Hearing Date: December 13, 2017 at 11:00 a.m. (prevailing Atlantic Standard Time)

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 EMPLOYEES RETIREMENT SYSTEM OF THE GOVERNMENT OF THE COMMONWEALTH OF PUERTO RICO, Debtor.	PROMESA Title III Case No. 17-cv-01685 (LTS) Case No. 17-bk-03566 (LTS)
THE FINANCIAL OVERSIGHT AND MANAGEMENT BOARD FOR PUERTO RICO, as representative of THE EMPLOYEES RETIREMENT SYSTEM OF THE GOVERNMENT OF THE COMMONWEALTH OF PUERTO RICO, Plaintiff, -against- ALTAIR GLOBAL CREDIT OPPORTUNITIES FUND (A), LLC, ET AL., ERS Bondholders-Counterclaimants.	Adv. Proc. No. 17-00213 (LTS)

ERS BONDHOLDERS' REPLY BRIEF IN SUPPORT OF MOTION FOR SUMMARY JUDGMENT ON ISSUES RELATING TO PERFECTION AND APPLICATION OF SECTION 552 OF THE BANKRUPTCY CODE

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PRELIMINARY STATEMENT

1. The ERS Bondholders'[1] first two briefs established that the ERS Bondholders possess valid, enforceable, attached, and perfected first priority liens on, and security interests in, the Pledged Property. As the ERS Bondholders have explained, a search conducted on the Title III petition date would have revealed no less than six separate financing statements, each of which would have put an interested party on notice of the ERS Bondholders' security interests in the Pledged Property. The ERS does not seriously dispute this fact, but nonetheless argues that these financing statements failed to comply with a variety of nonexistent perfection requirements that the ERS reads into the applicable law. Not only do the ERS Bondholders satisfy all the applicable technical requirements, but the ERS's approach is also inconsistent with both Puerto Rico law and case law interpreting identical perfection statutes, which make clear that the approach must be pragmatic, focusing on notice. Because each of these six financing statements, either standing alone or construed together, met all requirements for perfection, this Court should declare that the ERS Bondholders possess perfected security interests in the Pledged Property.

2. The ERS Bondholders' earlier briefs also established these perfected security interests include all of the disputed property—including proceeds of the Right to Receive Employers' Contributions and Employee Loans—and that the ERS cannot avoid these perfected security interests under Section 552. The ERS seeks to avoid these perfected liens by offering interpretations of the ERS Bond Resolution and applicable law that are flatly inconsistent with the law governing legal documents, have no grounding in facts, and would raise serious constitutional

[1] Capitalized terms used and not otherwise defined herein shall have the meaning ascribed to them in the ERS Bondholders' Memorandum in Support of Motion for Summary Judgment on Issues Relating to Perfection and Application of Section 552 of the Bankruptcy Code (the "Opening Br."), D.I. 94, Ex. A, and in the ERS Bondholders' Answer, D.I. 36. Any evidentiary concerns the ERS has regarding the declarations accompanying the Opening Brief are addressed by the declarations accompanying this Reply.

questions that this Court should avoid. Because the ERS Bondholders' perfected security interests encompass all disputed property, and because Section 552 does not grant the ERS the power to avoid these perfected security interests, the ERS Bondholders are entitled to a declaratory judgment on these issues.

ARGUMENT

I. THE ERS BONDHOLDERS HOLD PERFECTED LIENS AND SECURITY INTERESTS IN THE PLEDGED PROPERTY.

A. The 2008 Financing Statements Perfected The ERS Bondholders' Security Interests In The Pledged Property.

3. The ERS Bondholders' first two briefs demonstrated that the 2008 Financing Statements met all of the requirements for perfection under then-applicable Puerto Rico law, and therefore perfected the ERS Bondholders' security interests in the Pledged Property. Each of the 2008 Financing Statements identified in the "collateral description" field "[t]he pledged property described in the Security Agreement attached as Exhibit A hereto and by this reference made a part hereof." Opening Br. ¶¶ 10, 14. The attached Security Agreement then described the collateral as "(i) the Pledged Property, and (ii) all proceeds thereof and all after-acquired property," and further provided that "[a]ll capitalized words not defined herein shall have the meanings ascribed to them in the [ERS] Pension Funding Bond Resolution adopted by the [ERS]'s Board of Trustees on January 24, 2008, as amended and supplemented from time to time (the "Resolution")"—a public act memorialized in a public document that, to this day, is widely available to anyone. Opening Br. ¶ 14. Because this description of collateral was more than sufficient to "apprise creditors that the [ERS Bondholders] may have a security interest in the collateral described in the financing statement"—the Pledged Property—the 2008 Financing Statements met all applicable requirements for perfection. Opp. Br., D.I. 120 ¶ 10 (quoting *In re Cushman Bakery*, 526 F.2d 23, 28 (1st Cir. 1975)).

4. The ERS wrongly challenges the sufficiency of the 2008 Financing Statements by contending that a Financing Statement can *never* incorporate other documents by reference when describing collateral. ERS Opp. Br., D.I. 115, at 5-6; Intervener Br., D.I. 123, at 6-7. That is not the law. As our prior briefs explained, because a financing statement's primary goal is to "notify other potential creditors of a secured party's interest in collateral," rather than to "enable other creditors to learn the 'true nature' of the secured transaction," *In re Cushman*, 526 F.2d at 28-29, courts have long recognized that "there is no requirement that the description of the collateral be within the four corners of the security agreement or other single document," *In re Amex-Protein Development Corp.*, 504 F.2d 1065, 1060 (9th Cir. 1974). *See* Opening Br. ¶¶ 12-13 (citing cases). Accordingly, courts have repeatedly held that the "collateral description" requirement is satisfied when a financing statement incorporates by reference even private agreements, let alone public resolutions. Opening Br. ¶¶ 12-13 & n.7; Opp. Br. ¶¶ 10-11 (collecting cases).

