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

LEX CLAIMS, LLC, *et al.*, Plaintiffs, vs. ALEJANDRO GARCÍA PADILA, *et al.*, Defendants.	Case No. 3:16-cv-02374 (FAB)

REPLY MEMORANDUM IN SUPPORT OF COFINA SENIOR BONDHOLDERS' MOTION FOR LEAVE TO INTERVENE FOR THE LIMITED PURPOSE OF ENFORCING PROMESA STAY

INTRODUCTION

Plaintiffs are unsecured bondholders who seek to invalidate a decade-old statute that created the safest and securest financing for Puerto Rico at the lowest possible cost of borrowing. Plaintiffs not only misconstrue the text of PROMESA,[1] but they seek to undermine Congress' stated purpose of a temporary stay on litigation. Plaintiffs attempt to bait COFINA's bondholders into a fight on substantive issues during the stay period while simultaneously objecting to their ability to be heard. In doing this, Plaintiffs cherry pick portions of Puerto Rico's Constitution and ignore the history of its drafting and a coherent reading of its text. They do the same exercise with PROMESA.

Plaintiffs' request to litigate now and prevent the COFINA Senior Bondholders from participating is a blatant attempt to frustrate the expressed intentions of Congress and circumvent the text and structure of PROMESA: PROMESA established an Oversight Board and imposed a temporary stay under Title IV; for the duration of the temporary stay, creditors are barred from litigating the merits of their claims but are encouraged to negotiate consensual resolutions with the Oversight Board; if consensual resolutions are not achieved within the timetable carefully crafted by Congress, the Oversight Board can pursue judicial restructurings under Title III whereupon the automatic stay of the Bankruptcy Code will take effect. Under Title III, the Court will have discretion to continue to stay or to permit litigation. The Court will make such a determination by balancing the interests of all stakeholders and providing all parties in interest with the right to be heard on all issues (like in chapter 11 reorganization cases).[2] In deciding

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[1] Capitalized terms not otherwise defined herein shall have the meanings set forth in the COFINA Senior Bondholders' Motion for Leave to Intervene for the Limited Purpose of Seeking Enforcement of the PROMESA Stay ("Motion to Intervene"). Dkt. No. 50.

[2] *See* PROMESA § 301(a) (incorporating § 1109 from the Bankruptcy Code).

whether litigation should proceed at that stage, a key determinant in the Court's decision would likely be the Oversight Board's view on the work accomplished to date, the prospects for consensual solutions, and the preferred course of proceeding. Lifting the stay before negotiations can even begin is tantamount to allowing Plaintiffs to rewrite the statute to their liking.

The COFINA Senior Bondholders have moved to intervene in this action solely to enforce the PROMESA stay (not to argue now the merits of the Second Amended Complaint). In their Opposition to COFINA Senior Bondholders' Motion for Leave to Intervene ("Opposition"), Plaintiffs raise two procedural barriers to exclude the COFINA Senior Bondholders from being heard on the narrow issue of the applicability of the stay—(i) failure to file a "pleading" under Rule 24(c) with the Motion to Intervene, and (ii) the "no action" provision in the COFINA Resolution. As applied to the COFINA Senior Bondholders' request, however, the Opposition is circular. First, given that the COFINA Senior Bondholders merely wish to advise the Court that this litigation is stayed under PROMESA, it is unclear why it would assist the Court's determination to hear movants' views on the merits of the underlying dispute through an answer or answer and counterclaim. For this reason, courts have exercised their discretion to flexibly apply Rule 24(c)'s requirement of filing a pleading in similar contexts. Second, the "no action" clause in the COFINA Resolution prevents individual bondholders from seeking relief that the COFINA Senior Bondholders are not seeking. By its own terms, the "no action" clause only applies to obtaining relief "under" the Bond Resolution.

Plaintiffs' Opposition confirms the COFINA Senior Bondholders' main point: Plaintiffs' newly-added allegations are nothing more than never-before expressed grievances with the decade-old COFINA structure. The preemption provisions of PROMESA are a check on

unlawful executive actions, not a vehicle to litigate pre-existing "questions" of substantive Puerto Rico law during the stay period. There is no doubt that countless creditors could articulate "questions" that bear on their rights. Allowing such questions to go forward now would vitiate the stay that Congress found so vital to Puerto Rico's recovery efforts.

