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

FINANCIAL GUARANTY INSURANCE COMPANY, Plaintiff, v. ALEJANDRO GARCÍA PADILLA et al., Defendants.	CIVIL NO. 16-1095 (JAF)

REPLY TO OPPOSITION TO MOTION TO DISMISS

TO THE HONORABLE COURT:

COME NOW defendants,[1] specially appearing and without submitting to the jurisdiction or venue of this Court, and hereby state and pray as follows:

I. INTRODUCTION

On February 29, 2016, plaintiff filed a "Memorandum of Law in Opposition to Defendants' Motion to Dismiss" (Docket No. 47, the "Opposition"). Plaintiff contends that its complaint falls squarely within the Ex parte Young exception to Eleventh Amendment Sovereign Immunity and that the Pennhurst rule is inapplicable in this case. These contentions rest on two flawed propositions:

1. That by merely pleading a federal claim and asking for prospective injunctive relief a complaint automatically survives dismissal on Eleventh Amendment grounds.
2. That the rule of Pennhurst can only apply to pendent state law claims brought into Federal Court.

[1] Specifically, Hon. Alejandro García Padilla, Hon. Juan C. Zaragoza Gómez, Hon. Luis Cruz Batista, Hon. Víctor Suárez Meléndez, Hon. César Miranda Rodríguez, Hon. Melba Acosta Febo, solely in her official capacity as member of the Working Group for the Fiscal and Economic Restoration of Puerto Rico, and Hon. Juan Flores Galarza, in their respective official capacities (collectively "defendants").

Plaintiff's Opposition oversimplifies Supreme Court case law on the contours of the Eleventh Amendment and understates the nature and effect of the relief requested. When viewed against the facts alleged in the complaint, the applicable law and plaintiffs' own motions, glaring and internal inconsistencies in plaintiffs' arguments become evident. When seen in their true light, plaintiffs' claims are clearly the sort of relief barred by Pennhurst.

Plaintiff also argues that Article VI, Section 8 of the Constitution of Puerto Rico and several statutes enacted pursuant to it are preempted by Section 903(1) of the Bankruptcy Code. 11 U.S.C. §903(1) ("Section 903(1)"). Plaintiff's preemption argument fails because, even if the Tenth Amendment is not applicable in Puerto Rico, Section 903(1) does not apply to a sovereign's management of its own fiscal affairs. In addition, any delay in the availability of the funds pledged as collateral for payment of the relevant bonds is not a preempted method of composition requiring consent of creditors. Finally, a balance of the equities counsels in favor of a stay of proceedings, should this Court determine that plaintiff's preemption claims survive a motion to dismiss.

II. ARGUMENT

A. The fact that only federal claims are pled is not dispositive.

Plaintiff's attempt to survive dismissal rests on an oversimplified proposition: that because it requested only prospective injunctive relief against state officials for alleged violations of federal law, the Pennhurst rule does not apply, because allegedly the rule only applies to pendent state law claims included in a federal lawsuit. In other words, plaintiff believes that by solely alleging federal claims in a lawsuit, those claims must always survive dismissal as long as only prospective injunctive relief is sought from a state official. The Supreme Court has never interpreted the Ex parte Young exception to sovereign immunity so mechanically.

The fact that a lawsuit is brought against state officials and not against a State or sovereign does not automatically insulate such a suit from the application of the Eleventh Amendment or sovereign immunity. "When the suit is brought only against state officials, a question arises as to whether that suit is a suit against the State itself." Pennhurst State Sch. & Hosp. v. Halderman, 465 U.S. 89, 101 (1984). As recognized by the Supreme Court, "[t]he Eleventh Amendment bars a suit against state officials when 'the state is the real, substantial party in interest.'" Id. (quoting Ford Motor Co. v. Department of Treasury, 323 U.S. 459, 464 (1945)). The High Court in Pennhurst stated these general principles while recognizing the Ex parte Young **exception** to this general rule. Id. at 102; see also Ex parte Young, 209 U.S. 123, 160 (1908). Moreover, the Court in Pennhurst also acknowledged that "[w]hile the rule permitting suits alleging conduct contrary to 'the supreme authority of the United States' has survived, the theory of *Young* has not been provided an expansive interpretation." Id.

Against this backdrop, the Pennhurst Court turned "to the question whether the claim that petitioners violated state law in carrying out their official duties at Pennhurst is one against the State and therefore barred by the Eleventh Amendment." Contrary to plaintiff's arguments in its Opposition, this pivotal question was not answered solely in the context of a pendent state law claim. To respond to this inquiry, the Supreme Court looked at two distinct issues. **First**, whether "under the doctrine of [Edelman v. Jordan, 415 U.S. 651 (1974)], the suit is not against the State because the courts below ordered only prospective injunctive relief". Id. at 103-104. **Second**, whether "the state-law claim properly was decided under the doctrine of pendent jurisdiction." Id. at 104.

Although the Pennhurst Court recognized that "the *Young* doctrine rests on the need to promote the vindication of federal rights" (id. at 105), the Court also noted "that the need to

promote the supremacy of federal law must be accommodated to the constitutional immunity of the States." Id. In this connection, the Court concluded that "[t]his need to reconcile competing interests is wholly absent, however, when a plaintiff alleges that a state official has violated *state* law." Id. at 106 (italics in original). The Court further concluded that a "federal court's grant of relief against state officials on the basis of state law, **whether prospective or retroactive**, does not vindicate the supreme authority of federal law." Id. (emphasis added).

