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

NATIONAL PUBLIC FINANCE GUARANTEE CORPORATION, *Plaintiff*, v. Alejandro J. GARCÍA PADILLA; Juan C. ZARAGOZA GÓMEZ; and LUIS F. CRUZ BATISTA, *Defendants*.	Civil No. 16-cv-2101 FAB

OPPOSITION TO MOTION FOR PARTIAL SUMMARY JUDGMENT

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INTRODUCTION

Plaintiff's motion for partial summary judgment represents an effort to transform the Supreme Court's recent decision in Puerto Rico v. Franklin California Tax-Free Trust, 136 S. Ct. 1938 (2016), into something it is not: an advisory opinion on the validity of Public Act 21-2016, the Puerto Rico Emergency Moratorium and Financial Rehabilitation Act ("Act 21"). Franklin has absolutely nothing to do with Act 21, which was not even enacted until Franklin had reached the Supreme Court. Rather, Franklin involved an entirely different statute, the Puerto Rico Public Corporation Debt Enforcement and Recovery Act ("Recovery Act"), which created a mechanism for Puerto Rico public corporations to restructure their debts. Act 21, in sharp contrast, does not provide a mechanism for restructuring any debts; rather, it authorizes the Governor to declare a state of emergency and to temporarily suspend certain transfers and payments until January 2017.

This simple point resolves plaintiff's motion for partial summary judgment: Act 21 creates a temporary emergency mechanism for deferring certain payments and transfers, as opposed to restructuring or discharging any portion of the principal or interest owed. Thus, Act 21 does not prescribe a method for the "composition" of any debts. See, e.g., Ropico, Inc. v. City of New York, 425 F. Supp. 970, 977 (S.D.N.Y. 1976) (distinguishing between a composition and a moratorium, and holding that § 903(1) does not apply to a moratorium). Nothing in Franklin suggests that any temporary suspension of payments is a "composition" of debt, and indeed the recently enacted Puerto Rico Oversight, Management, and Economic Stability Act of 2016 (PROMESA) refutes any such suggestion by distinguishing between a composition law and a moratorium law. See PROMESA § 303(1).[1]

[1] Plaintiff filed both its complaint and its motion for partial summary judgment before the enactment of PROMESA on June 30, 2016. Although plaintiff acknowledges in that motion that

At bottom, plaintiff's motion for partial summary judgment represents classic litigation overreach: although Franklin was narrowly based on the specific language of Section 903(1), they try to turn that decision into a sweeping implied-preemption and field-preemption decision, which it is not. Act 21 is a very different statute than the Recovery Act, and nothing in Franklin requires or allows the conclusion that Act 21 is preempted by the Bankruptcy Code. Accordingly, this Court should deny the motion for partial summary judgment.

BACKGROUND

As Puerto Rico teetered on the precipice of a default this past spring, the Governor and the Legislative Assembly moved to take steps to prevent a financial meltdown and protect the health, safety, and welfare of Puerto Rico's residents. Among these steps was Act 21, enacted on April 6, 2016, which directs the Governor "to prioritize payment of essential services" over debt obligations of government entities during the "covered period" (the period from the date of enactment to January 31, 2017), which can be extended for up to two months. Act 21 §§ 103(m), 201(a). The Act also authorizes the Governor to issue executive orders declaring the Commonwealth or any "government entity" of the Commonwealth "to be in a state of emergency." Act 21 § 201(a). With respect to an entity in such a "state of emergency," the Act

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"federal preemption does not leave the Commonwealth without a remedy for its fiscal problems" because "[t]he U.S. Congress is currently considering legislation that would create a framework for the Commonwealth and its creditors to work toward a restructuring," Mot. 4 (citing PROMESA), plaintiff has neither withdrawn nor amended its complaint or its motion in light of PROMESA. To the contrary, plaintiff has expressed a desire to continue litigating this dispute as if nothing had happened, arguing that the PROMESA automatic stay does not apply here. Defendants respectfully disagree with that position, and believe that merits briefing in this case should be suspended until the Court decides whether the automatic stay applies. Accordingly, defendants file this brief under protest, and without prejudice to their rights under the PROMESA automatic stay. This brief is strictly limited to the matters set forth in plaintiff's motion for partial summary judgment, and does not address the myriad other issues raised by the enactment of PROMESA.

provides that "no payment on a covered obligation of such … government entity shall be made … during the emergency period for such … government entity…." Id.

