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

NATIONAL PUBLIC FINANCE GUARANTEE CORPORATION, Plaintiff, -against- ALEJANDRO GARCÍA PADILLA, JUAN C. ZARAGOZA GÓMEZ, and LUIS F. CRUZ BATISTA, Defendants.	Civil No. 16-cv-2101 (FAB) **RE: PUBLIC ACT 21-2016; PREEMPTION BY FEDERAL BANKRUPTCY CODE; DECLARATORY JUDGMENT**

PLAINTIFF'S MOTION FOR PARTIAL SUMMARY JUDGMENT

TO THE HONORABLE COURT:

COMES NOW Plaintiff National Public Finance Guarantee Corporation ("National"), by and through its undersigned counsel, and respectfully states and prays as follows:

PRELIMINARY STATEMENT

The Commonwealth's economic crisis is well known to this Court. The Commonwealth owes creditors over $72 billion in debt. But instead of working with creditors and the United States Congress towards a consensual resolution, the Commonwealth has instead sought to create leverage over creditors by taking illegal actions contrary to the United States Constitution, most recently through its adoption of the Puerto Rico Emergency Moratorium and Financial Rehabilitation Act (the "Moratorium Act"). Once again this Court is faced with the Commonwealth's unconstitutional activity, and once again this Court must rein in the Commonwealth's disregard for the United States Constitution.

For years, the Commonwealth has reaped the benefits of financial guarantee insurance offered by Plaintiff National. National's insurance provided financial comfort to buyers of debt

issued by the Commonwealth and its municipalities, made that debt more affordable, and thereby helped the Commonwealth to market its debt and raise billions of dollars at a lower cost to the Commonwealth and its residents. To induce investors to purchase its debt, the Commonwealth even touted in its marketing materials that the debt was "insured under a financial guaranty insurance policy" and carried AAA credit ratings "on the strength of the issuance" of such insurance policies. The Commonwealth and its municipalities also provided binding legal guarantees to National, including liens on revenue streams and seniority rights set forth in the Commonwealth Constitution. But under the guise of the Moratorium Act and executive orders issued by the Governor under color of that Act, the Commonwealth has by fiat repudiated its binding legal obligations to National; unilaterally restructured its debt and that of its municipalities; seized National's collateral and reduced National from the position of a senior creditor to a junior one; and thereby threatened National with hundreds of millions of dollars of losses. In doing so, the Commonwealth has acted in a blatantly unlawful manner.

On June 13, 2016, the United States Supreme Court upheld this Court's decision that the Puerto Rico Public Corporation Debt Enforcement and Recovery Act (the "Recovery Act") is preempted by Section 903(1) of the federal Bankruptcy Code, which prohibits the Commonwealth from enacting laws to restructure municipal debts without creditor consent. *Puerto Rico v. Franklin California Tax-Free Trust*, No. 15-233, 2016 WL 3221517, at *2 (U.S. June 13, 2016); 11 U.S.C. § 903(1). The Bankruptcy Code likewise preempts the Moratorium Act for three independent reasons.

First, Section 903(1) *expressly* preempts the Moratorium Act. The Supreme Court held that Section 903(1) "bars Puerto Rico from enacting its own municipal bankruptcy scheme to restructure the debt of its insolvent public utilities companies." *Franklin*, 2016 WL 3221517, at

*2. And that is exactly what the Moratorium Act does. It purports to allow the Commonwealth to restructure municipal debts—and impair creditors—by, among other things, converting senior debt to junior debt and converting secured debt to unsecured debt, all without creditor consent. As in *Franklin*, "[t]he plain text of the Bankruptcy Code begins and ends [the] analysis": the Moratorium Act is expressly preempted. *See Franklin*, 2016 WL 3221517, at *7; *infra* Part I.

Second, 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. As the First Circuit recognized in *Franklin*, "Congress quite plainly wanted a single federal law to be the sole source of authority if municipal bondholders were to have their rights altered without their consent." *Franklin California Tax-Free Trust v. Puerto Rico*, 805 F.3d 322, 343 (1st Cir. 2015). The Commonwealth may not enact its own laws, like the Moratorium Act, that purport to adjust bondholders' rights. *See infra* Part II.

And finally, 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. As courts have frequently observed, "federal bankruptcy law is pervasive and involves a federal interest so dominant as to preclude enforcement of state laws on the same subject." *Sherwood Partners, Inc. v. Lycos, Inc.*, 394 F.3d 1198, 1201 (9th Cir. 2005) (internal quotations omitted). *See infra* Part III.

