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)

PLAINTIFF'S OPPOSITION TO MOTION TO DISMISS

TO THE HONORABLE COURT:

COMES NOW Plaintiff National Public Finance Guarantee Corporation ("National"), by and through its undersigned counsel, and in opposition to Defendants' Motion to Dismiss [Dkt. No. 41] (the "Motion") National's Complaint [Dkt. No. 1] (the "Complaint"), respectfully states and prays as follows:

PRELIMINARY STATEMENT

National's Complaint details the legal and factual basis for National's claims that the Puerto Rico Emergency Moratorium and Financial Rehabilitation Act (the "Moratorium Act" or the "Act") violates the United States Constitution. The Complaint alleges that National and the holders of bonds issued by the Commonwealth and its instrumentalities have numerous property and contract rights relating to this debt, including: the right to timely payment of principal and interest as well as first-priority payment on Commonwealth general obligation debt, liens on various revenue streams, acceleration rights in the event of certain defaults, and the Commonwealth's pledge of non-interference with various creditor rights. Specifically, the

Complaint alleges that the bondholders have these rights under the contracts governing such debt and/or the Commonwealth constitution, and that National, as insurer of certain Commonwealth and Commonwealth-instrumentality bonds,[1] can assert rights equivalent to those of bondholders.

The Complaint also alleges, and National's Motion for Partial Summary Judgment [Dkt. No. 21] fully demonstrates, that the Moratorium Act is preempted by the federal Bankruptcy Code for the same reasons that the Puerto Rico Public Corporation Debt Enforcement and Recovery Act (the "Recovery Act") was preempted. *Puerto Rico v. Franklin Cal. Tax-Free Trust*, 136 S. Ct. 1938, 1942 (2016). National respectfully refers the Court to its Motion for Partial Summary Judgment on this claim, which is fully briefed and ripe for resolution. And the Complaint demonstrates that the Moratorium Act unconstitutionally takes National's property without compensation, in violation of the Takings Clause, by allowing the Governor of the Commonwealth to suspend debt payments, violate priority rights, and divert pledged revenues. Insofar as National's rights relating to the insured debt are grounded in contract, the Complaint further alleges that the Moratorium Act violates the Contract Clause by substantially impairing National's rights in ways not reasonable or necessary to an important government purpose.

Faced with the Complaint's well-pled claims, Defendants' Motion launches a series of

[1] As of the filing of the Complaint, National insured approximately $3.8 billion of debt issued by the Commonwealth (including general obligation debt) and related entities including the Puerto Rico Sales Tax Financing Corporation ("COFINA"), Puerto Rico Highways and Transportation Authority ("PRHTA"), and the Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental Control Facilities Financing Authority ("AFICA") (collectively, the "Issuers"). (Compl. ¶¶ 1, 3.) After Puerto Rico's July 1, 2016, default, National insures over $3.7 billion. (*See* Declaration of Adam Bergonzi in Support of Plaintiff's Opposition to Motion to Dismiss, filed contemporaneously herewith ("Decl."), ¶ 9.) The default resulted in National making over $170 million in payments for the benefit of insured bondholders. (*Id.* ¶¶ 7-8.)

arguments that mischaracterize or ignore key allegations, misconstrue governing law, and inject factual disputes that cannot be resolved at this stage.

First¸ Defendants claim that National lacks standing because it supposedly attempts to assert "the rights of bondholders" and has purportedly failed to plead injury in fact. (Mot. at 9-10.) This argument fails on multiple levels: the Complaint unmistakably alleges that *National itself* has contract and property rights, on the same terms as bondholders, through the governing insurance agreements and bond resolutions. Those documents, which the Court may consider on this motion and are filed herewith, confirm this allegation. In any event, the Complaint independently alleges standing by pleading that National was at risk of imminent financial injury based on the Commonwealth's looming default on insured general obligation payments due July 1, 2016. And just as predicted, the Commonwealth did in fact invoke the Moratorium Act and default on those payments, causing National to make the payments and suffer financial injury of $173 million. *See infra* Part I. Accordingly, any claim that National has not been injured is completely frivolous.

Second, Defendants contend that National's claims are unripe. (Mot. at 10.) This argument fails for the same reasons that Defendants' challenge to standing fails—and also because National asserts a facial challenge to the Moratorium Act, which became ripe the moment the Act became law. *See*, *e.g.*, *Franklin Cal. Tax-Free Trust v. Puerto Rico*, 805 F.3d 322, 333 (1st Cir. 2015) (challenge to Recovery Act was ripe when plaintiffs "allege[d] that the very enactment of the . . . Act, rather than the manner of enforcement, impairs their contractual rights"); *infra* Part II.

Third, Defendants ask the Court to abstain from adjudicating this matter under

Louisiana Power & Light Co. v. City of Thibodaux, 360 U.S. 25 (1959), and *Burford v. Sun Oil Co.*, 319 U.S. 315 (1943). (Mot. at 12-14.) But the *Burford* and *Thibodaux* doctrines are concerned with federal courts deciding unsettled questions of *state* law. National's Complaint asserts exclusively *federal* claims. Defendants do not even purport to identify a single question of Commonwealth law that the Court will have to resolve here. *See infra* Part III.

Fourth, Defendants assert that so-called no-action clauses in contracts governing COFINA and AFICA debt preclude National from bringing this lawsuit as to the COFINA and AFICA debt issuances. (Mot. at 10-12.) No-action clauses, however, are narrowly construed according to their express terms. And the clauses Defendants cite are limited to claims based on an "event of default" or "breach of duty," or that seek to enforce "any right" or "any remedy" "under" the agreements. National does not sue for default or breach, or to enforce contractual rights or remedies. National's claims—for declarations that the Moratorium Act is preempted and unconstitutional—are beyond the scope of the no-action clauses. *See infra* Part IV.

Fifth, Defendants claim that National has failed to allege a Takings Clause violation. (Mot. at 22-30.) Defendants challenge this claim largely on the mistaken premise that National attempts to assert property interests belonging only to bondholders, which is incorrect for the reasons previously noted. Defendants also contend that National's contract-based rights cannot also be property rights. The U.S. Supreme Court, and this Court, have held to the contrary. *See U.S. Trust Co. of N.Y. v. New Jersey*, 431 U.S. 1, 19 n.16 (1977) ("Contract rights are a form of property . . . ."); *Franklin Cal. Tax-Free Trust v. Puerto Rico*, 85 F. Supp. 3d 577, 611-12 (D.P.R. 2015) (Besosa, J.) (same). Defendants further argue that no taking has occurred

because the Moratorium Act's effects supposedly are temporary. This argument fails both because "a taking need not be permanent to be compensable," *Arkansas Game & Fish Comm'n v. United States*, 133 S. Ct. 511, 519 (2012), and because National alleges a permanent taking, including, *inter alia*, insofar as National is permanently deprived of the benefit of security interests in pledged revenues diverted under the Act. Finally, Defendants claim that National is owed no compensation because it supposedly will suffer no losses if Defendants continue to enforce the Moratorium Act. But National has already been deprived of liens and priority rights, for which the Commonwealth has no intention of paying just compensation. In any event, Defendants' assertion that it will eventually make good on principal and interest payments at most raises factual questions that cannot be resolved on this Motion, and in any event, a promise to eventually make payments does not provide a basis to dismiss National's claim. *See infra* Part V.

Sixth, Defendants challenge National's Contract Clause claim, again on the mistaken premise that National has failed to invoke its own contract rights. (Mot. at 14-22.) Defendants also assert that any impairment of contract rights is only temporary and, thus, not substantial. But an impairment need not be "permanent" to be substantial. And National has, in fact, alleged permanent impairments of its liens and other rights; Defendants' factual arguments to the contrary must wait until a later date. Defendants further contend that the Moratorium Act is necessary to an important government purpose because the numerous (less drastic) alternatives identified in the Complaint are all "unrealistic." Beyond the total lack of explanation or support for this assertion, it at best raises a host of factual questions further warranting denial of the Motion. *See infra* Part VI.

Seventh, Defendants dispute that the Bankruptcy Code preempts the Moratorium Act. (Mot. at 30-34.) They are incorrect for the reasons set forth in National's Motion for Partial Summary Judgment. *See infra* Part VII.

Eighth, Defendants concede that this case is not stayed by the Moratorium Act, but acknowledge that the Act purports to bar at least some litigation in federal court. They also concede that a state *court* would lack authority to impose such a prohibition. (Mot. at 35-37.) They claim, however, that state *legislatures* can prohibit federal litigation. But nothing in law or logic supports that distinction. As a matter of basic federal supremacy, no branch of a state (or commonwealth) government can shut the door to federal court. *See infra* Part VIII.

