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

LEX CLAIMS, LLC, et al.,

Case No. 3:16-cv-02374 (FAB)

Plaintiffs,

v.

THE COMMONWEALTH OF PUERTO RICO, et al.,

Defendants.
_____/

REPLY MEMORANDUM IN SUPPORT OF THE PUERTO RICO FUNDS' MOTION TO INTERVENE AS DEFENDANTS TO SECOND AMENDED COMPLAINT WITH RESPECT TO COUNTS I-IX AND XII-XIII AND INCORPORATED MEMORANDUM OF LAW

INTRODUCTION

The Puerto Rico Funds,[1] as holders of approximately $645 million in COFINA Bonds, moved to intervene in this action to defend against certain of Plaintiffs' claims that challenge the entire COFINA structure and that, if successful, will ensure that the COFINA Bonds are not repaid.

Plaintiffs acknowledge that their COFINA Counts directly impact the Puerto Rico Funds' interests. Faced with a motion that admittedly meets the standards of Rule 24 of the Federal Rules of Civil Procedure, Plaintiffs are forced to argue that the Puerto Rico Funds somehow *waived* their ability to defend their right to repayment under a "no-action" clause in the COFINA Resolution. But that Resolution expressly allows COFINA Bondholders, such as the Puerto Rico Funds, to take any action to enforce their right to repayment. That is why Plaintiffs cannot cite a single case where a party was precluded from intervening as a defendant in a lawsuit that threatened its interests based on a "no-action" clause. The Court should grant the Puerto Rico Funds' Motion to Intervene.

ARGUMENT

I. The No-Action Clause Does Not Preclude The Puerto Rico Funds From Intervening

The "no-action clause" at issue is found in Section 1106 of the COFINA Resolution.[2] It states:

---

[1] Capitalized terms not otherwise defined herein shall have the meaning set forth in the Puerto Rico Funds' Motion to Intervene as Defendants to the Second Amended Complaint with Respect to Counts I-IX and XII-XIII and Incorporated Memorandum of Law (the "Motion to Intervene") [Docket No. 95].

[2] Rather than recite the controlling language in Section 1106, Plaintiffs instead recite the disclosures contained in the Form of Bond included in the Supplemental COFINA Resolutions. Opposition at 7. But these disclosures are not controlling; they are merely descriptive of the controlling terms found in the COFINA Resolution. Indeed, Plaintiffs recognize this in their Opposition. Opposition at 7 n.6 (stating that the COFINA Resolution "sets forth general terms governing all bonds issued by COFINA"). But even if the disclosures cited in the Form of Bond were operative, they only limit bondholders' ability to "appear in or defend any suit or other proceeding with respect [to the COFINA Resolution]." *See id.* at 7. The instant suit, however, does not challenge provisions in the COFINA Resolution; it challenges the actions taken by the Commonwealth.

> 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 on account of which such suit, action or proceeding is to be taken, 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 § 1106(1) (the "No-Action Clause")(emphasis added).[3] Importantly, the No-Action Clause expressly carves out a right to payment:

> ***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 Owners' Bonds . . . .

Id. (the "Carve-Out") (emphasis added).

This litigation directly bears on the Puerto Rico Funds' right to payment because Plaintiffs are attempting to prevent payment of principal and interest on the COFINA Bonds. Specifically, Plaintiffs seek (1) a declaration that "revenues diverted to COFINA . . . cannot be transferred to COFINA or COFINA bondholders"; (2) an injunction "prohibiting the diversion of revenues arising from the collection of SUT (or any substitute revenues to COFINA"); and (3) an injunction "directing the COFINA Defendants to transfer any revenues received from the collection of the Commonwealth's SUT in their possession or held on behalf of COFINA to the Commonwealth." Second Amended Complaint at 66-67 [Docket No. 78]. There could be no more of a direct threat to the Puerto Rico Funds' right to payment.

Plaintiffs' reliance on Emmet & Co., Inc. v. Catholic Health East, 951 N.Y.S.2d 846 (N.Y. Sup. Ct. 2012) to argue that the Puerto Rico Funds cannot defend their right to payment is

---

Furthermore, although Plaintiffs cite to Sections 705, 802, and 1105 of the COFINA Resolution as additional restrictions on the bondholders' right to participate in litigation (id.), these provisions simply empower the Trustee to take certain actions and provide for how bondholders may direct proceedings when the Trustee is in fact acting under the COFINA Resolution.