5. The ERS does not cite any authority to the contrary. Its reliance upon *In re Quality Seafoods*, 104 B.R. 560 (D. Mass. 1989), is misplaced because the continuation statement at issue there contained *no* collateral description whatsoever, and thus could not be deemed to be "incorporating the [underlying] financing statement by reference." Opp. Br. ¶ 12. Here, by contrast, the 2008 Financing Statements did expressly incorporate the Security Agreement (which in turn incorporates the ERS Bond Resolution's definition of Pledged Property). *Id.*

6. The ERS fails in its efforts to distinguish the many cases the ERS Bondholders cited holding that the "description of collateral" requirement can be satisfied through incorporation by reference of outside, unattached documents. Opening Br. ¶¶ 12-13 & n.7; Opp. Br. ¶¶ 10-11. The ERS argues that some of those cases involved security agreements, rather than financing

statements, ERS Opp. Br. at 7 & n7.[2] But under both Old and New PR Article 9, financing statements and security agreements alike must provide a sufficient description of collateral, Old PR Article 9-110, § 2010; New PR Article 9-108; § 2218, and courts have repeatedly recognized that under either version of Article 9, the requirements for description of collateral are more stringent for security agreements than for financing statements. *Prod. Credit Ass'n of W. Central Minn. v. Bartos*, 430 N.W.2d 238, 240 (Minn. Ct. App. 1988) ("Case law makes clear that this 'reasonable identification' standard is applied more strictly to collateral descriptions in security agreements than it is to collateral descriptions in financing statements."); *Regions Bank v. Bric Constructors, LLC*, 380 S.W.3d 740, 771 (Tenn. Ct. App. 2011) (same).

7. The cases cited by the ERS hold that a security agreement's heightened description of collateral requirement can be satisfied if it incorporates by reference non-public, outside documents. ERS Opp. Br. at 7. In fact, by highlighting cases such as *In re Amex-Protein Dev. Corp.*, *In re Production Design & Fabrication Inc.*, *Greenville Riverboat*, and *Kimley*, which involved security agreements subject to more stringent requirements than those that apply to financing statements, the ERS tacitly admits that the 2008 Financing Statements also satisfy all of the requirements for perfection here: these Statements incorporated by reference the definition of Pledged Property from the publicly available ERS Bond Resolution.[3]

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[2] As the ERS acknowledges, the ERS Bondholders also cite cases such as *Chase Bank of Fla., N.A. v. Muscarella*, 582 So. 2d 1196 (Fla. Dist. Ct. App. 1991), holding that financing statements can incorporate by reference unattached, outside materials to fulfill the "description of collateral" requirement. Opening Br. ¶ 13 n.4; Opp. Br. ¶ 11 & n.3. While the ERS tries to distinguish this case by asserting that the title of the document incorporated by reference was sufficient, standing alone, to describe the collateral, ERS Opp. Br. at 7, that interpretation of *Muscarella* finds no support in the opinion itself. Opp. Br. ¶ 11 & n.3.

[3] The ERS does not even address the fact that its own counsel, Wolf Popper, opined in 2016 that the 2008 Financing Statements were sufficient to perfect the liens. *See* D.I. 96, Ex. L; *see also* Declaration of Christopher DiPompeo in Support of Reply Brief (hereafter, the "Third DiPompeo Dec."), Ex. B. And, indeed, the ERS has stipulated that it is aware of no evidence tending to prove that ERS believed prior to the Title III case that the liens were not perfected. Third DiPompeo Dec., Ex. C. The ERS's longstanding belief that the 2008 Financing Statements were sufficient casts serious doubt on its newfound arguments to the contrary.

B. The Financing Statements Did Not Lapse In 2013.

8. The ERS reiterates its argument that the 2008 Financing Statements lapsed in 2013, but again fails to provide any explanation how a five-year period would apply here. ERS Opp. Br. at 9-12; Intervener Br. at 9-12. As the ERS Bondholders explained, pursuant to New PR Article 9-705(c), the 2008 Financing Statements remain effective under current Puerto Rico law until at least 2018. Opp. Br. ¶¶15-17. Moreover, even if the ERS Bondholders' security interests were not perfected by the 2008 Financing Statements, these statements remained effective under the transition rules, New PR Article 9-704(b) and New PR Article 9-707.[4] Opp. Br. ¶¶ 15-18. And, in any event, the ERS does not and cannot identify any statutory provision establishing a five-year period which would have caused the 2008 Financing Statements to lapse, let alone lapse retroactively. Opp. Br. ¶ 18.

C. The Amended Financing Statements, Construed Together With The 2008 Financing Statements, Perfected The ERS Bondholders' Liens.

9. The ERS Bondholders established that all six of the financing statements that would have been found by a search on the Title III petition date (even if one or more were independently deficient)—construed together as "the functional equivalent of a single [effective] financing

[4] The Opening Brief also established that, at a minimum, there is a genuine issue of material fact as to whether both the 2008 Financing Statements and the Amended Financing Statements are effective "for a period of thirty (30) years" under 19 L.P.R.A. § 2335(b). Opening Br. ¶ 21 n.9. Intervener erroneously argues that this statute does not apply because the first box in Section 6a of the financing statement form was not "checked to indicate the filing [was] a public financing transaction." Intervener Br. 8-9. As the Intervener admits, however, the public-finance provision did not exist in Old Article 9, and therefore no such box existed at the time the 2008 Financing Statements were filed. Moreover, the absence of a check in the "public-finance transaction" box does not preclude a finding that the transaction is a public-finance one if there is an indication that the statement was filed in connection with a public-finance transaction—which is the case here. *See In re Lower Bucks Hosp. Lower Bucks Health Enters.*, Nos. 10-10239, 10-0174, 2010 Bankr. LEXIS 2734, at *3 n.3 (Bankr. E.D. Pa. Aug. 11, 2010) (concluding that "whether the financing statement 'indicates' that it was filed in connection with a public-finance transaction" could not be deduced from the statement itself and so an evidentiary record was necessary); *Becker v. Bank of N.Y. Mellon Tr. Co., N.A.*, No. 2:11-cv-6460, 2012 U.S. Dist. LEXIS 192813, at *31 (E.D. Pa. Oct. 31, 2012) (similar). The adjudication of this issue is unnecessary, however, given that the six Financing Statements were effective at the time of Title III petition.

statement"—perfected the ERS Bondholders' security interests.[5] Opp. Br. ¶¶ 22-23 (quoting *Miami Valley Prod. Credit Ass'n v. Kimley*, 536 N.E.2d 1182, 1185-86 (Ohio Ct. App. 1987) (deeming two defective financing statements sufficient to perfect a security interest when, construed together, they met all of the requirements for perfection)). The ERS attempts to distinguish *Kimley* on the ground that it "concerned two financing statements filed close in time," but *Kimley* did not turn upon the fact that the two statements were filed 13 months apart.

