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

In re: THE FINANCIAL OVERSIGHT AND MANAGEMENT BOARD FOR PUERTO RICO, as representative of THE COMMONWEALTH OF PUERTO RICO, *et al.*, Debtors.[1]	PROMESA Title III No. 17 BK 3283-LTS (Jointly Administered)
ACP MASTER, LTD., *et al.*, Plaintiffs, v. THE COMMONWEALTH OF PUERTO RICO, *et al.*, Defendants.	Adv. Proc. No. 17-189 in 17 BK 3283-LTS

REPLY OF INTERVENOR THE OFFICIAL COMMITTEE OF RETIRED EMPLOYEES OF THE COMMONWEALTH OF PUERTO RICO IN SUPPORT OF MOTION TO DISMISS PLAINTIFFS' COMPLAINT PURSUANT TO FED. R. CIV. P. 12(b)(1) AND 12(b)(6)

[1] The Debtors in these jointly-administered PROMESA title III cases, along with each Debtor's respective title III case number listed as a bankruptcy case number due to software limitations and the last four (4) digits of each Debtor's federal tax identification number, as applicable, are: (i) Commonwealth of Puerto Rico (Bankruptcy Case No. 17 BK 3283-LTS) (Last Four Digits of Federal Tax ID: 3481); (ii) Puerto Rico Sales Tax Financing Corporation (Bankruptcy Case No. 17 BK 3284) (Last Four Digits of Federal Tax ID: 8474); (iii) Puerto Rico Highways and Transportation Authority (Bankruptcy Case No. 17 BK 3567-LTS) (Last Four Digits of Federal Tax ID: 3808); (iv) Employees Retirement System of the Government of the Commonwealth of Puerto Rico (Bankruptcy Case No. 17 BK 3566-LTS) (Last Four Digits of Federal Tax ID: 9686); and (v) Puerto Rico Electric Power Authority (Bankruptcy Case No. 17 BK 4780-LTS) (Last Four Digits of Federal Tax ID: 3747).

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The Official Committee of Retired Employees of the Commonwealth of Puerto Rico (the "**Retiree Committee**"), respectfully submits its Reply in support of the Financial Oversight and Management Board for Puerto Rico's (the "**FOMB**") *Motion To Dismiss Plaintiffs' Complaint Pursuant To Fed. R. Civ. P. 12(b)(1) And 12(b)6)* [Adv. Dkt. No. 35] (the "**Motion to Dismiss**").

PRELIMINARY STATEMENT

1. This Court should dismiss the Complaint filed by Plaintiffs, certain holders of general obligation bonds (the "**GO Bondholders**"), for the reasons set forth in the FOMB's Motion and Reply, and the Retiree Committee joins in those arguments. [Adv. Dkt. Nos. 36, 78.] The Retiree Committee submits its own Reply, however, to emphasize four foundational points.

2. ***First***, the GO Bondholders fail to state a claim because PROMESA supersedes their alleged super-priority claim under the Puerto Rico Constitution. Congress enacted PROMESA under the Territory Clause of the United States Constitution, art. IV, sec. 3, cl. 2. To carry out the "fresh start" policy that is central to bankruptcy law, Congress left no doubt about PROMESA's effect on *any* Puerto Rico law that might interfere with that policy: "The provisions of this Act shall prevail over any general or specific provisions of territory law, State law, or regulation that is inconsistent with this Act." 48 U.S.C. §2103. PROMESA mandates a Fiscal Plan that, among other things, provides for the adequate funding of public pensions. *Id.* at. §2141(b)(1)(C). When it enacted PROMESA, Congress fully understood Puerto Rico's fiscal emergency and that it could not pay its debts in full while maintaining essential services, including the payment of retiree pensions. *Id.* at §2194(m)(2). Thus, by incorporating section 507(a)(2) of the Bankruptcy Code as the only priority provision governing claims in a plan of adjustment, Congress necessarily intended to displace the priorities established under Puerto Rican law so as to allow the other objectives recognized in section 201, to be realized. If it had not done so, the relief PROMESA is supposed to deliver to Puerto Rico and its citizens would be illusory at best. Accordingly, the GO

Bondholders' position that the Commonwealth must turn *all* of its money over to the holders of GO bonds without regard to the promises the Commonwealth made to its retirees finds no support in PROMESA and should be rejected.

