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

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

REPLY OF THE BANK OF NEW YORK MELLON, AS TRUSTEE,
IN SUPPORT OF MOTION TO DISMISS SECOND AMENDED COMPLAINT

TO THE HONORABLE COURT:

The Bank of New York Mellon ("BNYM"), as trustee, through its undersigned counsel, hereby replies to Plaintiffs' opposition [Doc. No. 180] (the "Opposition") to BNYM's motion [Doc. No. 162] (the "Motion") to dismiss the *Second Amended Complaint* [Doc. No. 78] (the "Complaint"), and in further support of the Motion, respectfully represents as follows:[1]

PRELIMINARY STATEMENT

1. The Opposition highlights multiple infirmities in the Complaint. *First*, Plaintiffs may not cure their pleading deficiencies by alleging new facts in their brief. *Second*, Plaintiffs cite no authority for the proposition that the Constitution affords Plaintiffs remedies against BNYM, and conspicuously ignore the Constitution's text which provides only for a mandamus action against the Secretary of the Treasury. *Third*, Plaintiffs unjustifiably conflate BNYM's ministerial act of receiving the Pledged Sales Tax, pursuant to a contract with COFINA, with joint participation with the Commonwealth in a scheme to deprive Plaintiffs of federally protected rights. The lengths to which Plaintiffs must go to distort their claims, the law, and BNYM's conduct underscores why the Motion must be granted.[2]

ARGUMENT

A. Plaintiffs Cannot Cure Pleading Deficiencies In The Complaint By Alleging New Facts In The Opposition.

2. Plaintiffs do not dispute that they are beneficial owners—not registered owners—of the GO Debt, nor do they question leading cases rejecting the notion that anyone

[1] Capitalized terms used but not defined in this reply have the meanings given in the Motion.

[2] Plaintiffs expend considerable effort in cataloguing arguments that BNYM has **not** made in the Motion. See Opposition pp. 11-12. For the avoidance of doubt, BNYM's focus on threshold procedural issues in the Motion—with the goal of avoiding unnecessary discussion of Plaintiffs' substantive allegations—does not constitute a waiver of substantive arguments by BNYM or any other defendant in this action. See Fed. R. Civ. P. 12(h). BNYM reserves the right to raise any and all defenses if and when appropriate.

other than the registered owner has standing to assert claims under a bond indenture or resolution. See Opposition pp. 6-7. Instead, Plaintiffs argue that they are not seeking to enforce a contract. Id. p. 8. Alternatively, Plaintiffs claim to have cured any deficiencies because they have obtained, or will obtain, delegations of authority from the bonds' registered owners. Id. p. 9. Neither argument withstands analysis.

3. Plaintiffs' contract argument is an exercise in misdirection. Plaintiffs commenced this action because the Commonwealth temporarily suspended payment on the GO Debt. See Opposition p. 1. The gist of the action is that they have a priority right to payment on their contract with the Commonwealth. See id. p. 4. Whatever rights Plaintiffs have are founded on their contract, and their claims could not exist but for the contract. As Plaintiffs admit, where a legal claim is a "creature of contract," it "makes sense to consult the terms of the relevant bond contracts to discern whether they restrict the right to sue to registered owners of the bonds." Opposition p. 7. Because Plaintiffs' claims derive from a contractual relationship, cases limiting standing to sue on a contract bar their suit against BNYM.

4. Plaintiffs cite no authority supporting the bald assertion that contractual standing principles are not relevant. Indeed, Plaintiffs' only support for this proposition is that different defendants in different lawsuits arising from the Commonwealth's financial distress have not challenged standing. See Opposition p. 8, n. 5. The failure of other defendants to challenge beneficial owners' standing in unrelated lawsuits is irrelevant.

5. References to delegations of authority in the Burke Declaration, see Opposition Exs. A-I, simply do not appear in the Complaint. To the contrary, Plaintiffs admit that they are beneficial owners of the GO Debt. See Complaint ¶¶ 5, 23. Plaintiffs' admission, coupled with the lack of other allegations in the Complaint supporting their standing to sue, is

fatal. Their attempt to repair the pleading deficiency by alleging new facts in the Opposition is ineffective.[3]