D. The Amended Financing Statements, Standing Alone, Perfected The Liens.

10. The ERS Bondholders' first two briefs established that each of the four Amended Financing Statements, standing alone, meets all of the requirements for perfection under Puerto Rico law, and, thus, at a minimum, the ERS Bondholders' security interests were perfected no later than 2015. As the ERS concedes, an amended financing statement is sufficient to perfect a security interest "by itself" when it "meets all of the technical statutory requirements of a filing statement." ERS Opp. Br. at 10. Here, each Amended Financing Statement (1) "provides the name of the debtor," (2) "provides the name of the secured party or a representative of the secured party," and (3) "indicates the collateral covered by the financing statement," as required by Puerto Rico law, New PR Article 9-502(a), § 2322(a). Each of the four Amended Financing Statements therefore constitutes a filing statement by itself, and each perfected the liens before the Petition Date.

11. The ERS challenges the sufficiency of the Amended Financing Statements on two grounds, both meritless. First, the ERS contends that the Amended Financing Statements are deficient because they provide the name of the debtor on the second page of the filing in an attached exhibit, rather than the first page. *See also* Intervener Br. at 13-14. But there is no such

[5] The Intervener is wrong that an amended financing statement can never operate as an original financing statement when it independently meets all of the requirements for perfection. Intervener Br. at 13-14. As the Opening Brief established, multiple courts (including *In re G.G. Moss Co., Inc.*, a case relied upon by the ERS), have rejected this very argument. Opening Br. ¶ 24 & n.10.

requirement in New PR-Article 9-502(a), § 2322(a). Opp. Br. ¶¶ 25-26. Nor does the lone case ERS cites, *In re Vorboril*, 568 B.R. 797 (Bankr. E.D. Wisc. 2017), support its position. As the ERS Bondholders explained, the location of the debtor's name mattered in *Voboril* because Wisconsin's "filing office maintains two *separate* databases," such that the failure to list the debtor's name in the correct location resulted in its absence from a search conducted by an interested party in the appropriate database. Opp. Br. ¶ 17 (quoting *Voboril*, 568 B.R. at 801 (emphasis added))). Here, by contrast, there can be no dispute that the Amended Financing Statements provided the precise information necessary (including the debtor's name) to alert an interested party searching the database to the ERS Bondholders' security interests. Indeed, the filing officer correctly indexed all four of the Amended Financing Statements, and all four would have been revealed to an interested party conducting a search on the Title III petition date.

12. Second and equally unavailing is the ERS's contention that its name changed in 2013, and therefore that the Amended Financing Statements do not list the correct debtor. ERS Opp. Br. ¶¶ 29-32. At the outset, this argument is not credible in light of the ERS's many filings, some including statements made under the penalty of perjury, in which it referred to itself as the "Employees Retirement System of the Government of the Commonwealth of Puerto Rico (ERS)" and verified that it has not used any variation of this name over the past eight years. Opp. Br. ¶ 28-32; D.I. 121, Ex. A (numerous instances where ERS, AAFAF, and FOMB used ERS's original name in court filings and other documents). Indeed, because the ERS admitted in its pleadings that its name is, in fact, ERS, it is now bound by that judicial admission here. Opp. Br. ¶ 33 & n.6. In any event, any alleged name change in 2013 would be irrelevant because the important portions of the Pledged Property that are subject to the ERS Bondholders' liens were acquired by ERS long before 2013. Opp. Br. ¶¶ 34-35. Because Puerto Rico law provides that a new financing statement

is not necessary to "perfect a security interest in collateral acquired by the debtor before, or within four months after" a name change, New PR Article 9-507(c), § 2327(c)(1), the ERS's purported name change has no bearing on the ERS Bondholders' liens here. Opp Br. ¶¶ 34-35.

E. The ERS Bondholders' U.C.C. Search Results Are Relevant To Establish Notice, The Primary Goal Of Perfection.

13. The ERS attempts to dismiss as irrelevant the results of a current U.C.C. search the ERS Bondholders commissioned. ERS Opp. Br. at 12-13; *see also* D.I. 97, Ex. A; Third DiPompeo Dec., Ex. A (results and parameters of search). But this argument misconstrues the ERS Bondholders' argument and illustrates the ERS's misunderstanding of perfection. The ERS Bondholders' first two briefs highlighted that a search conducted by an interested party today would reveal at least six separate financing statements, each of which makes clear that the ERS Bondholders hold security interests in the Pledged Property. The ERS Bondholders reference this search not for the proposition that these search results themselves establish that the requirements for perfection were met, as the ERS incorrectly suggests, ERS Opp. Br. at 12-14, but instead to show that each of the financing statements the ERS filed on the ERS Bondholders' behalf put an interested party on notice of their security interests, thus fulfilling the "primary goal" of perfection. *In re Montreal, Maine & Atl. Ry., Ltd.*, 799 F.3d 1, 11 (1st Cir. 2015). Indeed, the fact that all six financing statements would be revealed to an interested party demonstrates that the ERS's proposed additional requirements for financing statements—such as a requirement that the debtor's name appear in a particular place—are unnecessary. *See, e.g.*, *Millennium Fin. Servs., L.L.C. v. Thole*, 74 P.3d 57, 62-63 (2003) ("If [the interested party] had searched the record, he could not reasonably have been misled, [as] . . . [a]ny search under the debtors' legal names would have shown [that the creditor] had a security interest in the vehicle inventory."). Because any searcher would have been presented with all six financing statements upon a proper search on the

Petition Date, and thus would have been alerted to the ERS Bondholders' security interests in the Pledged Property, the ERS cannot seriously contend that any interested creditor has been, or would have been, misled by these financing statements. *See, e.g.*, *Kimley*, 42 Ohio App. 3d at 131 (two defective financing statements, construed together, accomplished perfection in "the absence of any evidence that anyone was misled" by their contents).