****

Preemption is not the only constitutional infirmity in the Moratorium Act. *See* Complaint ¶¶ 43-68 [Dkt. No. 1]. But it is a ground for invalidating the law that should be addressed straightaway. As in *Franklin*, "the preemption claim is purely legal and involves no disputed issues of material fact." *Franklin California Tax-Free Trust v. Puerto Rico*, 85 F. Supp. 3d 577,

595 (D.P.R. 2015) (Besosa, J.); *see also*, *e.g.*, *Shelby Cnty. v. Holder*, 270 F.R.D. 16, 19 (D.D.C. 2010) (refusing to deny plaintiff's pre-answer motion for summary judgment as premature, or stay the motion pending discovery, when plaintiff brought "only a facial challenge" to a statute). And if the Court holds the Moratorium Act is preempted, it will obviate the need for further motion practice and development of the other claims alleged in National's complaint.[1]

Notably, federal preemption does not leave the Commonwealth without a remedy for its fiscal problems. It simply means the Commonwealth cannot resort to unconstitutional methods to address those problems. The U.S. Congress is currently considering legislation that would create a framework for the Commonwealth and its creditors to work toward a restructuring. *See* Puerto Rico Oversight, Management, and Economic Stability Act, H.R. 5278, 114th Cong. (2d Sess. 2016) ("PROMESA"). But as the legislative process unfolds (and even thereafter), the Commonwealth must abide by the Constitution and laws of the United States.

Therefore, and for the reasons set forth more fully below, the Court should grant this Motion for partial summary judgment in favor of Plaintiff and enter a judgment declaring that Sections 201(a), (b), (d), and (e) of the Moratorium Act, and any prospective enforcement thereof or authorization thereunder, are preempted by the Bankruptcy Code and violate the Supremacy Clause of the United States Constitution.

[1] While Plaintiff has moved for partial summary judgment solely with respect to its preemption claim, that claim would dispose of the entire case if the Court holds that the Moratorium Act is preempted in all respects.

FACTUAL BACKGROUND

A. The Parties.

1. Plaintiff.

National is a monoline insurer that provides financial guarantees to the United States and global public finance, infrastructure, and structured finance markets. As such, National guarantees scheduled payments of principal and interest by, among others, the Commonwealth.

2. Defendants.

Defendant Hon. Alejandro García Padilla is the Governor of the Commonwealth Defendant Hon. Juan C. Zaragoza Gómez is the Secretary of the Treasury of the Commonwealth. Defendant Hon. Luis G. Cruz Batista is the Director of the Commonwealth's Office of Management and Budget. Plaintiff sues all defendants in their official capacities.

B. The Commonwealth's Prior Unconstitutional Actions.

To address its current circumstances, the Commonwealth has engaged in a series of unconstitutional acts. Despite successful challenges to these efforts in the courts—most recently before the United States Supreme Court—the Commonwealth has persisted in this unlawful course of conduct.

In June 2014, the Commonwealth enacted the Recovery Act. *Franklin*, 2016 WL 3221517, at *3 (citing 2014 P.R. Laws 371). The Recovery Act purported to provide Puerto Rico's public corporations, including the Puerto Rico Electric Power Authority ("PREPA") and the Puerto Rico Highways and Transportation Authority ("PRHTA"), with a means to restructure their debts. *See id.* The legislation included many bankruptcy-like features, including the public corporations' ability to propose and impose changes to their debt obligations (such as changes to the interest rate or the maturity date) on nonconsenting creditors, and the ability to file proposed restructuring plans. *See id.* Public corporation bondholders immediately sued, claiming in a

facial challenge that the Recovery Act was preempted by the Bankruptcy Code and violated the Takings and Contract Clauses of the United States Constitution. *See id.* In February 2015, this Court held that the Recovery Act was unconstitutional and preempted by section 903(a) of the Bankruptcy Code, by which "Congress expressly preempted the field of municipal composition procedures that bind nonconsenting creditors." *Franklin*, 85 F. Supp. 3d at 601-602. That decision was upheld on appeal, most recently by the U.S. Supreme Court. *Franklin*, 2016 WL 3221517, at *11.

Toward the end of 2015, as it became apparent that the Commonwealth could not rely on the unconstitutional Recovery Act to restructure its public corporations' debt, the Commonwealth changed tack and resorted to "clawing back" funds that had been pledged to various entities, including PRHTA. SOF ¶ 18.[2] In an executive order signed on November 30, 2015, Governor García Padilla ordered the Puerto Rico Treasury to withhold approximately $329 million of revenues dedicated to PRHTA and other entities and directed that they "be used only for the payment of the public debt when due."[3] SOF ¶ 19. In the face of evidence that the clawed-back funds were being used for purposes other than the payment of public debt, in response, several monoline insurers brought suit in Puerto Rico federal court, claiming that the Governor's actions violated the Contract, Takings, and Due Process Clauses of the United States Constitution. *See Assured Guaranty Corp., et al v. Garcia Padilla, et al.*, No. 3:16-cv-01037 (D.P.R. filed Jan. 7, 2016). That civil action is currently pending before this Court.