Congress designed PROMESA to promote negotiation among creditors, elected officials, and the Oversight Board in an effort to reach a consensual resolution to Puerto Rico's financial situation. The decision of whether Plaintiffs should be free to litigate the merits of their bond claims immediately upon nonpayment was answered in the negative by Congress. The COFINA Senior Bondholders seek to intervene in this matter for the purpose of enforcing the stay under PROMESA.

ARGUMENT

I. COFINA SENIOR BONDHOLDERS SHOULD BE HEARD ON OTHER BONDHOLDERS' EFFORTS TO UNDERMINE PROMESA

Notably absent from Plaintiffs' opposition is any suggestion that the COFINA Senior Bondholders do not satisfy the requirements of Rule 24(a) for intervention as a matter of right. This is not surprising because the COFINA Senior Bondholders easily qualify for intervention under both Rule 24 of the FRCP and this Court's interpretation of the rule. *See* Motion at 9–14; FRCP 24(a)(2); *Conservation Law Found. of New Eng., Inc. v. Mosbacher*, 966 F.2d 39, 41 (1st Cir. 1992). Instead, Plaintiffs try to block the COFINA Senior Bondholders' participation in this action on procedural grounds that do not apply to the limited relief sought.

A. The COFINA Senior Bondholders Have Complied with Rule 24(c)

The COFINA Senior Bondholders explained in their initial papers that they did not file a traditional pleading consistent with Rule 24(c) because of the unique nature of the issue currently before the Court; *i.e.*, Plaintiffs' disregard of a federal statute. *See* Motion to Intervene at 4 n.4.

The COFINA Senior Bondholders acknowledge this Court's decision in the consolidated *Peaje Investments LLC v. Garcia-Padilla* litigation, No. 16-cv-2365, 2016 WL 6500196 (D.P.R. Nov. 1, 2016), but respectfully submit that Rule 24(c) should be flexibly applied when the proposed relief is limited. *See, e.g.*, *United States v. Petters*, Civil. No. 08-5384 ADM/JSM, 2008 WL 5234527, at *2 (D. Minn. Dec. 12, 2008) (noting that a commonsense application of Rule 24 is appropriate when intervention is sought for a limited purpose, such as seeking to stay the action); *United States ex rel Frank M. Sheesley Co. v. St. Paul Fire & Marine Ins. Co.*, 239 F.R.D. 404, 412 (W.D. Pa. 2006) (concluding that intervenor's motion to compel arbitration and stay proceedings satisfied the requirements of Rule 24(c), and that it would be inefficient to require intervenor to file a third-party complaint so that it may immediately seek a stay of claims); *Inmates of The R.I. Training Sch. v. Martinez*, 465 F .Supp. 2d 131, 136 (D.R.I. 2006) (while "not a conventional motion to intervene," the court explained that "[r]ather than engaging in a convoluted analysis in order to fit the facts of this Motion's square peg into the Rule's round hole, the Court will fall back on the 'reasonable measure of latitude' that has been afforded by the First Circuit to the District Court in the practical application of Rule 24(a)(2)").[3]

The COFINA Senior Bondholders seek to intervene to enforce the PROMESA stay so parties will not need to engage in litigation and thus would not need to file a motion to dismiss or answer, commence discovery if claims are not dismissed, and all of the other hallmarks of expensive, time-consuming, and contentious litigation. That is because PROMESA was

[3] Plaintiffs attempt to distinguish *Hyland v. Harrison*, No. Civ.A. 05-162-JJF, 2006 WL 288247, at *5–6 (D. Del. Feb. 7, 2006), by arguing that the *Hyland* court allowed intervention in order to avoid a delay in resolving the dispute. Opposition at 7 n.3. However, the COFINA Senior Bondholders are not attempting to intervene to delay the resolution of a dispute properly before a court. It is Plaintiffs who have filed this lawsuit in violation of PROMESA and are thereby obstructing the parties (including the Oversight Board) from focusing on negotiations towards a consensual resolution. Granting intervention and enforcing PROMESA's stay will hasten, not delay, a resolution by motivating the recalcitrant parties to employ the processes set out by Congress.