II. THE ERS BONDHOLDERS' LIENS WOULD HAVE PRIORITY OVER THE ERS EVEN IF THEY WERE UNPERFECTED.

14. Our Opening Brief established that because it is not possible for any creditor to possess a lien that is superior to even an unperfected security interest held by the ERS Bondholders, Section 544(a) does not permit the ERS to avoid the ERS Bondholders' liens even if the liens were unperfected. Opening Br. ¶¶ 27-36. The result suggested by the ERS would produce the exact opposite outcome of what Section 544(a) requires. Act 66 prohibits judgment creditors from obtaining an interest in the Pledged Property so there could not have been a creditor with a security interest superior to even an unperfected ERS Bondholder security interest (as required under Section 544(a)). Moreover, the ERS's proposed interpretation of Section 544(a) raises serious constitutional concerns that this Court should avoid. Opening Br. ¶¶ 27-36.

15. The ERS advances three responses regarding Section 544(a), none of which is correct. First, the ERS erroneously contends that Section 544 automatically grants a debtor the status of a hypothetical lien creditor on all the debtor's assets, regardless of whether such a creditor could exist under applicable non-bankruptcy law. ERS Opp. Br. at 15. That argument is directly at odds with the text of Section 544, and the cases the ERS itself cites.[6] Even if the existence of such a creditor may be hypothetical, that creditor's rights must be found in actual law.

[6] 11 U.S.C. § 544(a) (granting a debtor the rights and powers of a creditor that obtains a "judicial lien on all property on which a creditor on a simple contract *could have obtained* such a judicial lien" (emphasis

16. Second, the ERS also incorrectly argues that Act 66 does not apply to Title III debtors like the ERS. But the ERS offers no authority for this sweeping proposition, and we are aware of none. As a preliminary matter, the ERS's newfound, bald assertion that it has funds sufficient to satisfy judgment creditors is curious given its recent and contemporaneous assertions of insolvency in the adversary complaint and elsewhere, *see, e.g.*, Complaint, D.I. 1, ¶ 50, and is insufficient to meet its burden to avoid the ERS Bondholders' liens, *see, e.g.*, *In re Jones*, 573 B.R. 665 (Bankr. N.D. Tex. 2017). In any event, the ERS is wrong when it contends that Act 66 applies "only when there are no funds available to pay a judgment." ERS Opp. Br. at 17. Courts have recognized that Act 66, which makes a payment plan the exclusive remedy for a judgment creditor of any agency, instrumentality, or municipality of the Commonwealth, 3 L.P.R.A. § 9141, applies to governmental entities even if the debtor has sufficient funds to satisfy the judgment.[7]

17. And even if the ERS were correct that Act 66 does not apply here because the ERS possesses available funds to pay judgment creditors, but nonetheless will choose to default on its obligations in the future, the ERS still cannot avoid the ERS Bondholders' liens under Section 544. First, and dispositively, even if a judicial lien could be obtained following a default on a payment plan, that lien could not be created until this default occurred, which will necessarily be *after* the Title III petition date because it takes at least a year to violate an Act 66 payment plan. *See*

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added)); *Musso v. Ostashko*, 468 F.3d 99, 104 (2d Cir. 2006) (ERS Opp. Br. at 15) (under Section 544, "[t]he trustee hypothetically extends credit to the debtor at the time of filing and, at that moment, obtains a judicial lien on all property in which the debtor has any interest *that could be reached by a creditor*" (emphasis added)); *see also* Opening Br. ¶ 30 ("Section 544(a) does not give the Trustee any greater rights than he, or any person, would have as a bona fide purchaser or judicial lien creditor under applicable state law." (quoting *In re Trask*, 462 B.R. 268, 273 (1st Cir. B.A.P. 2011))).

[7] *Wal-Mart P.R., Inc. v. Zaragoza-Gomez*, 174 F. Supp. 3d 585, 627 (D.P.R. 2016) (noting government's acknowledgment that under Act 66, a payment plan is required "even if the Commonwealth had the money to pay off the entire judgment at once"), *aff'd*, 834 F.3d 110, 124 (1st Cir. 2016) (observing that a payment plan is mandatory, but, pursuant to Act 66, Puerto Rico has discretion "not to pay even [the $3 million maximum] depending on the availability of funds that year").

Aldarondo & Lopez Bras P.S.C. v. Municipio De Arecibo, Representado Por Su Alcalde, KLCE201501959, 2016 PR App. LEXIS 1677, at *15 (P.R. Cir. Apr. 27, 2016). Because Section 544 grants a debtor only the rights of a creditor that could have existed "*at the time of the commencement of the case*," there is no scenario in which a hypothetical, Section 544 creditor could possess a judicial lien on any assets of the ERS, let alone one superior to the ERS Bondholders' security interests. Moreover, if a governmental entity possessed available funds sufficient to pay a judgment creditor, but that entity failed to abide by its obligations due under the payment plan, the remaining funds would simply be included in the entity's budget and then paid, such that no judicial lien could be granted in the first place. *Id*. at *14.