---

[2] Citations to "SOF ¶" are to National's Statement of Undisputed Material Facts Pursuant to Local Civil Rule 56(b) and (e), filed contemporaneously herewith. *See* Docket No. 22.

[3] Despite the stated purpose of the executive order, the Commonwealth now purports that it does not have enough funds to make public debt service payments on July 1, 2016.

C. The Moratorium Act.

The Commonwealth enacted the Moratorium Act on April 6, 2016. SOF ¶ 1. The Act 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) and allows the Governor to extend the covered period for up to two months. SOF ¶ 2; Moratorium Act §§ 103(m), 201(a).

Section 201(a) of the Moratorium Act grants the Governor the power to issue executive orders: i) declaring the Commonwealth or any other Puerto Rico "government entity" (including, but not limited to, PRHTA, PREPA, the Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental Control Facilities Financing Authority, and the Puerto Rico Sales Tax Financing Corporation) to be in a "state of emergency" and ii) suspending payment on the entity's "covered obligations." SOF ¶ 3. "Covered obligations" are defined broadly 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." SOF ¶ 4; Moratorium Act § 103(*l*).

The Moratorium Act contains the following additional provisions relevant to this Motion:

1. The Act imposes a blanket stay on creditor remedies—including court proceedings and rights of acceleration, termination, modification, and setoff—against the designated government entities during the emergency period. SOF ¶ 5; Moratorium Act § 201(b)(i)-(iii).

2. The Act permits the Governor to "expropriat[e] property or rights in property interests" related to covered obligations to the extent he claims necessary to further the public interest. SOF ¶ 6; Moratorium Act § 201(b)(iv)). The Act states that "just compensation or other relief may be sought in the Court of First Instance" in the event of an expropriation, but does not require the Commonwealth to deposit funds with the court before expropriating property. SOF ¶ 6; Moratorium Act § 201(b)(iv).

3. The Act states that, except in cases of such expropriation, "the Court of First Instance of the Commonwealth, San Juan Part, may grant any party in interest with security or property rights, to the extent required by applicable constitutional law, adequate protection of any security or other interest in property of such party in interest resulting from actions taken or not taken in furtherance of this Act." SOF ¶ 7; Moratorium Act § 204(b).

4. The Act permits the Governor to unilaterally suspend or modify any obligation (statutory or otherwise) i) to appropriate money to pay or secure covered obligations; ii) to transfer money to pay or secure any covered obligation; iii) to setoff revenues used to pay or cover, directly or indirectly, certain covered obligations; and iv) to ensure payment of a covered obligation as if the Act were not enacted. SOF ¶ 8; Moratorium Act § 201(d).

5. The Act permits the Governor to reprioritize the payment obligations in the Puerto Rico Office of Management and Budget Act (23 L.P.R.A. § 104(c)) ("OMB Act"). SOF ¶ 9; Moratorium Act § 201(e). The OMB Act (23 L.P.R.A. § 104(c)) sets payment priorities for Commonwealth expenditures and, consistently with Article VI, Section 8 of the Commonwealth Constitution, prioritizes payment on public debt above all other expenditures.

6. The Act permits the Governor to issue an executive order under Section 201, which provides for payment of only a minimum portion of the interest due on public debt obligations (such as general obligation bonds), while suspending payment of the principal due on public debt obligations and interest due on nonpublic debt obligations, with such unpaid principal and interest to accrue interest at the contract rate during the covered period. SOF ¶ 10; Moratorium Act § 202(a).

7. The Act purports to bar enforcement of *ipso facto* clauses. SOF ¶ 11; Moratorium Act Section 201(b)(iii) ("no contract to which such government entity is a party may be terminated or modified . . . because of a provision in such contract conditioned on . . . the insolvency or financial condition of such government entity [or] . . . the commencement of a restructuring, insolvency, bankruptcy, or other proceeding, or a moratorium by such government entity . . . .").

Presumably with this Court's *Franklin* decision in mind, the legislature insisted in a Statement of Motives that "[t]he Act does not provide for a composition or discharge of debts." *See* Moratorium Act, Statement of Motives ("SOM"), Part F. But, in fact, that is exactly what the Moratorium Act does, as the statute itself later acknowledges. To carry out the Act's purposes, Section 106(b) authorizes the Governor to engage advisors for "matters related to

restructuring or adjusting any covered obligation." SOF ¶ 12; Moratorium Act § 106(b) (emphasis added).