[3] A copy of the COFINA Resolution is attached as Exhibit B to the Puerto Rico Funds' Motion to Intervene [Docket No. 95-1].

misplaced. Opposition at 8-9. The issue in Emmet was whether the plaintiff could *prosecute* claims under the payment-enforcement exception to recover interest that they would have received had the bonds not been wrongfully redeemed. 951 N.Y.S.2d at 850. This case is entirely different. Here, the Puerto Rico Funds are not seeking to initiate or prosecute any claims. The Puerto Rico Funds are simply seeking to *prevent* the Plaintiffs from securing a declaratory judgment and injunction that would have the effect of ensuring the COFINA Bonds are not repaid. This is exactly what the right to payment exception permits.

The policy arguments on which Emmet is based are also not applicable here. Emmet held that the right to payment exception only permitted the bondholder to sue for recovery of past due– not future unrealized– interest.[4] 951 N.Y.S.2d at 851. The court explained that the payment-enforcement "exception must not be [broadly] construed to render the no-action clause ineffective" because "[b]arriers to action by individual bondholders serve an important purpose by both preventing expensive lawsuits that do not have the support of a substantial portion of the creditors while also centralizing the prosecution of lawsuits whose benefits should properly accrue to all bondholders." Id. Here, such a narrow interpretation of the Carve-Out does not prevent an expensive lawsuit – that lawsuit has already been instituted by the Plaintiff. While Emmet supports invoking a no-action clause as a shield to prevent expensive litigation, it is not support for invoking a no-action clause as a sword to cut off a bondholder's right to defend its right to payment. To find otherwise would eviscerate the right to payment exception and allow

[4] Federal courts interpreting New York law have come to a different conclusion, finding that right-to-payment exceptions *do not* bar claims to recover future principal and interest unless they are so expressly limited. For example, in Continental Casualty Co. v. New York Mortgage Agency, the court interpreted a payment-enforcement exception that is nearly identical to the one found in the COFINA Resolution and found that it permitted claims for future interest because it contained no express language limiting its application to only suits for unpaid interest. 1998 U.S. Dist. LEXIS 12784, at *16 (S.D.N.Y. Aug. 5, 1998); see also Meehancombs Global Credit Opportunities Funds, LP v. Caesars Entm't Corp., 80 F. Supp. 3d 507, 518-519 (S.D.N.Y. 2015) (refusing to limit bondholders' right to sue for past due amounts only absent express language in the indenture); In re Cendant Corp. Sec. Litig., 2005 U.S. Dist. LEXIS 35549, *41-42 (D.N.J. Dec. 21, 2005) (same).

bondholders to be denied their right to payment without ever having their day in court. This is not the law.

While Emmet is not instructive, In re City of Detroit speaks directly to the case at hand. There, the court rejected the argument that the no-action clause prevented certain bondholders from intervening as defendants, holding:

> [B]y the plain language of the 'no-action' clause, it is intended to prevent certificate holders from *instituting* proceedings against others . . . . It is clear that these types of clauses are intended to prevent individual or small groups of certificate holders from initiating piecemeal, harassing or redundant litigation. *Those concerns are simply not present here. Rather, parties representing a majority of the outstanding COPs seek to defend against the action brought by the City that may affect their legal and pecuniary interests.*

City of Detroit, Mich. v. Detroit Gen. Ret. Sys. Serv. Corp. (In re City of Detroit, Mich.), Ch. 9 Case No. 13-53846, Adv. No. 14-04112, at *12-13 (Bankr. E.D. Mich. June 30, 2014) (citation omitted) (emphasis added) (attached as **Exhibit 1**). This same analysis applies here.

The No-Action Clause found in Article XI ("Defaults and Remedies") of the COFINA Resolution applies to the Puerto Rico Funds' right as COFINA Bondholders to "*institute*" a lawsuit after written notice of an event of default or breach of a duty. COFINA Resolution § 1106(1) (emphasis added). But Plaintiffs "instituted" this suit, not the Puerto Rico Funds. And the Puerto Rico Funds have not moved to intervene to seek any remedy for an event of default or breach of duty, but simply to defend against claims that would deprive them of their right to payment.

Moreover, the No-Action Clause applies to the "protection or enforcement of any right *under [the] Resolution*." COFINA Resolution § 1106(1) (emphasis added). The phrase "under [the] Resolution" limits the clauses' scope to contractual claims arising from the Resolution itself.

See Quadrant Structured Prods. Co., Ltd. v. Vertin, 23 N.Y.3d 549, 564 (N.Y. 2014) (holding that no-action clauses are to be strictly construed and finding that a no-action clause with the language "under [the] Indenture" only bars indenture-based contract claims). Here, the Puerto Rico Funds' Motion to Intervene is unrelated to the COFINA Resolution, and the Puerto Rico Funds are not seeking to compel compliance by the Commonwealth or COFINA with their respective obligations under the COFINA Resolution (or the COFINA Bonds). Instead, the Puerto Rico Funds seek to defend against Plaintiffs' constitutional attacks against the Commonwealth's actions, which is also an attack on the Puerto Rico's Funds' right to payment,[5] and prevent a Court order that forecloses the Commonwealth or COFINA from complying with the obligations to repay the COFINA Bondholders.