6. In deciding a motion to dismiss, a court "may properly consider only facts and documents that are part of or incorporated into the complaint." Rivera v. Centro Médico de Turabo, Inc., 575 F.3d 10, 15 (1st Cir. 2009) (quoting Trans-Spec Truck Serv., Inc. v. Caterpillar, Inc., 524 F.3d 315, 321 (1st Cir. 2008)). There is an exception to this rule "for documents the authenticity of which are not disputed by the parties; for official public records; for documents central to plaintiffs' claim; or for documents sufficiently referred to in the complaint." Alternative Energy, Inc. v. St. Paul Fire & Marine Ins. Co., 267 F.3d 30, 33 (1st Cir. 2001) (quotation marks and citation omitted).[4] Consistent with these general principles, "it is axiomatic that the complaint may not be amended by the briefs in opposition to a motion to dismiss." Velázquez-Ortiz v. FDIC, No. 11-1757 (PG), 2012 WL 1345174, *6 (D.P.R. Apr. 18, 2012) (quoting Car Carriers v. Ford Motor Co., 745 F.2d 1101, 1007 (7th Cir. 1984)); see also O'Brien v. DiGrazia, 544 F.2d 543, 545 (1st Cir. 1976), cert. denied, 431 U.S. 914 (1977) (lower court erred in considering facts not set out in complaint while deciding motion to dismiss); McGrath v. MacDonald, 853 F.Supp. 1, 2-3 (D. Mass. 1994) (improper to consider a report cited in an opposition brief in deciding motion to dismiss). Accordingly, the Court should not consider the new factual allegations set forth in the Opposition in determining the sufficiency of the Complaint under Federal Rule 12(b)(6).

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[3] Further demonstrating the weakness of Plaintiffs' argument on standing, at least two Plaintiffs sought delegations of authority from the registered owner of the bonds *prior* to BNYM raising the contractual standing argument. See Opposition Exs. A-B. Apparently, they too believed that contractual standing was an impediment to filing suit. Other Plaintiffs hurried to obtain such delegations after the Motion was filed. See id. Exs. C-I.

[4] If the Court elects to consider any supplemental materials that fall outside this narrow exception, "the motion must be decided under the more stringent standards applicable to a Rule 56 motion for summary judgment" and "all parties must be given a reasonable opportunity to present all the material that is pertinent to the motion." Rivera, 575 F.3d at 15; see Fed. R. Civ. P. 12(d).

7. Consistent with these authorities, the Burke Declaration and accompanying exhibits (*i.e.*, letters purportedly demonstrating that Plaintiffs have or are seeking delegations of authority from registered owners) are not properly before the Court and should not be considered. The narrow exception for official public records, documents central to plaintiffs' claims, and documents referred to in the Complaint is not applicable, and BNYM cannot stipulate to the exhibits' authenticity. Consequently, the Court should disregard the declaration and exhibits filed in connection with the Opposition. See, e.g., Star Multi Care Servs., Inc. v. Empire Blue Cross Blue Shield, 6 F. Supp. 3d 275, 294 (E.D.N.Y. 2014) (court declined to consider declaration attached to opposition brief in connection with a motion to dismiss); Ping Chen v. EMSL Analytical, Inc., 966 F. Supp. 2d 282, 304 n. 15 (S.D.N.Y. 2013) (same); Fennell v. AARP, 770 F. Supp. 2d 118, 129 (D.D.C. 2011) (same).

8. Because Plaintiffs failed to allege facts in the Complaint supporting their standing to sue and that pleading deficiency cannot be cured by allegations in the Opposition, the Court should dismiss the Complaint.

B. The Constitution Does Not Afford Plaintiffs A Basis To Pursue Claims Against BNYM.

9. Plaintiffs do not dispute that BNYM is a stranger to Plaintiffs and the GO Debt. See Opposition p. 2. Despite the lack of a contractual or other relationship, Plaintiffs maintain that they may pursue claims against BNYM based upon an alleged "constitutional lien" and priority of payment. See Opposition p. 14. These arguments lack merit.

10. Nothing in the Constitution gives Plaintiffs a "constitutional lien."[5] Plaintiffs bargained for a general payment obligation from the Commonwealth, supported by a

[5] The constitutions of several states, unlike the Commonwealth's, create "constitutional liens" in certain defined circumstances. See, e.g., Tex. Const. art. XVI, § 37 ("Mechanics, artisans and material men, of every class, shall have a lien upon the buildings and articles made or repaired by them for the value of

pledge of the Commonwealth's "good faith, credit, and taxing power." See Complaint ¶¶ 60-61, 113; 2014 GO Resolution § 19. "[A]n obligation containing a pledge of the [municipality's] 'faith and credit' is secured by a promise both to pay and to use in good faith the [municipality's] general revenue powers to produce sufficient funds to pay the principal and interest of the obligation as it becomes due." See, e.g., Flushing Nat'l Bank v. Mun. Assistance Corp., 40 N.Y.2d 731, 735 (N.Y. 1976); accord World Holdings, LLC v. Fed. Republic of Germany, 794 F. Supp. 2d 1341, 1352-53 (S.D. Fla. 2011), aff'd, 701 F.3d 641 (11th Cir. 2012); see also Sylvan G. Feldstein & Terry J. Goode, *How to Analyze General Obligation Bonds*, The Handbook of Municipal Bonds 789, 791 (Sylvan G. Feldstein & Frank J. Fabozzi eds., 2008) (a pledge of full faith and credit typically "involves the levy of unlimited taxes on property, a first claim by the bondholder to monies in the issuer's general fund, and the legal duty or pledge of the governing body to pass any legislation needed to increase revenues.").