D. The Governor's Actions Under The Moratorium Act.

Since the Moratorium Act became law, the Governor has exercised his purported authority to issue executive orders adjusting debt. SOF ¶¶ 13, 14, 16. On April 8, 2016 the Governor issued an executive order that declared a state of emergency at the Government Development Bank for Puerto Rico ("GDB"). SOF ¶ 13. On April 30, 2016—one day before a $422.8 million GDB debt payment was due—the Governor issued a second executive order, which declared a moratorium on a portion of that payment. SOF ¶ 14. GDB then defaulted on a portion of the $423 million payment due. *See* Am. Complaint ¶ 28, *Brigade Leveraged Capital Structures Fund Ltd. v. García Padilla*, No. 3:16-cv-01610 (D.P.R. filed May 20, 2016), ECF No. 52.

The Governor next invoked the Moratorium Act on May 17, 2016, signing an executive order that declared a state of emergency at PRHTA (the "PRHTA Executive Order"). SOF ¶ 16. This time, the Governor relied on the Moratorium Act to strip bondholders of bargained-for collateral. Various toll revenues and other funds are irrevocably pledged to the payment of PRHTA bondholder debt until that debt is repaid in full. *See* SOF ¶ 15; 9 L.P.R.A. § 2004(*l*). The PRHTA Executive Order purports to suspend PRHTA's contractual obligations to transfer those pledged funds to bondholders and diverts the funds to other purposes instead, thus eliminating the bondholders' liens and permanently depriving them of collateral. SOF ¶ 17.

STANDARD OF REVIEW

Summary judgment is appropriate when "there is no genuine issue as to any material fact and . . . the moving party is entitled to a judgment as a matter of law." *Sands v. Ridefilm Corp.,*

212 F.3d 657, 660-61 (1st Cir. 2000); Fed. R. Civ. P. 56(c). The purpose of summary judgment motions is "to see whether there is need for trial." *Kemco Food Distributors, Inc. v. R.L. Schreiber, Inc.*, No. 15-1955, 2016 WL 814833, at *2 (D.P.R. Feb. 29, 2016). A factual issue is genuine if "there is sufficient evidence supporting the claimed factual disputes to require a trial," and is material if it "might affect the outcome of a lawsuit under the governing law." *CMI Capital Mkt. Inv., LLC v. Municipality of Bayamon*, 239 F.R.D. 293, 297 (D.P.R. 2006). To defeat summary judgment, the non-moving party "must do more than simply show that there is some metaphysical doubt as to the material facts" *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586 (1986). "Conclusory allegations, empty rhetoric, unsupported speculation, or evidence which, in the aggregate, is less than significantly probative will not suffice to ward off a properly supported summary judgment motion." *Nieves-Romero v. United States*, 715 F.3d 375, 378 (1st Cir. 2013) (quotations and editing removed).

ARGUMENT

"A federal statute can preempt a state law in three ways: express preemption, conflict preemption, and field preemption." *Franklin*, 85 F. Supp. 3d at 595 (citing *Arizona v. United States*, 132 S. Ct. 2492, 2500-01 (2012)). "[T]he test for federal preemption of the law of Puerto Rico . . . is the same as the test under the Supremacy Clause for pre-emption of the law of a State." *Puerto Rico Dep't of Consumer Affairs v. Isla Petrol. Corp.*, 485 U.S. 495, 499 (1988); *see also* 48 U.S.C. § 734 (statutory laws of the United States generally "have the same force and effect in Puerto Rico as in the United States").

Federal law preempts the Moratorium Act—and any and all executive orders that the Governor has issued or will issue thereunder—on all three grounds. The federal Bankruptcy Code expressly preempts the Act by prohibiting state laws that prescribe a composition of

municipal debt and bind non-consenting creditors—all of which the Moratorium Act does. *See* 11 U.S.C. § 903(1); *infra* Part I. The Moratorium Act is also preempted on the independent ground that it stands as an obstacle to the achievement of Congress' objectives regarding the adjustment of debts. *See infra* Part II. Finally, federal law preempts the Moratorium Act because the intricate, comprehensive Bankruptcy Code reflects a Congressional determination to occupy the entire field of bankruptcy law. *See infra* Part III.

I. Section 903(1) Of The Federal Bankruptcy Code Expressly Preempts Sections 201 (a), (b), (d), And (e) Of The Moratorium Act.

"Express preemption occurs when congressional intent to preempt state law is made explicit in the language of a federal statute." *Tobin v. Fed. Exp. Corp.*, 775 F.3d 448, 452 (1st Cir. 2014). Chapter 9 of the federal Bankruptcy Code reflects an explicit congressional intention to preempt municipal restructuring laws such as the Moratorium Act. Article I, Section 8, clause 4 of the United States Constitution grants Congress the power "[t]o establish … uniform Laws on the subject of Bankruptcies throughout the United States." Exercising that authority, Congress enacted Section 903(1) of the Bankruptcy Code, which provides in pertinent part:

> This chapter does not limit or impair the power of a State to control, by legislation or otherwise, a municipality or in such State in the exercise of the political or governmental powers of such municipality, including expenditures for such exercise, but –
>
> (1) 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).