As demonstrated more fully below, Defendants' Motion should be denied in its entirety.

STATEMENT OF FACTS

A. The Moratorium Act

The Commonwealth enacted the Moratorium Act on April 6, 2016. (Compl. ¶ 20.) The Act directs the Governor to prioritize payment of undefined "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. (*Id.* ¶ 21.) Pursuant to section 201(a) of the Moratorium Act, the Governor has the power to issue executive orders: i) declaring the Commonwealth or any other "government entity" of the Commonwealth to be in a "state of emergency" and ii) suspending payment on the entity's "covered obligations." (*Id.* ¶ 22.)

The Moratorium Act also contains the following relevant provisions:

1. The Act imposes a blanket stay on creditor remedies—including rights of acceleration, termination, modification, and setoff—against the designated entities

during the emergency period, and also purports to prohibit certain court proceedings. (*Id.* ¶ 23(a).)

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. (*Id.* ¶ 23(b).)

3. 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. (*Id.* ¶ 23(c).)

4. Section 201(e) of the Moratorium Act permits the Governor to reprioritize the payment priorities set by the Office of Management and Budget Act ("OMB Act"). (Compl. ¶ 23(d).) The OMB Act (23 L.P.R.A. § 104(c)) determines payment priorities for Commonwealth expenditures and, consistent with the Article VI, Section 8 of the Commonwealth Constitution, prioritizes payment on public debt above all other expenditures.

5. The Act permits, but does not require, the Governor to order the payment of a government entity's interest obligations during a declared emergency period. (Compl. ¶ 23(e).)

Defendants' Motion falsely asserts that "Section 202(a) provides that, throughout the emergency period, interest will accrue on covered obligations as provided in any applicable agreement [and] holders of public debt will receive at least the minimum public debt payment." (Mot. at 6.; *id.* at 18, 22, 28, 29, 34.) In fact, Section 202(a) provides for such accrual of interest and making of minimum payment only "If provided for in an executive order"—and *none* of the executive orders at issue here contain such provisions. (*See* Exs. 16-18.)

B. National Insures Puerto Rico Bonds Covered By The Moratorium Act

National provides financial guaranty insurance and, as such, guarantees scheduled payments of principal and interest as and when due by, among others, the Commonwealth, PRHTA, COFINA, and AFICA. (Compl. ¶ 40.) Under the bond documents, insurance agreements

and policies,[2] and applicable law, National may i) exercise bondholders' rights through its control rights; or ii) step into bondholders' shoes as a subrogee.[3]

Under the insurance agreements for various general obligation bonds, PRHTA bonds, COFINA bonds, and the AFICA Trust Agreement (defined below), National is deemed the registered owner or holder of certain bonds regardless of whether it makes any insurance payments, and may enforce all rights, remedies, and claims with respect to such bonds:

- The PRHTA insurance agreement states that National is the "registered owner" of the bonds "for the purposes of exercising all rights and privileges available to bondholders," including "the right to institute any suit, action, or proceeding at law or in equity under the same terms" as the bondholders. (Ex. 2 § 1(vii).)

- The general obligation insurance agreement states that National "shall be deemed to be the holder of all of the MBIA Insured Bonds for the purpose of granting consent, direction or approval or taking any action permitted by or required under the Resolution to be granted or taken by the holders of such MBIA Insured Bonds." (Ex. 1, § 4(d).)

- The COFINA insurance policy states that National "shall have all rights to institute any suit, action, or proceeding at law or in equity . . . under the same terms as an Owner of the MBIA Insured Bonds under the Resolution." (Ex. 3 (Ex. B) § vi, at 2.)

- The AFICA Trust Agreement provides that National "shall be deemed to be the owner" of the bonds "in lieu of the registered owners thereof for purposes of directing remedies" upon an event of default, which occurred on June 26, 2016. (Ex. 4, § 208, at 31.)[4]

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[2] The referenced insurance agreements and policies were entered into or issued by MBIA Insurance Corporation ("MBIA"). National, an affiliate of MBIA, stepped into MBIA's shoes through a reinsurance agreement dated March 2009 and a second-to-pay policy dated February 2009. (Decl. ¶ 6.)

[3] As noted, National also owns COFINA bonds.

[4] The AFICA Trust Agreement defines events of default to include defaults under the lease agreement (the "UPR Lease Agreement") between Desarrollos Universitarios, Inc. and University of Puerto Rico ("UPR"), dated December 21, 2000. (*See* Ex. 4 § 801(d).) Defaults under the UPR Lease Agreement include the failure to make lease payments when due. (*See* Ex. 5 ¶ 7.1(a).) UPR defaulted on its obligations under the UPR Lease Agreement by failing to

Moreover, under applicable insurance agreements, policies, and/or Authorizing Resolutions, National has express subrogation rights pertaining to any insurance payments it makes. (*See*, *e.g.*, Ex. 2, § 1(vi)(1); Ex. 3, § viii(1); Ex. 4, § 208(g); Ex. 6, § 70(c)(vi)(1); Ex. 7, § 1(vi)(1).) Since, as described below, National made payments on July 1 on defaulted general obligation and PRHTA bonds, National is now subrogated to the rights of the bondholders.

Finally, National directly owns approximately $632 million (final maturity value) of COFINA bonds. (Decl. ¶ 4.) Therefore, National also has standing in its capacity as a COFINA bondholder.

Accordingly, National may assert all rights of a bondholder under the contracts governing insured PRHTA debt (the "PRHTA Bond Resolutions"), insured COFINA debt (the "COFINA Bond Resolutions"), insured AFICA debt (the "AFICA Trust Agreement"), and insured Commonwealth general obligation debt (the "GO Bond Resolutions") (collectively, the "Authorizing Resolutions").

C. National's Property And Contract Rights Relating To Insured Debt

1. Right To Priority Of Payment On General Obligation Debt

Article VI of the Commonwealth Constitution prioritizes general obligation debt over other disbursements. It provides that if "the available revenues . . . for any fiscal year are insufficient to meet the appropriations made for that year, interest on the public debt and amortization thereof *shall first be paid*, and other disbursements shall thereafter be made in accordance with the order of priorities established by law." P.R. Const. art. VI, § 8. National

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make a payment due on June 25, 2016, thus triggering a default under the AFICA Trust Agreement. (*See* Decl. ¶ 10; Exs. 14-15.)

insures Commonwealth general obligation debt governed by contracts—which were entered into under the authority of the Puerto Rico Constitution and therefore incorporate the priority of payment required thereby[5]—that similarly guarantee to bondholders first-priority payment of principal and interest when due (*see* Compl. ¶ 48):

- "The good faith, credit and taxing power of the Commonwealth are irrevocably pledged for the prompt payment of the principal of and the interest on the Refunding Bonds."
- "The Secretary [of the Treasury of Puerto Rico] is authorized and directed to pay the principal of and premium, if any, and the interest on the Refunding Bonds as the same shall fall due from any funds in the Treasury of the Commonwealth available for such purpose in the fiscal year for which said payment is required."

2. Liens On Pledged Revenues

National insures debt of PRHTA, COFINA, and AFICA governed by contracts that provide bondholders with the benefit of liens on certain funds pledged for the payment of the respective bonds issued thereunder. More specifically, PRHTA bonds are secured by PRHTA's property and revenues—various toll revenues, excise taxes, and motor vehicle license fees—as well as by any tax "made available to [PRHTA] by the Commonwealth," authorized by the Commonwealth to be pledged to the payment of the principal and interest of bonds, and pledged by PRHTA to such payments. *See* 9 L.P.R.A. § 2004(*l*); (Compl. ¶ 29). PRHTA has covenanted to prioritize such liens and to reserve the pledged funds for payment on the PRHTA bonds. (Compl. ¶ 51.) COFINA bonds are secured by a lien on COFINA's revenues and property,

[5] *See*, *e.g.*, *Norfolk & W. Ry. Co. v. Am. Train Dispatchers Ass'n*, 499 U.S. 117, 129–30 (1991) ("Laws which subsist at the time and place of the making of a contract, and where it is to be performed, enter into and form a part of it, as fully as if they had been expressly referred to or incorporated in its terms. This principle embraces alike those laws which affect its construction and those which affect its enforcement or discharge.").

including pledged sales tax revenues. *See* 13 L.P.R.A. §§ 12, 13; (Compl. ¶¶ 51, 64). AFICA bonds are secured by a lien on revenues and other moneys as provided under the AFICA Trust Agreement, and those funds cannot be subject to any other lien. (Compl. ¶ 51.)

