IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF PUERTO RICO

LEX CLAIMS, LLC, et al., Plaintiffs, v. ALEJANDRO GARCIA PADILLA, et al., Defendants.	Case No. 3:16-cv-02374 (FAB)

MAJOR COFINA BONDHOLDERS' REPLY IN SUPPORT OF INTERVENTION[1]

[1] This Reply is identical to the Proposed Reply attached as an exhibit to the Major COFINA Bondholders' motion for leave to file a reply brief [ECF No. 160], except that certain changes have been made to Section C of the Argument to account for developments occurring subsequent to the filing of the motion for leave.

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES iii

INTRODUCTION 1

ARGUMENT 1

A. The No Action Clause Expressly Carves Out the Inviolable Right of COFINA Bondholders to Enforce Their Right to Payment of Principal or Interest 1

B. The No Action Clause Does Not Apply in a Non-Default Scenario 4

C. The No Action Clause Does Not Apply Because the Trustee's Ability to Adequately Represent All COFINA Bondholders Is in Question 6

D. The Major COFINA Bondholders' Participation in this Suit Does Not Implicate the Purposes Underlying No Action Clauses 7

E. The Plaintiffs Have No Standing to Raise the No Action Clause 8

CONCLUSION 9

TABLE OF AUTHORITIES

Page(s)

Cases

City of Detroit, Mich. v. Detroit Gen. Ret. Sys. Serv. Corp. (*In re City of Detroit, Mich.*),
No. 13-53846, Adv. No. 14-04112, slip op. (Bankr. E.D. Mich. June 30, 2014) 7

Continental Cas. Co. v. N.Y. Mortg. Agency,
No. 94 Civ. 8408, 1998 WL 5133054 (S.D.N.Y. Aug. 18, 1998) 3

Ellington Credit Fund, Ltd. v. Select Portfolio Servicing, Inc.,
837 F. Supp. 2d 162 (S.D.N.Y. 2011).....7

Emmet & Co., Inc. v. Catholic Health East,
951 N.Y.S. 2d 846 (N.Y. Sup. Ct. 2012) 2, 3

Feldbaum v. McCrory Corp.,
C.A. No. 11866, 1992 WL 119095 (Del. Ch. June 2, 1992) 7

Howe v. Bank of New York Mellon,
783 F. Supp. 2d 466 (S.D.N.Y. 2011).....4

Meehancombs Global Credit Opportunities Funds, LP v. Caesars Entm't Corp.,
80 F. Supp. 3d 507 (S.D.N.Y. 2015).....3, 4

Metro. W. Asset Mgmt., LLC v. Magnus Funding, Ltd.,
No. 03 CIV. 5539 (NRB), 2004 WL 1444868 (S.D.N.Y. June 25, 2004).....4

Quadrant Structured Prods. Co. v. Vertin,
23 N.Y. 3d 549 (N.Y. 2014) 4

Rajamin v. Deutsche Bank Nat'l Trust Co.,
757 F.3d 79 (2d Cir. 2014).....8

Sterling Fed. Bank, F.S.B. v. DLJ Mortg. Capital, Inc.,
No. 09 C 6904, 2010 WL 3324705 (N.D. Ill. Aug. 20, 2010).....7

Other Authorities

Fed. R. Civ. P. 24(a)(2).....1

INTRODUCTION

The Major COFINA Bondholders have the largest economic stake of any defendant or putative defendant in the outcome of this litigation.[2] It is thus unsurprising that Plaintiffs do not dispute the Major COFINA Bondholders' satisfaction of the Rule 24(a)(2) standards for intervention as of right. Instead, seeking to prevent their true adversaries from joining this litigation, the Plaintiffs argue that the "no action clause" in the COFINA Resolution bars the Major COFINA Bondholders' participation in this case. For at least five independently dispositive reasons – including, most notably, the "right to payment" exception – the no action clause has no applicability here. The Court should thus reject Plaintiffs' attempt to litigate the scope of the Major COFINA Bondholders' rights in their absence.[3]

ARGUMENT

A. The No Action Clause Expressly Carves Out the Inviolable Right of COFINA Bondholders to Enforce Their Right to Payment of Principal or Interest

As explained in the Intervention Motion (at 9-10), the Major COFINA Bondholders' right to intervene is protected by the last sentence of the no action clause, which provides:

> Nothing contained in this Article shall affect or impair *the right of any Bondowner to enforce the payment of the principal of and interest on such Owner's Bonds* or the obligation of the Corporation to pay the principal of (or Compounded Amount, if any) and interest on each Bond issued hereunder to the Owner thereof at the time and place in said Bond expressed.