In *Franklin*, the Supreme Court held (as this Court had) that Section 903(1) expressly preempts the Recovery Act, which purported to allow Commonwealth municipalities to restructure their debt. The Supreme Court's decision hinged on three provisions of the

Bankruptcy Code: the "gateway" provision, Section 109(c), which identifies "who may be a debtor" and requires a Chapter 9 debtor to be an insolvent municipality that is "specifically authorized" by a State "to be a debtor"; the preemption provision, Section 903(1), which expressly bars States from enacting municipal bankruptcy laws; and the definition of State, Section 101(52), which includes Puerto Rico "except for the purpose of who may be a debtor under chapter 9." *Franklin*, 2016 WL 3221517, at *14.

The Court reasoned that the definitional provision's exclusion of Puerto Rico for the single purpose of defining who may be a Chapter 9 debtor was a reference to the Section 109 gateway provision, such that "the Code prevents Puerto Rico from authorizing its municipalities to seek Chapter 9 relief." *Franklin*, 2016 WL 3221517, at *2, 8. However, because Puerto Rico remains a "State" for all other purposes related to Chapter 9, it is nonetheless subject to Section 903(1)'s preemption provision, which "bars Puerto Rico from enacting its own municipal bankruptcy scheme to restructure the debt of its insolvent public utility companies." *Id.*

The Court acknowledged that this outcome may leave Puerto Rico with no choice but to "wait for possible congressional action to avert the consequences of the Commonwealth's fiscal crisis." *Id.* at *11. But "our constitutional structure does not permit [the] Court to rewrite the statute that Congress has enacted." *Id.* (internal quotation omitted).

Franklin controls the result here, and is thus dispositive. There is no room to dispute that the Moratorium Act is a "State law," (*id.* at *4), that it binds non-consenting creditors, or that it applies to the debts of municipalities, *see* 11 U.S.C. § 101(40) (defining "municipality" as a "political subdivision or public agency or instrumentality of a State"). The only question is whether the Moratorium Act prescribes a composition of indebtedness. It clearly does.

Just like the Recovery Act, Sections 201 (a), (b), (d), and (e) of the Moratorium Act

"create procedures for indebted public corporations to adjust or discharge their obligations to creditors," and, "[t]herefore . . . prescribe[] a method of composition of indebtedness, which is exactly what section 903(1) prohibits." *Franklin*, 85 F. Supp. 3d at 597; *see also Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 585 (1935) ("So far as concerns dissenting creditors, the composition is a method of adjusting among creditors rights in property in which all are interested."). These provisions adjust the debt of Commonwealth municipalities in at least two ways.

First, the Moratorium Act turns secured debt into unsecured debt. *See In re Borgelt*, 10 F. Supp. 113, 116 (S.D. Ill. 1935) (compositions may "impair[] the lien of [a] secured creditor"), *aff'd*, 79 F.2d 929 (7th Cir. 1935). Before the Moratorium Act was enacted, tolls, revenues and other funds were irrevocably pledged to repay bondholders. The Moratorium Act takes this collateral away. 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. Despite the Moratorium Act's ostensibly limited time frame, this impairment is permanent: every dollar the Commonwealth diverts is forever lost to secured creditors; whether the Commonwealth intends to make good on the underlying debt or not, the collateral has been taken, thereby converting secured debt into unsecured debt. And the Governor has already invoked section 201(d) in the PRHTA Executive Order to eliminate PRHTA bondholders' lien on pledged toll revenues—an unlawful application of the facially preempted statute. *See supra* p. 9. Section 201(b)(iv) also allows for the conversion of secured debt into unsecured debt by allowing the Governor to expropriate collateral, including liens, related to the payment of debt service.

Second, the Moratorium Act adjusts Commonwealth municipal debt by enabling the Governor to turn senior debt into subordinated debt. Prior to the Moratorium Act, the

bondholders' debt was superior to claims asserted by other creditors. Under the bond resolutions and other binding documents, the borrowers *must* use pledged revenues to pay bondholders in full before paying other expenses. The Moratorium Act reshuffles these priorities. Sections 201(a), (d), and (e) empower the Governor to "prioritize payment of essential services" above the payment of bondholders who bargained for senior debt. And because the Moratorium Act nowhere defines or limits "essential services," it gives the Governor carte blanche to reorder payment priorities however he sees fit.[4]

That the Moratorium Act is a restructuring law is made clear by comparing the Act with the Bankruptcy Code. Time and again, the Commonwealth law and federal bankruptcy law address the exact same subject matter:

