for failure to state a claim, *United States Trust Co.* was decided after trial. Nonetheless, it must be emphasized that the First Circuit established that depending on what party has the burden of proof, it will be decided whether a complaint is legally sufficient at the pleading stage. *United Auto*, 633 F.3d at 42.

In accordance with the less deference scrutiny established by this Court regarding the impairment of a public contract, and in consonance with the principles established by the founding fathers of the U.S. Constitution, the Ninth, Sixth, and Seventh Circuits Courts of Appeals have placed the burden on the State to prove the reasonableness/necessity of a law challenged under the Contract Clause. For instance, in *University of Hawaii Professional Assembly v. Cayetano*, 183 F.3d 1096 (9th Cir. 1999), which was decided through preliminary injunction, the plaintiffs challenged a Hawaii statute allowing the State to postpone by a few days the dates on which state employees were to be

paid, and established that it was not subject to negotiation. *Id*. at 1099. They alleged that such statute impaired their collective bargaining agreements in violation of the Contract Clause. *Id*. at 1101. Considering that a higher level of scrutiny is required to review the impairment of public contracts, the Ninth Circuit determined that the Defendants "bear the burden of proving that the impairment was reasonable and necessary because 'the burden is placed on the party asserting the benefit of the statute only when that party is the state.'" *Id*. at 1106. *See also State of Nev. Employees Ass'n v. Keating*, 903 F.2d 1123, 1228 (9th Cir. 1990) ("In this case, which was decided after bench trial, the State did not meet its burden of proving that the impairment of public employees' pension rights was necessary to achieve an important public purpose"); *Southern California Gas Co. v. City of Santa Ana*, 336 F.3d 885, 894-95 (9th Cir. 2003) (which adopted the District Court's opinion granting summary judgment in favor of the plaintiffs that stated that "[b]ecause Santa Ana has substantially impaired its own contract, it has the burden of establishing that the trench cut ordinance is both reasonable and necessary to an important public purpose").

Likewise, in *Toledo Area AFL-CIO Council v. Pizza*, 154 F.3d 307 (6th Cir. 1998), decided through preliminary injunction, the plaintiffs challenged an Ohio statute alleging that their collective bargaining agreements were impaired unconstitutionally. *Id.* at 311-12. In that case, the Sixth Circuit determined that once the complaining party established that the

challenged law substantially impaired their contractual obligations with the State and the extent of the impairment is measured, the burden shifts to the state. *Id*. at 323. "If the state proffers such a significant and legitimate public purpose for the regulation, the court must determine whether 'the adjustments of the rights and responsibilities of contracting parties [is based] upon reasonable conditions and [is] of a character appropriate to the public purpose justifying [the legislation's] adoption.'" *Id*. The Sixth Circuit determined that the challenged law in that case violated the Contract Clause of the U.S. Constitution.

Additionally, in *Elliot v. Board of School of Trustees of Madison Consolidated Schools*, 876 F.3d 926 (7th Cir. 2017), which affirmed the district court's summary judgment in favor of the plaintiff on its claim for the impairment of the State's contractual obligations with him, the Seventh Circuit acknowledged that the existence of an important public purpose is not always sufficient to overcome the Contract Clause's limitation. *Id*. at 938 (*citing United States Trust Co.*, 431 U.S. at 29-30). Also, that a substantial impairment is not necessary if the State could achieve its goal through a less drastic modification or without modifying the contract at all. *Id*. With that in mind, the Seventh Circuit held that "Indiana **has not shown** it needs to impose this retroactive impairment of its earlier promises of job security to improve teacher quality." *Id*. (emphasis added). Therefore, the Seventh Circuit concluded that the challenged law was unconstitutional under the Contract Clause.