3. ***Second,*** the GO Bondholders seek relief that is unavailable under PROMESA. These Title III cases present complex factual and legal issues, over a hundred billion dollars in debt and other obligations, and multiple parties, including numerous government instrumentalities and an array of competing creditor constituencies. PROMESA provides for the resolution of these competing interests through a plan of adjustment process. It directs that the treatment of claims, including the determination of their priority vis-à-vis other creditors, should be determined through the plan confirmation process. *See* 48 U.S.C. §§2161(a), 2172, 2173, 2174; 11 U.S.C. §§ 1123, 1124, 1129. The GO Bondholders seek to circumvent that process by asking this Court to determine—in a purportedly two-party dispute between only certain GO Bondholders and the Commonwealth—that the GO Bondholders are entitled to super-priority treatment for their prepetition unsecured claims to the detriment of the Commonwealth's retirees and other creditors. But an adversary proceeding, which by its very nature is intended for two-party disputes, not for issues involving all creditors, is not the appropriate forum to resolve priority of claim issues.

4. ***Third***, the Adversary Proceeding is not ripe for determination. The Complaint attacks a Fiscal Plan that all parties understand is being reformulated as a result of the economic effects of Hurricane Maria. Moreover, it is the Commonwealth's plan of adjustment, not the Fiscal Plan, that will resolve and determine the GO Bondholders' claims. Under analogous circumstances, courts have held that a creditor's attempt to seek declaratory relief on issues central to a plan outside of the plan process is premature and not ripe and have granted motions to dismiss.

See, e.g., *In re Energy Future Holdings Corp.*, 531 B.R. 499 (Bankr. D. Del. 2015); *In re Adelphia Commc'ns. Corp.*, 307 B.R. 432 (Bankr. S.D.N.Y. 2004).

5. ***Fourth***, this Court should dismiss the Complaint because Federal Rule of Bankruptcy Procedure 7001 limits the relief a party can obtain in an adversary proceeding to ten exclusive categories. Here, despite their best efforts to position their claims as "secured," the GO Bondholders hold, at most, general unsecured claims. Rule 7001 does not permit an unsecured creditor to litigate its claim in an Adversary Proceeding.

6. To the extent this Court does not grant the FOMB's Motion to Dismiss, the Retiree Committee requests that this Court use its equitable powers to stay litigation in the Adversary Proceeding pending the Court's consideration of the Commonwealth's plan of adjustment.

BACKGROUND REGARDING THE INTERVENOR RETIREE COMMITTEE

7. On June 15, 2017, the United States Trustee, pursuant to section 1102(a)(1) of the Bankruptcy Code, appointed the Retiree Committee. [17-BK-3283 Dkt. No. 340.] The Retiree Committee represents approximately 160,000 retired employees of the Commonwealth and various governmental bodies and their surviving beneficiaries, including retired teachers, police officers, firefighters, judges, clerks, engineers, and other government workers of all categories.

8. The Retiree Committee's constituents' pensions are underfunded by at least $49 billion and they are the largest group of creditors in these Title III cases. In addition to holding the largest claim, the Retiree Committee's constituents differ substantially from the Commonwealth's commercial creditors in that they have a very personal, long-term interest in the financial health and recovery of the Commonwealth, and for many, their very livelihoods depend on preserving their pensions. And unlike other creditor groups which until now have not even been asked to reduce their contractual entitlements, the Commonwealth's retirees have experienced significant reductions of their contractual benefits over the past several years. *See,*

e.g. 2013 P.R. Laws Act No. 3; 1999 P.R. Laws Act No. 305; 1990 P.R. Laws Act No. 1; 2013 P.R. Laws Act. No. 160; 2013 P.R. Laws Act. No 162.