Resolution § 1106(1) (emphasis added). Here, by design and intended effect, the Plaintiffs seek to stop all future payments of principal and interest on the COFINA Bonds. *See, e.g.*, Second

[2] Capitalized terms used but not defined herein have the meanings ascribed to them in the *Intervention Motion of Major COFINA Bondholders* [ECF No. 113] (the "Intervention Motion").

[3] In a vain attempt to diminish the significance of the Major COFINA Bondholders' interest in this litigation, the Plaintiffs suggest that the Major COFINA Bondholders' COFINA Bonds may be insured. In fact, however, the $3.6 billion in bond holdings referenced in the Intervention Motion does not include any insured COFINA Bonds.

Amend. Compl. at 67-68. Accordingly, the Major COFINA Bondholders have the unqualified right to intervene to "enforce the payment of the principal of and interest on" their COFINA Bonds.

The Plaintiffs contend that this "right to payment" exception applies only when an issuer is in payment default. *See* Pls.' Opp'n at 8-9. This is contrary to both common sense and the plain language of the Resolution. The no action clause preserves "the right of any Bondowner to enforce the payment of the principal of and interest on such Owner's Bonds," without regard to whether the bonds are in default at the time when enforcement is called for. Where, as here, an action is brought seeking to prevent future payments on the COFINA Bonds, opposing such relief is clearly necessary to "enforce" the bondholders' right to payment.

Relying entirely on a single New York trial court decision, *Emmet & Co. v. Catholic Health East*, 951 N.Y.S. 2d 846 (N.Y. Sup. Ct. 2012), Plaintiffs contend that the bondholders' indisputable right to act independently of the trustee to enforce scheduled payments is limited to bringing actions ". . . at the time and place in said Bond expressed." Resolution § 1106(1).

As an initial matter, Plaintiffs' argument misreads Section 1106(1) – set forth again to show the error:

> Nothing contained in this Article shall affect or impair the right of any Bondowner to enforce the payment of the principal of and interest on such Owner's Bonds or the obligation of the Corporation to pay the principal of (or Compounded Amount, if any) and interest on each Bond issued hereunder to the Owner thereof *at the time and place in said Bond expressed*.

Id. (emphasis added).

The phrase "time and place in said Bond expressed" modifies ***payment*** (which is, naturally, expressed in the Bond) and does not refer to the time and place of ***enforcement*** (which is not expressed in the Bond). Indeed, Plaintiffs' reading of "time ***and place***" as modifying

enforcement would have the effect of providing unique venue (and perhaps even submission to jurisdiction) in New York – the location of the Trustee's "Corporate Trust Office" and the only "place" which is "expressed in the Bond."[4]

Moreover, *Emmet* is entirely off-point. That case involved an action by individual bondholders who, aggrieved by a putatively improper early redemption, sought to collect the interest they "*would have* been entitled to had the bonds not been called." *Emmet*, 951 N.Y.S.2d at 849-50 (emphasis added). The court held that a suit to collect unaccrued interest arising from wrongful bond redemptions was not a suit to enforce payment when due. *Id.* at 851-52. Even assuming *Emmet* was correctly decided, this case could not be more different. Here, the Plaintiffs are seeking to enjoin payment when due; the Major COFINA Bondholders are seeking to defeat the injunction and enforce payment when due.[5]