In this case, the First Circuit assumed that Petitioners' CBAs were substantially impaired by the challenged legislation. Nonetheless, it affirmed the FAAC's Contract Clause claims' dismissal because, after establishing that Petitioners have the burden of proof, it concluded that they did not meet their burden of plausibly alleging that the challenged legislation was unreasonable or unnecessary to address the Commonwealth's Central Government's fiscal crisis. App. 11, 13. Therefore, its determination is completely based on the rule it established in *United Auto*, 633 F.3d at 42. As acknowledged by the First Circuit, this rule conflicts with this Court's determination that less deference must be given to the State when it has impaired a contract to which it is a party. *United Auto*, 633 F.3d at 43. If the First Circuit would have followed the less deference rule, it would not have placed the burden on Petitioners regarding the reasonableness/necessity inquiry, particularly, because Petitioners alleged that their CBAs, which are public contracts, were substantially impaired. Moreover, Petitioners alleged that it is unnecessary and unreasonable for the CBAs to be impaired to address the Central Government's fiscal crisis, since CFSE is a public corporation that is solvent and, by virtue of law, it is independent from the Commonwealth's general fund.

The soundest interpretation of this Courts' case law on Contract Clause claims for the impairment of public contracts are the ones established by the Ninth, Sixth, and Seventh Circuits, which placed the burden on the State on the reasonableness/necessity inquiry.

It is logical to conclude that since less deference must be accorded to the State, the State must be the party with the burden of establishing that the law impairing contract was not enacted for its own sake in total disregard of its contractual obligations, and that such legislation is reasonable and necessary to address an important governmental purpose.

2. This case represents an opportunity for this Court to clarify that an intermediate scrutiny must be employed when giving less deference to the States' assessment of reasonableness and necessity of a law that impaired a contract to which it is a party.

Regarding the impairment of private contracts, this Court established that "[a]s is customary in reviewing economic and social regulation, however, courts properly defer to legislative judgment as to the necessity and reasonableness of a particular measure." *United States Trust Co.*, 431 U.S. at 22. Nonetheless, this Court established that a heightened scrutiny must be applied when the State is a party to the impaired contract because "complete deference to a legislative assessment of reasonableness and necessity is not appropriate because the State's self-interest is at stake." *Id*.

Therefore, for the evaluation of the impairment of a public contract, this Court did not establish a rational scrutiny where the legislation is presumed constitutional and where complete deference must be granted to the State, but neither set a strict scrutiny

where the law must have a compelling governmental interest. However, it did employ elements of the strict scrutiny that have to be applied when evaluating a law affecting fundamental rights. For instance, this Court established that a "State is not completely free to consider impairing the obligations of its own contract on a par with other policy alternatives." *United States Trust Co.*, 431 U.S. at 30-31. Neither is the State free "to impose a drastic impairment when an evident and more moderate course would serve its purposes equally well." *Id*. Compare with *United States v. Alvarez*, 567 U.S. 709, 725, 729 (2012) (stating that when the government restricts protected speech through a law that is content based, the restriction must be "actually necessary" to achieve a compelling interest. Also "when the Government seeks to regulate protected speech, the restriction must be the 'least restrictive means among available, effective alternatives.' ").

The less deference scrutiny, which has not been defined with clarity as a rational, intermediate, or strict scrutiny, has caused confusion on how to employ it. *See Baltimore Teachers Union v. Mayor and City Council of Baltimore*, 6 F.3d 1012, 1019 (4th Cir. 1993) ("Although the Court has never specified what it intends by the requirement of a more searching examination, it appears to mean by this only that the legislature's asserted justifications for the impairment shall not be given the complete deference that they otherwise would enjoy."). Since only fundamental rights affected by a governmental regulation are subject to strict scrutiny, *see Lawrence v. Texas*, 539 U.S. 558, 593 (2003),

the proper scrutiny to evaluate the constitutionality of a government contract's impairment is an intermediate one.

According to this Court, a stricter scrutiny must be applied when a public contract has been impaired than when it concerns a private contract. *Energy Reserves Group, Inc. v. Kansas Power and Light Co*., 459 U.S. 400, 412 n. 14 (1983). Thus, since the State's self-interest is at stake, a law that impairs a public contract must be subject to an intermediate scrutiny where the law is presumed unconstitutional. *See United States v. Virginia*, 518 U.S. 515, 533 (1996) (applying an intermediate scrutiny to a gender based classification and placing the burden on the State of proving that such classification is constitutional under the Equal Protection Clause); *Plyler v. Doe*, 457 U.S. 202, 227 (1982) (establishing that the State must demonstrate that a classification affecting the right to education, which is not a fundamental right, is constitutional under the Equal Protection Clause). If otherwise, a State would be allowed to impair and therefore breach a contract to which it is a party and simultaneously impose on the other party the financial burden of proving that the impairment is unconstitutional.