9. Because the GO Bondholders' Complaint directly attacks the Commonwealth's retirees, the Retiree Committee moved to intervene in this Adversary Proceeding on August 4, 2017. [Adv. Pro. Dkt. 23.] As the Retiree Committee set forth in its motion to intervene, although they do not name the Retiree Committee or any retiree as a defendant, the GO Bondholders seek relief with the express aim of establishing a priority scheme that will shift billions of dollars from retirees to themselves. The GO Bondholders do not disguise this goal, repeatedly attacking the Commonwealth's proposed treatment of pensions in their Complaint. (*See, e.g.*, Compl. ¶¶ 99, 101, 126, 147-154.) On November 8, 2017, this Court entered an order permitting the Retiree Committee to intervene in this Adversary Proceeding to file this Reply. [Adv. Dkt. No. 75.]

REPLY

I. The Court Should Dismiss The Adversary Proceeding.

10. Through this Adversary Proceeding, the GO Bondholders seek to substitute two-party litigation for PROMESA's collective debt adjustment process. The GO Bondholders ignore PROMESA's supremacy over the territorial law on which the GO Bondholders stake their claim, and ask this Court for relief that Congress specifically rejected when it enacted PROMESA. Rather than resolve their claims alongside competing constituencies through a plan of adjustment and the ongoing mediation process, the GO Bondholders filed this Adversary Proceeding to modify the Fiscal Plan, impose their preferred treatment of claims, and grant themselves rights superior to parties not named in the Adversary Proceeding, including the Commonwealth's retirees. (Compl. ¶¶ 179–237.) Because the relief the GO Bondholders seek only should be considered in the context of a confirmation hearing at which *all* creditors will have the right to be heard and their substantive

due process rights respected, this Complaint is in conflict with PROMESA, is not ripe for determination, and is procedurally improper. The Complaint should be dismissed.

A. PROMESA Supersedes The Puerto Rico Constitution And Territorial Laws That The GO Bondholders Rely Upon To Claim Super-Priority Status.

11. PROMESA supersedes anything in the Puerto Rico Constitution or territorial law that is inconsistent with PROMESA, and the GO Bondholders' interpretation of their constitutional super-priority and absolute claim to "Restricted Revenues" certainly is so. The Complaint should be dismissed because the GO Bondholders fail to state a claim upon which relief may be granted.

12. In their Opposition [Adv. Dkt. No. 67], the GO Bondholders now assert that their "constitutional first-priority claim and lien on all available resources is not at issue in this action." (Opposition, 40 (emphasis omitted).) But, as the FOMB explains in its Reply, the lynchpin to the GO Bondholders' claim to the "Restricted Revenues" is their argument that they hold a super-priority claim to payment under the Puerto Rico Constitution. And as COLLIER explains, this argument fails because Congress establishes priorities in bankruptcy, not the states or territories:

> To the extent a federal nonbankruptcy statute purports to affect priorities within a bankruptcy case, that statute is preempted by the more specific provisions in the Code. To the extent that a state statute purports to establish the priority of a claim over other claims, that statute is preempted by the Code and of no effect in the bankruptcy case.

4 COLLIER ¶ 507.02.[2]

13. Consistent with that rule, numerous courts have held that "[c]onflicting priorities established by state law must yield upon the intervention of bankruptcy to superior federal law." *In re Leslie*, 520 F.2d 761, 762 (9th Cir. 1975); *accord In re Allen Care Ctrs., Inc.*, 163 B.R. 180,

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[2] COLLIER's general discussion of preemption in the context of section 507(a) applies because PROMESA incorporates §507(a)(2) as its only priority provision. 48 U.S.C. § 2161(a).

183 (Bankr. D. Or.), *aff'd*, 175 B.R. 397 (D. Or. 1994), *aff'd*, 96 F.3d 1328 (9th Cir. 1996)); *see also In re City of Columbia Falls, Mont., Special Improvement Dist. No. 25*, 143 B.R. 750, 759 (Bankr. D. Mont. 1992) (chapter 9 permits impairment of obligations imposed by state statute). In *Leslie*, a state statute required the proceeds from a sale of a liquor store to be placed in escrow and, after state approval of transfer, distributed to the seller and creditors in accordance with a particular priority scheme. The court held that the Bankruptcy Code's priority scheme governed, commenting that "title to the proceeds in question passed to the trustee under § 70(a)(5) of the Bankruptcy Act, 11 U.S.C. § 110(a)(5), for distribution in accordance with the priorities enumerated in § 64 of the Act, 11 U.S.C. § 104, with any remainder to be divided pro rata among the bankrupt's general creditors." 520 F.2d at 762.[3]