II. There Are No Other Grounds for Denying The Puerto Rico Funds' Motion to Intervene

Plaintiffs assert a number of other objections to the Puerto Rico Funds' Motion to Intervene. First, Plaintiffs point out that the Puerto Rico Funds have not affirmatively sought to enforce the PROMESA stay like other COFINA Bondholders seeking to intervene. Opposition at 3. Plaintiffs argue then there could be duplicative litigation while the Puerto Rico Funds pursue discovery and other COFINA Bondholders litigate the issue of the stay. Id. But this argument ignores the practical reality that any stay granted would apply to all COFINA Bondholders – including the Puerto Rico Funds – and any potential discovery sought in the meantime would not be "duplicative" as it would all relate to the same issues concerning the CONFINA Bonds.

[5] See Opposition at 2-3 ("To the extent that the Court holds that the Commonwealth's actions violate federal and Puerto Rico law, [the Puerto Rico Funds] will have to surrender their unlawfully privileged position among the Commonwealth's creditors . . . .").

Second, Plaintiffs argue that the Puerto Rico Funds have failed to demonstrate their entitlement to proceed under the No-Action Clause because they have not complied with its terms. Opposition at 10. For example, Plaintiffs argue that the Puerto Rico Funds have not given notice of an event of default to the Trustee Defendant. Id. This argument fails because those requirements are only necessary where a bondholder seeks to *institute a lawsuit* or *enforce a right under the Resolution.* COFINA Resolution § 1106(1). As explained above, the Puerto Rico Funds are seeking neither of these things against the Commonwealth or COFINA, but are seeking to prevent Plaintiffs from terminating their right to payment.

Third, Plaintiffs argue that the Puerto Rico Funds' assertion of a potential conflict of interest where the Trustee Defendant may be unable to adequately represent the interest of both holders of the senior COFINA Bonds and the holders subordinated COFINA Bonds does not excuse compliance with the No-Action Clause. Opposition at 10. Again, because the No-Action Clause is not implicated, these provisions are inapplicable.[6]

CONCLUSION

For the foregoing reasons, the Puerto Rico Funds request that the Court enter an Order granting the Puerto Rico Funds' leave to intervene in this action as defendants to the COFINA Counts.

RESPECTFULLY SUBMITTED,

We hereby CERTIFY that on December 13, 2016, we caused the foregoing Reply Memorandum in Support of the Puerto Rico Funds' Motion to Intervene as Defendants to Second Amended Complaint with Respect to Counts I-IX and XII-XIII, to be electronically filed in this case with the Clerk of Court, using the CM/ECF system, which will send notifications of such filing to all counsel of record.

[6] Plaintiffs also remark that the Puerto Rico Funds "do not explain – because they cannot – why they are equipped to represent the interests of both senior and subordinated bonds, while the Trustee cannot not." Opposition at 11. This remark ignores the fact that, under the COFINA Resolution, in an event of default and while there is senior COFINA Bonds outstanding only the *senior* holders of COFINA Bonds may direct the Trustee to take certain action, without regard to the best interests of the subordinated holders. See COFINA Resolution §§ 1101-1102. The Puerto Rico Funds seeking to intervene here are not bound by any such direction provision and can therefore proceed based on full consideration of *all* holders' interests.

In San Juan, Puerto Rico, this 13th day of December, 2016.

By:

/s/ *Arturo Díaz-Angueira*
Arturo Díaz-Angueira
USDC-PR 117907
adiaz@lsplawpr.com

José C. Sánchez-Castro
USDC-PR 213312
jsanchez@lsplawpr.com

Alicia I. Lavergne-Ramírez
USDC-PR 215112
alavergne@lsplawpr.com

Maraliz Vázquez-Marrero
USDC-PR 225504
mvazquez@lsplawpr.com

LÓPEZ SÁNCHEZ & PIRILLO LLC
270 Muñoz Rivera Avenue, Suite 504
San Juan, PR 00918
Tel. (787) 522-6776
Fax: (787) 522-6777