Finally, evaluating an impairment of a public contract under an intermediate scrutiny where the law is presumed unconstitutional, is in accordance with this Court's rule that less deference must be given to the State's assessment of reasonableness and necessity of the impairment. It does not subject States to a strict scrutiny where they must show a compelling interest,

but it requires States to justify the reasonableness and necessity of a law when it has substantially impaired, and therefore breached, a contract to which it is a party.

3. Despite that addressing Puerto Rico's severe fiscal crisis is an important public purpose, the Commonwealth's legislation to address it must be constitutional.

As explained, subject to the State's police power, the Contracts Clause limits the power of the States to modify their own contracts as well as to regulate those between private parties. *United States Trust Co. of New York v. New Jersey*, 431 U.S. 1, 17 (1977). To determine whether the State has exceeded its police power and thus violated the Contracts Clause, it must be assessed if there was a substantial contractual impairment, and if such impairment is reasonable and necessary to serve an important governmental purpose. *See id*.

However, concluding that a law impairing contractual obligations has a legitimate purpose does not end the inquiry into such legislation's constitutionality under the Contracts Clause. *Id*. To be constitutional, the law impairing contracts must be **both** reasonable and necessary to achieve an important governmental purpose. *Id*. at 29; *see also United Steel Paper and Forestry Rubber Manufacturing Allied Industrial and Service Workers, Int'l Union v. Government of Virgin Islands*, 842 F.3d 201, 211 (3d Cir. 2016) ("[. . .] to pass muster

under our Contract Clause analysis, the impairment must be reasonable, in addition to being necessary").

For an impairment of a public contract to be necessary to achieve a governmental purpose, it must be shown that the State did not consider impairing the contracts on par with other policy alternatives, or that it did not impose a drastic impairment when an evident or more moderate course would serve its purpose equally well. *Id*. at 29-31. Moreover, for an impairment to be constitutional, it must be reasonable in light of the surrounding circumstances. *Id*. at 31. Also, a contractual impairment is not reasonable if the problem sought to be resolved by it existed at the time the contractual obligation was incurred. *Univ. v. Hawaii of Pro'l Assembly v. Cayetano*, 183 F.3d 1096, 1107 (9th Cir. 1999*); United Steel Paper*, 843 F.3d at 486; *Elliot v. Board of School of Trustees of Madison Consolidated Schools*, 876 F.3d 926 (7th Cir. 2017). "[T]he State must show that it did not know and could not have known the impact of the contract on that state interest at the time the contract was made." *United States Trust Co.*, 431 U.S. at 32 (J. Burger concurring). Finally, as discussed extensively, less deference must be accorded to the State's assessment of reasonableness and necessity of the challenged legislation when it has been alleged a substantial impairment of a public contract, because the State's self-interest is at stake. *Id*. at 26.

In this case, the First Circuit overvalued the Commonwealth's Central Government's fiscal crisis. For instance, it stated that Petitioners did not dispute that resolving a fiscal crisis of Puerto Rico's Central

Government constitutes an "important governmental purpose." App. 13. Moreover, it stated "that, at least, as a general matter, limiting the amount of benefits paid out to workers would produce cost savings that could be useful in resolving a fiscal crisis." App. 13. Therefore, the First Circuit concluded, without any evidence as the case is currently in the pleading stage, that the challenged legislation is reasonable and necessary to address the Commonwealth's fiscal crisis. Moreover, it gave complete deference to the Commonwealth's legislature assessment of reasonableness and necessity of the challenged legislation to address the Central Government's fiscal crisis, which conflicts with this Court's established standard of less deference when a public contract has been substantially impaired.