14. This rule applies equally in bankruptcy cases involving governmental entities. In the City of Detroit chapter 9 case, for example, the bankruptcy court held "[s]tate law cannot reorder the distributional priorities of the bankruptcy code. If the state consents to a municipal bankruptcy, it consents to the application of chapter 9 of the bankruptcy code." *In re City of Detroit*, 504 B.R. 97, 161 (Bankr. E.D. Mich. 2013); *accord Mission Indep. Sch. Dist. v. Texas*,

[3] *Accord In re Chambers*, 500 B.R. 221, 229 (Bankr. N.D. Ga. 2013); *In re Kitty Hawk, Inc.*, 255 B.R. 428, 439 (Bankr. N.D. Tex. 2000) ("Where a state statute would alter the priority of claims in a bankruptcy case, the state statute is pre-empted by the Code."); *In re Lull Corp.*, 162 B.R. 234, 240 (Bankr. D. Minn. 1993) ("A state statute cannot reset bankruptcy priorities."); *In re Webster*, 126 B.R. 4, 5-6 (Bankr. D. Me. 1991) ("Congress may, and has, determined the extent of the [claim's] wage priority. Having done so, its determination is exclusive, notwithstanding the content of state enactments with which it may collide" citing U.S. CONST. art. I, § 8, cl. 4; art. VI, cl. 2); *In re Nat'l Bickford Foremost, Inc.*, 116 B.R. 351, 352 (Bankr. D.R.I. 1990) ("[U]nder the Supremacy Clause of the U.S. Constitution, Article VI, Clause 2 … this Court is required to recognize and hold that the [state-law statute creating higher priority] is preempted by Sections 507(a)(3) and (a)(4) of the Bankruptcy Code."); *In re Cropper Co.*, 63 B.R. 874, 876 (Bankr. M.D. Ga. 1986) ("The Court recognizes that Georgia law governs the priority of liens in a non-bankruptcy situation. When a bankruptcy has been filed, however, the priority of liens as set forth by Congress in the Bankruptcy Code governs."); *In re Redford Roofing Co.*, 54 B.R. 254, 255 (Bankr. N.D. Ill. 1985) ("Priority of distribution in a bankruptcy case is governed exclusively by sections 507 and 726 of the Bankruptcy Code."); *In re Sw. Fabricators, Inc.*, 40 B.R. 790, 791 (Bankr. W.D. Tex. 1984) ("State law is determinative on the issue of entitlement to property rights while federal bankruptcy law is relevant on the issue of priorities of rights.").

116 F.2d 175 (5th Cir. 1940) (rejecting the state's attempt by legislation to exempt itself as a bondholder from the operation of Chapter IX), *cert. denied*, 313 U.S. 562 (1941).

15. These preemption cases apply with equal force under PROMESA; indeed, the case for preemption is even stronger, because the Tenth Amendment does not apply to Puerto Rico. As explained above, Congress expressly superseded territorial law by enacting section 4 of PROMESA which provides that the provisions of PROMESA "shall prevail over any general or specific provisions of territory law, State law, or regulation that is inconsistent with this Act." By incorporating section 507(a)(2) into Title III, Congress established which claim priorities apply and, by implication, which do not. Although Congress also required that a fiscal plan "respect the relative *lawful* priorities or lawful liens," 48 U.S.C. 2141(b)(1)(N) (emphasis added), the key word is "lawful." To the extent it grants a super-priority to the GO Bondholders over all other creditors of the Commonwealth, the Puerto Rico Constitution is superseded by PROMESA and section 507(a)(2) and therefore does not create a "lawful" priority.