Counsel for Proposed Intervenor-Defendants Puerto Rico AAA Portfolio Bond Fund II, Inc., Puerto Rico AAA Portfolio Bond Fund, Inc., Puerto Rico AAA Portfolio Target Maturity Fund, Inc., Puerto Rico Fixed Income Fund, Inc., Puerto Rico Fixed Income Fund II, Inc., Puerto Rico Fixed Income Fund III, Inc., Puerto Rico Fixed Income Fund IV, Inc., Puerto Rico Fixed Income Fund V, Inc., Puerto Rico Fixed Income Fund VI, Inc., Puerto Rico GNMA & U.S. Government Target Maturity Fund, Inc., Puerto Rico Investors Bond Fund I, Puerto Rico Investors Tax-Free Fund, Inc., Puerto Rico Investors Tax-Free Fund, Inc. II, Puerto Rico Investors Tax-Free Fund III, Inc., Puerto Rico Investors Tax-Free Fund IV, Inc., Puerto Rico Investors Tax-Free Fund V, Inc., Puerto Rico Investors Tax-Free Fund VI, Inc., Puerto Rico Mortgage-Backed & U.S. Government Securities Fund, Inc., Tax-Free Puerto Rico Fund, Inc., Tax-Free Puerto Rico Fund II, Inc., Tax-Free Puerto Rico Target Maturity Fund, Inc. and UBS IRA Select Growth & Income Puerto Rico Fund

/s/ *John K. Cunningham*
Glenn M. Kurtz (admitted *pro hac vice*)
John K. Cunningham (admitted *pro hac vice*)
WHITE & CASE LLP
1155 Avenue of the Americas
New York, NY 10036
Tel. (212) 819-8200
Fax (212) 354-8113
gkurtz@whitecase.com
jcunningham@whitecase.com

Jason N. Zakia (admitted *pro hac vice*)
WHITE & CASE LLP
200 S. Biscayne Blvd. Suite 4900
Miami, FL 33145
Tel. (305) 371-2700
Fax: (305) 358-5744
jzakia@whitecase.com

Counsel for Proposed Intervenor-Defendants Puerto Rico AAA Portfolio Bond Fund II, Inc., Puerto Rico AAA Portfolio Bond Fund, Inc., Puerto Rico AAA Portfolio Target Maturity Fund, Inc., Puerto Rico Fixed Income Fund, Inc., Puerto Rico Fixed Income Fund II, Inc., Puerto Rico Fixed Income Fund III, Inc., Puerto Rico Fixed Income Fund IV, Inc., Puerto Rico Fixed Income Fund V, Inc., Puerto Rico Fixed Income Fund VI, Inc., Puerto Rico GNMA & U.S. Government Target Maturity Fund, Inc., Puerto Rico Investors Bond Fund I, Puerto Rico Investors Tax-Free Fund, Inc., Puerto Rico Investors Tax-Free Fund, Inc. II, Puerto Rico Investors Tax-Free Fund III, Inc., Puerto Rico Investors Tax-Free Fund IV, Inc., Puerto Rico Investors Tax-Free Fund V, Inc., Puerto Rico Investors ax-Free Fund VI, Inc., Puerto Rico Mortgage-Backed & U.S. Government Securities Fund, Inc., Tax-Free Puerto Rico Fund, Inc., Tax-Free Puerto Rico Fund II, Inc., Tax-Free Puerto Rico Target Maturity Fund, Inc. and UBS IRA Select Growth & Income Puerto Rico Fund

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

In re:
City of Detroit, Michigan,
Debtor.
_____/

Chapter 9
Case No. 13-53846
Hon. Steven W. Rhodes

City of Detroit, Michigan,

Plaintiff,

v.

Adv. Pro. No. 14-04112

Detroit General Retirement System Service Corporation, et al.,

Defendants.
_____/

Opinion and Order
(1) Denying Motion to Dismiss Filed by Defendants Detroit General Retirement System Service Corporation and Detroit Police and Fire Retirement System Service Corporation
and
(2) Granting Motions to Intervene with Limitations

Defendants Detroit General Retirement System Service Corporation and Detroit Police and Fire Retirement Systems Service Corporation (collectively, the "Service Corporations") have filed a motion to dismiss the claims against them in this adversary proceeding.[1] The City filed a response in opposition to the motion.

[1] The Court notes that there is a discrepancy between the relief sought in the original motion (dismissal of the adversary proceeding in its entirety) and the relief requested in subsequent pleadings (dismissal of the claims against the Service Corporations only). *See* Reply in Support of Service Corporations' Motion to Dismiss, § III at 8 (Dkt. #54); Service Corporations' Supplemental Brief in Support of Motion to Dismiss at 5. (Dkt. #67) The Court assumes that the relief requested is for dismissal of the claims against the Service Corporations only and this opinion addresses that request.

In addition, Financial Guaranty Insurance Company ("FGIC") and certain COPs Holders[2] (collectively, the "Intervenors") have filed motions to intervene, which the City also opposes.

For the reasons stated below, the motion to dismiss is denied and the motions to intervene are granted with limitations.

I. Introduction

By 2005, the City had fallen behind in its constitutional and statutory requirements to make contributions to its two pension systems. At the time, the City did not have sufficient resources to fully fund the pension systems, and the amounts it needed to borrow would have exceeded the debt limits imposed on the City by the Home Rule City Act ("HRCA"), M.C.L. § 117.1.