Also, the First Circuit implied that if the Commonwealth is facing a fiscal crisis, any measure to address it is reasonable and necessary to address such economic challenge. However, a fiscal crisis is not a blank check for the Government to enact unconstitutional legislation that impairs contractual obligations unreasonably and unnecessarily. Concluding that a law impairing contractual obligations has a legitimate purpose does not end the inquiry into such legislation's constitutionality under the Contracts Clause. *United States Trust Co. of New York*, 431 U.S. 1. **To conclude otherwise, would leave the Contract Clause meaningless and useless.**

As explained, to be constitutional, the challenged legislation must be reasonable in light of the surrounding circumstances. *Id.* at 31. Petitioners alleged

extensively in the District Court and the Court of Appeals that CFSE is a public corporation that is fiscally self-sufficient, solvent, and independent from the Commonwealth's general fund. Moreover, CFSE does not depend on the general fund for its effectiveness, nor to pay Petitioners' members' salaries and benefits under the CBAs. Furthermore, the Central Government is not the employer of Petitioners' members. Rather, it is CFSE, which is independent, as a matter of law, from the general fund.

However, the challenged legislation, which was enacted to address the Central Government's fiscal crisis, made no distinction between employees of public corporations and employees of the Central Government. Neither did the legislature consider whether it was reasonable or necessary to impair the contractual rights of public employees that are separate from the Central Government and that, on top of that, are employed by a public corporation that is fiscally self-sufficient and solvent. Therefore, considering the surrounding circumstances of CFSE, the challenged legislation is unreasonable to address the Central Government's fiscal crisis, and thus, unconstitutional.

Nonetheless, the Court of Appeals stated that the benefit cuts implemented by the challenged legislation are related to Puerto Rico's interest of addressing the Central Government's fiscal crisis. App. 14. Additionally, it concluded that the Central Government benefits from the savings generated at public corporations, such as Act 26-2017's order to public corporations of transferring to the Department of Treasury all the

necessary funds to guarantee the government's liquidity. App. 14-15. Nevertheless, the challenged legislation's text is missing an explanation of why and how the impairment of CFSE's workers' contractual rights will address the Central Government's fiscal crisis.

Also, as explained, a legislation is unreasonable for purposes of the Contract Clause analysis if the problem sought to be resolved by the impairment of the CBAs existed at the time that the contractual obligation was incurred. *Univ. v. Hawaii of Prof'l Assembly v. Cayetano*, 183 F.3d 1096, 1107 (9th Cir. 1999)*; United Steel Paper*, 843 F.3d at 486; *United States Trust Co.*, 431 U.S. at 31. In this case, UECFSE's CBA was executed in 2011 and UMCFSE's in 2001. Meanwhile, Puerto Rico's fiscal stability was already in danger. Puerto Rico entered into an economic recession in 2000 that worsened in 2006.[5] As of 2017, Puerto Rico's Gross Domestic Product is the same as that in 2000.[6] Consequently, the fiscal problem sought to be resolved by the challenged legislation already existed by the time that Petitioners negotiated their CBAs with CFSE. Thus, that is another reason why the challenged legislation is unreasonable, and consequently, unconstitutional.

Regarding the necessity inquiry of the challenged legislation, Petitioners alleged that it is unconstitutional because the Commonwealth had other alternatives to

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[5] *See* Puerto Rico's Economic Crisis: A Story Map by Sarah Small. Available at: https://www.arcgis.com/apps/Cascade/index.html?appid=761529cfc93a4c5e975d796aac6ea28f (last visit: March 29, 2021).

[6] *Id*.

address the Central Government's fiscal crisis that did not involve impairing contractual obligations. Specifically, Petitioners proposed these alternatives in the FAAC: (a) Increase in compliance and revenue collection across the major tax lines (personal income tax, corporate income tax, and sales and use tax); (b) Reduction or elimination of useless tax credits or incentives; (c) Rightsizing measures within the instrumentalities of the Commonwealth that do not operate as private businesses or enterprises; and, (d) Planning, development and investment in economic growth projects to increase revenues and collections. These measures are not tailored to CFSE specifically because CFSE does not have a fiscal problem that it has to address. Thus, Petitioners do not have to suggest or propose alternative measures to a non-existent problem.