16. Similarly, to the extent that the territorial statutes directing that the Restricted Revenues be "clawed back" for the benefit of the GO Bondholders mandate that those funds be paid to the GO Bondholders, those statutes are inconsistent with the broad authority that PROMESA grants to the FOMB to implement fiscal reforms and restructure the Commonwealth's debts. 48 U.S.C. §§ 2121(a); 2141(b). PROMESA grants the FOMB the authority to develop a Fiscal Plan that "provide[s] a method to achieve fiscal responsibility." *Id.* § 2141(b)(1). The FOMB's certified Fiscal Plan provides such a "method" by requiring the Commonwealth to retain all tax revenues and other funds that it previously transferred to the Agencies and directing that the Commonwealth's Funds be used to fund a plan of adjustment. (Fiscal Plan at 5-6.) While the restructuring measures contemplated by the Fiscal Plan remain subject to the District Court's

confirmation of a plan of adjustment, the District Court may approve their implementation even though inconsistent with Puerto Rico law. *See In re City of Vallejo*, 432 B.R. 262, 268-70 (E.D. Cal. 2010) (the Bankruptcy Code authorizes municipalities to take actions "notwithstanding state laws to the contrary").

B. The Adversary Proceeding Seeks Relief Unavailable Under PROMESA.

17. The Court should dismiss the Adversary Proceeding because it seeks relief unavailable under PROMESA. The relief the GO Bondholders seek amounts to a modification of the Fiscal Plan with a resulting change in all stakeholders' rights to recovery outside of PROMESA's requirements for a plan of adjustment. (Compl. ¶¶ 179–237.) By establishing a plan of adjustment confirmation procedure and granting the FOMB the ability to classify claims in that plan, PROMESA does not create a right of action that permits one subset of creditors to jump the queue and obtain an advisory decision as to how any plan of adjustment should treat their claims.

18. The GO Bondholders seek to evade PROMESA's requirements for a collective debt-adjustment process by seeking relief in two-party litigation that excludes the vast majority of affected stakeholders—including the Retiree Committee, which represents the largest creditor constituency in these Title III Cases. *See* 48 U.S.C. §§ 2172, 2173, 2174. Specifically, sections 312 and 313 of PROMESA provide that only the FOMB may file a plan of adjustment and make modifications to that plan of adjustment pending confirmation. Section 314 sets forth the requirements for confirmation of any plan of adjustment, and section 301(a) makes certain requirements of sections 1123, 1124, and 1129 of the Bankruptcy Code applicable to plan confirmation. The GO Bondholders will have the opportunity to make their objections to the plan of adjustment at the appropriate time. But neither PROMESA nor the applicable provisions of the Bankruptcy Code permit the GO Bondholders to use the Complaint to attack a cornerstone of the Fiscal Plan itself and, in turn, define the contours of any plan of adjustment.

19. Earlier this year, the First Circuit considered a lawsuit by a separate coalition of general obligation bondholders seeking declaratory and injunctive relief that is similar to what the GO Bondholders seek in this Adversary Proceeding. *Lex Claims, LLC v. Fin. Oversight & Mgmt. Bd.*, 853 F.3d 548, 552 (1st Cir. 2017). The *Lex Claims* court considered a slightly different legal issue—whether the lawsuit violated the temporary stay imposed upon PROMESA's enactment—but like plaintiffs here, the *Lex Claims* plaintiffs sought to commandeer control of the Commonwealth's finances and prioritize repayment of their debt over all other expenditures. As the First Circuit explained:

> When Congress enacted PROMESA and its "immediate—but temporary—stay" of litigation, it could hardly have envisaged that, during the stay period, one of these groups of bondholders could seek and potentially obtain injunctive relief that would dispossess the other by driving its bonds into default. And yet, that is what the GO bondholders evidently intend to do.

Id. at 550. The court rejected the plaintiffs' attempts to circumvent PROMESA's stay through their allegations that the Commonwealth's allocation of certain proceeds and funds were unlawful: "the plaintiffs' attempt to alter [the Commonwealth's] resource-allocation decision falls comfortably within PROMESA's stay of acts to exercise control over Commonwealth property." *Id.* at 552.

20. The First Circuit's reasoning applies with equal force here. Like the *Lex Claims* suit, which was dismissed for violating the stay, this litigation should be dismissed because it seeks to preclude parties in interest from resolving their claims as PROMESA requires, through a plan of adjustment, and instead shifts the focus of debt adjustment to piecemeal two-party litigation.