18. The ERS's remaining Act 66 arguments also fail. As the Opening Brief established, courts have rejected the ERS's contention that Act 66's "prohibition on garnishment does not prohibit other kinds of levies by a lien creditor" in a governmental entity's property. *See, e.g.*, *Wal-Mart PR*, 834 F.3d at 122 (explaining that by enacting Act 66 and other measures, "Puerto Rico has chosen to severely restrict the ability of its courts to provide adequate remedies to [a creditor]"); *see also* Opening Br. ¶ 33 & n.13 (collecting cases holding that under Act 66, plaintiffs have no available remedy other than a payment plan). And ERS's contention that the "garnishment" portion of Act 66 applies only to the Commonwealth, and not agencies like ERS, is at odds with the Act's text, as courts have recognized. 3 L.P.R.A. § 9142 (payment plan is exclusive remedy in actions against any "[a]gency or instrumentality of the Commonwealth, or public corporation or municipality, official or employee"); *see also Aldarondo & Lopez Bras P.S.C*, 2016 PR App. LEXIS 1677, at *14 (stating that Act 66 prohibits the garnishment of funds to execute on a judgment against municipality).

19. *Third*, the ERS's contention that the ERS Bondholders do not have standing to "assert an exemption claim regarding" the ERS's assets under Act 66 is belied by the ERS's own cases. All of the cases the ERS cites involved provisions of the Bankruptcy Code that apply only in the context of consumer bankruptcy, and therefore do not apply here.[8]

20. If anything, these cases prove the ERS Bondholders' point. The cases explain that "[p]roperty claimed as exempt [under section 522] is property of the estate on the petition date, and a trustee's ability to avoid a transfer is judged as of the petition date." *In re Davis*, No. 07-42789, 2009 WL 1033194, at *6 (Bankr. E.D. Tex. Mar. 24, 2009). Thus, as a temporal matter, an exemption under Section 522 can never shield the exempt property from the bankruptcy trustee's Section 544-strong-arm powers because the debtor cannot elect the exemption until sometime *after* the petition date. *Id.* In contrast to the election of an exemption, Act 66 is automatic and mandatory, and prohibits a judicial lien from attaching to property *on* the petition date. Cases interpreting Section 522 simply highlight that there is no scenario where a judicial lien could attach to the Pledged Property on the ERS's petition date. Consequently, because it is not possible for any creditor to possess a lien that is superior to even an unperfected ERS Bondholder security interest, Section 544(a) does not permit the ERS to avoid those liens.

III. SECTION 552 NEITHER TERMINATES NOR LIMITS THE ERS BONDHOLDERS' VALID LIENS ON POST-PETITION REVENUES.

A. The ERS Bondholders' Prepetition Security Interests Attach To Post-Petition Employers' Contributions Under The ERS Bond Resolution.

21. The ERS contends that "[t]he plain language of the Resolution does not encompass future Employers' Contributions which have not been paid to ERS." ERS Opp. Br. at 21-22. This

[8] *See, e.g.*, *In re Noblit*, 72 F.3d 757, 758-59 (9th Cir. 1995) (explaining that law was otherwise under Bankruptcy Act, but that law changed due to statutory amendment regarding property of the estate); *In re Taylor*, 226 B.R. 284 (B.A.P. 10th Cir. 1998) (same); *In re Ruel*, 457 B.R. 164, 171 (Bankr. D. Mass. 2011) (rejecting creditor's assertion of exemption based on "the plain meaning of the [bankruptcy] statute").

new position is directly contrary to the ERS's prior representations to this Court and the First Circuit. Opening Br. ¶¶ 39, 45, 73-74. Moreover, the ERS has stipulated that it is not aware of any evidence tending to prove that it believed prior to the Title III petition date that Pledged Property did not include the right to receive Employers' Contributions. Third DiPompeo Dec., Ex. C. In any event, ERS's new interpretation is wrong because, as previously explained, it distorts the plain text of the ERS Bond Resolution and makes no economic sense. Opening Br. ¶¶ 40-44; Opp. Br. ¶¶ 46-48.

22. The ERS argues that Employers' Contributions are "qualified by the past tense verb 'paid.'" ERS Opp. Br. at 22. As a preliminary matter, the ERS's reading is divorced from economic reality. Opp. Br. ¶¶ 47-48. Moreover, in 2008, when the ERS Bond Resolution was enacted, no Employers' Contributions subject to any lien had yet been made. Thus, under the ERS's interpretation, the ERS Bondholders never had any collateral, nor had a *prospective* right to acquire collateral—which is contrary to what the ERS Bondholders were offered. Yet, the bonds were sold as secured limited recourse bonds, to be paid out of collateral. The ERS, under its reading, cannot account for the fact that the ERS Bonds were, in fact, paid for nearly a decade, through the enactment of PROMESA, which was possible only because there has been collateral for the ERS Bonds at all times *since* they were issued in 2008 and after the word "paid" was first included in the ERS Bond Resolution.

23. The actual text written in 2008 is also inconsistent with the ERS's new interpretation of the ERS Bond Resolution in several additional respects. First, the ERS's interpretation is contradicted by the only explicit temporal reference in the 2008 language: the definition of Employers' Contributions ("contributions paid ***from and after the date hereof***") makes clear that the ERS Bondholders have the right to receive all *future* contributions,

irrespective of when they are actually received. Opening Br. ¶ 43; Opp. Br. ¶ 46. To be in accordance with the rest of the ERS Bond Resolution, therefore, the term "paid" must mean "whenever paid" (as opposed to "previously paid"). Plus, even if "paid" did qualify Employers' Contributions in some way (and it does not), the ERS ignores the fact that "Pledged Property" includes all "right, title, and interest of [the ERS] in and to" all Revenues and "all rights to receive the same"—which means that the ERS Bondholders had a lien on the ERS's rights to the Employers' Contributions regardless of when they were or are paid. Opp. Br. ¶ 46-47.

24. Similarly, the ERS's claim that "any collection right for postpetition Employers' Contributions is nothing more than after-acquired property," ERS Opp. Br. at 22, is wrong because, under the ERS Bond Resolution, the ERS Bondholders have an existing *pre*-petition lien on the ERS's right to receive Employer Contributions and the right to collect those contributions.