In an attempt to meet its funding obligations without violating the HRCA, the City entered into a series of complex financial transactions. First, the City created the Service Corporations and entered into contracts with them in which the City agreed to make payments to the Service Corporations (the "City Payments"), for the service of helping the City with its funding obligations to the pension funds (the "Service Contracts"). The Service Corporations then created the defendant Detroit Retirement Systems Funding Trust 2005 and the defendant Detroit Retirement Systems Funding Trust 2006 (collectively, the "Funding Trusts") to sell certificates of participation ("COPs") in the City's payment obligations to the Service Corporations. The proceeds from the sale of the COPs were remitted by the Funding Trusts to the Service Corporations, which in turn remitted the funds to the pension systems to satisfy the unfunded pension obligations of the City. Finally, the Service Corporations assigned their rights to receive the City Payments to the Funding Trusts, which used the payments to pay the COPs

[2] The COPs Holders joining in the motion to intervene are listed in the Joint Motion of Certificate Holders to Intervene. (Dkt. #12)

Holders the interest and principal they were due. For purposes of this opinion, the Court will refer to the above described transactions collectively as the "COPs Transaction."

By creating this structure, the City could characterize the payments it made as contractual obligations under the Service Contracts rather than debt service, which would have violated the debt limitations in the HRCA. According to the City, the current outstanding amount owed to COPs Holders is estimated to be approximately $1.45 billion.

In order to make the COPs marketable to investors, the City sought out monoline insurers, including FGIC, to issue policies guaranteeing the scheduled payments of principal and interest on certain of the COPs. Immediately before filing its petition for relief under chapter 9 of the bankruptcy code, the City stopped making the payments it owed under the Service Contracts, including those that came due on June 17, 2013, September 16, 2013, and December 16, 2013. FGIC has made payments to the COPs Holders under the insurance policies it issued for the amounts that are due and owing by the City.

On January 31, 2014, the City filed this adversary proceeding against the Service Corporations and the Funding Trusts seeking a declaratory judgment that the Service Contracts are void *ab initio* and related injunctive relief.

II. The Motion to Dismiss

A.

The Service Corporations bring their motion to dismiss under Fed. R. Civ. P. 12(b)(1) and 12(b)(6), which are incorporated into bankruptcy adversary proceedings by Fed. R. Bankr. P. 7012(b). In deciding a motion to dismiss, the Court must accept the plaintiff's allegations as true, and construe the complaint in the light most favorable to the plaintiff. *Davis v. Malatinsky*, No. 12-13761, 2013 WL 6008612, *2-3 (E.D. Mich. Nov. 13, 2013) (A motion under Rule

12(b)(1) "challenges the court's subject matter jurisdiction by attacking the claim on its face, in which case all factual allegations of the Plaintiff must be considered as true . . . .") (citing *DLX, Inc. v. Ky.*, 381 F.3d 511, 516 (6th Cir. 2004));[3] *Benzon v. Morgan Stanley Distribs., Inc.*, 420 F.3d 598, 605 (6th Cir. 2005) (A court considering a 12(b)(6) motion must accept all allegations as true and construe the complaint in the light most favorable to the plaintiff.). Only if the complaint's factual allegations raise a right to relief above a speculative level will it survive a motion to dismiss. *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 555 (2007); *see also Ashcroft v. Iqbal*, 556 U.S. 662, 663-64 (2009).

In the complaint, the City seeks a declaratory judgment that the Service Contracts are void *ab initio* because they are illegal under Michigan law. The City argues that the Service Contracts are not future service contracts at all but rather a means for the City to create debt that was not authorized under the HRCA and other state laws. To that end, the City argues that the Service Corporations are shell entities created for the sham purpose of entering into the Service Contracts so that the City's payments could be characterized as payments for future services by the Service Corporations rather than for debt service.

The Service Corporations argue that the claims asserted against them should be dismissed because the Court does not have subject matter jurisdiction and the City has failed to state a claim against the Service Corporations. They contend that if the City's allegations are taken as true, the Service Corporations are "shams" and "mere alter-egos" of the City. If the Service Corporations are merely "alter egos" of the City, the Service Corporations claim, then there are

[3] The Court notes that the cases addressing dismissal under Rule 12(b)(1) identify two separate grounds for dismissal: a facial attack on the pleadings or an attack on the factual basis for jurisdiction which would require the Court to weigh the evidence. *See Malatinksy*, 2013 WL 6008612, at *2. The Service Corporations assert that their motion to dismiss constitutes a facial attack on the pleadings. Service Corporations' Supplemental Brief at 1 n.1. (Dkt. #67)

no truly adverse parties here and no "case or controversy" as required for subject matter jurisdiction under Article III of the U.S. Constitution and the Declaratory Judgment Act, 28 U.S.C. § 2201(a). Further, the Service Corporations argue that because they assigned their right to receive the City Payments to the Funding Trusts, they have no interest in the dispute and so there can be no substantial controversy between the City and the Service Corporations.