The Act defines "covered obligations" to include "any interest obligation, principal obligation or enumerated obligation of a government entity that is due or becomes due during the emergency period in respect of such government entity." Act 21 § 103(l). The Act specifies, however, that it "does not provide for a composition or discharge of debts," but preserves "all claims and priorities" for payment "at the end of any moratorium period to the extent permitted by otherwise applicable law." Act 21 at F-5; see also id. § 204(a) ("[N]othing in this Act shall be construed to limit the rights of a holder to any collateral, security interest, or lien that secures such obligation, and nothing in this Act authorizes any government entity to compromise any obligation over the objection of a creditor.").

Act 21 also provides for ancillary protections to ensure the moratorium affords a covered entity the breathing room necessary to regain its financial footing. Specifically, no action may be commenced or continued "in any court in any jurisdiction" that could result in recovery against a covered entity related to covered obligations. Id. § 201(b). For similar reasons, no entity or person may exercise any remedy with respect to covered obligations, and no contract with a covered entity may be terminated or modified solely because of a provision conditioned on the insolvency of the entity or a default triggered by the moratorium. Id. Additionally, no person may be held liable for actions taken within their authority related to the Act, except in the case of "willful misconduct for personal gain or gross negligence comprising reckless disregard of applicable duties," as demonstrated by the specific burden of proof articulated in the Act. Id. § 105.

LEGAL STANDARD

Summary judgment is warranted only if "the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a); Walsh v. TelTech Sys., Inc., 821 F.3d 155, 160 (1st Cir. 2016). In ruling on a motion for summary judgment, all reasonable inferences should be drawn in favor of the nonmoving party, "while ignoring conclusory allegations, improbable inferences, and unsupported speculation." Id.

ARGUMENT

Act 21 Is Not Preempted By Federal Law.

According to plaintiff, "[t]he Bankruptcy Code likewise preempts the Moratorium Act for three independent reasons." Mot. 2. First, plaintiff contends that "Section 903(1) expressly preempts the Moratorium Act." Id. (emphasis in original). Second, plaintiff contends that "the Moratorium Act is implicitly preempted because it stands as an obstacle to the accomplishment of Congress' purposes with respect to the restructuring of debt." Id. (emphasis in original). And third, plaintiff contends that "the Moratorium Act is preempted because federal law occupies the field, and leaves no room for competing or supplemental state restructuring schemes like the Moratorium Act." Id. (emphasis in original). As described below, plaintiff is wrong on each score.

I. Section 903(1) Does Not Expressly Preempt Act 21.

Plaintiff first argues that Act 21 is expressly preempted by 11 U.S.C. § 903(1), the statutory provision at issue in Franklin, which provides that "a State law prescribing a method of composition of indebtedness of such municipality may not bind any creditor that does not consent to such composition." 11 U.S.C. § 903(1) (emphasis added). See Mot. 11-16. The

simple problem with that argument is that Act 21, in sharp contrast to the Recovery Act, does not "prescrib[e] a method of composition of indebtedness."

Plaintiff challenges that conclusion on two grounds. First, plaintiff argues that "the Moratorium Act turns secured debt into unsecured debt." Id. at 13. That is so, in plaintiff's view, because "Section 201(d) empowers the Governor to suspend the transfer of funds pledged to the repayment of municipal debts and divert those funds to other purposes." Id. That argument misses the point. As a matter of law, a "composition" of indebtedness is an adjustment of the principal or interest amount due. See, e.g., Franklin Cal. Tax-Free Trust v. Puerto Rico, 85 F. Supp. 2d 577, 597 (D.P.R.) (Besosa, J.) ("A 'composition' is an 'agreement between a debtor and two or more creditors for the adjustment or discharge of an obligation for some lesser amount.') (quoting Black's Law Dictionary 346 (10th ed. 2014)), aff'd, 805 F.3d 322 (1st Cir. 2015), aff'd, 136 S. Ct. 1938 (2016); see also Black's Law Dictionary 234 (2d ed. 1910) (defining "composition" as "[a]n agreement ... between an insolvent or embarrassed debtor and his creditors, whereby the latter, for the sake of immediate payment, agree to accept a dividend less than the whole amount of their claims, to be distributed pro rata, in discharge and satisfaction of the whole."); Perry v. Commerce Loan Co., 383 U.S. 392, 398-99 (1966) (distinguishing between an "extension" and a "composition" on the ground that "under an extension plan, the wage earner who makes the required payments will have paid his debts in full and will not need a discharge"); Ropico, 425 F. Supp. at 982 ("'If the proposal is to reduce debts, it is a composition; if the proposal is merely to postpone payment, it is an extension.'") (quoting Garrison, The New Bankruptcy Amendments: Some Problems of Construction, 8 Wisc. L. Rev. 291, 294 (1933)). Thus, an action that alters the date on which the payment is due, or the nature or value of the creditor's collateral, is not a "composition of indebtedness."