It was only after answering this first question that the Court in Pennhurst turned to the second question involving the jurisdictional bases of the relevant claims. In rejecting the possibility that a pendent state law claim may automatically survive an Eleventh Amendment challenge if other federal claims are alleged, the Court noted that the Eleventh Amendment "is a specific constitutional bar against hearing even *federal* claims that otherwise would be within the jurisdiction of the federal courts." The Supreme Court concluded as follows:

> In sum, contrary to the view implicit in decisions such as *Greene*, *supra*, neither pendent jurisdiction **nor any other basis of jurisdiction may override the Eleventh Amendment**. A federal court **must examine each claim in a case to see if the court's jurisdiction over that claim is barred by the Eleventh Amendment**. We concluded above that a claim that state officials violated state law in carrying out their official responsibilities is a claim against the State that is protected by the Eleventh Amendment. See *supra*, at 908. We **now hold** that this principle applies **as well** to state-law claims brought into federal court under pendent jurisdiction.

Id. at 121 (emphasis added).

As can be clearly seen from the previous discussion, the holding in Pennhurst is twofold. First, the Court in Pennhurst held that a claim that state officials violated state law in carrying out their official responsibilities is a claim against the State that is protected by the Eleventh Amendment. Second, the Supreme Court held that this principle holds true regardless of the stated basis for jurisdiction, and that a federal court must examine each claim individually to see if it is

barred by the Eleventh Amendment. See also Henry v. Metro. Sewer Dist., 922 F.2d 332, 338 (6th Cir. 1990) ("...state and federal claims barred by the eleventh amendment are identical for purposes of the limitation upon federal jurisdiction imposed by the eleventh amendment"). The principle that each claim must be evaluated individually to determine whether it is barred by the Eleventh Amendment has been reaffirmed by the Supreme Court before and after Pennhurst.[2]

Plaintiff cites to the case of Verizon Maryland, Inc. v. Pub. Serv. Commn. of Maryland, 535 U.S. 635 (2002) for the proposition that, "[i]n determining whether the doctrine of *Ex parte Young* avoids an Eleventh Amendment bar to suit, a court need only conduct a 'straightforward inquiry into whether [the] complaint alleges an ongoing violation of federal law and seeks relief properly characterized as prospective.'" Id. at 645 (quoting Coeur d'Alene, 521 U.S. at 296). See Docket No. 47 at 16. As plaintiff would have it, as long as a complaint alleges a federal claim and alleges that the relief sought is prospective, it should not be barred by the Eleventh Amendment, regardless of the actual relief or remedy sought or its effect. Such an isolated reading of Verizon is misleading, as it is not only at odds with the case law cited above; it is also contradicted by the same opinion on which plaintiff relies.

Plaintiff fails to take into account that before quoting Coeur d'Alene, supra, the Verizon Court also stated as follows:

> As we have said, "the district court has jurisdiction if 'the right of the petitioners to recover under their complaint will be sustained if the Constitution and laws of the United States are given one construction and will be defeated if they are given another,' **unless the claim 'clearly appears to be immaterial and made solely for the purpose of obtaining jurisdiction or where such a claim is wholly insubstantial and frivolous**.'"

[2] See Ford Motor Co. v. Department of Treasury of Ind., 323 U.S. 459, 464 (1945) ("[T]he nature of a suit as one against the state is to be determined by the essential nature and effect of the proceeding."); Idaho v. Coeur d'Alene Tribe of Idaho, 521 U.S. 261, 270 (1997) ("The real interests served by the Eleventh Amendment are not to be sacrificed to elementary mechanics of captions and pleading.").

Id. at 643 (quoting Steel Co. v. Citizens for Better Environment, 523 U.S. 83, 89 (1998)).

In other words, before reaching the question of whether Ex parte Young applied in the case, the Court in Verizon actually looked at the type of claims made to determine whether they were "immaterial and made solely for the purpose of obtaining jurisdiction" or whether they were "insubstantial and frivolous." Id. This result is consistent with the holding in Pennhurst that federal courts "must examine each claim in a case to see if the court's jurisdiction over that claim is barred by the Eleventh Amendment." Pennhurst, 465 U.S. at 121. If it were otherwise, any plaintiff could avoid the effect of the Eleventh Amendment by simply dressing any state claim barred by Pennhurst as a federal claim, regardless of how baseless or frivolous it may be. The state defendants would be forced to defend the merits of every one of those claims in federal court. In the midst of the current fiscal crisis affecting Puerto Rico, this would mean that every individual bondholder of the Commonwealth or its instrumentalities could try to bring a purely contractual claim into federal court and, regardless of standing or its merits, the Commonwealth defendants would be barred from raising sovereign immunity against such claims as long as they are couched as federal claims. Such a result would be at odds with the very essence of sovereign immunity and against the doctrine that federal courts are courts of limited jurisdiction.

In Verizon, prior to making the Ex parte Young analysis, the Supreme Court expressly determined that the claims in that case were not immaterial or wholly insubstantial and frivolous. Verizon, 535 U.S. at 643. That does not necessarily have to be the case. Hill v. Kansas Gas Serv. Co., 323 F.3d 858, 867-68 (10th Cir. 2003) ("Significantly, the Court in *Verizon* specifically stated that Verizon's claim was within § 1331's grant of jurisdiction because 'there is no suggestion that Verizon's claim is 'immaterial' or 'wholly insubstantial and frivolous.'' *Id.* We cannot say the same about Plaintiffs' claims in the present action.").

This Court must look at each of plaintiff's claims and determine whether it is immaterial and made solely for the purpose of obtaining jurisdiction. If plaintiff's claims in effect amount to an order seeking compliance by state officials with state law, it must dismiss the action on Eleventh Amendment grounds regardless of whether the relief sought is retroactive or prospective. Pennhurst, 465 U.S. at 106. As defendants' motion to dismiss and this reply show, that is clearly the case here.