3. Additional Property And Contract Rights

The contracts that govern the Commonwealth, PRHTA, COFINA, and AFICA debts National insures all provide for timely payment of principal and interest when due. (Compl. ¶ 47.) Further, the COFINA Bond Resolutions and the AFICA Trust Agreement provide bondholders with acceleration rights. (*Id.* ¶ 56.) Finally, through the COFINA Bond Resolutions and the COFINA Act, the Commonwealth covenanted not to interfere with COFINA's obligations to its bondholders. (*Id.* ¶ 58.)

D. The Governor Issues Orders Blocking Payment On Commonwealth And Instrumentality Debt And Taking PRHTA Toll Revenue Liens

To date, the Governor has issued nine executive orders pursuant to the Moratorium Act, several of which have caused National direct financial injury.[6] As relevant here, on May 17, 2016, the Governor signed an executive order that declared a state of emergency at PRHTA (the "PRHTA Executive Order"). (*Id.* ¶ 29; Ex. 16.) In a purported effort to "guarantee the ongoing provision of PRHTA's essential services," (Ex. 16, at 4) the PRHTA Executive Order suspended the transfer of toll revenues and "any other revenues allocated to or received by PRHTA" for the benefit of PRHTA's bondholders until June 30, 2016. (*Id.* ¶¶ 1, 3; *see* Compl. ¶ 29.) This order constitutes a direct taking of the lien held by National on such revenues. (Compl. ¶ 29.)

[6] These nine orders are available on the website of the Puerto Rico Department of State. *See* http://estado.pr.gov/es/ordenes-ejecutivas. Specifically, the nine orders are: (1) OE-2016-10; (2) OE-2016-14; (3) OE-2016-17; (4) OE-2016-18; (5) OE-2016-26; (6) OE-2016-27; (7) OE-2016-29; (8) OE-2016-30; and (9) OE-2016-31.

National's complaint, filed June 15, 2016, alleged that additional executive orders violating the rights of bondholders and, thus, National's rights, were a foregone conclusion. (Compl. ¶¶ 31-42.) That allegation unfortunately (for National) proved correct on June 30, 2016, when the Governor issued two additional executive orders. The first order ("EO-30") declared, *inter alia*, that the Commonwealth was in a state of emergency and ordered a moratorium on payments of Commonwealth debt, including general obligation bonds. (Ex. 17, ¶ 1.) This order also extended the PRHTA Executive Order for "the entirety of the covered period"—*i.e.*, continuing the diversion of pledged toll and other PRHTA revenues until January or possibly March 2017—and suspended payment of PRHTA's debt obligations. (*Id.* ¶ 2.) The second order signed on June 30 ("EO-31") declared various Puerto Rico entities, including the University of Puerto Rico, to be in a state of emergency, suspended transfers of certain revenues to these entities, and suspended payment on certain of their debt. (Ex. 18, ¶¶ 1, 5.)

E. Puerto Rico Defaults Under Color Of The Moratorium Act, Causing Direct Financial Injury To National

On July 1, 2016, pursuant to the Governor's executive orders issued under color of the Moratorium Act, the Commonwealth and other Puerto Rico entities defaulted on more than half of the $2.008 billion in payments that came due that day, including $779 million of general obligation debt. (*See* Ex. 19.) As a result, National made principal and interest payments of approximately $169 million to general obligation bondholders and approximately $4 million to PRHTA bondholders, and thus became subrogated to their rights. (Decl. ¶¶ 7, 8); *supra* p. 9.

National remains at risk of future defaults under color of the Moratorium Act, including with respect to $855 million of insured general obligation bonds and $706 million of insured PRHTA bonds. (Decl. ¶ 9.) The PRHTA Executive Order and EO-30 have diverted revenues

pledged to bond service, turning secured debt into unsecured debt. Further, consistent with the moratorium on general obligation debt authorized by the Moratorium Act and implemented by EO-30, the Commonwealth budget for fiscal year 2016-2017 does not appropriate any funds for general obligation debt service payments. (Ex. 20.) And on August 1, the Governor vetoed Puerto Rico House Bill 2959, which would have earmarked approximately $450 million to pay interest on the public debt. (Ex. 21.) Such actions, if left unchecked, make future defaults and further financial injury to National inevitable.

STANDARD OF REVIEW

A motion to dismiss under F.R.C.P. 12(b)(6) should be denied where, as here, the complaint "satisfies Rule 8(a)(2)'s requirement of 'a short and plain statement of the claim showing that the pleader is entitled to relief.'" *Ocasio-Hernández v. Fortuño-Burset*, 640 F.3d 1, 11-12 (1st Cir. 2011). In making this determination, this Court must accept all non-conclusory factual allegations as true, *id*. at 12, and "the plaintiff need not demonstrate that [it] is likely to prevail." *García-Catalán v. United States*, 734 F.3d 100, 102 (1st Cir. 2013). If the Complaint's allegations "allow[] the court to draw the reasonable inference that the defendant is liable for the misconduct alleged, . . . the claim has facial plausibility," and the motion must be denied. *Ocasio-Hernández*, 640 F.3d at 12 (quoting *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009). A motion to dismiss under F.R.C.P. 12(b)(1) is governed by a similar standard, except that the Court "may consider materials outside the pleadings." *Franklin*, 85 F. Supp. 3d at 587.

ARGUMENT

I. National Has Standing Because It Suffered Injury Resulting Directly From The Unconstitutional Moratorium Act

The standing inquiry "involves both constitutional limitations on federal-court

jurisdiction and prudential limitations on its exercise." *Warth v. Seldin*, 422 U.S. 490, 498 (1975). Constitutional standing requires "a concrete and particularized injury in fact, a causal connection that permits tracing the claimed injury to the defendant's actions, and 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) (quotations omitted). "The contours of the injury-in-fact requirement, while not precisely defined, are very generous, requiring only that claimant allege some specific, identifiable trifle of injury." *Adams v. Watson*, 10 F.3d 915, 918 (1st Cir. 1993) (quotations and editing removed). Thus, "at the pleading or motion to dismiss stage, general factual allegations of injury resulting from the defendant's conduct may suffice" to establish standing. *Universal Ins. Co. v. Dep't of Justice*, 866 F. Supp. 2d 49, 58 (D.P.R. 2012) (Besosa, J.) (quotations omitted).

Here, Defendants challenge only one element of standing: injury-in-fact.[7] Defendants argue that National has failed to establish injury because National supposedly attempts to assert the rights of bondholders (not its own rights) and has shown only a "speculative" possibility of injury to itself. (Mot. at 9-10.) Defendants are wrong in both respects: National may assert property and contract rights to the same extent as a bondholder and the Commonwealth's implementation of the Moratorium Act has resulted in National making more than $170 million in payments to insured bondholders.

On the first point, Defendants cite allegations in the Complaint discussing the rights of bondholders under the Authorizing Resolutions. (Mot. at 9.) But the Motion ignores the

[7] Defendants do not challenge the traceability or redressability elements of standing, and thus concede that National meets these requirements.

Complaint's allegations that, as insurer, National stands in the shoes of holders of insured bonds and can *itself* assert rights and remedies under the Authorizing Resolutions. (*See* Compl. ¶ 1 ("*Plaintiff* obtained various property and contractual rights relating to the debt that it insures, including, among others, the right to first-priority payment on the Commonwealth's general obligation debt and security interests in toll revenues pledged to the repayment of [PRHTA] bonds"), ¶ 42 (similar).) The relevant insurance policies and agreements governing insured general obligation, COFINA, PRHTA, and AFICA debt, which the Court may consider on this motion,[8] confirm this allegation. *See supra* p. 8. Specifically:

- National is the "registered owner" of certain PRHTA bonds "for the purposes of exercising all rights and privileges available to bondholders," including "the right to institute any suit, action, or proceeding at law or in equity under the same terms" as the bondholders. (Ex. 2 § 1(vii).)

- National "shall be deemed to be the holder of" certain general obligation bonds "for the purpose of granting consent, direction or approval or taking any action permitted by or required under the Resolution to be granted or taken by the holders of such . . . Bonds." (Ex. 1, § 4(d).)

- National "shall have all rights to institute any suit, action, or proceeding at law or in equity . . . under the same terms as an Owner of" certain COFINA bonds "under the [COFINA bond] Resolution." (Ex. 3 (Ex. B), § vi).

- National "shall be deemed to be the owner" of AFICA bonds "in lieu of the registered owners thereof for purposes of directing remedies" upon an event of default, which has occurred. (Ex. 4, § 208, at 31); *supra* p. 8 n. 4.