In any event, several other cases have held that a "right to payment" exception should not be limited to *unpaid* principal and interest unless that limitation is express. *See Continental Cas. Co. v. N.Y. Mortg. Agency*, No. 94 Civ. 8408, 1998 WL 513054, at *4 (S.D.N.Y. Aug. 18, 1998) ("In the absence of such an express limitation, the Court finds that [plaintiff's] suit falls within [the indenture's] provisions for suits for payment of principal and interest despite the fact that [plaintiff] seeks payment for interest that had not accrued at the time it initiated suit."); *Meehancombs Global Credit Opportunities Funds, LP v. Caesars Entm't Corp.*, 80 F. Supp. 3d

[4] As the form of bond attached as Exhibit A to the Plaintiffs' Opposition shows, the COFINA Bonds are payable "upon presentation and surrender of this bond at the Corporate Trust Office (as defined in the General Resolution) of the Trustee." *See* Exhibit A to Plaintiffs' Opposition, ECF No. 155-1, at page 14 of 23 (page A-1 of the "Form of Current Interest Series 2011C Bonds"). The definition of "Corporate Trust Office" in Section 101 of the Resolution states that the office is located at 101 Barclay Street, New York, NY. Other series of COFINA bonds for which the Form of Bond is publicly available contain language substantially identical with respect to the place of payment.

[5] *Emmet* also relied on policy considerations not present here, including a desire for "centralizing the prosecution of lawsuits whose benefits should properly accrue to all bondholders." *Emmet*, 951 N.Y.S. 2d at 851; *see also infra* Section D.

507, 518 (S.D.N.Y. 2015) ("This plain language does not limit the applicability of these provisions to suits for past due amounts."). No such express language is present here.

Even if there were ambiguity in the "right to payment" exception, it would appropriately be resolved in favor of the Major COFINA Bondholders, as the case law makes clear that limitations on bondholder action are to be "construed strictly and [] read narrowly." *Quadrant Structured Prods. Co. v. Vertin*, 16 N.E.3d 1165, 1172 (N.Y. 2014). A strict construction makes particular sense here, where Plaintiffs' lawsuit, if successful, would destroy the very "right to payment" that Plaintiffs claim the Major COFINA Bondholders have prematurely asserted. The "right to payment" exception would be a hollow right, indeed, if bondholders were forced to wait until after third parties had litigated and resolved the bondholders' "right to payment" before the bondholders themselves could even be heard on the subject.[6]

B. The No Action Clause Does Not Apply in a Non-Default Scenario

The no action clause provides that a bondholder may not institute a covered suit unless, among other things, the bondholder gives the Trustee "written notice of [an] Event of Default or breach of duty." Resolution § 1106(1). It thus makes sense to read a no action clause such as this as applying only to suits or actions arising from an Event of Default or breach of duty – and courts have so held. *See Howe v. Bank of N.Y. Mellon*, 783 F. Supp. 2d 466, 473-74 (S.D.N.Y. 2011); *Metro. W. Asset Mgmt., LLC v. Magnus Funding, Ltd.*, No. 03 CIV. 5539 (NRB), 2004 WL 1444868, at *5 (S.D.N.Y. June 25, 2004). Here, because the Plaintiffs' lawsuit does not

[6] Plaintiffs' interpretation would lead to absurd results in other cases as well. If Plaintiffs were correct, a third party to the Resolution could commence a declaratory judgment action against the Trustee seeking to stop a future payment to a small (*e.g.*, 1%) bondholder. The only party with an interest in defending such an action would be the individual holder – who, owing to the size of its holdings, would be unable to comply with the no action clause or otherwise direct the Trustee. It cannot be the case that, in those circumstances, the holder would be prohibited from defending its right to future payment.

arise out of an Event of Default or breach of duty, but rather under the laws and constitutions of the United States and Puerto Rico, the no action clause simply does not apply.

The Plaintiffs do not dispute that the first sentence of the no action clause – which sets forth the criteria for commencing a covered action – applies only in a default scenario. That sentence makes clear that it applies only to actions arising under the Resolution, stating that a bondholder may not "institute any suit, action, mandamus or other proceeding in equity or at law *hereunder*, or for the protection or enforcement of any right *under this Resolution* unless [the bondholder complies with certain requirements]." Resolution § 1106(1) (emphasis added).