25. Finally, the fact that the ERS has treated the ERS Bondholders' interests as secured since the bonds were issued is fatal to their newfound interpretation of the ERS Bond Resolution. Under Puerto Rico law "[i]n order to judge as to the intention of the contracting parties, attention must principally be paid to their acts, contemporaneous and subsequent to the contract." 31 L.P.R.A. § 3472. As the Puerto Rico Supreme Court has explained, "[a]lthough the starting point of contract interpretation must be the expressions contained in the words [of a contract], the trier cannot stop at the literal sense, but must fundamentally investigate the intent of the parties and the spirit and purpose of the transaction, as they are inferred from the overall conduct of the interested parties and from the concurring circumstances that may contribute to an adequate investigation of the will of the executing parties." *E.g.*, *Marcial v. Tome*, 144 D.P.R. 522, 537 (P.R. 1997).[9]

[9] *See also Marina Ind., Inc. v. Brown Boveri Corp.*, 114 D.P.R. 64, 69-70 (P.R. 1983) (same); *Cooperativa La Sagrada Familia v. Castillo*, 107 D.P.R. 405, 461 (P.R. 1978) (same).

Because, under the ERS's interpretation, the ERS Bondholders never had any collateral to begin with, *see* Opp. Br. ¶¶ 46-48, the fact that the ERS has transferred Employers' Contributions to the fiscal agent for payment to the ERS Bondholders ever since the bonds were issued shows that the ERS's interpretation is flawed. So too does the fact that the ERS has admitted it is aware of no evidence tending to prove that, prior to the commencement of the ERS Title III case, the ERS believed Employers' Contributions did not include the right to receive those contributions. Third DiPompeo Dec., Ex. C. Under Puerto Rico law, this is powerful evidence that ERS's newfound interpretation of the ERS Bond Resolution is wrong.

B. The ERS Bondholders' Liens On Proceeds Of The Right To Receive Employers' Contributions Are Not Cut Off By Section 552(a) Because They Are Preserved Under Section 552(b)(1).

26. The ERS asserts that it "had no right to receive future Employers' Contributions on the petition date" and so Section 552(b)'s exception does not apply here. ERS Opp. Br. at 23-25; Intervener Br. at 15. The ERS's argument is both incorrect and irrelevant, because post-petition Employers' Contributions are proceeds of the Right to Receive Employers' Contributions. Opp. Br. ¶ 48. Likewise, the ERS's assertion that it had "no existing right to receive future Employers' Contributions until an employee works" is contrary to both the ERS Bond Resolution, which says the right to receive payments is the ERS's property, Opening Br. ¶ 42 & n.15, and Puerto Rico law, which imposes a clear obligation on employers to make Employers' Contributions regardless of the level of payroll, Opp. Br. ¶¶ 49-51. The ERS's cases are thus inapposite. Opp. Br. ¶ 52 & n.9.

27. The ERS claims that the ERS Bondholders' "fatal flaw" is relying on cases where "an existing prepetition receivable . . . was collected postpetition." ERS Opp. Br. at 25. But this is not a problem for the ERS Bondholders because the right to receive Employers' Contributions is a pre-petition right. Opp. Br. ¶¶ 51-57. And, tellingly, the ERS only mentions the most instructive case, *Johnson*, in passing, ERS Opp. Br. at 26, even though that case is directly on point.

Opening Br. ¶ 49; Opp. Br. ¶¶ 54-55. In any event, these cases show that Section 552(b) still applies even if the proceeds arose post-petition and from the work of employers' employees.[10] Lastly, the ERS's "collection right" is not a "brand new asset;" rather, it is an existing *pre*-petition right connected to the ERS's right to future Employers' Contributions. *See* Opp. Br. ¶ 51.[11]

C. Section 552(a) Is Inapplicable Because Employers' Contributions Are "Special Revenues."

28. Contrary to the plain text of Sections 928 and 902 of the Bankruptcy Code, the ERS continues to maintain that the Employers' Contributions are not "special revenues" exempt from Section 552(a). ERS Opp. Br. at 26-30; Intervener Br. at 14-15. Yet, as the ERS Bondholders have previously explained, Employers' Contributions qualify as "special revenues" under at least two prongs of the statutory definition. Opening Br. ¶¶ 52-53.

29. The ERS impermissibly narrows the Section 902(2)(D) definition by asserting that Employers' Contributions "are not a result of any services ERS provides," that the exception is primarily for "ministerial service[s]," and that the ERS Bondholders' interpretation would render Section 902(2)(A) "meaningless." ERS Opp. Br. at 28-29. Absent from the ERS's brief, however,

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[10] *See Cadle Co. v. Schlichtmann*, 267 F.3d 14, 20 (1st Cir. 2001) (determining that the fact that the debtor "performed much of the work," and thus generated the collateral, "after the firm's dissolution and his bankruptcy and before the right to payment arose does not alter the fact that [the creditor] had a security interest in that payment"); *In re Bumper Sales, Inc.*, 907 F.2d 1430, 1432, 1439 (4th Cir. 1990) (agreeing that a debtor's post-petition inventory and accounts receivable constituted "proceeds" exempt from Section 552(a) notwithstanding the fact that these proceeds were generated post-petition by continued manufacturing conducted by the debtor's own employees).

[11] In a single paragraph void of any legal citations, Intervener argues that the ERS Bondholders' position will "eviscerate" Section 552 and that, if anything, post-petition Employers' Contributions are proceeds of post-petition labor and employment activity. Intervener Br. at 15. As the ERS Bondholders have established in detail, however, post-petition Employers' Contributions are proceeds from the ERS's existing pre-petition Right to Receive Employers' Contributions—a view supported by the case law. Moreover, the Employers' Contributions are not linked to the debtor's employees' labor and activities; rather, the ERS simply collects the proceeds generated by third-party employers. Opening Br. ¶¶ 37-47; Opp. Br. ¶¶ 44-57. In any event, to the extent Intervener suggests one debtor is precluded from collecting a receivable from another debtor because the second debtor is reliant on the services of employees to pay its debts, that is in conflict with the cases cited by the ERS Bondholders. *See* Opp. Br. ¶¶ 53-54.