specifically designed to stay all such litigation in favor of negotiation, especially when good-faith negotiations could obviate the need for litigation. Where, as here, a traditional pleading is wholly inconsistent with the reason intervention is sought, courts have applied their discretion to accept a motion in lieu of pleading where the spirit of Rule 24(c) is satisfied, *i.e.*, the filed papers sufficiently inform the court of the intervening party's interest in the litigation and its position on the relevant issues. *City of Bangor v. Citizen Commc'ns Co.*, No. CIV. 02-183-B-S, 2007 WL 1557426, at *2, *4 (D. Me. May 25, 2007), *aff'd sub nom. City of Bangor v. Citizens Commc'ns Co.*, 532 F.3d 70 (1st Cir. 2008) (allowing the State of Maine to intervene and file a consent decree rather than a pleading because intervention decisions "must be driven by the merits of the motion, especially when the record otherwise makes clear exactly what claims or defenses the proposed intervenor seeks to pursue or otherwise resolve," and in this case "the other submissions . . . adequately describe the State's basis for intervention"); *see also Beckman Indus., Inc. v. Int'l Ins. Co.*, 966 F.2d 470, 474–75 (9th Cir. 1992) (allowing limited intervention to modify a protective order without meeting the technical requirements of 24(c) where "the court was otherwise apprised of the grounds for the motion"); *Spring Constr. Co. v. Harris*, 614 F.2d 374, 376–77 (4th Cir. 1980) (allowing intervention where the intervenor provided sufficient notice of the reason for intervention and the parties suffered no prejudice, even though no pleading was included). That is exactly what the COFINA Senior Bondholders have done here. *Frank M. Sheesley Co.*, 239 F.R.D. at 412 ("Though no pleading—as that term is strictly defined in FED. R. CIV. P. 7—accompanies [intervenors'] motion, [intervenor] has included its Motion to Compel and Stay, and the purpose of the intervention and the [intervenor's] conduct that the parties can expect going forward are quite clear.").[4]

[4] To the extent the Court is inclined to deny the Motion to Intervene on this procedural ground, the COFINA

B. Plaintiffs Misread the COFINA Resolution's "No Action" Clause

The Court should reject Plaintiffs' mischaracterization of the "no action" clause in the COFINA bond documents. Plaintiffs cite the three-page form of bond, which itself refers the holder to the COFINA Resolution for the procedures a bondholder must follow to enforce the resolution itself. Section 1106 of the COFINA Resolution states that:

> No Owner of any Bond shall have any right to 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 such Owner shall have given to the Trustee written notice of the Event of Default or breach of duty . . . and unless the Owners of not less than 25% in principal amount of the Bonds then Outstanding shall have made written request of the Trustee. . . .

COFINA Resolution at 76 (Dkt. No. 87-2) (emphasis added). First, the "no action" clause is applicable only to issues concerning the trust (*i.e.*, "under this resolution"), and is not a ban on being heard in lawsuits that affect rights arising outside of the COFINA Resolution. Second, the COFINA Resolution only prevents bondholders from (under certain circumstances) commencing litigation—not from defending litigation that adversely impacts their rights.[5]

"No action" clauses are narrowly construed to give effect to the precise words and language used. *Quadrant Structured Prods. Co. v. Vertin*, 23 N.Y.3d 549, 560 (2014).[6] In *Quadrant*, for example, the New York Court of Appeals held that a "no action" clause stating, in relevant part, that "[n]o holder of any Security shall have the right ***by virtue or by availing of any provision of this Indenture*** to institute any action or proceeding at law or in equity or in

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Senior Bondholders respectfully request that the Court afford the undersigned a short period of time to allow the filing of a formal pleading.

[5] Contrary to Plaintiffs' suggestion, Sections 705 and 802 of the COFINA Resolution do not limit bondholder rights in any way, but only empower or obligate the Trustee to take certain actions, and Section 1105 does not limit bondholder rights, but only provides for how bondholders may direct proceedings and remedies where the Trustee is in fact acting under the COFINA Resolution.