> 1. **Payment Priority**. As noted, Sections 201(a), (d), and (e) allow the Governor to reset payment priority rights by, among other things, directing the Governor to "prioritize payment of essential services" over senior debt; and permitting the Governor to "reprioritize services and expenses" in contravention of the OMB Act. The Bankruptcy Code, 11 U.S.C. § 507, likewise establishes payment priorities for creditors whose obligations are being restructured. *See generally First Fed. of Mich. v. Barrow*, 878 F.2d 912, 915 (6th Cir. 1989) ("[T]he Bankruptcy Act of 1978 explicitly defined the order of creditor priority and declared the congressional intent of federal supremacy over declared but conflicting state law orders of priority.").
>
> 2. ***Ipso Facto* Provisions.** Section 201(b)(iii) of the Moratorium Act purports to bar enforcement of *ipso facto* provisions relating to covered obligations.[5]

---

[4] Indeed, the Governor apparently has approved as an "essential service" a $17 million expenditure to build a new road for access to a mall owned by a Venezuelan company. *Destinan $17 millones para carretera que conduce a centro commercial*, El Vocero, June 17, 2016, http://elvocero.com/destinan-17-millones-para-carretera-que-conduce-a-centro-comercial/.

[5] Specifically, the Moratorium Act states that no contract to which a government entity is a party may be terminated or modified solely because of a provision in such a contract conditioned on 1) the insolvency or financial condition of the entity, 2) the commencement of a bankruptcy or restructuring proceedings, or 3) a default under another contract. Section 365(e)(1) is to the same effect, stating that an executory contract of the debtor may not be terminated or modified solely because of a provision in the contract conditioned on, among other things 1) the insolvency of financial condition of the debtor, or 2) the commencement of a bankruptcy case.

Section 365(e)(1) of the Bankruptcy Code likewise bars such provisions. 11 U.S.C. § 365(e)(1).

3. **Automatic Stay**. Section 201(b) of the Moratorium Act provides an automatic stay of any act to recover or exercise any remedy related to a covered obligation. The Bankruptcy Code, 11 U.S.C. §§ 362 and 922, likewise provides for an automatic stay of proceedings against a debtor once a bankruptcy petition is filed.

4. **Adequate Protection.** Section 204(b) provides that (other than in cases of Expropriation under the Act), parties may petition the Commonwealth courts for "adequate protection of any security or other interest in property of such party in interest resulting from actions taken or not taken in furtherance of this Act." The Bankruptcy Code, too, calls for adequate protection against the diminution in value of assets pledged as collateral. *See* 11 U.S.C. § 361.

5. **Restructuring Advice**. Section 106(b) of the Moratorium Act permits the Governor (among others) to engage advisors and professionals for "matters related to *restructuring* or *adjusting* any covered obligation." The Bankruptcy Code permits debtors and trustees to do so as well. *See* 11 U.S.C. §§ 327-30.

The Moratorium Act and the Bankruptcy Code share these common features because both are examples of restructuring laws. But only the federal government can enact such laws. The Commonwealth cannot.

The Moratorium Act's Statement of Motives claims the Act is lawful because it supposedly just "extend[s] due dates and maturities on the obligations of the state and its instrumentalities," citing *Ropico, Inc. v. City of New York*, 425 F. Supp. 970, 982 (S.D.N.Y. 1976). Moratorium Act, SOM, Part F. But even if the Court was persuaded that *Ropico* was correctly decided, it would have no choice but to hold that the Moratorium Act is preempted. *Ropico* stands for a simple proposition: state law may in some exigent circumstances *extend* municipal debt payments without running afoul of the Bankruptcy Code, but states cannot *adjust* municipal debt without doing so. The New York state law at issue in *Ropico* imposed a three-year suspension on the payment of principal and provided noteholders the ability to exchange their notes for new securities or accept a temporarily reduced interest rate. *See* 425 F. Supp. at

972, 982. Because the debt at issue was otherwise unaltered, the court held that the challenged statute was "an extension and not a proscribed composition." *Id.* at 983.

The Moratorium Act, in sharp contrast, falls well on the prohibited side of this line. It features provisions clearly more onerous than those more modest ones at issue in *Ropico*: Section 201(b) of the Moratorium Act expressly permits the Governor to "expropriat[e] property . . . related to a covered obligation"; the statute in *Ropico* did not expropriate property. Section 201(d) of the Moratorium Act permits the Governor to seize collateral, turning secured debt into unsecured debt; the statute in *Ropico* did not authorize the seizing of collateral. And Sections 201(a), (d), and (e) allow the Governor to violate priority rights by paying for "essential services" before senior debt; the statute in *Ropico* did not violate priority rights. These contrasts with *Ropico* confirm that the Moratorium Act provides for an unlawful composition of debt.[6]

A state law that "run[s] afoul of the clear language of federal law" may not stand "[n]o matter how worthy the objective." *Telecomm. Regulatory Bd. of P.R. v. CTIA-Wireless Ass'n*, 752 F.3d 60, 68 (1st Cir. 2014) ("*CTIA*"). And here, as in *Franklin*, "[t]he plain text of the Bankruptcy Code begins and ends [the preemption] analysis." *See Franklin*, 2016 WL 3221517, at *7. Because Sections 201(a), (b), (d), and (e) of the Moratorium Act provide for the composition of municipal debt without creditor consent, they, along with the PRHTA Executive Order issued under Section 201(d), are expressly preempted by Section 903(1) of the federal Bankruptcy Code.