The City argues that the Service Corporations are necessary parties and inherently adverse to it because they are the counterparties to the Service Contracts. The City further states that it seeks a declaratory judgment that the Service Contracts are void because they are not actually future services contracts but rather a means of obtaining debt in contravention of the HRCA, a declaration, the City contends, that does not rest upon a finding that the Service Corporations are shams.

B.

For the reasons set forth below, the Court finds that the motion to dismiss the claims against the Service Corporations must be denied.

The Article III requirement of a "case or controversy" for subject matter jurisdiction has its roots in the need to limit judicial power to "the right to determine actual controversies arising between adverse litigants." *Muskrat v. United States*, 219 U.S. 346, 361 (1911). The purpose of this limitation is to ensure that the "clash of adverse parties sharpens the presentation of issues upon which the court so largely depends for illumination of difficult . . . questions." *GTE Sylvania v. Consumers Union of the United States, Inc.*, 445 U.S. 375, 382-3 (1980) (internal quotations omitted).

This adversary proceeding most certainly involves a case or controversy as contemplated by Article III of the U.S. Constitution and the Declaratory Judgment Act, 28 U.S.C. § 2201(a).

The COPs Transaction resulted in an enormous financial obligation for the City and that obligation was a significant factor in later forcing the City into bankruptcy. As part of its restructuring efforts, the City is now attempting to invalidate the COPs Transaction in an effort to relieve itself of that burden.

On the other hand, there are many stakeholders in the COPs Transaction whose substantial pecuniary interest could be severely impaired if the City's obligations under the COPs Transaction are invalidated. Indeed, Wilmington Trust, the trustee of the Funding Trusts (the "Trustee") has filed a lengthy answer to the complaint asserting significant affirmative defenses and counterclaims.

In addition, as noted above, other parties to the COPs Transaction have moved to intervene in this litigation with proposed answers that would vigorously challenge the City's allegations.

Undoubtedly, the parties on either side of this litigation have significant and adverse interests in its outcome such that the issues will be fully presented for the Court to decide. *See GTE Sylvania*, 445 U.S. at 382-3.

Accordingly, this adversary proceeding clearly involves a case or controversy such that the Court has subject matter jurisdiction over the action. The remaining question is whether the City has stated a claim against the Service Corporations.

The fundamental question at issue in this adversary proceeding is the validity of the COPs Transaction. The COPs Transaction is structured such that the only direct contractual obligation the City has is the City Payments due under the Service Contracts. Thus, the Service Contracts are arguably the most important component of the COPs Transaction. Assuming that the allegations in the complaint are true, the Service Corporations are the only counterparties to

the Service Contracts; indeed they are the only parties with whom the City has a direct contractual relationship in the entire framework of the COPs Transaction.[4] Likewise, the Service Corporations have the only direct contractual relationship with the Funding Trusts and the Trustee. In order for the Court to resolve all of the issues relating to the validity of the COPs Transaction, the Service Corporations must be included. In other words, dismissing the Service Corporations may leave the Court unable to accord complete relief among the remaining parties because there is no direct contractual relationship between them.

At this stage in the proceedings, the record does not establish that the Service Corporations have no remaining interest in the Service Contracts. The complaint alleges that the Service Corporations assigned their right to receive the City Payments to the Funding Trusts; however, nowhere in the complaint does the City allege that the Service Corporations assigned *all* of their rights, interests and obligations to the Funding Trusts such that the Court could reasonably consider the Funding Trusts to have displaced the Service Corporations as counterparties to the Service Contracts. *See, e.g., Macomb Interceptor Drain Drainage Dist. v. Kilpatrick*, 896 F. Supp. 2d 650, 658 (E.D. Mich. 2012) (an assignment of a contract right is a contract between the assignor and the assignee); *Keyes v. Scharer*, 165 N.W.2d 498, 501 (Mich. Ct. App. 1969) (assignment of rights does not automatically include assumption of duties). For example, there are several duties of the Service Corporations under the Service Contracts to make payments to third parties, such as insurers, that were not assumed by the Funding Trusts. *See* GRS Service Contract 2005, General Terms and Conditions, §9.09 (May 25, 2005), attached as Exhibit C to the Complaint. In addition, Section 9.10 of the General Terms and Conditions

[4] The Court notes that the City did assume direct contractual obligations with other entities related to swap agreements designed to hedge against interest rate changes on the payments due to COPs Holders. However, those agreements are not at issue here.

explicitly states that the only permitted assignment under the Service Contracts is that of the right to receive the City Payments specifically. The Court simply cannot conclude, based on the pleadings, that the assignment of the right to receive the City Payments alone requires the conclusion that the Service Corporations have no continuing interest in the Service Contracts or in this adversary proceeding.