Additionally, by virtue of its payments in connection with the July 1 defaults, National has become subrogated to the rights of the general obligation and PRHTA bondholders. *See supra*

[8] As Defendants admit (Mot. at 8) the Court may consider extrinsic documents on a Rule 12(b)(1) motion. *Gonzalez v. United States*, 284 F.3d 281, 288 (1st Cir. 2002) ("While the court generally may not consider materials outside the pleadings on a Rule 12(b)(6) motion, it may consider such materials on a Rule 12(b)(1) motion . . . ."); *SURCCO v. PRASA,* 157 F. Supp. 2d 160, 165 (D.P.R. 2001) (plaintiff "refuted Defendants' attack as to Article III standing by alleging, and sustaining [its argument] with exhibits" submitted in opposition to motion to dismiss).

p. 12. And finally, National also owns approximately $632 million (final maturity value) of COFINA bonds. (Decl. ¶ 4.)

National, therefore, has standing to assert the contract and property rights at issue on the same terms as a bondholder. And aside from their incorrect contention that no-action clauses bar claims relating to COFINA and AFICA debt (*see infra* Part IV), Defendants do *not* argue that a bondholder would lack standing to bring the claims that National asserts herein.[9] Nor do they claim that the Complaint misstates the rights of bondholders under the Authorizing Resolutions.

Having thus established that National may assert property and contract rights on the same terms as bondholders, the Complaint readily pleads standing based on the Moratorium Act's unconstitutional invasion of those rights. This Court's decision in *Franklin* is directly on point in this regard. The *Franklin* plaintiffs challenged the Recovery Act as federally preempted and further alleged, *inter alia*, that they had constitutionally protected contract rights as holders of Puerto Rico Electric Power Authority ("PREPA") bonds, and that the Recovery Act substantially impaired those rights, in violation of the Contracts Clause. *Franklin*, 85 F. Supp. 3d at 594. This Court held that the plaintiffs had standing to bring those claims, for reasons fully applicable here: "the Recovery Act's nullification of several statutory and contractual security rights is a direct injury to the plaintiff bondholders"; "this injury was caused by the Commonwealth's enactment of the Recovery Act"; and a "declaratory judgment that the

[9] *See also Universal Ins. Co.*, 866 F. Supp. 2d at 58–59 (plaintiff insurers established standing by alleging they had "subrogation rights to the liens that are registered on the license and title of forfeited vehicles" and that they will "suffer an economic injury because they have to pay out insurance claims but cannot recuperate their losses because of [the challenged statute]").

Recovery Act is unconstitutional will afford plaintiffs redress for the injury because it will nullify the Recovery Act, restoring plaintiffs' statutory and contractual rights." *Id.*[10]

National sufficiently alleges standing for all of the same reasons. As the Complaint sets forth, bondholders, and thus National itself, have numerous contract and property rights pertaining to insured bonds, including the right to timely, first-priority payment on general obligation debt and contractually guaranteed liens on various revenues pledged to the repayment of PRHTA, COFINA, and AFICA debt. (Compl. ¶¶ 47-55; *id.* ¶¶ 56-60 (rights to acceleration and non-interference).) The Complaint further alleges that the Moratorium Act substantially impairs these rights, and takes National's property, by permitting the Governor to delay debt-service payments, prioritize so-called essential services over the payment of general obligation debt, and divert pledged revenues to other purposes. (*See id.* ¶¶ 47-60.) Thus, the Moratorium Act's "nullification of several statutory and contractual security rights is a direct injury to" National. *Franklin*, 85 F. Supp. 3d at 594.[11] Indeed, National's standing is even more clearly established than that of the *Franklin* plaintiffs: unlike in *Franklin*, where PREPA had never filed a petition under the Recovery Act, here the Governor has issued nine executive orders under the Moratorium Act, several of which directly impacted National's constitutional

[10] *Franklin* also held that the plaintiffs lacked standing to pursue a separate claim against PREPA because that claim depended on PREPA's filing a petition under the Recovery Act, which had not occurred. *Franklin*, 85 F. Supp. 3d at 594. Here, however, National's injuries are directly traceable to enactment of the Moratorium Act and do not depend on any further factual development. Moreover, the Governor has already issued nine executive orders under the Moratorium Act, directly injuring National. *See supra* pp. 11-12.

[11] *See also Universal Ins. Co.*, 866 F. Supp. 2d at 58-59 (insurers had standing to assert Contract Clause and Taking Clause challenges to commonwealth statute that nullified their subrogation rights).

rights and caused it financial injury by violating priority rights and diverting pledged revenues. *See supra* pp. 11-12.

The Complaint pleads standing on the independent ground that the Moratorium Act put it at risk of imminent financial injury—which actually transpired two weeks after National brought suit. As Defendants undoubtedly know, their assertion that the Complaint offers only "speculation" in this regard (Mot. at 9) is simply not true.

National, as noted, insured general obligation payments due July 1, 2016 (two weeks after the Complaint was filed). As the Complaint alleges, in the weeks leading up to this action, numerous high-ranking Commonwealth officials warned that: i) the Commonwealth supposedly did not have the funds to make the July 1 payments; and ii) the Moratorium Act could be used as legal justification to default on those payments. (*See* Compl. ¶ 32 (Treasury Secretary Juan C. Zaragoza Gómez "think[s] the moratorium will be used" to block timely payment on general obligation debt), ¶ 34 (Government Development Bank for Puerto Rico ("GDB") President Melba Acosta: the Act provides "the central government the tools to work with its July payment . . . in case it does not have the funds to make a complete payment"), ¶ 37 (OMB Director Luis F. Cruz Batista: the Commonwealth "lack[s] the resources to comply with July's $800 million [general obligation] payment"), ¶¶ 33, 35, 36.) These threats were all too credible, given that the Governor had already employed the Moratorium Act to cause GDB to default on $367 million in debt payments due April 1, 2016. (Compl. ¶¶ 26-28, 35.) Accordingly, the Complaint alleges standing based on the risk of imminent financial harm to National. *See*, *e.g.*, *Playboy Enters., Inc. v. Pub. Serv. Comm'n*, 906 F.2d 25, 36 (1st Cir. 1990) ("imminent financial threat" to plaintiff established standing).

What is more, the financial injury to National that the Complaint accurately alleged to be imminent became a reality when the Commonwealth and PRHTA defaulted on July 1, 2016, resulting in National making over $170 million in payments to bondholders. That default occurred weeks *before* Defendants filed their Motion, making their entire standing argument highly disingenuous. *See Adams*, 10 F.3d at 924 (even "a relatively small economic loss—even an identifiable trifle—is enough to confer standing") (quotations omitted).

Even now, additional defaults on insured debt, and thus additional financial harm to National, are unmistakably threatened. This risk has been increased by executive orders diverting revenues pledged to bond service, which compound the economic injury to National on a daily basis. (Exs. 16-18.) Moreover, the Commonwealth government passed a budget for fiscal year 2016-2017 that does not appropriate funds for debt service payments on general obligation debt. (Ex. 20.) And on August 1, 2016, the Governor vetoed Puerto Rico House Bill 2959—which would have earmarked approximately $450 million to pay interest on the public debt, including general obligation bonds. (Ex. 21).

Thus, National has suffered injuries in fact, with more imminently threatened, and therefore has standing to bring this lawsuit.

II. National's Claims Are Ripe

For the same fundamental reasons that National has standing, all of National's claims are ripe. Defendants' contention that National's claims are unripe because National supposedly asserts the rights of bondholders and has shown only a "speculative" possibility of harm (Mot. at 10), fail for the reasons set forth above. *See supra* Part I.

Moreover, National brings exclusively facial challenges to the Moratorium Act, and

"facial challenges . . . are generally ripe the moment the challenged regulation is passed." *Asociación de Suscripción Conjunta del Seguro de Responsabilidad Obligatorio v. Juarbe-Jiménez*, 642 F. Supp. 2d 73, 77-78 (D.P.R. 2009); *see also Franklin*, 85 F. Supp. 3d at 613 ("[F]acial takings challenges are ripe the moment the challenged law is passed."). *Franklin*, once again, controls. There, the First Circuit found the claims ripe insofar as the plaintiffs "allege[d] that the very enactment of the Recovery Act, rather than the manner of enforcement, impairs their contractual rights-allegations that present purely legal issues or factual issues controlled by past events." *Franklin*, 805 F.3d at 333; *Franklin*, 85 F. Supp. 3d at 589 (similar). Of course, the fact that the Governor has issued executive orders under color of the Moratorium Act that resulted in National having to make insurance payments and that continue to injure National through the diversion of resources pledged to bond service—and that he is poised to issue more such orders in the future—underscores the live controversy here. *See supra* pp. 11-13.