B. Plaintiff is requesting an order to act in conformity with state law.

It is undisputed that, as a matter of law, the funds serving as collateral for the payment of the bonds (the "Authority Bonds") insured by plaintiff (referred to in prior motions as the "Pledged Funds") are subject to the availability of resources in the Commonwealth's coffers pursuant to Article VI, Section 8 of the Constitution of Puerto Rico ("Section 8"). See Docket No. 1 at ¶¶6 and 51-52. Plaintiff challenges the implementation of said constitutional provision through Executive Orders 2015-46 and 2015-49 (the "Executive Orders"). Plaintiff's attempt to circumvent this reality in their Opposition relies on circular logic and is belied by plaintiffs' own arguments in opposition to defendant Melba Acosta-Febo's motion to dismiss the claims against her as President of the Government Development Bank of Puerto Rico ("GDB"). See Docket No. 46.

Plaintiffs argue that their request for injunctive relief is outside the scope of Pennhurst because they are not asking this Court to order defendants to act in accordance with state law, but only to strike down the Executive Orders. If this were so, plaintiffs' request for injunctive relief would be unnecessary, as would be the inclusion of any defendant other than the Governor of Puerto Rico, who actually signed the Executive Orders.

Plaintiffs' opposition at Docket No. 46 tells a different story. In opposing Ms. Acosta-Febo's motion to dismiss, plaintiff reiterates time and again that the inclusion of Ms. Acosta-Febo

in the complaint and the issuance of injunctive relief against her is necessary in order to bar the **implementation** of the Executive Orders. See Docket No. 46 at 5, 6, 8 and 9. The Executive Orders apply or implement the Constitution of Puerto Rico (Section 8) and the statutory scheme regarding the order of payment of Commonwealth expenditures authorized and mandated by that constitutional provision. Plaintiff's claim boils down to its dissatisfaction with the way Section 8 is being implemented[3] and its disagreement with the order of payments provided for the in the Executive Orders or documents issued pursuant to them. These are purely matters of state law, and any request for declaratory judgment and injunctive relief asking the defendants to implement Section 8 one way or another is a request for an order asking state officials to comply with state law, a relief barred by Pennhurst.

Plaintiff cites this Honorable Court's decision in, Ctr. for Disease Detention, LLC v. Rullan, 288 F. Supp. 2d 136 (D.P.R. 2003), and other cases, to argue that it has legitimate federal claims and that the fact that state law has to be interpreted in deciding these federal claims does not bring Pennhurst into play. These cases are distinguishable given that in this case (1) the availability of the Pledged Funds is expressly conditioned on the application of Section 8; and that (2) this Court can assume that plaintiff has a property interest in the Pledged Funds, for purposes of this motion.

Ctr. for Disease Detention involved a request for declaratory judgment—not an injunction—and allegations that a requirement that an out-of-state laboratory be licensed by the Department of Health of Puerto Rico violated the Dormant Commerce Clause. In that case this

[3] Plaintiff in this case, as opposed to plaintiffs in the related action styled Assured Guaranty Corp. v. García Padilla, Civil No. 16-1037, is claiming that Section 8 and other Commonwealth laws are unconstitutional. While this Court has jurisdiction to hear plaintiff's preemption claims, to the extent Section 8 and other Commonwealth laws are not preempted and hence constitutional, this Court lacks jurisdiction to pass judgment on the way they are implemented, as their implementation is purely a matter of compliance with Puerto Rico law.

Court found Pennhurst inapplicable concluding that "[w]hile the resolution of these constitutional issues necessarily requires this Court to ascertain what state law means, this is a far cry from a prohibited *Pennhurst* type action which seeks injunctive relief on the basis of state law." Id. at 142 (citation omitted).

Ctr. for Disease Detention is clearly distinguishable. In that case this Court found that the contract between the out-of-state laboratory and the Department of Health, as per the Department's own "request for proposal" ("RFP"), was not conditioned on having a license issued by the Department. Id. at 138. It also found that the local licensing requirement established in the relevant statute was simply inapplicable to the plaintiff. Id. at 148.

In contrast, in this case the provisions of Section 8 are clearly applicable to the Pledged Funds, because the availability of said funds is expressly conditioned on the application of that constitutional provision. Plaintiff's challenge to the validity of this constitutional provision and the enabling act of the Office of Management and Budget (the "OMB Act") is a separate cause of action. To the extent these provisions are constitutional and not preempted, plaintiff's claims boil down to a dissatisfaction with the **implementation** of those laws through the Executive Orders. As opposed to the relief requested in Ctr. for Disease Detention, the relief requested here does involve injunctive relief based on a particular interpretation of state laws that, as will be shown in detail below, are constitutional.

Other cases relied on by plaintiff in an attempt to survive dismissal are also distinguishable. For example, in Piecknick v. Com. of Pa., 36 F.3d 1250 (3d Cir. 1994), the Court did not apply Pennhurst because questions regarding the applicability of state law revolved around the existence of a property interest. See Piecknick, 36 F.3d at 1255 n. 7. The rationale in this and similar cases is that an analysis of state law may always be necessary to determine the existence of a property

interest.[4] However, in this case this Court may assume for purposes of this motion that a property interest exists. This case revolves around the order in which the Commonwealth disburses its funds upon a shortfall during a given fiscal year. A number of the recipients of said funds, including plaintiff, may have a property interest in the funds to be received. As a matter of pure logic and arithmetic, if there are not enough resources to satisfy the Commonwealth's obligations, some fund recipients will receive disbursements before others. Assuming for purposes of this motion that plaintiff has a property interest in the Pledged Funds, plaintiff's remedy boils down to a breach of contract claim in light of any alleged delay or default in payment by the relevant Authorities. See Lujan v. G & G Fire Sprinklers, Inc., 532 U.S. 189, 196-197 (2001) ("Though we assume for purposes of decision here that [plaintiff] has a property interest in its claim for payment... it is an interest... that can be fully protected by an ordinary breach-of-contract suit").