C. The Adversary Proceeding Is Not "Ripe."

21. The FOMB has not proposed a plan of adjustment specifying how creditors' claims will be restructured. In light of the economic devastation caused by Hurricane Maria, the Commonwealth has represented that it is revising the current Fiscal Plan. Accordingly, the GO Bondholders' claims are speculative and not ripe for adjudication. As the First Circuit instructs:

> [The] ripeness doctrine seeks to prevent the adjudication of claims relating to contingent future events that may not occur as anticipated, or indeed may not occur at all. The facts alleged, under all the circumstances, [must] show that there is a substantial controversy, between parties having adverse legal interests, of sufficient immediacy and reality to warrant the issuance of the judicial relief sought.

Reddy v. Foster, 845 F.3d 493, 500 (1st Cir. 2017) (internal citations and quotations omitted) (granting a motion to dismiss under Rule 12(b)(1)).

22. Under analogous circumstances, courts in other Circuits have granted motions to dismiss on the basis that issues that may be addressed by a plan are not ripe for adjudication. *See Energy Future Holdings Corp.*, 531 B.R. 499; *Adelphia Commc'ns. Corp.*, 307 B.R. 432. In *Energy Future Holdings*, for example, the debtors filed an adversary proceeding to determine whether prepayment penalties and post-petition interest would be due under the terms of PIK notes that had been accelerated upon the bankruptcy filing. 531 B.R. at 501. The bankruptcy court dismissed the suit as not ripe. *Id.* It explained: "[t]he function of the ripeness doctrine is to prevent federal courts through avoidance of premature adjudication, from entangling themselves in abstract disagreements." *Id.*at 507 (internal citations and quotations omitted). The court dismissed the complaint because, as is the case here, there were "multiple contingencies that must be resolved prior to the determination," and the proposed plan that would substantively affect the PIK notes had not been solicited for vote or confirmed by the court. *Id.* at 510-11.

23. Similarly, in *Adelphia*, holders of subordinated bonds filed an adversary proceeding *before* a plan was on file asking for a declaratory judgment that senior bondholders' claims could not be impaired. 307 B.R. at 435–36. While the motion was pending, the debtors filed a plan that enforced subordination when making distributions of common stock in the reorganized company. In light of the pending plan, the court declined to rule on the request for a declaratory judgment, reasoning that if "such an argument [were] to carry the day, bankruptcy courts would be beset with

requests for numerous advisory opinions, many of which ultimately would have no practical application." *Id.* at 440–41.

24. The rationale underlying *Energy Future* and *Adelphia* applies here. The GO Bondholders premise their injury on the current draft of the Fiscal Plan, which can—and in light of Hurricane Maria, undoubtedly will—be modified, and not the plan of adjustment that will ultimately determine the treatment of the General Obligation Debt. (*See* Complaint ¶ 178.) The relief requested in this Adversary Proceeding, therefore, is speculative and advisory and would set a troubling precedent and invite duplicative and unnecessary litigation. Rather than adhere to PROMESA's collective framework for restructuring debt, Title III petitions would trigger a race to the courthouse, resulting in a morass of overlapping lawsuits by creditors seeking to vindicate their positions before any plan of adjustment is negotiated or confirmed. Particularly where, as here, claimants can only identify hypothetical or speculative injury based on anticipated treatment, dismissal is necessary to maintain an orderly, efficient, and just reorganization process.

25. Finally, the GO Bondholders suggest in their Complaint that the relief they seek has been routinely granted in analogous chapter 9 cases. (Complaint ¶ 67.) But none of the chapter 9 cases upon which the GO Bondholders rely support their position that the Court should decide this priority dispute outside of a collective plan process and in the context of a two-party adversary proceeding. In both *In re City of San Bernardino*, 499 B.R. 776, 789 (Bankr. C.D. Cal. 2013), and *In re City of Vallejo*, No. 08-26813-A-9, 2008 WL 4180008, at *5 (Bankr. E.D. Cal. Sept. 5, 2008), the bankruptcy courts merely held that restricted funds would not be considered in determining the debtors' solvency and eligibility to file a chapter 9 bankruptcy. The courts did not determine the validity and priority of creditor claims or issue a ruling that would pre-ordain how payments would be made under a plan of adjustment. The GO Bondholders cite the debtor's disclosure statement