Plaintiff, in contrast, asks this Court to hold that an alteration of a creditor's collateral is a method of "composition" of indebtedness. Plaintiff's only authority for that request is a single district court case from 1935. See Mot. 13 (citing In re Borgelt, 10 F. Supp. 113, 116 (S.D. Ill.), aff'd, 79 F.2d 929 (7th Cir. 1935)). But that case did not address the issue presented here, or analyze the meaning of the word "composition." Rather, that case involved the question whether, under the Bankruptcy Act as it existed at that time, a farmer had made "a composition or extension proposal" to his creditors before filing for bankruptcy, a required by the Act. The court held that the farmer in that case had not, because his proposal was too "indefinite and uncertain." 10 F. Supp. at 117. The case does not hold that any impairment of a secured creditor's collateral is, in and of itself, a "composition" of debt, and that issue was not presented in that case. It is nothing but wishful thinking for plaintiff to suggest that anything that in any way burdens a creditor's rights qualifies as a "composition" of debt. Were that the case, Congress would have had no basis for addressing a "moratorium" law separately from a "composition" law in PROMESA Section 303(1).

Second, plaintiff argues that Act 21 "prescrib[es] a method of composition of indebtedness" because it "enable[es] the Governor to turn senior debt into subordinated debt" by authorizing the Governor to prioritize payment of essential services above the payment of bondholders. Mot. 13. But that is nothing more than a variation on the foregoing argument that any impairment of a secured creditor's rights is a method of "composition" of indebtedness as a matter of law, which, as noted above, is incorrect. Again, plaintiff provides no authority for its sweeping interpretation of the statutory term "composition."

Plaintiff similarly misses the point by comparing Act 21 with the federal Bankruptcy Code, and arguing that they they have some overlapping subject matter. See Mot. 14-15.

According to plaintiff, that means that both Act 21 and Bankruptcy Code "are examples of restructuring laws," which "only the federal government can enact." Id. at 15 (emphasis added). What this argument has to do with express preemption under Section 903(1) is a mystery. As noted above, that provision by its plain terms preempts only state laws "prescribing a method of composition of indebtedness" of a "municipality." 11 U.S.C. § 903(1). Nothing in Section 903(1) remotely purports to preempt any and all state "restructuring" laws; indeed, the specific reference to preemption of state laws "prescribing a method of composition of indebtedness" of a municipality would be nonsensical if Section 903(1) broadly preempted all state restructuring laws. As plaintiff puts it, "here, as in Franklin, '[t]he plain text of the Bankruptcy Code begins and ends [the preemption] analysis.'" Mot. 16 (quoting Franklin, 136 S. Ct. at 1946). But here, in sharp contrast to Franklin, the plain text forecloses any conclusion of preemption.

II. The Bankruptcy Code Does Not Implicitly Preempt Act 21.

Plaintiff next argues that "Sections 201(a), (b), (d), and (e) of the Moratorium Act are also preempted on the independent basis that they conflict with the Bankruptcy Code." Mot. 17. In plaintiff's view, "[o]n this point too, Franklin controls" because "[a]s the First Circuit recognized, in addition to express preemption, '[c]onflict preemption applie[d] [to] the Recovery Act' because that law served to 'bind creditors without their consent,' thus 'frustrat[ing] Congress's undeniable purpose in enacting § 903(1).'" Mot. 16 (quoting Franklin, 805 F.3d at 343-44).