Everett v. Schramm, 772 F.2d 1114 (3d Cir. 1985), is equally distinguishable.[5] In Everett the Court reasoned that the ascertainment of state law is an everyday function of federal courts, and concluded that although the claims raised in that case required the District Court "to ascertain what the standard of need was under Delaware law, ascertaining state law is a far cry from compelling state officials to comply with it." Everett, 772 F.2d at 1119. In this case, plaintiff has taken issue with the implementation of Section 8 and other valid and constitutional laws through the Executive Orders. Plaintiff is indeed claiming that state officials must comply with a particular order of payment priorities allegedly established by state law. See Docket No 1 at ¶¶ 52, 59, 97-98. In sum, to the extent the relevant Commonwealth laws are not preempted, see infra, plaintiff's remaining claims regarding the Executive Orders do not involve the constitutionality of a state law

[4] See Board of Regents v. Roth, 408 U.S. 564, 577 (1972) (property interests are created and defined not by the United States Constitution but by independent sources, such as state law) (relied on by the Court in Piecknick).
[5] Plaintiffs cite to other cases at Docket No. 47, p. 17. Most of these cases simply follow Everett, supra.

(Ctr. for Disease Detention), the existence of a property interest (Piecknick); or the ascertainment of state law in determining whether a federal statute has been violated (Everett). This action is a collection case wrapped in federal garb. At the end of the day, plaintiff is asking nothing more and nothing less than for an order providing that plaintiff should be paid before others in the event of a shortfall during a fiscal year. Such relief is barred by the Eleventh Amendment.

C. The Commonwealth Laws are not preempted by Section 903(1).

Plaintiff argues that Article VI, Section 8 of the Constitution of Puerto Rico and the provisions of the OMB Act establishing an order of priorities in the payment of Commonwealth expenditures "when the available funds for a specific fiscal year are not sufficient to cover the appropriations approved for that year," 23 P.R. Laws Ann. §104(c) (collectively, the "Commonwealth Laws"), are unconstitutional because they are preempted by Section 903(1) of the Bankruptcy Code.

In their Motion to Dismiss, defendants explained that the question of whether Section 903(1) preempts Puerto Rico law is currently before the Supreme Court of the United States in the consolidated cases of Puerto Rico v. Franklin California Tax-Free Trust (No. 15-233) and Acosta-Febo v. Franklin California Tax-Free Trust (No. 12-255). In other words, the decision of the High Court in those cases could potentially moot plaintiff's first and second causes of action in this case. In order not to overburden this Court with arguments that have already been briefed before the Supreme Court, the defendants in this case (some of whom are also defendants in case No. 15-233) incorporated by reference the arguments made in the briefing in Case No. 15-233 into their Motion to Dismiss. See Docket No. 37 at 24 and n. 10.

In their dispositive motion, defendants respectfully submitted that, regardless of the preemptive effect of Section 903(1) on Puerto Rico laws, the relevant Commonwealth Laws being

challenged in this action simply do not fall within the preemptive scope of Section 903(1), among other reasons, because the relevant constitutional and statutory provisions do not prescribe a method of composition of a municipality. 11 U.S.C. §903(1). In the alternative, in order to avoid inconsistent decisions and the unnecessary expenditure of party and judicial resources, defendants submitted that if the Court harbors any doubts about the applicability of Section 903(1) to the Commonwealth Laws, it should stay the resolution of these causes of action until the Supreme Court determines whether Section 903(1) even applies to Puerto Rico.

Contrary to plaintiff's insinuations, the relief requested by defendants in their Motion to Dismiss does not impliedly concede plaintiff's field and conflict preemption arguments. To the contrary, defendants' dispositive motion is clear to the effect that defendants' arguments against preemption (express, field and conflict) have already been argued before the Highest Court in the Land, incorporates them by reference,[6] and respectfully asks this Court to abstain from issuing a ruling that could potentially be at odds with the Supreme Court's final determination of an issue that has already been briefed in a case where final disposition is forthcoming.

Without repeating all of the arguments already before the consideration of the Supreme Court in Case No. 15-233, incorporated herein by reference, several things must be noted. First, although the Bankruptcy Clause of the federal Constitution gives Congress "the power … [t]o establish … uniform Laws on the subject of Bankruptcies throughout the United States," U.S. Const. art. I, § 8, cl. 4,, the Supreme Court has recognized from the earliest days of the Republic that this grant of power does not, by negative implication, prevent States and Territories from enacting their own laws governing the restructuring of debts. See, e.g., Ogden v. Saunders, 25 U.S.

[6] See Docket No. 37 at 24 and n. 10 (referring the Court and the parties to: http://www.americanbar.org/content/dam/aba/publications/supreme_court_preview/briefs_2015_2016/15-233_pet2.authcheckdam.pdf).

(12 Wheat.) 213, 368 (1827); Sturges v. Crowninshield, 17 U.S. (4 Wheat.) 122, 193-97 (1819); see generally Stephen J. Lubben, Puerto Rico & The Bankruptcy Clause, 88 Am. Bankr. L.J. 553, 563-68 (2014). In other words, the Bankruptcy Clause, by itself, does not preempt state law.

Second, the Supreme Court has long held that state and territorial bankruptcy laws are "suspended only to the extent of actual conflict with the system provided by the Bankruptcy Act of Congress." Stellwagen v. Clum, 245 U.S. 605, 613 (1918). In other words, there is no field preemption in this area. See, e.g., Sturges, 17 U.S. (4 Wheat.) at 196 (under the Bankruptcy Clause, "the states are not forbidden to pass a bankrupt law"); Chicago Title & Trust Co. v. Forty-One Thirty-Six Wilcox Bldg. Corp, 302 U.S. 120, 125 (1937) ("While state laws in conflict with the laws of Congress on the subject of bankruptcies are suspended, they are suspended 'only to the extent of actual conflict with the system provided by the Bankruptcy Act of Congress.'") (quoting Stellwagen, 245 U.S. at 613)). To the contrary, it has long been recognized that states may enact their own restructuring regimes governing entities, such as banks and insurance companies, that are expressly excluded from the scope of the federal Bankruptcy Code. See, e.g., 11 U.S.C. §109(b) (excluding banks and insurance companies from Chapter 7); Neblett v. Carpenter, 305 U.S. 297, 303-05 (1938) (upholding state statute governing rehabilitation of an insurance company); Doty v. Love, 295 U.S. 64, 70-74 (1935) (upholding state statute governing reorganization of a bank).