Regarding these alternatives, the Court of Appeals stated that they do not "identify any specific 'useless tax credits or incentives' or explain why the savings generated by eliminating such tax breaks would rival the savings generated by benefit cuts." App. 15. Moreover, that the proposed alternatives "are not adequate to support the plaintiffs' claims that the cutting of CFSE benefits caused by the challenged laws were unreasonable or unnecessary." App. 15-16. By contrast, in the *United Auto* case the First Circuit decided that the plaintiffs **did not** allege any alternatives. *United Auto*, 633 F.3d at 47. Nevertheless, in this case, Petitioners proposed four (4) alternatives, and the First Circuit discarded them without any evidence. However, if the case was on the trial stage there would be evidence

that proves that the alternatives proposed by Petitioners address the Commonwealth's fiscal crisis. For instance, the Puerto Rico Tax Expenditure Report for Tax Year 2017, issued by the Department of Treasury, demonstrates that tax expenditures increase economic activities which induces economic growth.[7]

Likewise, in *Univ. of Hawaii*, 183 F.3d at 1107, considering other alternatives, the Ninth Circuit determined that the defendants did not explain how the challenged law in that case, which was enacted to address a budgetary crisis, was reasonable and necessary. Specifically, it concluded that the State had other options available that would effectively raise revenues, such as additional budget restrictions, the repeal of tax credits, and the raising of taxes. *Id*. Therefore, the alternatives proffered by Petitioners in this case are not inadequate and are other available options that the Commonwealth had to address the Central Government's fiscal crisis that do not involve impairing Petitioners' CBAs.

In sum, the Court of Appeals' *Opinion* in this case is erroneous because it implies that if a government is facing a fiscal crisis, any measure to address it is reasonable and necessary. However, having a legitimate public purpose is not the end of the inquiry on the constitutionality of the challenged legislation, since it must be reasonable and necessary to achieve such

[7] Puerto Rico Tax Expenditure Report for Tax Year 2017, September 2019. Available at: http://www.hacienda.pr.gov/sites/default/files/comunicaciones/puerto_rico_tax_expenditure_report_2017_version_final_septiembre_2019.pdf (last visit: Feb. 16, 2021).

purpose. Neither did the Commonwealth, nor the District Court, nor the Court of Appeals consider the surrounding circumstances – CFSE's self-sufficiency, solvency, and independence from the general fund – to evaluate the reasonableness of the impairment. Therefore, the Court of Appeals' determination leaves the Contract Clause meaningless and useless. Finally, the First Circuit gave complete deference to Puerto Rico's legislature's assessment of reasonableness and necessity of the impairment to address the Central Government's fiscal crisis, without any evidence, since the case is currently in the pleading stage. Consequently, the Court of Appeals erred drastically in the application of the Contract Clause standard established by this Court when a public contract has been impaired.

4. This case presents an opportunity for this Court to establish that a fiscal crisis is not a blank check for Governments to impair contracts unreasonably and unnecessarily.

The Commonwealth of Puerto Rico has been facing a severe fiscal crisis for several years. It is facing the biggest bankruptcy in the history of the U.S. municipal bond market.[8] In an attempt to address the economic crisis, the Government of Puerto Rico has enacted legislation and approved, along with the FOMB,

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[8] Dawn Giel, *Puerto Rico starts $70 billion bankruptcy proceeding, biggest ever for municipal bond market*, CNBN (May 3, 2017). Available at: https://www.cnbc.com/2017/05/03/puerto-rico-officially-triggers-bankruptcy-protection-proceedings-.html (last visit: March 15, 2021).

fiscal plans and budgets that aim to tackle the problem. However, such course of action has resulted in imposing austerity measures that include a substantial impairment to contractual obligations of the Government with its public employees and those of instrumentalities as well.

There is no doubt that the Central Government, and other public corporations, are facing economic distress. However, that is not the case for CFSE, since it is solvent and does not depend on the Commonwealth's general fund for its operations and for the payment of the salaries and benefits of its employees. However, as thoroughly explained in this petition, the Commonwealth enacted the challenged legislation to address the Central Government's fiscal crisis through, among other measures, the impairment of Petitioners' CBAs with CFSE. Therefore, through the challenged legislation, the Commonwealth treated public corporations and the Central Government as one sole entity, disregarding that public corporations, such as CFSE, have an independent legal personhood from the Commonwealth with the authority of entering into contractual obligations protected by the U.S. Constitution.