Again, plaintiff is trying to extend Franklin far beyond its proper sphere. The First Circuit in Franklin held that the Recovery Act frustrated the purpose of the Bankruptcy Code insofar as it created a method for the composition of municipal debt outside of federal law. See 805 F.3d at 343-44. The First Circuit based that conclusion on the legislative history of Section 903(1) and its statutory precursors, which reflected "Congress's undeniable purpose" of ensuring

that "'[o]nly under a Federal law should a creditor be forced to accept such an adjustment without his consent.'" Id. at 343 (emphasis added; quoting H.R. Rep. No. 79–2246, at 4). In other words, wholly apart from the text of Section 903(1), the First Circuit held that the legislative history of that provision indicates that a "State" (including Puerto Rico) cannot create an alternative method for the composition of municipal debt. But that does not mean, as plaintiff suggests, that a "State" (including Puerto Rico) cannot enact any law that in any way impairs the rights of municipal bondholders without their consent. See, e.g., Ropico, 425 F. Supp. at 978-83. Plaintiff, once again, is simply overreading Franklin. Because Act 21 does not create a method for the composition of municipal indebtedness, it does not frustrate the purpose and objectives of Congress.

III. The Federal Bankruptcy Code Does Not Preempt The Field Of Restructuring, And Does Not Prevent The Commonwealth From Enacting Emergency Measures To Protect Public Health, Safety, And Welfare.

Finally, at the broadest level, plaintiff argues that the federal Bankruptcy Code preempts Act 21 because the Code occupies the entire field of restructuring. See Mot. 18-20. But the Supreme Court has long held that the federal Bankruptcy Code does not preempt States from enacting their own restructuring laws, at least insofar as they do not conflict with federal law. See, e.g., Stellwagen v. Clum, 245 U.S. 605, 613 (1918) (State and territorial restructuring laws "suspended only to the extent of actual conflict with the system provided by the Bankruptcy Act of Congress"); see also Faitoute Iron & Steel Co. v. City of Asbury Park, 316 U.S. 502, 508-09 (1942); Neblett v. Carpenter, 305 U.S. 297, 303-05 (1938); Doty v. Love, 295 U.S. 64, 70-74 (1935); Sturges v. Crowninshield, 17 U.S. (4 Wheat.) 122, 193-97 (1819). Neither this Court, the First Circuit, or the Supreme Court in Franklin accepted the sweeping field preemption argument advanced by plaintiff.

Not surprisingly, thus, plaintiff appears to beat a hasty retreat to the narrower theory that "'by enacting section 903(1), Congress expressly preempted the field of municipal composition procedures that bind nonconsenting creditors.'" Mot. 19 (quoting Franklin, 85 F. Supp. 3d 601-02; emphasis added). But that is nothing more than a restatement of plaintiff's erroneous argument, discussed above, that Section 903(1) expressly preempts Act 21 because it "prescribes a composition of indebtedness" of nonconsenting municipal creditors. Id. In light of the failure of plaintiff's express preemption argument, it follows that plaintiff's derivative field preemption argument also fails. As the Supreme Court has explained, an express preemption clause "would be pure surplusage if Congress had intended to occupy the entire field." Wisconsin Pub. Intervenor v. Mortier, 501 U.S. 597, 612-13 (1991).

Insofar as plaintiff argues—inconsistently—that "[f]ield preemption applies to any debt affected by the Moratorium Act, not merely municipal debt," Mot. 20, the argument is manifestly incorrect. That argument is based on the premise that "Congress has fully occupied the field of bankruptcies," so that "its choices are exhaustive." Id. (emphasis added). As noted above, the Supreme Court has long rejected that premise, see, e.g., Faitoute, 316 U.S. at 508-09; Neblett, 305 U.S. at 303-05; Doty, 295 U.S. at 70-74; Stellwagen, 245 U.S. at 613; Sturges, 17 U.S. (4 Wheat.) at 193-97, and it did not receive the endorsement of a single judge at any level of the federal judiciary in Franklin.

CONCLUSION

For the foregoing reasons, this Court should deny the motion for partial summary judgment.

RESPECTFULLY SUBMITTED.

I HEREBY CERTIFY that on this same date, I electronically filed the foregoing with the Clerk of the Court using the CM/ECF system which will send notification of such filing to all counsel of record.

In San Juan, Puerto Rico, this 11th day of July, 2016.

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