Third, no provision in the Bankruptcy Code expressly preempts all state laws. See Matter of Borne Chem. Co., Inc., 54 B.R. 126, 130 (Bankr. D.N.J. 1984) ("A review of the Bankruptcy Code fails to disclose any provision wherein Congress explicitly states that the Code supersedes all state law."); see also Midlantic Nat. Bank v. New Jersey Dep't of Envtl. Prot., 474 U.S. 494, 501 (1986) ("If Congress wishes to grant the trustee an extraordinary exemption from nonbankruptcy law, 'the intention would be clearly expressed, not left to be collected or inferred

from disputable considerations of convenience in administering the estate of the bankrupt.'") (citation omitted).

Section 903(1) in particular was carefully and narrowly tailored so that its preemptive effect (assuming it applies in Puerto Rico in the first place) would be strictly limited to state laws "prescribing a method of composition of indebtedness of [a] municipality." 11 U.S.C. §903(1). Not only does Section 903(1) **not preempt** the general power of the States to manage their own fiscal affairs (and those of their municipalities), but its enacting clause—Section 903—expressly left that power in the hands of the states in order to permit Chapter 9 to pass constitutional muster. 11 U.S.C. §903 (reservation of power to the states); U.S. v. Bekins, 304 U.S. 27, 51 (1938) (relying on Section 903 to uphold the precursor to Chapter 9).

Hence, in this case there is not only no express preemption, but also no implied preemption (field or conflict). The subject Commonwealth Laws do nothing more than address the order of priority of **Commonwealth** expenditures in the event of a shortfall in a given fiscal year. They are absolutely necessary and intrinsically tied to the management of the Commonwealth's fiscal affairs. They are clearly not preempted by Section 903(1), regardless of the applicability of said statutory provision in Puerto Rico.

Conscious of this predicament, plaintiff argues that, because allegedly the Tenth Amendment does not apply to Puerto Rico in light of Puerto Rico's territorial status, Congress is free to regulate any aspect of the Commonwealth's management of its fiscal affairs. Even assuming that this is true for purposes of this motion (which is denied), that is simply not what Congress actually did when it enacted Section 903 and its precursors, which predate the Commonwealth of Puerto Rico itself. Plaintiff cannot seriously contend that a sentence added to the Bankruptcy Code in 1984 excluding Puerto Rican **municipalities** from the reach of Chapter 9 of the Code, 11 U.S.C.

§101(52), somehow has the effect of creating federal oversight over every aspect of the Commonwealth's management of its **own** fiscal affairs (vis-a-vis those of its municipalities) to such an extent that it preempts all Commonwealth laws in this regard. Plaintiff's theory assumes too much.

In order to clearly see the fallacy of plaintiff's argument, three well-settled principles must be considered. First, "[i]t has long been settled … that we presume federal statutes do not … preempt state law." Bond v. United States, 134 S. Ct. 2077, 2088 (2014) (citing Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947)).[7] See also Philip Morris Inc. v. Harshbarger, 122 F.3d 58, 68 (1st Cir. 1997) ("...there exists an assumption that federal law does not supersede a state's historic police powers 'unless that [is] the clear and manifest purpose of Congress.'") (citations omitted). Second, whether a federal law preempts a state law "is a question of congressional intent." Hawaiian Airlines, Inc. v. Norris, 512 U.S. 246, 252 (1994). Finally, "when deciding which of two plausible statutory constructions to adopt, a court must consider the necessary consequences of its choice. If one of them would raise a multitude of constitutional problems, the other should prevail—**whether or not those constitutional problems pertain to the particular litigant before the Court**." Clark v. Martínez, 543 U.S. 371, 380-81 (2005) (emphasis added).

Against this backdrop, plaintiff's historical account of the origin and scope of Section 903 must be put in proper context. When the first precursor to Chapter 9 was struck down by the Supreme Court in 1936, the Court was emphatic in the need to preserve the integrity of a federal system of government which largely depends on the sovereignty of each individual state or unit that comprises it:

> If obligations of states or their political subdivisions may be subjected to the interference here attempted, they are no longer free to manage their own affairs; the

[7] The test for federal preemption of the law of Puerto Rico is the same as the test under the Supremacy Clause. Puerto Rico Dept. of Consumer Affairs v. Isla Petroleum Corp., 485 U.S. 495, 499 (1988)

> will of Congress prevails over them; although inhibited, the right to tax might be less sinister. And really the sovereignty of the state, so often declared necessary to the federal system, does not exist.

Ashton v. Cameron County Water Imp. Dist. No. 1, 298 U.S. 513, 531 (1936). The Court eventually upheld Chapter 9 two years later, once the statute had been "carefully drawn so as not to impinge upon the sovereignty of the State." U.S. v. Bekins, 304 U.S. 27, 51 (1938); see also id, ("The State retains control of its fiscal affairs. The bankruptcy power is exercised in relation to a matter normally within its province and only in a case where the action of the taxing agency in carrying out a plan of composition approved by the bankruptcy court is authorized by state law."). Case law decided after Bekins recognized that Chapter 9 had ultimately passed constitutional muster because the precursor to Section 903[8] ensured that States were "free to manage their own affairs." Faitoute Iron & Steel Co. v. City of Asbury Park, 316 U.S. 502, 508 (1942). Section 903(1) could not undo that reservation of power to the States without severely undermining Chapter 9's constitutional status. See Alan N. Resnick & Henry J. Sommer eds., 6 Collier on Bankruptcy § 903.01 (16th ed. 2014) ("Section 903 is the constitutional mooring for Bankruptcy Code chapter 9 as it embodies a statutory declaration that the enactment of municipal bankruptcy law ... does not limit or impair the rights reserved to the States pursuant to the Tenth Amendment.").