11. Contrary to Plaintiffs' bald assertion that they hold a "first lien" on all available resources of the Commonwealth, see, e.g., Complaint ¶ 68, the "effect of [a] pledge of 'full faith and credit' is **not** to create a general or special lien or charge upon the unspecified revenues, moneys or income of the obligor . . . ." Flushing Nat'l Bank, 40 N.Y.2d at 735 (emphasis added); State v. City of Lakeland, 16 So. 2d 924, 925 (Fla. 1943) (pledge of full faith and credit "does not create a specific lien on any particular property"). Rather, the Commonwealth's pledge serves only "to acknowledge an indebtedness for the amount of money

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their labor done thereon, or material furnished therefor; and the Legislature shall provide by law for the speedy and efficient enforcement of said liens."); Cal. Const. art. XIV, § 3 ("Mechanics, persons furnishing materials, artisans, and laborers of every class, shall have a lien upon the property upon which they have bestowed labor or furnished material for the value of such labor done and material furnished; and the Legislature shall provide, by law, for the speedy and efficient enforcement of such liens."); see also Ohio Const. art. II, § 33. In each instance, the constitution indicates a clear intent to create a lien by expressly using that term and describing the collateral. The Commonwealth's Constitution contains no such clear intent to create a "constitutional lien" in favor of Plaintiffs.

received as a consideration for the bonds, which indebtedness will become enforceable in an ordinary action, should the special contractual obligation as embraced in the bond itself, fail." Flushing Nat'l Bank, 40 N.Y.2d at 735.

12. Because holders of the GO Debt do not have a lien upon any specific assets or dedicated revenue stream, their only remedy for non-payment is to pursue a mandamus action against the controlling officer to compel the use of existing revenues or the levy of new taxes to pay amounts due on the bonds. See, e.g., Faitoute Iron & Steel Co. v. City of Asbury Park, 316 U.S. 502, 510 (1942) ("The **only** remedy for the enforcement of such a claim is a mandamus to compel the levying of authorized taxes.") (emphasis added); State ex rel. Buckwalter v. City of Lakeland, 150 So. 508, 512 (Fla. 1933) ("It is well settled that mandamus is the **only** remedy available to one holding a liquidated obligation of a municipal corporation to enforce the payment of his claim.") (emphasis added). Plaintiffs have not cited a single case where holders of general obligation debt were permitted to pursue any remedy for non-payment other than mandamus.

13. Plaintiffs' argument that the Constitution creates remedies beyond mandamus, "including the pursuit of the present claims against BNYM," Opposition p. 14, has no basis in the text. The Constitution provides only one remedy in the event of non-payment of the GO Debt: a mandamus action seeking to compel the Secretary of the Treasury to "apply the available revenues including surplus to the payment of interest on the public debt and the amortization thereof." P.R. Const. art. VI, § 2. The remedies under the 2014 GO Resolution similarly are limited to: (i) mandamus and (ii) any other remedies that are available under applicable law or in equity to any other holder of GO Debt. See Opposition p. 15. Plaintiffs' "most favored nation" argument, incorporating remedies of holders of other issues, see id., is

irrelevant if no other remedies are available to such holders. Other than the Constitution, which provides only a mandamus remedy, Plaintiffs fail to cite any other applicable law or equitable principle that could entitle holders of GO Debt to sue BNYM. Plaintiffs, in short, cannot get there from here.

14. The legal theories underlying the Second, Fourth, and Fifth Counts provide no basis to pursue claims against BNYM. BNYM had no role in the promulgation of the Executive Order and it has no obligations to, or common interests with, Plaintiffs. Plaintiffs overreached by pursuing claims against BNYM (and, by extension, COFINA and its Executive Director), and such claims should be dismissed.

C. Plaintiffs Failed To Allege That BNYM Deprived Them Of Federal Rights Under Color of State Law.

15. Private parties may be viewed as state actors for purposes of section 1983 "only in rare circumstances." Estades-Negroni v. CPC Hospital San Juan Capestrano, 412 F.3d 1, 4 (1st Cir. 2005). The Opposition clarifies Plaintiffs' theory that BNYM may be characterized as a state actor under the "nexus/joint action" test. See Opposition pp. 16-17. This test provides that "a private party can be held to be a state actor where an examination of the totality of the circumstances reveals that the state has 'so far insinuated itself into a position of interdependence with the [private party] that it was a joint participant in [the challenged activity]." Estades-Negroni, 412 F.3d at 5 (quoting Bass v. Parkwood Hosp., 180 F.3d 234, 242 (5th Cir. 1999)). Plaintiffs do not, and cannot, allege that a relationship between BNYM and the Commonwealth justifies a finding of state action by BNYM.