is any response to the ERS Bondholders' plain text reading of the exception, showing that Employers' Contributions "derive" from the ERS's self-acknowledged function of "collect[ing] and pay[ing] out pension payments." Opening Br. ¶ 52. Nor does the ERS deny that the relevant legislative history merely offers "examples." Opp. Br. ¶¶ 60-61. And the ERS's argument that the ERS Bondholders' interpretation would render Section 902(2)(A) meaningless is misplaced: the ERS Bondholders' reading appropriately differentiates between Section 902(2)(D), which only applies to revenues "derived from *particular* functions of the debtor, whether or not the debtor has other functions," and Section 902(2)(A), which encompasses revenues unrelated to the "particular functions" of the debtor. 11 U.S.C. § 902(2)(A), (2)(D) (emphasis added).[12]

30. Similarly, the ERS does not deny that it is a "system . . . primarily used to provide . . . services." ERS Opp. Br. at 28. Instead, the ERS attempts to sidestep the plain language of Section 902(2)(A) by arguing that this definition only concerns "a form of utility or transportation service." ERS Opp. Br. at 27-28. Nothing in that definition, its legislative history, or in the case law so contracts the language of the provision. Opp. Br. ¶ 63 & n.10.

D. The ERS Does Not Deny That Its Interpretation Of Section 552 As Applied Here Would Raise Serious Constitutional Issues That This Court Can And Should Avoid.

31. The ERS mischaracterizes the ERS Bondholders' constitutional avoidance arguments as a constitutional challenge, and thus fails to respond to it. The ERS claims that the ERS Bondholders view PROMESA itself as "caus[ing] an 'unprecedented' taking." ERS Opp. Br. at 31. That is wrong. This is not a constitutional challenge to PROMESA. Rather, as the ERS

[12] Intervener contends that "'special revenues' include[] only revenues pledged to secure financing that is used to create the pledged revenue," that the legislative history supports this view, and that the ERS Bondholders' interpretation of Section 902(2)(D) is too broad. Intervener Br. at 14-15. Yet Intervener does not explain how its arguments comport with the specific definitions of "Special Revenues" provided in Section 902, nor does it engage the ERS Bondholders' close reading of those definitions. Opp. Br. ¶¶ 59-63.

Bondholders explain, it is the ERS's effort to give certain provisions of PROMESA retroactive effect by applying Section 552 to secured creditors' property interests that raises serious constitutional questions under the Takings Clause. Opp. Br. ¶ 67. Because adopting the ERS's interpretation of Section 552 would raise a "grave and doubtful constitutional question[]," *see* Opening Br. ¶¶ 54-61, while the ERS Bondholders' reading does not, this Court should follow its "duty" under the constitutional avoidance canon by "adopt[ing] the latter" interpretation to avoid ruling on a serious constitutional question. *Jones v. United States*, 529 U.S. 848, 857 (2000).[13]

32. The ERS further argues that applying Section 552 to cut off purely contingent after-acquired property security interests does not violate the Takings Clause. ERS Opp. Br. at 31. But the ERS Bondholders' security interests are not "purely contingent"; rather, they are enforceable liens which constitute constitutionally protected property rights under applicable non-bankruptcy law. Opening Br. ¶¶ 55-60. Well-established Supreme Court precedent holds that (1) an enforceable lien under applicable non-bankruptcy law is a constitutionally protected right, *see, e.g., Armstrong v. United States*, 364 U.S. 40, 44, 46 (1960); *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 601 (1935); and (2) the Takings Clause protects against retroactive impairment of secured property rights, such as enforceable liens, *see, e.g.*, *Radford*, 295 U.S. at 555, *Securities Industrial Bank*, 459 U.S. 70 (1982). Opening Br. ¶¶ 55-59. These Supreme Court cases, which date back to the Great Depression and which invalidated attempts to retroactively impair secured property rights, including liens, counsel against construing Section 552 to apply retroactively here.

[13] The ERS suggests that even though "the Bankruptcy Code no longer applie[d] to Puerto Rico after the 1984 amendments" the ERS Bondholders "should have expected that the law could change" because the Bankruptcy Code "did previously apply." ERS Opp. Br. at 30-31 & n.27. This is absurd. What the ERS ignores is that, for over twenty years prior to the ERS Bond Resolution, the Bankruptcy Code did *not* apply to Puerto Rico and, up until this past year, there was no reason to think that the Code would be reimposed on Puerto Rico and then applied retroactively.

IV. THE ERS BONDHOLDERS' LIEN ENCOMPASSES EMPLOYEE LOANS AND LOAN PAYMENTS.

33. The ERS argues that "just because an employer sends ERS money does not make such money Employers' Contributions" and that 3 L.P.R.A. § 787f "never included Employee Loan Payments." ERS Opp. Br. at 32. The Loan Payments, however, are "contributions paid from and after the [signing of the ERS Bond Resolution] that are made by Employers"—or, at a minimum, "assets in lieu thereof or derived thereunder"—to the ERS and, as such, they are Employers' Contributions under the ERS Bond Resolution's plain text. Opp. Br. ¶ 39. The ERS's argument that the Loan Payments are not in a statutory section within the definition of Employers' Contribution is unavailing as, tellingly, the ERS offers no response to the ERS Bondholders' prior argument about the proper construction of this definition.[14] Opening Br. ¶ 68.

34. Similarly, the ERS's argument that any security interest in the Employee Loans would be perfected only if a new act of perfection occurred is mistaken because the Employee Loans and Loan Payments are "identifiable cash proceeds." Opp. Br. ¶ 40. Moreover, despite the ERS's protests to the contrary, the ERS has stated in this very briefing that "[t]he Employee Loans and Employee Loan Payments are ***assets generated by*** using employer contributions," ERS Opp. Br. at 33 n.28 (emphasis added), and thus, no independent filing is necessary. Opp. Br. ¶ 41. And, at a minimum, even if the ERS Bondholders' lien were unperfected, the ERS could not avoid this lien under Section 544. *See supra* Part II; Opp. Br. ¶ 42.