Section 903(1) and its precursor, which does not interfere with the prerogative of the States, **as sovereigns**, to manage their own fiscal affairs, originally applied equally to States and Territories, even before Puerto Rico became a Commonwealth. See Franklin, 805 F.3d at 335. For decades, regardless of the applicability of the Tenth Amendment, federal courts have recognized

[8] "The Code, at § 903(1), 'is derived, with stylistic changes, from' its precursor, Section 83(i). S.Rep. No. 95–989 at 110." Franklin California Tax-Free Trust v. Puerto Rico, 805 F.3d 322, 334 (1st Cir. 2015) cert. granted, 136 S. Ct. 582 (2015).

the sovereignty of Puerto Rico and the exercise of its police power in the management of its own affairs. See, for example, Armstrong v. Goyco, 29 F.2d 900, 902 (1st Cir. 1928) ("In the matter of local regulations and the exercise of police power Porto Rico possesses all the sovereign powers of a state, and any exercise of this power which is reasonable and is exercised for the health, safety, morals, or welfare of the public is not in contravention of the Organic Act nor of any provision of the Federal Constitution."); United States v. Laboy–Torres, 553 F.3d 715, 722–23 (3d Cir. 2009) (O'Connor, J., sitting by designation) ("[C]ongress has accorded the Commonwealth of Puerto Rico 'the degree of autonomy and independence normally associated with States of the Union.'") (citations omitted); Examining Bd. of Engineers, Architects and Surveyors v. Flores de Otero, 426 U.S. 572, 594 (1976) ("...the purpose of Congress in the 1950 and 1952 legislation was to accord to Puerto Rico the degree of autonomy and independence normally associated with States of the Union, and accordingly, Puerto Rico 'now 'elects its Governor and legislature; appoints its judges, all cabinet officials, and lesser officials in the executive branch; sets its own educational policies; **determines its own budget**; and amends its own civil and criminal code.'") (citations omitted) (emphasis added).

The clear intent of Congress when enacting Chapter 9, Section 903, and their precursors was to allow a federal mechanism for the restructuring of municipal debts without interfering with sovereign interests. These sovereign interests are equally present in the States as well as in Puerto Rico, regardless of Puerto Rico's territorial status or the applicability of the Tenth Amendment. "[T]he government of Puerto Rico is no longer a federal government agency exercising delegated power." U.S. v. Quinones, 758 F.2d 40, 42 (1st Cir. 1985). Whether Congress can change this status quo through legislation is beyond the scope of this brief. The crux of the matter here is that even if Congress could unilaterally legislate every single aspect of Puerto Rico's management of

its fiscal affairs (which is denied), it did not do so through the 1984 amendment to the Bankruptcy Code.

The 1984 amendment to the Bankruptcy Code involving Puerto Rico, 11 U.S.C. §101(52), expressly states as follows: "The term 'State' includes the District of Columbia and Puerto Rico, except for the purpose of defining who may be a debtor under chapter 9 of this title." The definition of a debtor under Chapter 9 of the Code is found at 11 U.S.C. §109(c)(1)-(2).[9] The First Circuit Court of Appeals in Franklin held that the consequence of this amendment was to bar Puerto Rico municipalities from being afforded the protections of Chapter 9, while nonetheless subjecting them to Chapter 9's burdens. Franklin, 805 F.3d at 341. Regardless of whether the First Circuit's holding in Franklin ultimately stands, the fact that Chapter 9 is not available to Puerto Rican municipalities does not support the untenable conclusion advanced by plaintiff that through Section 101(52) Congress somehow intended to preempt any and all laws dealing with the Commonwealth's handling of its own fiscal affairs, vis-a-vis those of its municipalities.

If Congress had wanted to manage Puerto Rico's fiscal affairs through Section 101(52), which would be at odds with the scope and intent of Section 903[10] and its precursors, as well as with decades of precedent regarding Puerto Rico's sovereignty, it would have stated such intent clearly and affirmatively. See Cordova & Simonpietri Ins. Agency Inc. v. Chase Manhattan Bank N.A., 649 F.2d 36, 42 (1st Cir. 1981) ("We believe that there would have to be specific evidence or clear policy reasons embedded in a particular statute to demonstrate a statutory intent to

[9] "An entity may be a debtor under chapter 9 of this title if and only if such entity--(1) is a municipality; (2) is specifically authorized, in its capacity as a municipality or by name, to be a debtor under such chapter by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor under such chapter."

[10] See Franklin, 805 F.3d at 342 ("The effect [of Section 903] is to preserve the power of political authorities to set their own domestic spending priorities, without restraint from the bankruptcy court.").

intervene more extensively into the local affairs of post-Constitutional Puerto Rico than into the local affairs of a state.").

In sum, Section 903(1) does not preempt the Commonwealth's management of its own fiscal affairs. Since the Commonwealth Laws do not address the restructuring of municipal debts but only the order of payment of Commonwealth expenditures in the event of a shortfall during a fiscal year, they are not preempted by Section 903(1), even if the same applies to Puerto Rico and the holding in Franklin is confirmed by the Supreme Court.

D. The Commonwealth Laws do not effectuate a modification or adjustment of the Authorities' debts, nor a deferral of any payment obligations. They are not a "method of composition" under any definition.

