UNITED STATES DISTRICT COURT
DISTRICT OF PUERTO RICO

ASSURED GUARANTY CORP. and ASSURED GUARANTY MUNICIPAL CORP.,

Movants,

-against-

COMMONWEALTH OF PUERTO RICO, PUERTO RICO HIGHWAYS AND TRANSPORTATION AUTHORITY, GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO, ALEJANDRO GARCÍA PADILLA, CARMEN VILLAR PRADOS, MELBA ACOSTA FEBO, JUAN C. ZARAGOZA GÓMEZ, and JOHN DOES 1-4,

Respondents.

No. 16-cv-02384-FAB

REPLY OF MOVANTS ASSURED GUARANTY CORP. AND ASSURED GUARANTY MUNICIPAL CORP.

TO THE HONORABLE COURT:

Movants Assured Guaranty Corp. and Assured Guaranty Municipal Corp. (collectively, "Assured") hereby reply to the opposition [ECF No. 22] ("Opp.") to Movants' Emergency Motion for Relief from the PROMESA Stay [ECF No. 1] (the "Motion" or "Mot."),[1] along with the joinders thereto [ECF Nos. 24 and 25].

I. Introduction

Assured filed a Proposed Complaint, asserting that the emergency executive orders diverting toll road revenues previously pledged as collateral violated PROMESA (Pub. L. No. 114-187, 130 Stat. 549 (2016)), the United States Constitution, and the laws of the Commonwealth. Accompanying the complaint was a motion seeking relief from the stay automatically imposed by Section 405(b) of PROMESA, to the extent that the stay applied.

[1] Capitalized terms not otherwise defined herein shall have the meanings ascribed to them in the Motion.

Respondents' opposition serves only to confirm that the stay should be lifted. First, Assured has already been injured by the diversion and dissipation of the pledged toll revenues and, accordingly, has standing. Second, Respondents' assertion that "cause" for relief from stay under Section 405(e)(2) does not include lack of adequate protection is proven false by the very history of the United States Bankruptcy Code on which Respondents rely. Respondents' further contention that diversion of the toll revenues does not constitute lack of adequate protection borders on the frivolous. Finally, the balance of harms favors granting relief from the stay. The stay was intended to preserve the *status quo* until the PROMESA Oversight Board could act. Respondents' diversion of collateral to which they have no entitlement is a disruption of the *status quo*, and, if permitted to continue, may handcuff the Oversight Board in the future.

II. Movants Have Standing

In order to have constitutional standing, a plaintiff must show "'[i] a concrete and particularized injury in fact, [ii] a causal connection that permits tracing the claimed injury to the defendants' actions, and [iii] a likelihood that prevailing in the action will afford some redress for the injury.'" Weaver's Cove Energy LLC v. R.I. Coastal Res. Mgmt. Council, 589 F.3d 458, 467 (1st Cir. 2009) (citation omitted). Respondents erroneously contend that Movants are "not bondholders" and do not step into the bondholders' shoes until a payment default has occurred. Opp. 8. This is incorrect. Under the relevant insurance agreements, Assured is deemed to be the sole owner of the PRHTA Bonds that it insures, for purposes of exercising rights and remedies. Mot. 4. Assured is also an express third party beneficiary under the Resolutions. Mot. 4. Thus, Assured's rights are not dependent upon either a default or subrogation. Assured has an actionable contract right to enforce the pledge of the toll revenues now. Respondents' contention that injury does not occur until a payment default occurs thus is equally specious. Opp. 9-10. The Resolutions authorizing the PRHTA Bonds require the timely deposit of the toll revenues into the Fiscal Agent's trust accounts. The monthly diversion of the tolls away from the Fiscal

Agent violated the terms of the bond issuance and is present injury in fact.