[6] The fact that the Moratorium Act purports not to impose a formal restructuring regime is irrelevant: "The plain language of [Section 903(1)] is not limited to bankruptcy proceedings." *City of Pontiac Retired Emps. Ass'n v. Schimmel,* 751 F.3d 427, 431 (6th Cir. 2014) (en banc).

II. The Moratorium Act Is Preempted Because It Conflicts With The Bankruptcy Code.

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. Conflict preemption occurs "when the state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *CTIA*, 752 F.3d at 64. On this point too, *Franklin* controls. As 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)." *Franklin*, 805 F.3d at 343-44. The Moratorium Act is preempted on this ground too.

Chapter 9 of the Bankruptcy Code authorizes some—but not all—municipal entities to seek bankruptcy protection. Congress could have permitted Puerto Rico's municipalities to adjust debts, but it chose not to. *See Franklin*, 2016 WL 3221517, at *7 ("We interpret Congress' use of the 'who may be a debtor' language in the amended definition of 'State' to mean that Congress intended to exclude Puerto Rico from this gateway provision delineating who may be a debtor under Chapter 9."). The Commonwealth cannot make a different choice. It cannot enact its own law altering creditor rights that Congress chose to leave intact. By permitting the Governor to restructure municipal debt, the Moratorium Act flouts Congress's determination—grounded in the Bankruptcy Clause of the U.S. Constitution and the Bankruptcy Code—that the debts of Puerto Rico's instrumentalities may not be adjusted without creditor consent. The Moratorium Act therefore stands as an obstacle to the achievement of Congress' full purposes and objectives.

The Moratorium Act thwarts Congress' objectives not only as to *who* may adjust debts but also *how* debts are adjusted. The polestar of federal bankruptcy law has long been equality between creditors. *See, e.g.*, *Clarke v. Rogers,* 228 U.S. 534, 548 (1913) ("Equality between creditors is necessarily the ultimate aim of bankruptcy law"); *In re Morales Vda. de Cruz*, 357 F. Supp. 1118, 1120 (D.P.R. 1973) ("The purpose of the Bankruptcy Law is to place the property of the bankrupt under the control of the Court for equal distribution among the creditors."). The Moratorium Act pursues other objectives. It vests the governor with unfettered discretion to seize collateral from secured creditors—as he has done through the PRHTA Executive Order—and convert senior debt into junior debt. *See supra* pp. 13-14. Unlike the Bankruptcy Code, the Moratorium Act does not require the Governor to modify debt equally between creditors. It lets the Governor choose winners and losers according to his own criteria. This arbitrary method of restructuring debt stands in stark contrast to the long-recognized objectives and purposes of the Bankruptcy Code. The Moratorium Act is therefore preempted. *See In re City of Orange*, 191 B.R. 1005, 1016-17 (Bankr. C.D. Cal. 1996) ("[T]o the extent that [non-federal law] creates a special class of creditors … [it is] in conflict with the priority scheme in the Code, [and] is preempted by federal law.").

III. The Moratorium Act Is Preempted Because It Attempts To Operate In A Field That Congress Has Comprehensively Occupied.

Finally, the Moratorium Act is preempted because it attempts to legislate in a field that federal law fully occupies. "There can be no doubt that federal bankruptcy law is 'pervasive' and involves a federal interest 'so dominant' as to 'preclude enforcement of state laws on the same subject.'" *Sherwood Partners, Inc*., 394 F.3d at 1201. As the Supreme Court has recognized, "[i]n respect of bankruptcies the intention of Congress is plain. The national purpose

to establish uniformity necessarily excludes state regulation." *Int'l Shoe Co. v. Pinkus*, 278 U.S. 261, 265 (1929); *id.* at 266 (holding that state law provisions governing "the distribution of property of insolvents for the payment of their debts and providing for their discharge or that otherwise relate to the subject of bankruptcies are within the field entered by Congress when it passed the Bankruptcy Act, and therefore such provisions must be held to have been superseded"). Accordingly, "states are not free to enact laws that interfere with federal bankruptcy law or that provide additional or auxiliary regulation with respect to bankruptcy matters." *In re Bank of New England Corp.*, 364 F.3d 355, 364 (1st Cir. 2004); *In re Boston Reg'l Med. Ctr, Inc.*, 291 F.3d 111, 126 (1st Cir. 2002) (similar); *Franklin*, 85 F. Supp. 3d 601-02 ("[B]y enacting section 903(1), Congress expressly preempted the field of municipal composition procedures that bind nonconsenting creditors . . . .").