Instead, Plaintiffs argue that the second sentence of the no action clause expands the clause to include actions (such as this one) not arising under the Resolution. Plaintiffs' argument is premised on a materially incomplete quotation of the second sentence, which reads in its entirety as follows (with the key words omitted by Plaintiffs in italics):

> It is understood and intended that no one or more Owners of the Bonds or other Beneficiary hereby secured shall have any right in any manner whatever *by his or their action* to affect, disturb or prejudice the security of this Resolution, or to enforce any right hereunder or under law with respect to the Bonds, or the Resolution, except in the manner herein provided, and that all proceedings at law or in equity shall be instituted, had and maintained in the manner herein provided and for the benefit of all Owners of the Outstanding Bonds.

Resolution § 1106(1) (emphasis added). Plaintiffs argue that the reference to any right "hereunder *or under law*" (emphasis added) expands the no action clause to include actions not arising out of an Event of Default or breach of duty. Pls.' Opp'n at 10.

Plaintiffs misunderstand the import of the second sentence. Having established in the first sentence of the no action clause what a bondholder (or holders) must do to commence a covered action, the second sentence of Section 1106(1) then describes certain limitations on what the bondholder (or holders) may seek to accomplish "by his or their action." Here, there is no

action that could be described, insofar as the Major COFINA Bondholders are concerned, as "his or theirs." The bondholders have not commenced this action, so the second sentence of Section 1106(1) – limiting what a bondholder may accomplish by "his or their action" – is simply inapplicable to the Major COFINA Bondholders' proposed intervention.

C. The No Action Clause Does Not Apply Because the Trustee's Ability to Adequately Represent All COFINA Bondholders Is in Question

In the Intervention Motion (at 11), the Major COFINA Bondholders argued that, assuming the no action clause applied, they should be excused from compliance due to (among other things) the Trustee's conflicts. Since the filing of the Intervention Motion, the Trustee has now moved to dismiss the case on grounds that could result in the Trustee – but not the Commonwealth – being dismissed as a Defendant. *See* ECF No. 162 ("Trustee's Motion to Dismiss"). Such an outcome would leave *no* bondholder representative to defend this action (absent grant of a bondholder intervention motion). Bondholder intervention is thus critical to ensure that Plaintiffs' claims are tested by a true adversarial process in which motivated, non-conflicted defendants contest the relief requested.[7]

The Plaintiffs contend that a trustee conflict will excuse compliance with a no action clause only when the action is one against the trustee itself. Pls.' Opp'n at 11-12. But the case law imposes no such rule, holding instead that compliance will be excused where bondholders "allege specific facts which if true establish that the trustee itself . . . is incapable of

[7] The Trustee argues that applicable law limits the remedies of GO Bondholders to a writ of mandamus. *See* Trustee's Mot. to Dismiss at ¶ 41. Whether or not this argument is valid as applied to the GO Bondholders, the Major COFINA Bondholders note that other remedies may be available to holders of bonds secured by revenues or other collateral, such as the holders of COFINA Bonds.

disinterestedly performing [its] duty." *Feldbaum v. McCrory Corp.*, No. 11866, 1992 WL 119095, at *7 (Del. Ch. June 2, 1992). Those facts have been alleged here.[8]

Finally, the Plaintiffs' contention (at 12) that the Major COFINA Bondholders are also "conflicted" is a complete non-sequitur. The Major COFINA Bondholders' cross-holdings of Senior and Subordinated Bonds imposes no "conflict" because the bondholders are not seeking to intervene in a representative capacity (like the Trustee) but rather on their own behalf.[9]

D. The Major COFINA Bondholders' Participation in this Suit Does Not Implicate the Purposes Underlying No Action Clauses

In their Intervention Motion (at 12), the Major COFINA Bondholders cited to a recent decision arising out of the bankruptcy of the City of Detroit – the only case any party has found that addresses a no action clause in the context of an intervention motion. The case permitted intervention, reasoning that the policies favoring the enforcement of no action clauses were simply not present in an intervention scenario. *See generally City of Detroit, Mich. v. Detroit Gen. Ret. Sys. Serv. Corp.* (*In re City of Detroit, Mich.*), No. 13-53846, Adv. No. 14-04112, [ECF No. 73] slip op. at 12-13 (Bankr. E.D. Mich. June 30, 2014); *see also Feldbaum*, 1992 WL 119095, at *6 ("The primary purpose of a no-action clause is thus to protect issuers from the expense involved in defending lawsuits that are either frivolous or otherwise not in the economic interest of the corporation and its creditors.").