This Court in Franklin defined a "composition" as an "agreement between a debtor and two or more creditors for the adjustment or discharge of an obligation for some lesser amount." Franklin California Tax-Free Trust v. Puerto Rico, 85 F. Supp. 3d 577, 597 (D.P.R.) aff'd, 805 F.3d 322 (1st Cir. 2015) cert. granted, 136 S. Ct. 582 (2015). Plaintiff does not seriously contend that the Commonwealth Laws adjust or discharge the Authorities' debts, which are, to date, collectable directly from the Authorities. In order to go around this fact and try to breathe air into a failed preemption argument, plaintiff tries to distinguish the ruling in the case of Ropico, Inc. v. City of New York, 425 F. Supp. 970 (S.D.N.Y. 1976), and argues that Chapter 11 bankruptcies should be distinguished from Chapter 13 bankruptcies, and that an extension of time in the payment of a debt may be considered a "simple composition" under Chapter 9 Bankruptcy Law. Its argument appears to be that by having an effect on the order of payment of Commonwealth disbursements, including the Pledged Funds, the Commonwealth Laws operate as an extension of time for the payment of the Authority Bonds, which in plaintiff's opinion is a preempted "method of composition" of indebtedness.

The fatal flaw with this argument lies in its reliance on "simple composition" as a term of art allegedly used interchangeably in the context of bankruptcies under former Chapters X and XI,[11] which plaintiff urges are more analogous to a Chapter 9 bankruptcy than a proceeding under Chapter 13. However, the reference to "simple composition" in the cases cited by plaintiff was made precisely to distinguish former Chapter X and Chapter XI bankruptcies.

In In re Contl. Inv. Corp., 586 F.2d 241 (1st Cir. 1978), relied on by plaintiff, the First Circuit explained that Chapter XI "was created 'to provide a quick and economical means of facilitating simple compositions among general creditors who have been deemed by Congress to need only the minimal disinterested protection provided by that Chapter.'" Id. at 245 (quoting SEC v. American Trailer Rentals Co., 379 U.S. 594, 606-607 (1965)). The Court went on to explain that "[t]he purpose of Chapter X, on the other hand, is 'to afford greater protection to creditors and stockholders by providing greater judicial control over the entire proceedings and impartial and expert administrative assistance . . . through appointment of a disinterested trustee and the active participation of the SEC..". Id. (quoting American Trailer, 379 U.S. at 604). The First Circuit explained that the Supreme Court's reference to an extension of time as a "simple composition" was only an "example," id., and went on to conclude that, as a "narrow exception," cases involving public investors could sometimes be adjusted in Chapter XI through a simple composition. Id. at 245-46. In other words, the general rule was that cases involving public investors were not "simple compositions" and were usually seen under Chapter X. Id.

The case of American Trailer, which lies at the foundation of plaintiff's argument, actually stands for the contrary proposition for which it is being cited. The Court in American Trailer

[11] The current "Chapter 11 is descended from both of the reorganization chapters, Chapters X and XI, under the old Act, but more from the latter than the former." In re Arnold, 471 B.R. 578, 593 (Bankr. C.D. Cal. 2012) (quoting Elizabeth Warren & Jay Westbrook, The Law of Debtors and Creditors 669 (6th ed. 2009)).

reaffirmed "that there is no absolute rule that Chapter X must be utilized in every case in which the corporate debtor is publicly owned." American Trailer, 379 U.S. at 610-611. It was in this context that it saw the possibility of a Chapter XI-type "simple composition" as a method of adjustment of a publicly owned debtor. However, it emphasized that "as a general rule Chapter X is the appropriate proceeding for adjustment of publicly held debt," id. at 613, and ruled that Chapter X was "the appropriate proceeding for the attempted rehabilitation of respondent in this case" because "public debts are being adjusted[,] [t]he investors are many and widespread, not few in number intimately connected with the debtor, and the adjustment is quite major and certainly not minor." Id at 614.

In sum, to the extent a municipal bankruptcy under Chapter 9 is similar to the adjustment of publicly held debt under former Chapter X, American Trailer and other cases relied on by plaintiff stand for the contrary proposition they are being cited for, to wit, that the restructuring of public debt is not a simple composition. Evidently, it is plaintiff who is trying to rely on semantics to find preemption where there is none.

The Court in Ropico did not rely on semantic distinctions. To the contrary, consistent with the case law cited in the previous section, it concluded that "[a] federal court decision that the federal Bankruptcy Act precludes the New York State legislature from implementing this emergency measure aimed at dealing with a fiscal crisis of unprecedented proportions affecting its largest city would raise very serious questions about the right of a state effectively to govern its political subdivisions." Ropico, 425 F.Supp. at 984. The Ropico Court validated the Moratorium Act at issue in that case because it found that the same did not effectuate a method of composition. In so holding, any doubts were resolved against preemption, or against the potential infringement

"on the sovereign power of a state to control its political subdivisions." Id. Plaintiff in this case impermissibly advocates for the completely opposite result.

In this case the Commonwealth Laws do not even provide an extension of time for the payment of the Authority Bonds. The due date for the payment of principal and interest on the Authority Bonds has not been changed. Neither the Commonwealth laws, nor the Executive Orders, provide a stay of any collection proceedings nor do they modify or alter any remedies the bondholders may have in the event of a default. The Commonwealth laws and the Executive Orders do not adjust the Authority Bonds or otherwise modify the amounts due, nor do they provide any payment deferrals. To the extent plaintiff has any standing, which is denied, it is free to pursue any and all available remedies against the Authorities.[12] The Commonwealth Laws merely deal with the order of payment of Commonwealth expenditures in the event of a shortfall. They do not address the payment obligations of the Authorities in any way.