in *In re City of Stockton*, No. 12-32118, ECF No. 1215 (Bankr. E.D. Cal. Nov. 21, 2013), which simply indicates that the plan comports with relevant state law. *In re City of Detroit*, No. 13-53846, ECF No. 2521 at *25-27 (SWR) (Bankr. E.D. Mich. Jan. 16, 2014), involved a challenge to the debtor's use of proceeds from post-petition financing—not a declaration made in the context of an adversary proceeding that a particular creditor would receive payment priority under a plan of adjustment. The single case the GO Bondholders identify involving an action to restrict the use of a debtor's revenues was filed four years after the debtor entered chapter 9, and even there, the court declined to make any findings regarding the status of the disputed funds under state law. *In re Sanitary & Imp. Dist. No. 7 of Lancaster Cty.*, 96 B.R. 967, 972 (Bankr. D. Neb. 1989).

26. Accordingly, this Court should dismiss the Complaint on the basis that it is not ripe.

D. The Adversary Proceeding Is Procedurally Improper.

27. Finally, this Court should dismiss the Complaint because the Adversary Proceeding is not a proper adversary proceeding under Federal Rule of Bankruptcy Procedure 7001. Bankruptcy Rule 7001 limits the relief a party can obtain in an adversary proceeding to ten exclusive categories. Fed. R. Bank. P. 7001. If a party in interest seeks relief that is not specified in one of these ten categories set forth in Rule 7001, it must seek relief through a contested matter under Federal Rule of Bankruptcy Procedure 9014. That is particularly true when the point of the complaint, like the Complaint here, is to establish a claim in a particular priority. It is well-established that the only means by which a creditor may seek recovery against a bankruptcy estate based on a pre-petition unsecured claim is by filing a proof of claim in the debtor's bankruptcy case. "[T]he filing of a proof of claim is a necessary condition to the allowance of an unsecured or priority claim...." *N.L.R.B. v. Bildisco & Bildisco*, 465 U.S. 513, 529 n.10 (1984).

28. The requirement that a proof of claim is the sole means by which a creditor may assert an unsecured claim exists because the formal proof of claim process is the only way in which

a bankruptcy estate can efficiently and practically deal with the claims asserted against an estate. As a bankruptcy court explained in *In re Crutchfield*, "[t]he fundamental purpose of the claims allowance process and the various rules for filing proofs of claim and allocating burdens of proof is to provide a fair and inexpensive procedure for the proper determination of claims on the merits." 492 B.R. 60, 68 (Bankr. M.D. Ga. 2013) (internal quotations omitted). Otherwise, debtors, their estates, and bankruptcy courts would be paralyzed by untold numbers of adversary proceedings corresponding to each individual creditor's claim. *Accord Welt v. Conston Corp. (In re Conston, Inc.)*, 181 B.R. 175, 176 (Bankr. D. Del. 1995) (adversary proceeding cannot be used "as a substitute for a proof of claim"); *Dade Cty. Sch. Dist. v. John-Manville Corp. (In re Johns-Manville Corp.)*, 53 B.R. 346, 354 (Bankr. S.D.N.Y. 1985) ("[T]he only appropriate way to assert a claim against a debtor's estate is through the timely filing of a properly executed proof of claim").

29. The Complaint alleges that the Adversary Proceeding is filed pursuant to Rule 7001(2) (a proceeding to determine the validity, priority, or extent of a lien or other interest in property) and Rule 7001(9) (a proceeding to obtain a declaratory judgment). (Complaint ¶ 20.) The GO Bondholders contend that the General Obligation Debt is "secured" by a "first claim and lien" on all of the Commonwealth's "available resources" pursuant to the Commonwealth Constitution, and thus, that the GO Bondholders are entitled to a "first claim and lien on all available resources" of the Commonwealth. (Compl. ¶¶ 2, 25, 28, 39, 68.) But conspicuously absent from the Complaint is any evidence that the GO Bondholders' claims are anything more than general, unsecured claims—the GO Bondholders do not allege the existence of any security agreements, financing statements, or recorded liens that support their contention that they are "secured" or any statutory or constitutional language that grants a lien on any property to secure

the General Obligation Debt. Thus, the Complaint as drafted does not satisfy the plausibility standard of pleading established in *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 570 (2007).