By passing the Moratorium Act, the Commonwealth has created a restructuring law in a field exclusively occupied by Congress. As described above, the Moratorium Act prescribes a composition of indebtedness: it permits the Governor to adjust municipal and Commonwealth debts by converting secured debt to unsecured debt and senior debt to subordinated debt. *See supra* pp. 13-14. The Commonwealth's legislation in this area is therefore preempted, and any and all executive orders issued thereunder, including the PRHTA Executive Order, are unlawful.[7]

[7] *See Sherwood Partners Inc.*, 394 F.3d at 1203-04 (finding that California state law granting an assignee selected by a debtor the power to avoid preferential transfers, which affected the discharge of debts and distribution of assets among creditors, was preempted by the Bankruptcy Code); *In re Old Carco LLC*, 406 B.R. 180, 199-200 (Bankr. S.D.N.Y. 2009) (under principles of field preemption, state dealer protection statute was preempted by § 365 of the Bankruptcy Code's provisions regarding rejection of executory contracts).

Field preemption applies to any debt affected by the Moratorium Act, not merely municipal debt. While many debts subject to the Act were incurred by municipalities like PRHTA, the Commonwealth itself owes payments under its general obligation bonds—including payments due as soon as July 1, 2016. The Moratorium Act purportedly covers those general obligation bonds too, by defining the Commonwealth as a "government entity" under the Act. But the Commonwealth has no more leeway to adjust its own debts than it does to alter debts of its municipalities. States (including Puerto Rico) are not among the entities that Congress authorized to seek bankruptcy protection. *See* 11 U.S.C. §§ 101(52), 109. Nor did Congress include them in the definitions of "debtors" or "municipalities."[8]

Had Congress intended to permit states to declare bankruptcy, it would have said so. Instead, the Code excludes states from bankruptcy protection. And because Congress has fully occupied the field of bankruptcies, its choices are exhaustive. States cannot afford themselves additional bankruptcy protections by enacting their own restructuring regimes. The Commonwealth's attempt to subvert this intentional omission is preempted by the Bankruptcy Code. The Moratorium Act's provisions allowing for a composition of state indebtedness impermissibly infringe upon the "pervasive," "dominant" federal interest in bankruptcy law. *Sherwood Partners Inc.*, 394 F.3d at 1201; *see also Bank of New England Corp.*, 364 F.3d at 364.

CONCLUSION

WHEREFORE National respectfully requests that this Honorable Court allow the

[8] *See* 11 U.S.C. § 101(13) ("The term 'debtor' means person or municipality concerning which a case under this title has been commenced."); 11 U.S.C. § 101(40) ("The term 'municipality' means a political subdivision or public agency or instrumentality of a state.").

instant Motion and, consequently, grant partial summary judgment in favor of National and enter a declaratory judgment declaring that Sections 201 (a), (b), (d), and (e) of the Moratorium Act, and any prospective enforcement thereof or authorization thereunder, are preempted by the Bankruptcy Code and violate the Supremacy Clause of the United States Constitution.

RESPECTFULLY SUBMITTED, in San Juan, Puerto Rico, this 22nd day of June, 2016.

ADSUAR MUÑIZ GOYCO SEDA & PÉREZ-OCHOA, P.S.C.

By: */s/* Eric Pérez-Ochoa
Eric Pérez-Ochoa
USDC-PR No. 206314

/s/ Alexandra Casellas-Cabrera
Alexandra Casellas-Cabrera
USDC-PR No. 301010

208 Ponce de León Avenue, Suite 1600
San Juan, PR 00936
Telephone: 787.756.9000
Facsimile: 787.756.9010
Email: epo@amgprlaw.com
acasellas@amgprlaw.com

WEIL, GOTSHAL & MANGES LLP

By: */s/ Jonathan D. Polkes*
Jonathan D. Polkes (*admitted pro hac vice*)
Edward Soto (*admitted pro hac vice*)
Salvatore A. Romanello (*admitted pro hac vice*)
Gregory Silbert (*admitted pro hac vice*)
Eric C. Hawkins (*admitted pro hac vice*)

767 Fifth Avenue
New York, N.Y. 10153
Telephone: (212) 310-8000
Facsimile: (212) 310-8007
Email: jonathan.polkes@weil.com
edward.soto@weil.com
salvatore.romanello@weil.com
gregory.silbert@weil.com
eric.hawkins@weil.com

Attorneys for Plaintiff