III. The Court Should Not Abstain From Resolving The Important Federal Constitutional Issues Raised In National's Complaint

Defendants ask the Court to abstain from addressing National's claims under the doctrines of *Louisiana Power & Light Co. v. City of Thibodaux*, 360 U.S. 25 (1959), and *Burford v. Sun Oil Co.*, 319 U.S. 315 (1943). But "both *Burford* and *Thibodaux* were cases in which the federal court was exercising its *diversity jurisdiction* and deciding complicated *questions of state law* previously undecided by the local courts." *Ass'n of Relatives & Friends v. Regulations & Permits Admin.*, 740 F. Supp. 95, 102 (D.P.R. 1990) (emphasis added). This case is the opposite: it arises under the Court's *federal-question jurisdiction* and it presents *exclusively federal issues*

for decision. The *Burford* and *Thibodaux* doctrines are inapplicable where—as here—a federal court is presented with purely federal claims.

The U.S. Supreme Court has "often acknowledged that federal courts have a strict duty to exercise the jurisdiction that is conferred upon them by Congress." *Quackenbush v. Allstate Ins. Co.*, 517 U.S. 706, 716 (1996). Accordingly, "[a]bstention from the exercise of federal jurisdiction is the exception, not the rule." *Colo. River Water Cons. Dist. v. United States*, 424 U.S. 800, 813 (1976). And "there is, of course, no doctrine requiring abstention merely because resolution of a federal question may result in the overturning of a state policy." *Zablocki v. Redhail*, 434 U.S. 374, 380 n.5 (1978).

The *Burford* doctrine "is concerned with protecting complex state administrative processes from undue federal interference." *New Orleans Pub. Serv., Inc. v. Council of New Orleans*, 491 U.S. 350, 362 (1989) ("*NOPSI*"). Its "fundamental concern . . . is to prevent federal courts from bypassing a state administrative scheme and *resolving issues of state law* and policy that are committed in the first instance to expert administrative resolution." *Sevigny v. Employers Ins. of Wausau*, 411 F.3d 24, 27 (1st Cir. 2005) (emphasis added). The rule of *Thibodaux*, similarly, permits staying actions that "rais[e] issues intimately involved with the States' sovereign prerogative, the proper adjudication of which might be impaired by *unsettled questions of state law*." *Quackenbush*, 517 U.S. at 717; *Coors Brewing Co. v. Mendez-Torres*, 678 F.3d 15, 23 (1st Cir. 2012) (*Thibodaux* may apply when "the state's law is unclear").

These considerations are entirely absent here. National's claims do not involve novel questions of Commonwealth law. Indeed, Defendants do not even purport to identify a single issue of Commonwealth law presented in this action. Nor could they have: National asserts

exclusively federal claims that are grounded in settled principles of federal preemption (under the Bankruptcy Code), the Takings Clause, and the Contract Clause. The question here is whether the Moratorium Act, on its face, violates federal law and the U.S. Constitution. Defendants do not contend, for example, that National has misconstrued the Act under *Puerto Rico* law, or that the validity of the Act under the U.S. Constitution turns on some unsettled question of Commonwealth law. "Unlike *Burford* . . . this case does not involve complex issues of state law, resolution of which would be disruptive of state efforts to establish a coherent policy." *Zablocki*, 434 U.S. at 380 n.5 (quotations omitted).

Defendants erroneously claim that adjudicating this dispute would require the Court to "speculate about potential application" of the Moratorium Act, when "most of its provisions have not been invoked." (Mot. at 14.) This argument ignores the basic nature of National's claims, which assert a *facial* challenge to the Act. *See NOPSI*¸ 491 U.S. at 363 (holding abstention unwarranted when "no inquiry beyond the four corners of the [challenged municipality] order is needed to determine whether it is facially pre-empted by [federal law]. Such an inquiry would not unduly intrude into the processes of state government . . . ."). It also ignores the fact that the Moratorium Act has been employed by the Governor *nine times* since its passage in April of this year, directly injuring National. *See supra* pp. 11-12.

Finally, Defendants incorrectly assert that the Court should abstain because the Moratorium Act's "driving force is inherently local" and the Act supposedly involves issues relating to "Puerto Rico's sovereign prerogative." (Mot. at 13-14 (quotations omitted).) In fact, the issues here are overwhelmingly federal. National seeks to vindicate its rights under the U.S. Constitution and seeks a judgment declaring, *inter alia*, that the Moratorium Act is void on

federal-supremacy grounds because it is expressly preempted by the U.S. Bankruptcy Code. This, of course, was an issue of sufficient federal weight for the U.S. Supreme Court to grant review last term in *Franklin* and strike down the Recovery Act on the same ground. *Franklin*, 136 S. Ct. at 1942. And Puerto Rico's fiscal crisis raises sufficiently national concerns that the federal government recently enacted the Puerto Rico Oversight, Management, and Economic Stability Act, Pub. L. No. 114-187 (2016) ("PROMESA"), to begin addressing it. Finally, the Commonwealth and the other Issuers have marketed the bonds at issue to investors nationwide, and plaintiffs from a myriad of different jurisdictions have brought suit in this Court (and elsewhere) to seek relief from the Commonwealth's recent unlawful actions.[12]

IV. The No-Action Clauses In Contracts Governing AFICA And COFINA Debt Do Not Apply

Defendants next argue that National's claims are barred by so-called no-action clauses in the contracts governing certain AFICA and COFINA debt. (Mot. at 10-12.) Putting aside that Defendants themselves have no ability to rely upon the no-action clauses, those clauses do not apply because they are expressly limited to claims for default, breach of duty, or to enforce rights or remedies under the respective agreements. No such claims are at issue here.

No-action clauses "apply according to their terms and are not broadly construed." *Metro. W. Asset Mgmt., LLC v. Magnus Funding, Ltd.,* 2004 WL 1444868, at *5 (S.D.N.Y. June 25,

[12] *See*, *e.g., Assured Guar. Corp. v. García Padilla*, No. 3:16-cv-01037-FAB (D.P.R.) (plaintiffs headquartered in New York and organized under the laws of New York and Wisconsin); *Fin. Guar. Ins. Co. v. García Padilla*, No. 3:16-cv-01095-FAB (D.P.R.) (New York plaintiff); *Brigade Leveraged Capital Structures Fund Ltd. v. Gov't Dev. Bank for P.R.*, No. 3:16-cv-01610-FAB (D.P.R.) (New York, Delaware, and Cayman Islands plaintiffs); *Ambac Assurance Corp. v. P.R. Highways & Transp. Auth.*, No. 3:16-cv-01893-PAD (D.P.R.) (Wisconsin-domiciled plaintiff headquartered in New York); *Peaje Invs. LLC v. García Padilla*, No. 3:16-cv-02365-ADC (D.P.R.) (Delaware entity plaintiff headquartered in New York); *Assured Guar. Corp. v. Puerto Rico*, No. 3:16-cv-02384-JAG (D.P.R.) (New York plaintiff).

2004); *see also Cruden v. Bank of N.Y.*, 957 F.2d 961, 968 (2d Cir. 1992) (no-action clauses "are strictly construed"). Courts give effect only "to the precise words and language used" in these provisions and construe them "narrowly." *Quadrant Structured Prods. Co. v. Vertin*, 23 N.Y.3d 549, 560 (2014). Accordingly, courts consistently hold that no-action clauses do "not bar a plaintiff from seeking a remedy for a claim outside the scope of the . . . clause." *Howe v. Bank of N.Y. Mellon*, 783 F. Supp. 2d 466, 473 (S.D.N.Y. 2011).