Moreover, at the pleading stage, "'injury-in-fact' need not entail currently *realized* economic loss[;] Article III standing in the commercial context must be premised, at a minimum, on particularized future economic injury which, though latent, nonetheless qualifies as 'imminent.'" Adams v. Watson, 10 F.3d 915, 920-21 (1st Cir. 1993) (emphasis in original; citation omitted); Universal Ins. Co. v. Dep't of Justice, 866 F. Supp. 2d 49, 59 (D.P.R. 2012) (Besosa, J.) (holding that injury in fact was established where plaintiff insurers alleged that they "**will** suffer an economic injury because they have to pay out insurance claims but cannot recuperate their losses because of [a Puerto Rican law]") (emphasis added). Here, as the result of the current ongoing diversions of toll revenues, a payment default is imminent and inevitable, because tolls collected after expiration of the emergency period will be totally insufficient to fund the July 1, 2017, payment. Based on the most recent information available, $223 million of debt service is due on July 1, 2017. After factoring in reserve funds, approximately $132 million in new toll revenues would be needed to cover this payment. However, PRHTA generates only about $10.5 million a month in toll revenues. Therefore, even assuming that the emergency period does expire on March 31, 2017, PRHTA is likely to generate only around $30 million of the $132 million needed to prevent a July 1 default, rendering a $100 million default both imminent and inevitable.

In any event, a direct and present injury has also occurred because the Respondents are already unconstitutionally infringing on Movants' statutory, contractual, and property interests. See Mot. 11-16. "'[T]he injury required by Art. III may exist solely by virtue of "statutes creating legal rights, the invasion of which creates standing."'" Pollard v. Law Office of Mandy L. Spaulding, 766 F.3d 98, 102 (1st Cir. 2014) (citations omitted). In Franklin Cal. Tax-Free Tr. v. P.R., 85 F. Supp. 3d 577 (D.P.R.) (Besosa, J.), aff'd, 805 F.3d 322 (1st Cir. 2015), aff'd, 136

S. Ct. 1938 (2016), this Court found that even though there was no payment default by PREPA, injury in fact had been established where plaintiffs alleged that the Recovery Act unlawfully (i) invaded a statutory non-impairment covenant by the Commonwealth, (ii) violated covenants in the relevant trust agreement, and (iii) prevented bondholders from enforcing remedies upon a future event of default. Id. at 594. Like the Recovery Act, the Moratorium Act and the Emergency Orders invade the Commonwealth's statutory non-impairment covenant with PRHTA Bondholders (9 L.P.R.A. § 2019); violate covenants in the Resolutions, including the covenant requiring PRHTA to turn the toll revenues over to the Fiscal Agent on a monthly basis; and prevent Movants from exercising remedies with respect to the PRHTA Bonds. See Mot. 15-16. Injury in fact clearly exists here, as it did in Franklin.

III. Cause Exists To Lift The PROMESA Stay

A. Lack Of Adequate Protection Constitutes "Cause" To Lift The Stay

Respondents argue that in setting forth the standard for relief from the PROMESA Stay under Section 405(e)(2) of PROMESA, Congress looked back forty years and chose the phrase "for cause shown" from old Rule 11-44(d) under the former Bankruptcy Act, rather than adopting the phrase "'for cause, including the lack of adequate protection'" from Section 362(d) of the modern Bankruptcy Code. Opp. 14-15 (citation omitted). Respondents' unlikely argument fundamentally ignores the caselaw showing that on this issue, the 1978 Bankruptcy Code did not represent a change in the law. Rather, lack of adequate protection was consistently recognized as cause for lifting the stay under old Rule 11-44(d) of the former Bankruptcy Act. As stated in In re Timbers of Inwood Forest Assocs., 793 F.2d 1380 (5th Cir. 1986), aff'd, 484 U.S. 365 (1988), "[t]he rules Congress set forth in § 361 and § 362 regarding the automatic stay and the circumstances under which it might be lifted were not particularly innovative[.] '**Case law had made adequate protection of the secured creditor a major consideration long before the draft predecessor of the Code proposed to codify it as a requirement.**'" Id. at

1390 (emphasis added; citation omitted).