[6] Plaintiffs have taken the position that New York law governs the question, and the COFINA Senior Bondholders accordingly cite to New York law in this Reply solely as it impacts administration of the trust created by the COFINA Resolution. COFINA Resolution § 1211.

bankruptcy or otherwise ***upon or under or with respect to this Indenture***," did not prevent security-holders from enforcing independent common law or statutory rights. *Id.* at 556–57 (emphasis added). These rights, according to the Court, did not arise "by virtue or by availing of any provision of th[e] Indenture," and thus were not prohibited by the "no action" clause. *Id.* at 560–61. This was in stark contrast to "no action" clauses that "extend beyond the four corners of the agreement" and prohibit "any remedy with respect to this Indenture ***or the Securities***." *Id.* at 561 (emphasis added).

The same is true here. Like in *Quadrant*, Section 1106 is limited to rights "hereunder" and "under this Resolution." There is no broad ban on actions seeking a remedy with respect to rights as a bondholder that are not "under" the COFINA Resolution, such as rights granted by statute. The issue underlying the Motion to Intervene is the applicability of the mandatory PROMESA stay, which does not concern the COFINA Resolution. The limitations set out in the COFINA Resolution simply do not prevent the COFINA Senior Bondholders from participating in this litigation.

II. THE CAREFULLY CRAFTED PROMESA STAY APPLIES TO THE COFINA COUNTS

Plaintiffs continue to contend that Counts Two, Three, and Twelve (the "COFINA Counts") allege only violations of PROMESA and are therefore not subject to the PROMESA stay. But repeating it does not make it true. COFINA's enhanced protection and insulation from the Commonwealth's financial woes is exactly why COFINA was created with overwhelming support of the Legislative Assembly a decade ago. The COFINA securitization working exactly as it was intended cannot be the basis to shoehorn it into PROMESA's narrow preemption provisions. Federal restructuring laws, as they must, respect pre-existing state/territorial law and PROMESA only preempted unlawful executive orders that were the subject of concern to

Congress during PROMESA's passage. Executive Order 2016-30 halted payments to Plaintiffs but it did not transfer any assets to COFINA: The transfer of a portion of the SUT occurred by several bi-partisan acts of the Legislative Assembly commencing 10 years ago.

Far from arising under PROMESA, prosecution of the COFINA Counts is ***directly contrary to it***. The Opposition ultimately admits this point, acknowledging that Plaintiffs' real complaint is with the creation of COFINA. *See* Opposition at 14 (questioning how "mere legislation could trump the Puerto Rico Constitution's declaration that all available resources must be used to service its public debt").[7] Congress declared that the stay period should not be used to litigate issues that existed prior to PROMESA. The Court should not allow Plaintiffs to violate this by now litigating the separateness of COFINA's Dedicated Sales Tax from the general fund—a fact with arose with the creation of COFINA.

Finally, Plaintiffs take the position (Opposition at 13-14) that PROMESA's requirement for fiscal plans to respect "lawful" priorities and liens means the determination is "ultimately a judicial task." To read Section 201(b)(1)(N) of PROMESA in this way would open the very floodgates of litigation that Title IV's mandatory stay specifically addressed. Section 201

[7] In addition to the stay under the first prong of Subsection 405(b)(1), the COFINA Counts are stayed under various other Subsections of 405(b). First, the COFINA Counts are stayed under the second prong of Section 405(b)(1) as actions to recover a Liability Claim against the Government of Puerto Rico that arose prior to PROMESA. Similar to the Bankruptcy Code's broad definition of the term "claim," PROMESA broadly defines the term "Liability Claim" to include not only a right to payment but also a right to "an equitable remedy for breach of performance if such breach gives rise to a right to payment . . . ." Disguising litigation as merely seeking "injunctive or declaratory relief" will not save the COFINA Counts from being collection efforts. *Green v. Mansour* , 474 US 64, 73 (1985). Second, Section 405(b)(3) stays any act to obtain possession of property of the Government of Puerto Rico or to exercise control over property of the Government of Puerto Rico. Since the Government of Puerto Rico is defined in PROMESA to include COFINA, Plaintiffs' request that the Commonwealth interrupt revenues from COFINA is an act to "obtain possession of" and/or "exercise control over" COFINA's property. Lastly, the COFINA Counts are also stayed under Section 405(b)(6) as they constitute acts to "collect, assess or recover" on a Liability Claim that arose prior to PROMESA. The stay under Section 405(b)(6) is broader than the prohibition against seeking to recover on a claim under Section 405(b)(1) and thus encompasses acts beyond technically seeking to recover on a claim.