To the extent any statute providing an order of payment of Commonwealth expenditures is deemed a preempted method of composition, then the same statutes relied on by plaintiff in support of its argument that the Authority bondholders are entitled to a super priority second only to public debt, Docket No. 1 at ¶¶ 94-102, must also be unconstitutional. The flaw of this argument lies in its circularity. The Commonwealth Laws provide a way for the Commonwealth to manage its fiscal affairs in a time of crisis, not a preempted method of composition. The chaos that would follow the nullification of this statutory scheme—including the very statutes on which plaintiff

[12] At most, the Commonwealth Laws and the Executive Orders make the Pledged Funds temporarily unavailable to the extent other government expenditures are paid first. Plaintiff itself alleges that, pursuant to Section 4(d) of the OMB Act, any postponement of payment obligations resulting from the application of the Commonwealth Laws "must be carried over on the Secretary of Treasury's books against funds available for appropriation in subsequent years." Docket No. 1 at ¶58 (quoting 23 P.R. Laws Ann. §104(d)). Hence, plaintiff's attempt to classify the application of the Commonwealth Laws as an indefinite deferral tantamount to a composition flies in the face of its own allegations.

relies—exemplifies why the preemptive effect of Section 903 cannot go as far as plaintiff would like to stretch it.

E. If Section 8 were to be deemed a "method of composition," its application was consented to by all Authority bondholders, as a matter of law.

Given that the Commonwealth Laws are not a "method of composition," the relevant bondholders' consent is not required in any way in order for them to be applied. The Commonwealth Laws do not adjust or modify obligations to creditors of public corporations that are not a party to this lawsuit. As explained above, these obligations remain intact.

Nevertheless, to the extent Section 8 is deemed a "method of composition," every single one of the Authority bondholders consented to it as a matter of law, given that the statutes authorizing the issuance of the Authority Bonds expressly conditioned the availability of the Pledged Funds to the application of Section 8.[13] Hence, to the extent a state statutory provision that is deemed a "method of composition" requires unanimous consent to avoid preemption, Section 8 would not be preempted, as it was consented to by all authority bondholders who purchased bonds conditioned by statute on the applicability of Section 8.

F. A stay of plaintiff's preemption claims is warranted if this Court believes that they should survive a motion to dismiss.

Plaintiff cites to Landis v. N. Am. Co., 299 U.S. 248, 255 (1936), where the Supreme Court stated that "[o]nly in rare circumstances will a litigant in one cause be compelled to stand aside while a litigant in another settles the rule of law that will define the rights of both." However, plaintiff fails to quote the very next sentence of the opinion in Landis, which goes on to explain that "[c]onsiderations such as these, however, are counsels of moderation rather than limitations upon power." Id.

[13] See, for example, 13 P.R. Laws Ann. §31751(a)(1)(C); 13 P.R. Laws Ann. §31751(a)(1)(E)-(G); 9 P.R. Laws Ann. §5681; 9 P.R. Laws Ann. §2021; 23 P.R. Laws Ann. §6446; 12 P.R. Laws Ann. §2271; 3 P.R. Laws Ann §1907.

A federal court clearly has discretion to stay an action while a similar issue is being resolved in another action, even if the parties are not identical. Id. at 254-255. This may be especially true when the related action is being heard by the Supreme Court. See White v. Ally Fin. Inc., 969 F. Supp. 2d 451, 461-62 (S.D.W. Va. 2013) ("A district court ordinarily has discretion to delay proceedings when a higher court will issue a decision that may affect the outcome of the pending case.") (relying on Landis, supra).

The balance of the equities in this case favors a stay in the circumstances it was requested. Defendants are not advocating an immediate and indefinite stay of all proceedings. In fact, defendants submitted to this Court that even if Section 903(1) preempts Puerto Rico law, it does not preempt the Commonwealth Laws in this case. Only if the Court harbors any doubts about the applicability of Section 903(1) to the facts of this case did defendants suggest that the Court should stay its determination, given that, if the Supreme Court determines that Section 903(1) does not preempt Puerto Rico law, plaintiff's preemption claims would be immediately mooted.

On the other hand, it is plaintiff who has the burden of showing irreparable harm in support of its claims. Irreparable harm is "a substantial injury that is not accurately measurable or adequately compensable by money damages." Ross–Simons of Warwick v. Baccarat, Inc., 102 F.3d 12, 19 (1st Cir. 1996). This case is purely an economic matter regarding payment of money (the Authority Bonds). But for PRIFA, the Authorities are admittedly up to date in their payments to bondholders. Docket No. 1 at ¶ 30. Plaintiff has other remedies at law against PRIFA for any alleged default, such as a collection action against the Authority directly. The next payment of the Authority bonds is not due until July 1, 2016.[14] By that time, Case No. 15-233 will in all likelihood have been decided by the Supreme Court. On the other hand, a rushed determination of this Court

[14] See http://www.gdb-pur.com/investors_resources/puerto-rico-transportation-highway.html; http://www.gdb-pur.com/investors_resources/prccda.html; http://www.gdb-pur.com/investors_resources/prifa.html.

to the effect that Section 903(1) preempts the Commonwealth Laws would invalidate a section of the Constitution of Puerto Rico and would do away with a statutory scheme that predates some of the bonds issued by the Authorities. This result would dislocate the functioning of the Government in a time of crisis and could prove an exercise in futility if the High Court reaches a contrary result, in a matter of months, in the Franklin action. The public interest, prudence and a balance of the equities counsel in favor of a stay, which was requested only in the event this Court finds that plaintiff's preemption claims survive a motion to dismiss.

WHEREFORE, the appearing defendants respectfully request that the Court dismiss plaintiffs' Complaint or, in the alternative, that plaintiff's first and second causes of action be stayed pending a ruling by the Supreme Court in Case No. 15-233.

RESPECTFULLY SUBMITTED.

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 send notification of such filing to all counsel of record.

In San Juan, Puerto Rico, this 10th day of March, 2016.

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