30. The GO Bondholders' suggestion that the Commonwealth's pledge of its full faith and credit and Puerto Rico's Constitution somehow create a security interest also is mistaken. (*See, e.g.*, Compl. ¶¶ 27, 28, 33, 38.) A contractual priority is not the same as possessing collateral. As the court explained in *Flushing National Bank v. Municipal Assistance Corp. for City of New York*, 40 N.Y.2d 731, 735 (1976), "[t]he effect of such 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 not therein specifically obligated to the payment of such bonds, but is to acknowledge an indebtedness for the amount of money received as a consideration for the bonds." *Id.* Therefore, these provisions do not confer upon the GO Bondholders a security interest in the Commonwealth's assets and are insufficient to create a property interest sufficient to bring an adversary proceeding before this Court. For these reasons and those advanced by the FOMB, the GO Bondholders possess only general unsecured claims.

31. Rule 7001 does not permit unsecured creditors, like the GO Bondholders, to litigate their claims in an adversary proceeding (*see, e.g.*, *Crutchfield*, 492 B.R. at 68; *Welt*, 181 B.R. at 176; *Johns-Manville*, 53 B.R. at 354); the Complaint should be dismissed as improper.

II. Alternatively, The Court Should Stay The Adversary Proceeding.

32. "[F]ederal district courts possess the inherent power to stay pending litigation." *Marquis v. FDIC*, 965 F.2d 1148, 1154 (1st Cir. 1992). If the Court does not dismiss the Adversary Proceeding, it should stay litigation on the Complaint, pursuant to section 105 of the Bankruptcy Code and this Court's inherent power, pending consideration and resolution of the Commonwealth's plan of adjustment. *See In re Baldwin-United Corp. Litig.*, 765 F.2d 343, 348 (2d Cir. 1985) (recognizing authority of bankruptcy court to enjoin litigation in a complex chapter

11 case); *see also Landis v. N. Am. Co.*, 299 U.S. 248, 254–55 (1936); *Kan. City S. Ry. Co. v. U.S.*, 282 U.S. 760, 763–64 (1931). Prior to imposing a stay, a court must ensure that (1) the stay is supported by good cause, (2) the stay is "reasonable in duration," and (3) "competing equities are weighed and balanced." *Marquis*, 965 F.2d at 1155; *Ainsworth Aristocrat Int'l Pty. Ltd. v. Tourism Co. of P.R.*, 818 F.2d 1034, 1039 (1st Cir. 1987). These criteria are fully satisfied in this case.

33. ***First,*** good cause exists to stay this litigation. As set forth above, this litigation attempts to adjudicate the Commonwealth's adjustment of debts prior to the Court's consideration of the FOMB's plan of adjustment, forcing the Court to consider overlapping issues in a piecemeal fashion and contrary to the plain language of PROMESA. To the extent any of the claims raised in the Complaint are not disposed of in connection with the plan of adjustment, the Court should stay consideration of such claims until disputes about priority and security are resolved.

34. ***Second***, the stay is reasonable in duration and is not open-ended. The proposed stay would remain in effect until this Court considers the plan of adjustment. Section 312(b) of PROMESA requires the FOMB to propose such a plan within a time period set by the Court.

35. ***Third***, the equities weigh strongly in favor of staying this litigation. The GO Bondholders will experience no harm as a result of the stay. The GO Bondholders' allegations regarding their purported "liens" on Commonwealth funds or priority in repayment of Commonwealth obligations will be properly addressed when this Court considers the Commonwealth's plan. But if this Court were to allow the Complaint to go forward, the interests of all other creditors of the Commonwealth would be prejudiced by their lack of the ability to participate in fully in this adversary proceeding.

WHEREFORE, the Retiree Committee respectfully requests that the Court enter an order dismissing the Complaint or, in the alternative, staying the Complaint.

November 13, 2017

Respectfully submitted,

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