Respondents wrongly contend that old Rule 11-44(d) imposed an "irreparable harm" or "irreparable damage" standard "higher" than the standard for showing "cause" under the modern Bankruptcy Code. Opp. 15. However, the original bankruptcy court decision suggesting an "irreparable damage" standard for lifting the stay under old Rule 11-44(d) defined "irreparable damage" as "**an erosion of the value of the security in respect of the outstanding obligation**" – a lack of adequate protection. In re Overmyer Co., 2 Bankr. Ct. Dec. (CRR) 992, 993 (S.D.N.Y. 1976) (attached as Ex. 1). The cases Respondents cite for the "irreparable damage" standard under old Rule 11-44(d), in turn, cite to precisely this meaning of "irreparable damage" from Overmyer, demonstrating that the distinction Respondents posit between "cause" under old Rule 11-44(d) and modern section 362(d)(1) is illusory.[2] See Opp. 15 (citing In re Rutter, 9 B.R. 878, 879 (Bankr. E.D. Pa. 1981) (quoting Overmyer for the proposition that, "'**in the context of this dispute [over stay relief], ["irreparable damage"] should be read to mean an erosion of the value of the security in respect of the outstanding obligation.**'")) (emphasis added).

Further, the requirement to provide adequate protection is rooted in the Takings Clause of the U.S. Constitution, which "requires . . . that the value of the secured position of a creditor be maintained during the stay." In re Timbers, 793 F.2d at 1390. The mere absence of an express *statutory* reference to this requirement in Section 405(e)(2) of PROMESA cannot excuse Respondents from their *constitutional* obligation to provide adequate protection.

B. Assured Lacks Adequate Protection

Respondents concede that a secured party lacks adequate protection if there is a "decrease in the value" of the collateral. Opp. 16. They contend, however, that there is no decrease in collateral here because Movants' lien is on a "stream" of revenues and the diversion of payments

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[2] In any event, Movants are suffering "irreparable harm" or "irreparable damage" under any standard, as set forth in section IV of this Reply below.

from that stream does not decrease the value of the "stream." Opp. 16. Respondents' argument makes no sense. First, as noted above, the diversion will cause a payment default on July 1, 2017. Further, the diversion of any portion of a "stream" of revenues obviously decreases the value of the stream. See, e.g., In re Bldrs. Grp. & Dev. Corp. 502 B.R. 95, 122 (Bankr. D.P.R. 2013) ("'where there is a specific assignment of rents given as security, a diversion of **any portion** of the rents to a party other than the secured party is clearly a diminution of the secured party's interest'") (emphasis added; citation omitted).

Respondents suggest that this obvious decrease in the value of Movants' collateral could be "made up for" by future toll revenues, and that this use of future toll revenues to replace current toll revenues provides adequate protection. Opp. 17. Because *both* current and future toll revenues constitute collateral, however, use of future toll revenues to replace current toll revenues does nothing to compensate Movants for the overall diminution in the value of their collateral and thus does not constitute adequate protection. See Bldrs. Grp., 502 B.R. at 122 (any decrease in collateral value "'attributable to the debtor's usage'" of rents pledged as collateral "'must be protected by cash payments **from another source**, an additional or replacement lien, or other such indubitable equivalent'") (emphasis added; citation omitted); In re Buttermilk Towne Ctr., LLC, 442 B.R. 558, 566 (B.A.P. 6th Cir. 2010) (where a secured party had a security interest in future rents from an apartment complex, the future rents could not be used "'*to replace the [debtor's] expenditure of the prior months' rents*'" as a means of providing adequate protection) (emphasis in original; citation omitted). In addition, Respondents' actions demonstrate that future toll revenues may well also be diverted at any time, and PRHTA's auditors have questioned whether PRHTA will be able to continue as a revenue-generating going concern. Mot. 24. As such, future toll revenues are simply too speculative to provide adequate protection, and as noted above, they will not be enough to avoid a default. See Mot. 22-23.

It is equally absurd for Respondents to suggest that payments made by the Fiscal Agent from trust accounts constitute adequate protection in the form of "periodic cash payments" as described in section 361(1) of the Bankruptcy Code. Funds held by the Fiscal Agent already constitute collateral, and, as noted above with respect to future toll revenues, adequate protection against a decrease in the value of collateral cannot be provided by using, and reducing the value of, other collateral. See Bldrs. Grp., 502 B.R. at 122; In re Gen. Auto Bldg, LLC, 2012 WL 6737741, at *2 (Bankr. D. Or. Dec. 28, 2012) ("adequate protection for use of cash collateral to pay expenses . . . [to] someone other than the secured creditor cannot be provided by . . . payments [that] come from and reduce the value of the collateral.").