[8] Even the cases cited by the Plaintiffs recognize that a conflict short of asking a trustee to sue itself may excuse compliance with a no action clause. In *Ellington Credit Fund, Ltd. v. Select Portfolio Servicing, Inc.*, 837 F. Supp. 2d 162 (S.D.N.Y. 2011), the court held that "demand may be excused where the trustee is plainly conflicted," *id*. at 186, a circumstance adequately alleged here. And in *Sterling Fed. Bank, F.S.B. v. DLJ Mortg. Capital, Inc.*, No. 09 C 6904, 2010 WL 3324705, at *5 (N.D. Ill. Aug. 20, 2010), the court premised its holding on the fact that the only conflict alleged was that the indenture trustee regularly acted as trustee for the issuer's securities. To excuse compliance with a no action clause based on such a commonly-occurring "conflict" would, in effect, mean that "no[ ]action clauses would rarely (if ever) play a role in bondholder litigation." *Id.*

[9] To the extent relevant, the Major COFINA Bondholders are strongly weighted toward the Subordinated Bonds.

The Plaintiffs now argue that the "proliferation of intervention requests in this case" justifies application of the no action clause as a policy matter. Pls.' Opp'n at 12. At most, this argument would support a selective granting of intervention requests (or a coordinated briefing schedule), not a wholesale denial of the requests. More to the point, the proliferation of interventions in a *single case* (brought by a non-bondholder) poses none of the problems that no action clauses were designed to avert. The issuer will have to defend the case, regardless of the interventions; there is no danger of multiple lawsuits in different jurisdictions; and there is no risk that a minority group of COFINA Bondholders will seek relief that other bondholders may oppose, because the intervenors are seeking no relief other than to defend the COFINA Bonds.

E. The Plaintiffs Have No Standing to Raise the No Action Clause

Plaintiffs, who have not alleged they are parties (or third-party beneficiaries) to the Resolution, nevertheless assert that "courts routinely allow non-parties to enforce no-action clauses." Pls.' Opp'n at 8 n.8.[10] To the extent courts have allowed non-parties to a contract to enforce rights thereunder, they have acted inconsistently with fundamental principles of contract law. *See, e.g.*, *Rajamin v. Deutsche Bank Nat'l Trust Co.*, 757 F.3d 79, 86 (2d Cir. 2014) ("The principles that any contractual provision may be waived by implication or express intention of the party for whose benefit the provision inures, and that strangers may not assert the rights of those who do not wish to assert them, underlie the rule . . . that the terms of a contract may be enforced only by contracting parties or intended third-party beneficiaries of the contract.") (citations and quotations omitted).

Leaving aside whether Plaintiffs' cases were wrongly decided, the no action clause in this case is in any event distinguishable. Following recitation of the prerequisites to bringing suit

[10] The Resolution expressly disclaims the existence of third party beneficiaries. *See* Resolution § 1205.

(*e.g.*, notice of default, request to bring suit, and offer of indemnity), Section 1106(1) then states that "such notification, request and offer of indemnity are hereby declared in every such case, *at the option of the Trustee*, to be conditions precedent to the execution of the powers under this Resolution or for any other remedy provided hereunder or by law." Resolution § 1106(1) (emphasis added). This language makes clear that the protections afforded under Section 1106(1) are to be invoked only by the Trustee – who has not objected to the Intervention Motion.

CONCLUSION

For the foregoing reasons, the Major COFINA Bondholders respectfully request that the Court enter an order authorizing them to intervene as a defendant in this action.

I hereby certify that, on this same date, I electronically filed the foregoing with the clerk of the Court using the CM/ECF system, which will notify the attorneys of record.

RESPECTFULLY SUBMITTED,
In San Juan, Puerto Rico, today December 19, 2016.

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