The no-action clauses that Defendants cite, Section 808 of the AFICA Trust Agreement and Section 1106 of the Amended and Restated COFINA Bond Resolution, are expressly limited to claims based on an "event of default" or "breach of duty," and/or that seek to enforce "any right" or "any remedy" "under" those agreements. (Mot. at 11-12.) But National's claims are not based on an event of default or contractual breach, nor do they seek to enforce rights or remedies under the AFICA or COFINA bond documents. Instead, National seeks a judgment declaring that the Moratorium Act is preempted by the Bankruptcy Code, violates the Takings Clause and the Contracts Clause of the U.S. Constitution, and unlawfully purports to bar access to federal court.[13] (Compl. ¶¶ 69-82.) Indeed, Defendants themselves elsewhere acknowledge that National's complaint is a "constitutional challenge to the [Moratorium] Act," and *not* a "suit[] to recover covered obligations." (Mot. at 35.) Accordingly, the AFICA and COFINA no-

[13] Defendants' citations on this point are inapposite. The no-action clause in *McMahon & Co. v. Wherehouse Entm't, Inc.*, 65 F.3d 1044, 1050 (2d Cir. 1995) applied to claims seeking "any remedy with respect to this Indenture or Securities" issued thereunder and was thus broader that the AFICA and COFINA clauses. In *Friedman v. Chesapeake & Ohio Ry. Co.*, 261 F. Supp. 728, 730 (S.D.N.Y. 1966), unlike here, the "plaintiffs [had] in fact based their claims on the indenture," thus bringing them within the scope of the no-action clause.

action clauses do not apply. *See, e.g.*, *Cruden*, 957 F.2d at 967 (holding that no-action clause barring claims made "with respect to this Indenture" did not bar statutory and fraud claims).[14]

V. The Complaint Adequately Alleges Violations Of The Takings Clause

The Takings Clause provides that property shall not "be taken for public use, without just compensation." U.S. Const. amends. V, XIV.[15] To succeed on a takings claim, a plaintiff must demonstrate (1) that it possesses a recognized property interest covered by the Fifth Amendment and (2) that the challenged action "cause[d] an illegal taking" of that interest. *Wash. Legal Found. v. Mass. Bar Found.*, 993 F.2d 962, 973-74 (1st Cir. 1993). The Complaint adequately pleads these elements.

A. The Complaint Adequately Alleges That National Has A Variety Of Property Rights Relating To The Debt It Insures

As detailed above, the Complaint alleges that National can assert a number of property rights, equivalent to those of a bondholder, relating to the debt that it insures. These include:

- the right to timely, first-priority payment of general obligation debt;
- the right to timely payment of general obligation, PRHTA, COFINA, and AFICA debt;
- liens on various revenues pledged to the repayment of insured COFINA, PRHTA, and AFICA debt;
- the right to accelerate debt payments upon certain events of default; and
- the Commonwealth's covenant not to interfere with the rights of COFINA bondholders.

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[14] *See also Howe*, 783 F. Supp. 2d at 473-74 (no-action clause barring claims "with respect to this Indenture, or for any other remedy hereunder" did not bar breach of contract and breach of fiduciary duty claims); *Metro. W.*, 2004 WL 1444868, at *5 (no-action clause limited to events of default did "not prevent noteholders from bringing extra-contractual tort claims or breach of contract claims").

[15] The Takings Clause applies to the Commonwealth through the Fourteenth Amendment. *See, e.g., Tenoco Oil Co. v. Dep't of Consumer Affairs*, 876 F.2d 1013, 1017, n.9 (1st Cir. 1989).

See supra pp. 9-11.

Insofar as these rights are grounded in contract—or, in the case of general obligation debt, both contract and the Commonwealth Constitution—they are property rights for purposes of the Takings Clause. *See U.S. Trust Co. of N.Y. v. New Jersey*, 431 U.S. 1, 19 n.16 (1977) ("Contract rights are a form of property and as such may be taken for a public purpose provided that just compensation is paid.").[16] Moreover, it is well established that liens, such as those attaching to the above-referenced COFINA, PRHTA, and AFICA revenues, constitute property as well. *See Koontz v. St. Johns River Water Mgmt. Dist*., 133 S. Ct. 2586, 2601 (2013) ("[W]e have repeatedly held that the government takes property when it seizes liens . . . .").[17]

Defendants offer three arguments why the Complaint supposedly fails to allege a property interest. First, Defendants claim that National fails to allege that it, as opposed to the bondholders, has any rights pertaining to the insured debt. (Mot. at 24.) This is incorrect for the reasons demonstrated in Part I, *supra*.

Second, Defendants claim that National's contract-based rights—as distinct from "rights in particular property acquired through a contract"—cannot constitute property interests for purposes of the Takings Clause. (Mot. at 24-25.) But this Court has already held to the

[16] *See also Franklin*, 85 F. Supp. 3d at 611 (same); *Winston v. City of N.Y.*, 759 F.2d 242, 247 (2d Cir. 1985) ("[A] contractual right to a pension under the State Constitution . . . is a property interest . . . ."); *Gonzalez v. Torres*, 915 F. Supp. 511, 516 (D.P.R. 1996) (Commonwealth Constitution creates "a property interest in [plaintiff's] right to a public education" for federal due process purposes).

[17] *See also Armstrong v. United States*, 364 U.S. 40, 48 (1960) ("The total destruction by the Government of all value of these liens, which constitute compensable property, has every possible element of a Fifth Amendment 'taking' . . . ."); *United States v. Sec. Indus. Bank*, 459 U.S. 70, 75-76 (1982) (similar); *In re Weinstein*, 164 F.3d 677, 685 (1st Cir. 1999) (judicial liens constitute "property within the meaning of the . . . takings clause" (citations omitted)).

contrary. *See Franklin*, 85 F. Supp. 3d at 611-12 ("When the Government and private parties contract . . . the private party usually acquires an intangible property interest within the meaning of the Takings Clause in the contract. The express rights under this contract are just as concrete as the inherent rights arising from ownership of real property, personal property, or an actual sum of money." (quotations omitted)). So has the Supreme Court. *See Connolly v. Pension Ben. Guar. Corp.,* 475 U.S. 211, 224 (1986) (rejecting suggestion that "contractual rights are never property rights or that the Government may always take them for its own benefit without compensation"); *U.S. Trust*, 431 U.S. at 19 n.16 (same). Neither of the cases Defendants cite supports their contention that National's contractual rights cannot constitute property interests.[18]

Third, Defendants claim that National's liens do not constitute property because they supposedly represent just a "generalized interest in a pool of money." (Mot. at 26.) But unlike

[18] *Security Indus. Bank*, 459 U.S. at 75 (cited in Mot. at 24) did not state or suggest that contractual rights are not property interests; it merely commented that "traditional property rights are entitled to . . . greater protection under the takings clause than traditional contract rights." Defendants' reliance on *Peick v. Pension Ben. Guar. Corp*., 724 F.2d 1247, 1276 (7th Cir. 1983) (holding that contractual right to avoid pension liability was not a compensable property interest) is misplaced. Insofar as Seventh Circuit law holds that contract rights do not constitute property, it is inconsistent with Supreme Court precedent, the law of this circuit, and this Court's decision in *Franklin*. *Compare Pittman v. Chicago Bd. of Educ.*, 64 F.3d 1098, 1104 (7th Cir. 1995) ("in this circuit," the concept of property under the Takings Clause "does not extend to contracts"); *with Franklin*, 85 F. Supp. 3d at 611 ("Contracts are a form of property for purposes of the Takings Clause.") (citing, *inter alia*, *U.S. Trust,* 431 U.S. at 19 n.16 ("Contract rights are a form of property and as such may be taken for a public purpose provided that just compensation is paid."), and *Lynch v. United States,* 292 U.S. 571, 579 ("Valid contracts are property" for purposes of the Takings Clause)); *Puerto Rico Telecomm. Co. v. Tel. Reg. Bd.*, 189 F.3d 1, 16 (1st Cir. 1999) ("An enforceable contract right can in some circumstances provide the necessary property right" for a takings claim); *Nat'l Educ. Ass'n—Rhode Island v. Retirement Bd. of R.I. Emp. Ret. Sys.*, 172 F.3d 22 (1st Cir. 1999) ("If there were a contractual right to such payment, that right itself would be property for the purposes of the Takings Clause.")).

the cases upon which Defendants rely—which focus on statutory entitlements to payment or the government's assessment of fees[19]—the liens at issue pertain to specific PRHTA toll revenues and other specific funds pledged to the repayment of PRHTA, COFINA, and AFICA debt. *See supra* p. 10-11. Accordingly, these liens and payment rights are specific, identifiable property protected by the Takings Clause. *Temple-Inland, Inc. v. Cook*, 2016 WL 3536710, at *17 (D. Del. June 28, 2016) (Takings Clause applies to "the taking of a specific fund of money").

B. The Complaint Adequately Alleges That The Moratorium Act Has Taken National's Property

Next, the Complaint pleads facts demonstrating that the Moratorium Act effectuates a taking of Plaintiff's property interests.[20] Specifically:

- Sections 201 and 202 of the Act take the right to timely repayment of debt, and to first-priority payment of general obligation debt. Section 201(a) permits the Governor to issue orders providing that "no payment on a covered obligation of . . . [a] government entity shall be made." Section 202(a)(i)(A) states that interest on covered obligations shall be paid during the emergency period *only* "*If* provided for in an executive order." And Sections 201(a), (d), and (e) direct the Governor to "prioritize payment of essential services" over the payment of general obligation debt. (Compl. ¶¶ 47-49.)