In its *Opinion*, the First Circuit implied that if the Commonwealth is facing a fiscal crisis, any measure to address it is reasonable and necessary. Considering the global crisis because of the COVID-19 pandemic, both the Federal Government and the States are facing severe economic distress, with lots of businesses closing, hundreds of thousands of persons unemployed, etc. Consequently, it is not a hypothetical situation that the

States' economy will continue to worsen, which will lead them to enact legislation impairing public contracts like collective bargaining agreements if they had not already done so. Therefore, this case is an opportunity for this Court to establish that a fiscal crisis is not a blank check for governments to enact legislation impairing and breaching its own contractual obligations unreasonably and unnecessary in violation of the Contract Clause. Additionally, this case sets the facts for this Court to state that even in moments of economic distress, the State has the burden on the reasonableness/necessity inquiry when it substantially impaired a contract to which it is a party, thus, resolving the current Courts of Appeals split. In this way, this Court will be safeguarding the meaning and purpose of the Contract Clause even in these hard times.

5. The Court of Appeals decided upon probability, rather than plausibleness, that Petitioners' First Amended Adversary Complaint fails to state a claim upon which relief may be granted.

"A pleading that states a claim for relief must contain [. . .] a short and plain statement of the claim showing that the pleader is entitled to relief [. . .]." Fed. R. Civ. Proc. 8(a)(2). To withstand a Rule 12(b)(6) motion, a complaint must contain sufficient factual matter, accepted as true, to state a claim to relief that is plausible on its face. *Ríos-Campbell v. United States Dept. of Commerce*, 927 F.3d 21, 24 (1st Cir. 2019). "A claim has facial plausibility when the plaintiff pleads

factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (citations omitted).

Likewise, the pleading standard of Rule 8(a)(2) of the Federal Rules of Civil Procedure does not impose a requirement of probability, but merely requires sufficient facts "to raise the reasonable expectation that the discovery will reveal evidence of illegal [conduct]." *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 556 (2007). Finally, on the procedural stage that the case is, the court must accept as "true all well-pleaded facts and draw all reasonable inferences in the plaintiff's favor." *Parker v. Hurley*, 514 F.3d 87, 90 (1st Cir. 2008).

In this case, the FAAC alleged sufficient facts that lead courts to draw a reasonable inference that the challenged legislation is unconstitutional under the Contract Clause. Moreover, Petitioners alleged repeatedly that since the challenged legislation's purpose is to address the Central Government's fiscal crisis, it is unreasonable to impair Petitioners' CBAs because CFSE is fiscally self-sufficient and independent from the Commonwealth's general fund. Therefore, in light of the surrounding circumstances, the challenged legislation is unreasonable. However, the First Circuit did not analyze the FAAC properly under Rule 12(b)(6) because it demanded probability instead of plausibility.

As a matter of fact, the First Circuit cited *Buffalo Teachers* to state that resolving a financial crisis is a legitimate public purpose, and that the austerity

measures imposed by the challenged legislation tackle Puerto Rico's fiscal crisis. However, *Buffalo Teachers'* appeal followed from a summary judgment entered by the district court, and therefore, the record had evidence to support or otherwise oppose the allegations contained in the complaint. That is not the case here. Besides granting full deference to the Commonwealth's assessment of reasonableness and necessity of the challenged legislation, it concluded in this pleading stage that the challenged legislation is constitutional. Consequently, the Court distanced from the standard required in the pleading stage.

Additionally, regarding the "necessity" element of the second prong of the Contracts Clause inquiry, Petitioners proposed particular alternatives available to the Commonwealth. However, the First Circuit stated that such alternatives are not adequate without any evidence. App. 15-16. Nevertheless, if the First Circuit would have taken the alternatives pled by Petitioners in the most favorable way to them, the Court of Appeals could have inferred that reducing or eliminating useless tax incentives or credits would generate billions of dollars for Puerto Rico, as it would require foreign investors and corporations to pay reasonable taxes for doing business on the island. Consequently, the First Circuit did not follow this Court's established standard to evaluate whether a complaint is legally sufficient.

CONCLUSION

Considering that six (6) of the eleven (11) Circuits are split on which party bears the burden on the reasonableness/necessity inquiry of a public contract under the Contract Clause, and for all the other reasons herein, this Court should grant this petition for writ of certiorari.

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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