Finally, the Court rejects the Service Corporations' argument that the Court lacks subject matter jurisdiction over them, or that the City has failed to state a claim against them because they and the City are the same entity and the City "cannot sue itself." The cases cited by the Service Corporations for this proposition either deal with the same person or entity appearing on both sides of the action, *see Globe & Rutgers Fire Ins. Co. v. Hines*, 273 F. 774, 777-84 (2d Cir. 1921) (insurance company subrogated to owner of plaintiff railroad cannot sue same entity as owner of defendant railroad); *Allen v. Evans*, 64 P. 414, 415 (Ariz. 1901) (representative of one estate cannot sue himself as representative of another estate); *Tate v. Tate*, 227 S.W.2d 50, 52 (Tenn. 1950) (sister of incompetent person cannot sue herself as guardian of incompetent person's estate for support), or address concerns about conflicts of interest, *see Chadd v. Delavan Industries, Inc.*, No. 86-74241, 1987 U.S. Dist. LEXIS 15758, at *5 (E.D. Mich. May 19, 1987) (subsidiary of defendant is not permitted to intervene as plaintiff where the "intervenor would have an interest in both sides of the tort action"); *Harrison v. Ford Motor Co.*, 122 N.W.2d 680, 681-82 (Mich. 1963) (insurance company is not permitted to intervene as plaintiff when it also insured the defendant).

These concerns are not present here. While the City does allege that the Service Corporations were created for the unlawful purpose of enabling the City to avoid debt limitations imposed by state law, nowhere in the pleadings does the City allege that the Service

Corporations are not distinct and separate legal entities. Further, the Service Corporations have engaged their own independent legal counsel who have filed pleadings and appeared in court for them. For these reasons, the City and the Service Corporations cannot be considered the same entity.

Further, nothing here suggests the same kind of conflict of interest that warranted dismissal in the cases cited by the Service Corporations.

For these reasons, the motion to dismiss the claims against the Service Corporations must be denied.

III. The Motions to Intervene

A.

The Intervenors argue that they have a right to intervene in this adversary proceeding under Fed. R. Civ. P. 24(a)(2),[5] made applicable to bankruptcy adversary proceedings by Bankruptcy Rule 7024. Rule 24(a)(2) provides in pertinent part:

> On timely motion, the court must permit anyone to intervene who . . . claims an interest relating to the property or transaction that is the subject of the action, and is so situated that disposing of the action may as a practical matter impair or impede the movant's ability to protect its interest, unless existing parties adequately represent that interest.

In the Sixth Circuit, intervention under Rule 24(a)(2) is appropriate where:

> (1) the motion to intervene is timely; (2) the proposed intervenors have a significant legal interest in the subject matter of the pending litigation; (3) the disposition of the action may impair or impede the proposed intervenors' ability to protect their legal interest; and

[5] The Intervenors also claim a right to intervene under Fed. R. Civ. P. 24(a)(1) and Section 1109(b) of the Bankruptcy Code. The Court notes that there is a split in the decisions of the courts of appeals on whether 11 U.S.C. § 1109(b) applies in adversary proceedings and the Sixth Circuit has not ruled on this issue. Because the motions should be granted under Rule 24(a)(2), it is not necessary to address the arguments under Rule 24(a)(1) and Section 1109(b) at this time.

> (4) the parties to the litigation cannot adequately protect the proposed intervenors' interests.

Jansen v. City of Cincinnati, 904 F.2d 336, 340 (6th Cir. 1990). Further, courts in the Sixth Circuit construe these elements broadly in favor of intervention. *Stupak-Thrall v. Glickman*, 226 F.3d 467, 472 (6th Cir. 2000); *Purnell v. Akron*, 925 F.2d 941, 950 (6th Cir. 1991).

B.

The Court finds that the motions meet the requirements of intervention as a matter of right under Rule 24(a)(2). Accordingly, the motions are granted, subject to the limitations set forth below.

Specifically, the Court finds as follows:

(1) The motions are timely. They were filed on the same day the Funding Trusts filed their answer to the complaint and the case is clearly in its initial stages. *See Michigan State AFL-CIO v. Miller*, 103 F.3d 1240, 1245 (6th Cir. 1997).

(2) The Intervenors have a significant legal interest in the subject matter of this adversary proceeding. The certificates held by the COPs Holders have a combined value of close to $1 billion, with each certificate evidencing an individual undivided proportionate legal interest in the right to receive certain payments made by the City under the Service Contracts. FGIC, as an insurer of the COPs, has already made payments under its insurance policies to the COPs Holders and thus has become subrogated to the rights of the COPs Holders to the extent of those payments. Further, FGIC is an express third-party beneficiary under the Service Contracts and could incur further significant financial obligations to the COPs Holders if the Service Contracts are declared void.