concerns the Oversight Board's development and approval of fiscal plans. Indeed, according to the text of Section 201(a), development of that plan in the Oversight Board's discretion is one of the most important near-term tasks of the Oversight Board. The protection of "lawful" priorities and liens is just one of several requirements that could "ultimately" find its way into a courtroom, presumably at the hands of Plaintiffs who have an excessively broad reading of their rights (*e.g.*, Section 201(b)(1)(B) ("ensure the funding of ***essential*** public services"); Section 201(b)(1)(C) ("provide ***adequate*** funding for public pension systems"); Section 201(b)(1)(K) ("adopt ***appropriate*** recommendations submitted by the Oversight Board"); Section 201(b)(1)(M) ("ensure that assets, funds, or resources of a territorial instrumentality are not loaned to, transferred to, or otherwise used for the benefit of a covered territory or another covered territorial instrumentality of a covered territory, ***unless permitted by the constitution of the territory***"). Plaintiffs are mistaken in their view, however, that the Oversight Board must obtain multiple judicial determinations as a pre-condition to developing and approving a fiscal plan under Section 201 of PROMESA. In fact, the statute (in another section omitted by Plaintiffs) clearly states the contrary view of Congress—and unmistakably gives the Oversight Board discretion. Section 201(c)(3) expressly provides:

> The Oversight Board shall review any proposed Fiscal Plan to determine whether it satisfies the requirements set forth in subsection (b) and, if the Oversight Board determines in its sole discretion that the proposed Fiscal Plan—
>
> > (A) satisfies such requirements, the Oversight Board shall approve the proposed Fiscal Plan; or
> >
> > (B) does not satisfy such requirements, the Oversight Board shall provide to the Governor—
> >
> > > (i) a notice of violation that includes recommendations for revisions . . . ; and
> > >
> > > (ii) an opportunity to correct the violation in accordance with subsection (d)(1).

Contrary to Plaintiffs' litigation agenda, nothing in PROMESA supports the view that litigation is necessary or even desirable to aid the Oversight Board in developing a Fiscal Plan. Reading the entirety of the statute (or the other portions of the statute cited by Plaintiffs), the outcome is clear that all litigation is stayed while the Oversight Board develops a Fiscal Plan in its sole discretion. If creditors disagree with the determinations made, there may be an opportunity to "ultimately" bring issues before the Court, but that time is certainly not now during the pendency of the Title IV stay that Congress provided precisely to enable the Oversight Board to study the issues and make judgments in its discretion.

At bottom, Plaintiffs' contention that allowing the litigation to proceed will facilitate the negotiations that PROMESA envisions flies in the face of the contrary determination of Congress. There can be no doubt that Congress was advised of the pluses and minuses of imposing a temporary stay, and that Congress flatly disagreed with Plaintiffs' position. *See* PROMESA § 405(m)(4)–(6) ("***Congress finds***" in favor of the following: a "comprehensive" approach to "restructure debts in a fair and orderly process"; "immediate—but temporary—stay is essential"; and the goal is to restore access to "capital markets"); *id.* § 405(n)(2) (purpose of the stay is to "allow the Government of Puerto Rico a limited period of time during which it can focus its resources on negotiating a voluntary resolution with its creditors ***instead of defending numerous, costly creditor lawsuits***") (emphasis added).

CONCLUSION

For the foregoing reasons, as well as those raised in the Motion to Intervene, the COFINA Senior Bondholders' Motion for Leave to Intervene for the Limited Purpose of Seeking Enforcement of the PROMESA Stay should be granted.

ORIGINALLY FILED: November 14, 2016

RE-FILED TO ADD ELECTRONIC SIGNATURE AND CERTIFICATE OF SERVICE AS PER NOTICE OF DOCKET TEXT MODIFICATION: November 15, 2016

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on November 15, 2016, I electronically filed the foregoing with the Clerk of the Court using the CM/ECF system which will send notification of such filing to counsel for the parties of record.

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