Finally, a possible cause of action against the Commonwealth or GDB under Section 407 of PROMESA also fails to provide adequate protection. See Rocco v. J.P. Morgan Chase Bank, 255 F. App'x 638, 641 (3d Cir. 2007) ("[A] lawsuit is too speculative in nature to offer adequate protection"). The essence of adequate protection is to give the secured creditor the "indubitable equivalent" of its existing property interest. See In re Grant, 29 B.R. 375, 376 (Bankr. Md. Pa. 1983). Even a successful lawsuit under Section 407(a) would, in the first instance, give rise only to an *unsecured* claim against the Commonwealth and GDB, and such an unsecured claim is not the indubitable equivalent of Movants' *secured* property interest in the toll revenues, particularly since the Commonwealth and GDB likely are insolvent. See, e.g., In re Kenny Kar Leas., Inc., 5 B.R. 304, 309 (Bankr. C.D. Cal. 1980) (unsecured claims against guarantors do not constitute adequate protection).[3]

C. The Balance Of Harms Favors Lifting The PROMESA Stay

While lack of adequate protection is, in itself, sufficient to grant relief from the stay,

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[3] The fact that the Moratorium Act purports, in some abstract sense, to preserve Movants' security interest also fails to provide adequate protection, given that the actual collateral is being diverted and used. See, e.g., In re Kenny Kar, 5 B.R. at 309 ("The use of [the secured creditor's] cash collateral . . . expose[s] [the secured creditor] to a decrease in the value of its interests").

Respondents acknowledge that cause to lift the stay also exists when "'the harm that would result from a continuation of the stay would outweigh any harm that might be suffered by the debtor or the debtor's estate if the stay is lifted.'" Mot. 19 (citation omitted); Opp. 15 n.6. Yet Respondents fail even to address Movants' core argument demonstrating that Respondents cannot be legally harmed by a lifting of the stay, because the toll revenues constitute trust funds in which Respondents have no beneficial interest. See Mot. 20-21. Given that Respondents have conceded that they have no beneficial interest in or legal entitlement to the toll revenues, it is impossible to see how it is equitable for the PROMESA Stay to shield their wrongful misappropriation of those funds. A person who steals property has no entitlement to retain the property, and no ground to claim hardship when enjoined from continuing the theft.

Similarly, Respondents' arguments about the need to preserve the *status quo* pending appointment of the Oversight Board strongly militate *in favor* of lifting the stay. Many of the provisions of PROMESA that Assured seeks to enforce, as well as Section 405 itself, are designed specifically to preserve the pre-PROMESA *status quo*. See 130 Stat. 572 (§ 204(c)(3)(A), prohibiting the "enact[ment]" of "new laws" authorizing transfers inconsistent with pre-PROMESA laws); 130 Stat. 579 (§ 303(3), prohibiting "unlawful executive orders" that amend pre-PROMESA creditor rights and priorities); 130 Stat. 592 (§ 407(a), prohibiting unlawful transfers following creation of Oversight Board). By challenging Respondents' unlawful *interference* with "lawful priorities" and "lawful liens," Movants will be giving effect to PROMESA as Congress intended and laying the groundwork for a viable and lawful fiscal plan. See 130 Stat. 564 (§ 201(b)(1)(N)).

IV. Movants Are Suffering "Irreparable Damage"

Irreparable damage is relevant only to the extent Assured seeks emergency relief from the stay prior to a hearing under Section 405(g). Irreparable damage is not necessary to lift the stay under Section 405(e)(2). Nonetheless, Assured is suffering irreparable damage, because the

Commonwealth, which is insolvent, is misappropriating and dissipating Assured's collateral. See Micro Signal Research, Inc. v. Otus, 417 F.3d 28, 31 (1st Cir. 2005) (irreparable injury shown where "the defendant may **dissipate** or conceal assets") (emphasis added). Irreparable damage is particularly apparent where, as here, "the very assets subject to a potential judgment will likely be dissipated without entry of an order" enjoining such dissipation. See Elliott v. Kiesewetter, 98 F.3d 47, 58 (3d Cir. 1996) (cited by Micro, 417 F.3d at 31). The fact that the assets at risk of dissipation "are primarily money assets" (Elliott, 98 F.3d at 58)—or "just money," as Respondents put it (Opp. 12)—does *not* preclude a showing of irreparable injury or damage. See Elliott, 98 F.3d at 58.[4] More specifically, "irreparable damage" justifying emergency relief under section 362(f) of the Bankruptcy Code, on which Section 405(g) of PROMESA is modeled, has been shown where, as here, there is a risk that a debtor could use or otherwise dissipate cash collateral. See, e.g., In re First Conn. Small Bus. Inv. Co., 118 B.R. 179, 183-84 & n.2 (Bankr. D. Conn. 1990); In re Krisle, 54 B.R. 330, 337 (Bankr. D.S.D. 1985).[5] Therefore, emergency relief under Section 405(g) is also warranted.