(3) The disposition of this action may impair or impede the Intervenors' ability to protect their legal interests. As the court in *Miller* pointed out, an intervenor need only show that

impairment of its legal interest is possible if intervention is denied and that this burden is minimal. *Id.* at 1247. The Intervenors have met that burden here. If the Court were to declare that the Service Contracts are void *ab initio* and the City has no duty to make payments under them, the Intervenors may be precluded from re-litigating that issue in later proceedings to determine their own rights and obligations under the same and related transactional documents. Indeed, in response to these motions to intervene, the City argues that, under Michigan law, bondholders have no right to restitution when they hold debt that was unlawfully issued. City of Detroit's Opposition to Motions to Intervene, at 21 n.8. (Dkt. #19) So, if intervention in this adversary proceeding is denied, the Intervenors could lose rights based on findings in an action in which they were not permitted to take part. This is exactly the type of concern that warrants intervention. *See Smith v. Nitschke* (*In re Nitschke*), Bankr. No. 05-74861, Adv. No. 06-3131, 2008 WL 141510, at *2-3 (Bankr. N.D. Ohio Jan. 11, 2008) (finding insurer could intervene in adversary proceeding because of potential collateral estoppel effect in later proceedings).

(4) The parties to the litigation cannot adequately protect the Intervenors' interests. The City argues that the Trustee, who is also the Contract Administrator under the Contract Administration Agreement ("CAA"), can adequately represent the parties without their intervention. Indeed, the City argues that the Trustee is the only party entitled to defend this action based on the limitations of the so-called "no-action" clause contained in Section 6.8 of the CAA.

The Intervenors' burden of showing inadequate representation is minimal. *Grutter v. Bollinger*, 188 F.3d 394, 400 (6th Cir. 1999). "The proposed intervenors need show only that there is a *potential* for inadequate representation." *Id.* (citing *Trbovich v. United Mine Workers*,

404 U.S. 528, 538 n.10 (1972); *Linton v. Comm'r of Health & Env't*, 973 F.2d 1311, 1319 (6th Cir. 1992)).

The Court finds that the Intervenors have met that burden here. As the Intervenors point out, the Trustee's pecuniary interest in the Service Contracts is limited to its general corporate expenses. This is in sharp contrast to the $1 billion that the Intervenors have at stake. Further, the Intervenors suggest that they have defenses unique to them which the Trustee would not be capable of raising. As the Court in *Miller* found, it can be "enough to show that the existing party who purports to seek the same outcome will not make all of the prospective intervenor's arguments." 103 F.3d at 1247. Consequently, the Court finds that the Intervenors have met the minimal burden of showing that the existing parties may not adequately represent their interests.

Furthermore, the Court concludes that the "no-action" clause in the CAA does not bar the Intervenors from intervening in this action. The "no-action" clause specifically does not apply to FGIC as an insurer and third party beneficiary under the Service Contracts. CAA § 6.8 ("No *Certificateholder* shall have any right to institute any proceeding . . . .") (emphasis added).

Further, by the plain language of the "no-action" clause, it is intended to prevent certificate holders from instituting proceedings against others. Indeed, in each of the cases cited by the City, the "no-action" clause was used to justify dismissing a plaintiff-certificate holder's case against a defendant. It is clear that these types of clauses are intended to prevent individual or small groups of certificate holders from initiating piecemeal, harassing or redundant litigation. *See e.g., Cent. States Life Ins. Co. v. Koplar Co.*, 80 F.2d 754, 758 (8th Cir. 1935) ("If . . . every holder of a bond or bonds were free to sue at will for himself and for others similarly situated, the resulting harassment and litigation would be not only burdensome but intolerable."); *Feldbaum v. McCrory Corp.*, No. 11866, 1992 WL 119095, at *6 (Del. Ch. June 2, 1992)

(purpose of "no-action" clause is "to deter individual debentureholders from bringing independent law suits for unworthy or unjustifiable reasons"). Those concerns are simply not present here. Rather, parties representing a majority of the outstanding COPs seek to defend against the action brought by the City that may affect their legal and pecuniary interests.

For the reasons set forth above, the Court hereby grants the Intervenors' motions to intervene under Rule 24(a)(2), subject to the limitations set forth below.

In the interests of judicial efficiency, the intervention of these parties is granted for the limited purpose of defending against the City's claims in its complaint, and with the condition that the Intervenors shall file neither a third party complaint against any party nor a counterclaim except upon leave of the Court.

It is so ordered.

Not for publication

Signed on June 30, 2014

/s/ Steven Rhodes
Steven Rhodes
United States Bankruptcy Judge