16. Preliminarily, it is important to identify BNYM's role in the challenged acts.[6] Plaintiffs claim that the Executive Order and the Moratorium Act deprive them of their contractual and property rights in violation of the U.S. Constitution. See Complaint ¶¶ 165, 179. Plaintiffs argue that BNYM jointly participated in the challenged acts by receiving the Pledged Sales Taxes. See Opposition pp. 16-17. In support of this theory, the **only** specific allegation in the Complaint is that "SUT revenues diverted to COFINA are transferred to a trust account held by BNYM as trustee for the COFINA bonds." Complaint ¶ 97 (cited at Opposition p. 16). This does not come close to a material factual allegation showing BNYM is a state actor. See Harrison v. New York, 95 F. Supp. 3d 293, 322 (E.D.N.Y. 2015) ("conclusory allegations or naked assertions of a joint activity are not sufficient to survive a motion to dismiss.").

17. Indeed, this conclusory allegation that BNYM is a state actor under the "nexus/joint action" test fails for three reasons. *First*, BNYM's receipt of the Pledged Sales Tax from COFINA is unrelated to the enactment, issuance, implementation, or operation of the Executive Order and the Moratorium Act. Actions suspending payments on the GO Debt have no effect on COFINA, BNYM, or BNYM's receipt of the Pledged Sales Tax pursuant to the COFINA Resolution and Act No. 56 (which receipt is not alleged to violate Plaintiffs' federally protected rights). *Second*, even if BNYM could be perceived as acting pursuant to the Executive Order and the Moratorium Act, "a private party is not transformed into a state actor merely because the private party acted pursuant to a state statute." Estades-Negroni, 412 F.3d at 6 (citing Spencer v. Lee, 864 F.2d 1376, 1381 (7th Cir. 1989)). To act under color of law, the private party must engage as "a willful participant in joint activity with the State or its agents"

[6] Prior to an event of default, as is the case here, an indenture trustee's role is limited to avoiding conflicts of interest with beneficiaries and performing "basic non-discretionary ministerial tasks" that are defined exclusively by the terms of the indenture or resolution. Peak Partners, LP v. Rep. Bank, 191 Fed. Appx. 118, 122 (3d Cir. 2006) (analyzing New York law and citing cases).

that deprives plaintiffs of federally protected rights. Lugar v. Edmonson Oil Co., Inc., 457 U.S. 922, 941 (1982) (quoting United States v. Price, 383 U.S. 787, 794 (1966)). BNYM's ministerial act of receiving the Pledged Sales Tax in accordance with the COFINA Resolution is not willful participation in the Commonwealth's suspension of payments on the GO Debt. *Third*, the receipt of public funds, by itself, is insufficient to satisfy the nexus/joint action test. Estades-Negroni, 412 F.3d at 6 (quoting Rockwell v. Cape Cod Hosp., 26 F.3d 254, 258 (1st Cir. 1994)).

18. Cases cited in the Opposition are not to the contrary. While the Court in Lugar held that "invoking the aid of state officials to take advantage of state-created attachment procedures" constituted state action, the Court limited its holding to contexts where "the State has created a system whereby state officials will attach property on the *ex parte* application of one party to a private dispute." 457 U.S. at 942. Lugar is irrelevant here because Plaintiffs are not challenging any Commonwealth-created attachment procedures invoked by BNYM. By contrast, the Court in Estades-Negroni confirmed that the "nexus/joint action" test is not satisfied by allegations that a private actor involuntarily committed an individual to a hospital acting pursuant to state statute and upon court authorization. Estades-Negroni, 412 F.3d at 6. Similarly, BNYM's mere receipt of the Pledged Sales Tax in accordance with the COFINA Resolution and Act No. 56 does not justify a finding that BNYM is a state actor.

19. Because Plaintiffs failed to allege facts to support the contention that BNYM deprived Plaintiffs of federal rights under color of state law, the Twelfth Count should be dismissed as to BNYM.

WHEREFORE, BNYM respectfully requests that the Court enter an order (i) granting the Motion, (ii) dismissing the Second, Fourth, Fifth, and Twelfth Counts against BNYM, and (iii) granting such other and further relief as may be just and proper.

Dated: January 9, 2017

Respectfully submitted,

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CERTIFICATE OF SERVICE

It is hereby certified that on this same date this document has been electronically filed with the Clerk of the Court using the CM/ECF system which will send notification of such filing to all attorneys of record.

Dated: January 9, 2017

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