V. The PROMESA Stay Does Not Apply To Claims Arising Under PROMESA

Finally, while Assured has demonstrated clear entitlement to relief from the PROMESA Stay, we respectfully submit that the stay does not even apply to Assured's proposed claims based on violations of PROMESA, itself. The only language from PROMESA's stay provision that Respondents cite as applicable here is Section 405(b)(1), which refers to "judicial proceedings" that "could have been commenced before the enactment" of PROMESA. Opp. 6-7. However, Section 405(b)(1) is clearly *inapplicable* with respect to (i) Assured's second claim for

4 K-Mart Corp. v. Oriental Plaza, Inc., 875 F.2d 907 (1st Cir. 1989), is not to the contrary, because that case only discussed generally the standards for granting equitable relief and did not specifically concern dissipation of assets, much less assets in which a secured creditor had a security interest.

5 Moreover, the fact that Movants' constitutional rights are being violated also constitutes irreparable damage. See UPS, Inc. v. Flores-Galarza, 210 F. Supp. 2d 33, 44 (D.P.R. 2002), aff'd in part, remanded in part on other grounds, 318 F.3d 323 (1st Cir. 2003).

relief, which seeks a declaration that the Emergency Orders are preempted by PROMESA § 303(3) as "unlawful executive orders" that alter the rights of PRHTA Bondholders (Proposed Compl. ¶¶ 74-76), and with respect to (ii) Assured's third claim for relief, which seeks a declaration that EO-30 and EO-31 are preempted by PROMESA § 204(c)(3)(A) as new laws that permit the transfer of funds outside the ordinary course of business (Proposed Compl. ¶¶ 77-79). Unlike the claims held to be subject to the stay in Brigade Leveraged Cap. Structures Fund, Ltd. v. García Padilla, No. 16-1610 (D.P.R. Aug. 22, 2016), Assured's second and third claims for relief seek to enforce PROMESA, and as such could not have been brought "before the enactment" of PROMESA. Plainly, PROMESA does not stay itself. See, e.g., In re Knowles, 442 B.R. 150, 160 (B.A.P. 1st Cir. 2011) (automatic stay does not apply to actions expressly sanctioned by the Bankruptcy Code). Moreover, PROMESA § 106(d) requires courts "to expedite to the greatest possible extent the disposition of any matter brought under [PROMESA]." 130 Stat. 562. Accordingly, the PROMESA Stay does not apply to Assured's second and third claims for relief, and the Court should expedite disposition of those claims.

RESPECTFULLY SUBMITTED, in San Juan, Puerto Rico, this 29th day of August, 2016.

CASELLAS ALCOVER & BURGOS P.S.C.

By: */s/ Heriberto Burgos Pérez*
Heriberto Burgos Pérez
USDC-PR 204809
Ricardo F. Casellas-Sánchez
USDC-PR 203114
Diana Pérez-Seda
USDC-PR 232014
P.O. Box 364924
San Juan, PR 00936-4924
Telephone: (787) 756-1400
Facsimile: (787) 756-1401
Email: hburgos@cabprlaw.com
dperez@cabprlaw.com

CADWALADER, WICKERSHAM & TAFT LLP

By: */s/ Howard R. Hawkins, Jr.*
Howard R. Hawkins, Jr. (*Pro Hac Vice*)
Mark C. Ellenberg (*Pro Hac Vice*)
Ellen M. Halstead (*Pro Hac Vice*)
200 Liberty Street
New York, NY 10281
Telephone:(212) 504-6000
Facsimile: (212) 406-6666
Email: howard.hawkins@cwt.com
mark.ellenberg@cwt.com
ellen.halstead@cwt.com