- The Moratorium Act and PRHTA Executive Order take Plaintiff's liens on PRHTA toll revenues and pledged COFINA and AFICA revenues insofar as: Section 201(a) directs the Governor to prioritize the payment of undefined "essential services" over debt payments; Section 201(b)(iv) authorizes the Governor to "expropriate[e]" property rights related to covered obligations; and Section

[19] For instance, *United States v. Sperry Corp*, 493 U.S. 52, 62 (1989), concerned monies "taken" as repayment for government services. Likewise, *Santiago-Ramos v. Autoridad de Energía Electrica de P.R.*, 2015 WL 846750, at *3-4 (D.P.R. Feb. 26, 2015), found that certain utility rates did not effect a taking of customers' property because they were not "tied to any specific fund" or "related to any other particular property."

[20] Because Plaintiff alleges that "the mere enactment of [the Moratorium Act] constitutes a taking," this claim falls "squarely within the United States Supreme Court's definition of a facial takings challenge." *Franklin*, 85 F. Supp. 2d at 611 (citing *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470, 494 (1987)) (internal quotation marks omitted).

201(d) permits the Governor to "suspend[] or modif[y]" any obligation "to transfer money . . . to pay or secure any covered obligation." (Compl. ¶¶ 51-52.)

- Section 201(b)(ii) of the Act takes acceleration rights (pertaining to COFINA and AFICA debt) by prohibiting any person from "exercis[ing] any remedy," including "any right of acceleration or termination . . . related to any covered obligation" during an emergency period. (Compl. ¶ 56.)

- Sections 201(a), (b), and (d) of the Act take Plaintiffs' rights in the COFINA non-interference covenant by empowering the Governor to suspend payment on COFINA Bonds, stay judicial proceedings, restrict the exercise by bondholders of their acceleration rights and other remedies, expropriate property, and suspend the transfer of money to pay or secure the COFINA debt. (Compl. ¶¶ 58-59.)

The Moratorium Act has "totally eliminated" the foregoing rights, thereby taking Plaintiff's property. *See Franklin*, 85 F. Supp. 3d at 612 (holding that the Recovery Act effected a "direct taking" by eliminating plaintiff's contractual right to seek appointment of a receiver); *see also Armstrong*, 364 U.S. at 47-49 (transfer to government of secured property effected "a taking of [the] liens for which just compensation is due" because sovereign immunity would render liens unenforceable); *Murray v. United States*, 817 F.2d 1580, 1583-84 (Fed. Cir. 1987) (mortgagees pled takings claim by alleging that prohibition on redeeming mortgaged property "extinguished their lien").

Defendants claim that the Moratorium Act does not effect a taking because it "merely suspend[s] [the] operation [of National's rights] for less than one year," and all payments otherwise due during the Act's covered period "will be due to be paid on the last day of the covered period." (Mot. at 26.) But Defendants' own authority recognizes that "a taking need not be permanent to be compensable." *Arkansas Game & Fish Comm'n*, 133 S. Ct. at 519

(cited in Mot. at 27).[21] Moreover, Defendants again ignore the substance of National's allegations, which show that the Act has permanently taken its property. The effect on National's liens, for example, cannot be dismissed as temporary: the liens securing PRHTA toll revenues diverted under color of the Act are forever lost to PRHTA creditors. *See supra* p. 11-12. Similarly, when the Commonwealth pays a junior creditor but not a senior one, the senior creditor can never regain the priority it lost. And the Commonwealth's fiscal crisis—detailed in the Complaint and acknowledged by Defendants when it suits their purposes (Compl. ¶¶ 31-39; Mot. at 1-2)—casts serious doubt on Defendants' assertions that the Commonwealth will cease invoking the Moratorium Act, begin honoring creditors' rights, and make up payment shortfalls beginning on the Act's currently stated expiration date. When and whether any of that will happen is a question of fact that cannot be resolved at this stage of the litigation.

C. The Complaint Adequately Alleges The Lack Of Just Compensation

Finally, the Complaint adequately alleges that the Commonwealth has not paid just compensation and almost certainly will not do so. (Compl. ¶¶ 61-63.) Under the Fifth Amendment, "however great the [government's] need, private property shall not be . . . taken even for a wholly public use without just compensation." *Sec. Indus. Bank*, 459 U.S. at 77 (quotations omitted). Here, however, the Commonwealth has provided no compensation whatsoever for the taking of Plaintiff's property rights. And the Moratorium Act does not even purport to require compensation for takings like those at issue here. (*See* Compl. ¶ 62.)

Defendants respond that National is not owed any compensation because it supposedly

[21] *Tahoe-Sierra Pres. Council, Inc. v. Tahoe Reg'l Planning Agency*, 535 U.S. 302, 342 (2002) (cited in Mot. at 26), merely held that "the duration of the restriction is one of the important factors that a court must consider in the appraisal of a regulatory takings claim"—which is not asserted here—but declined to adopt "what amount to *per se* rules in either direction."

"will not ultimately suffer any losses as a result of [the Moratorium Act's] stay provisions," as they do not formally reduce principal or interest owed. (Mot. at 29.) But "the amount of compensation due" for a taking is a question of fact. *Portland Natural Gas Transmission Sys. v. 19.2 Acres of Land*, 318 F.3d 279, 281 (1st Cir. 2003). Further, given the Commonwealth's financial distress, the promise of compensation in the foreseeable future is meaningless. *See Wal-Mart Puerto Rico, Inc. v. Zaragoza-Gomez*, 2016 WL 1183091, at *3, 38 (D.P.R. Mar. 28, 2016) (finding that the ability to seek a tax refund from "an insolvent government, without any hope that the victimized taxpayers will be reimbursed in the foreseeable future," was "the very definition of an inadequate remedy," and a court order directing such refund would be "worthless"); (*see also* Compl. ¶¶ 61-63). Moreover, to the extent that the Commonwealth expropriates cash pursuant to Section 201(a)(iv), there is a presumption that the Commonwealth does not intend to provide compensation. *See In re Chateaugay Corp.*, 53 F.3d 478, 493 (2d Cir. 1995) ("[W]here the challenged statute requires a person or entity to pay money to the government, it must be presumed that Congress had no intention of providing compensation for the deprivation . . . .").[22]

VI. The Complaint Adequately Alleges Violations Of The Contract Clause

The Contract Clause provides that "[n]o State shall . . . pass any . . . Law impairing the Obligation of Contracts." In determining whether a statute violates this prohibition, courts consider whether the legislation "operated as a substantial impairment of a contractual

[22] Defendants do not and could not argue that Plaintiff was required to seek compensation from the Commonwealth before bringing its takings claim. *See García-Rubiera v. Calderón*, 570 F.3d 443, 453 (1st Cir. 2009) (a plaintiff need not seek compensation before asserting a facial takings challenge, or when the compensation procedure is "inadequate or futile") (citing, *inter alia*, *Williamson Cnty. Reg'l Planning Comm'n v. Hamilton Bank*, 473 U.S. 172, (1985)).

relationship" and whether the impairment "was necessary to meet an important general social problem." *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 240, 244, 247 (1978). National has sufficiently pled that the Moratorium Act substantially impairs its contract rights in manners neither reasonable nor necessary to address the Commonwealth's fiscal crisis.

A. The Moratorium Act Substantially Impairs National's Contract Rights

To determine whether there has been a substantial impairment of a contract right, courts consider "whether there is a contractual relationship, whether a change in law impairs that contractual relationship, and whether the impairment is substantial." *Vázquez-Velázquez v. P.R. Highway & Transp. Auth.*, 2016 WL 183653, at *9 (D.P.R. Jan. 14, 2016). To determine whether an impairment is substantial, courts consider the expectations of the parties and whether the contract rights were a central undertaking of the contract. *See Mercado-Boneta v. Administración del Fondo de Compensación Paciente*, 125 F.3d 9, 13 (1st Cir. 1997).

As set forth above, National has sufficiently alleged that holders of the bonds it insures have a variety of contract rights, which National itself can assert, including the right to timely, first-priority payment on the Commonwealth's general obligation debt and liens on various revenues pledged to the repayment of COFINA, PRHTA, and AFICA debt. (Compl. ¶¶ 42, 47-48, 51, 56, 58); *supra* pp. 9-11. Further, enactment of the Moratorium Act substantially impaired these contractual rights by "authorizing the Governor to delay payments," undermining the right to "payment as and when due," (Compl. ¶ 50); "prioritiz[ing] the payment of essential services over . . . debt service payments," thereby impairing "contractually guaranteed liens" (*id.* ¶ 54); prohibiting the exercise of the contractual right to accelerate (*id.* ¶ 57); and permitting the Governor to interfere with COFINA contract rights (*id.*¶ 60). *See Franklin*, 85 F.