V. THE ERS SHOULD BE HELD TO ITS PRIOR ADMISSION THAT THE ERS BONDHOLDERS POSSESS VALID LIENS IN THE PLEDGED PROPERTY.

[14] The ERS also claims, without citing to any authority, that the "Employee Loan Payments were remitted to ERS in addition to the employers' contribution obligation, not in lieu of the contribution." This argument ignores that Employee Loans are Employers' Contributions that have been temporarily diverted and that the Loan Payments are payments "in lieu of" those temporarily diverted Employers' Contributions, and not standalone, separate payments made in addition to Employers' Contributions.

35. The ERS admits that it has changed its position regarding whether the ERS Bondholders possess perfected valid liens in the Pledged Property, but the ERS tries to minimize that inconvenient truth by claiming that the ERS Bondholders fail to explain the legal effect or relevance of such statements. ERS Opp. Br. at 34 n.29. That is wrong. The ERS Bondholders explained that "'a position taken by a party in court is *obviously weakened* if on some previous occasion he has taken a contradictory one.'" Opening Br. ¶ 72-73 (quoting *Pro-Phy-Lac-Tic Brush Co. v. Jordan Marsh Co.*, 165 F.2d 549, 553 (1st Cir. 1948) (emphasis added)). Moreover, because, under Puerto Rico law, a party's acts are indicative of the meaning of a contract, the ERS's longstanding treatment of the liens securing the ERS Bonds and its inability to produce any evidence calling that treatment into question prior to the Title III case, *see* Third DiPompeo Dec., Ex. C, shows that the ERS's new argument that the ERS Bondholders do not possess perfected valid liens in the Pledged Property is fatally flawed. *See* 31 L.P.R.A. § 3472; *Marcial*, 144 D.P.R. at 537.

36. The ERS also incorrectly argues that the affirmative equitable defenses of laches, waiver, and estoppel are not viable here. ERS Opp. Br. at 34 n.29. As explained before, the ERS has previously taken the position both before this Court and the First Circuit that the ERS Bondholders possess valid and enforceable liens in the Pledged Property—a view which the ERS's own counsel has endorsed. This blatant change in position, at a minimum, reflects a genuine issue of material fact as to whether the ERS waived or is otherwise estopped from now contending that the ERS Bondholders' liens are not valid and enforceable.

CONCLUSION

37. The ERS Bondholders respectfully request that this Court enter a declaratory judgment that the ERS Bondholders possess valid, enforceable, attached, perfected, first priority liens on, and security interests in, the Pledged Property, which encompasses all disputed property.

In San Juan, Puerto Rico, today November 22, 2017.

By:

/s/ Alfredo Fernández-Martínez
Alfredo Fernández-Martínez
DELGADO & FERNÁNDEZ, LLC
PO Box 11750
Fernández Juncos Station
San Juan, Puerto Rico 00910-1750
Tel. (787) 274-1414
Fax: (787) 764-8241
afernandez@delgadofernandez.com
USDC-PR 210511

Counsel for ERS Bondholders Altair Global Credit Opportunities Fund (A), LLC, Andalusian Global Designated Activity Company, Glendon Opportunities Fund, L.P., Mason Capital Management, LLC, Nokota Capital Master Fund, L.P., Oaktree-Forrest Multi- Strategy, LLC (Series B), Oaktree Opportunities Fund IX, L.P., Oaktree Opportunities Fund IX (Parallel 2), L.P., Oaktree Value Opportunities Fund, L.P., Ocher Rose, L.L.C., and SV Credit, L.P.

/s/ Bruce Bennett
Bruce Bennett (*pro hac vice*)
JONES DAY
555 South Flower Street
Fiftieth Floor
Los Angeles, California 90071
Tel. (213) 489-3939
Fax: (213) 243-2539
bbennett@jonesday.com

Benjamin Rosenblum (*pro hac vice*)
Victoria Dorfman (*pro hac vice*)
James M. Gross (*pro hac vice*)
JONES DAY
250 Vesey Street
New York, NY 10281
Tel. (212) 326-3939
Fax: (212) 755-7306
brosenblum@jonesday.com
vdorfman@jonesday.com
jgross@jonesday.com

Geoffrey S. Stewart (*pro hac vice*)
Beth Heifetz (*pro hac vice*)
Christopher J. DiPompeo (*pro hac vice*)
JONES DAY
51 Louisiana Ave. N.W.
Washington, DC 20001
Tel. (202) 879-3939
Fax: (202) 626-1700
gstewart@jonesday.com
bheifetz@jonesday.com
cdipompeo@jonesday.com

Counsel for ERS Bondholders Altair Global Credit Opportunities Fund (A), LLC, Andalusian Global Designated Activity Company, Glendon Opportunities Fund, L.P., Mason Capital Management, LLC, Nokota Capital Master Fund, L.P., Oaktree-Forrest Multi- Strategy, LLC (Series B), Oaktree Opportunities Fund IX, L.P., Oaktree Opportunities Fund IX (Parallel 2), L.P., Oaktree Value Opportunities Fund, L.P., Ocher Rose, L.L.C., and SV Credit, L.P.

/s/ Alicia I. Lavergne-Ramírez
José C. Sánchez-Castro
USDC-PR 213312
jsanchez@sanpir.com

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

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

SÁNCHEZ PIRILLO LLC
270 Muñoz Rivera Avenue, Suite 1110
San Juan, PR 00918
Tel. (787) 522-6776
Fax: (787) 522-6777

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

/s/ John K. Cunningham
John K. Cunningham (*pro hac vice*)
Glenn M. Kurtz (*pro hac vice*)
WHITE & CASE LLP
1221 Avenue of the Americas
New York, NY 10036
Tel. (212) 819-8200
Fax (212) 354-8113
jcunningham@whitecase.com
gkurtz@whitecase.com

Jason N. Zakia (*pro hac vice*)
Cheryl T. Sloane (*pro hac vice*)
WHITE & CASE LLP
200 S. Biscayne Blvd., Suite 4900
Miami, FL 33131
Tel. (305) 371-2700
Fax (305) 358-5744
jzakia@whitecase.com
csloane@whitecase.com

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