Supp. 3d at 607 ("When a state law authorizes a party to do something that a contract prohibits it from doing, or . . . prohibits a party from doing something that a contract authorizes it to do, the state law impairs a contractual relationship, independent of whether or how the party acts pursuant to the state law.") (quotations omitted) (citing *U.S. Trust Co.,* 431 U.S. at 19-21).

In the face of these well-pled allegations, Defendants challenge the first element of National's Contract Clause claim on two grounds. First, Defendants contend that National has asserted only "*bondholders'* contractual rights, not its own." (Mot. at 15.) This is incorrect because, as demonstrated, National itself has contract rights coextensive with those of bondholders. *See supra* Part I. Second, Defendants assert that the impairment of National's contract rights is not substantial because the Moratorium Act supposedly does nothing more than "permit a temporary delay in payment on bonds" so that the Commonwealth can supposedly "make the fiscal reforms necessary to make those payments in the future." (Mot. at 18.) But the Moratorium Act does much more than temporarily delay payment. It nullifies the right to first-priority payment on general obligation debt, destroys National's liens on pledged COFINA, PRHTA, and AFICA revenues, and eliminates the rights to acceleration and non-interference. *See supra* pp. 9-12. This is substantial impairment. *See Allied Structural*, 438 U.S. at 247 (finding a substantial impairment when the regulation in question "nullifie[d] express terms of the company's contractual obligations and impose[d] a completely unexpected liability"); *Franklin*, 85 F. Supp. 3d at 607 (substantial impairment established when Recovery Act made more than "a single or modest impairment to [contractual] obligations").[23]

[23] The cases Defendants cite (Mot. at 17-18) are inapposite, as none involved impairments as severe as those here. *See Faitoute Iron & Steel Co. v. City of Asbury Park*, 316 U.S. 502, 511 (1942) ("[W]e are not here concerned with legislative changes touching secured claims"); *Home*

Third, Defendants claim that insofar as the Moratorium Act permits the Commonwealth to take liens, this does not constitute an impairment because liens supposedly are merely a form of "contractual remedy," which the Act supposedly "supplants . . . with an equally effective remedy: a claim for just compensation." (Mot. at 19.) But, as the Complaint alleges, the Commonwealth's distressed finances cast serious doubt on its ability and willingness to pay compensation. (Compl. ¶¶ 61-63.) This assertion, along with Defendants' contention that there has been no impairment because the Commonwealth supposedly *will in the future* pay its debts in full, at most raises additional questions of fact warranting denial of the Motion.

B. The Act's Impairments Are Not Reasonable Or Necessary

In determining whether a contractual impairment is reasonable or necessary to an important government purpose, courts ask whether the law is "reasonable in light of the surrounding circumstances" and whether the law imposes "a drastic impairment when an evident and more moderate course would serve its purposes equally well." *U.S. Trust*, 431 U.S. at 31. The Complaint alleges a number of reasons why the Moratorium Act fails this test. First, the Commonwealth and the other Issuers have not exhausted their ability to voluntarily restructure their debts—as sovereign nations and other entities that are not eligible for bankruptcy traditionally do. (Compl. ¶ 64.) Moreover, the Commonwealth could reduce expenditures, and the other Issuers could increase their revenues (PRHTA, for example, could

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Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 424–25 (1934) (statute did not "impair the integrity of the mortgage indebtedness" because mortgagee had "the equivalent of possession during the [foreclosure-extension] period"); *Ropico, Inc. v. City of New York*, 425 F. Supp. 970, 977 (S.D.N.Y. 1976) (statute did not seize collateral or alter creditor priorities); *Des Moines Joint Stock Land Bank of Des Moines v. Nordholm*, 217 Iowa 1319, 253 N.W. 701, 707 (1934) (moratorium act "provide[d] for compensation for the mortgagee during the period of redemption"); *see also Trompeter & Co. v. Monaco*, 51 Cal. App. 2d 668, 670, 125 P.2d 581, 583 (1942) (act delayed certain bondholder remedies but did not eliminate or take liens).

raise toll revenues). (*Id.*) And the Moratorium Act is wildly overbroad, insofar as it indiscriminately targets all public entities and debts, secured and unsecured. (*Id.* ¶ 65.) Finally, the Moratorium Act's purported temporal limitation will likely prove illusory. The Act purports to expire by March 2017. But with $757 million in interest and $371 million in principal payments on general obligation and other Commonwealth-guaranteed debt due in fiscal year 2017, the Commonwealth enacted a budget allocating no funds for service on such debt—unmistakably demonstrating that Defendants intend to enforce the Moratorium Act beyond its supposed expiration date. *See supra* p. 13.[24]

Defendants dismiss all of these available alternatives as "myopic," "speculative," "unrealistic," and "pure fantasy." (Mot. at 22.) Defendants also claim "there can be no doubt that the Commonwealth could no longer wait" before passing the Moratorium Act. (*Id.*) But these are inherently factual questions that cannot be resolved against National on this motion. *See Franklin*, 85 F. Supp. 3d at 609 ("[T]he Court accepts as true at this stage in the litigation . . . [plaintiffs' allegations] that other cost-cutting and revenue-increasing measures are reasonable alternatives to the Recovery Act's drastic impairment of contract rights . . . ").[25] And while Defendants argue that the Court should defer to the Commonwealth's determination that the

[24] *See U.S. Trust*, 431 U.S. at 29 (Contract Clause violation established when "a less drastic modification" of rights would have facilitated the government's policy objectives); *Franklin*, 85 F. Supp. 3d at 610 ("The Court infers from plaintiffs well-pled and numerous factual allegations that the Recovery Act imposes a drastic impairment when several other moderate course[s] are available to address Puerto Rico's financial crisis.").

[25] Defendants misplace reliance on *United Auto., Aerospace, Agric. Implement Workers of Am. Int'l Union v. Fortuño*, 633 F.3d 37 (1st Cir. 2011) (cited in Mot. at 14, 15, 20-22). There, unlike here, the plaintiffs "failed to sufficiently describe the contractual provisions allegedly impaired" and failed to "specify any alternatives" available to the government to achieve its policy objectives without impairing contract rights. *Id*., 633 F.3d at 46-47.

Moratorium Act is necessary (Mot. at 20), "[b]ecause the Commonwealth is alleged to have impaired a public contract, where the impairment operates for the state's benefit," the Court should give, as most, "limited deference" to that claim. *Franklin*, 85 F. Supp. 3d at 609; *see also Allied Structural Steel Co.*, 438 U.S. at 244 n.15 (states' impairments of government contracts "face more stringent examination under the Contract Clause than would laws regulating contractual relationships between private parties"); *Energy Reserves Grp., Inc. v. Kan. Power & Light Co.*, 459 U.S. 400, 412 n.14 (1983) ("[I]n almost every case, [the Supreme Court has] held a governmental unit to its contractual obligations when it enters financial and other markets.").

VII. Sections 201(a), (b), (d), And (e) Of The Moratorium Act Are Federally Preempted

Contrary to Defendants' assertions in the Motion that National's preemption claim should be dismissed, National's Complaint alleges that Sections 201(a), (b), (d), and (e) of the Moratorium Act are preempted by Section 903(1) of the Bankruptcy Code, which provides that "a State law prescribing a method of composition of indebtedness of [a] municipality may not bind any creditor that does not consent to such composition." 11 U.S.C. § 903(1); *Franklin*, 136 S. Ct. at 1942 (holding that that Section 903(1) "bars Puerto Rico from enacting its own municipal bankruptcy scheme"). To avoid burdening the Court with duplicative briefing, National respectfully refers the Court to Plaintiff's Motion for Partial Summary Judgment [Dkt. No. 21] (June 22, 2016) and Plaintiff's reply in support thereof [Dkt. No. 37] (July 18, 2016).

VIII. The Moratorium Act Unlawfully Purports To Bar Access To Federal Court

The Complaint sufficiently alleges that Section 201(b) of the Moratorium Act violates the U.S. Constitution by purporting to prohibit litigants from commencing or continuing suit in federal court. (Compl. ¶¶ 66-68.) Defendants now admit that Section 201(b) does not apply to

this action because the Act "does nothing to bar . . . constitutional challenge[s]," such as those here, and applies only to suits "to recover covered obligations."[26] (Mot. at 35.) But Defendants still maintain that the Act would bar at least some federal claims. That is incorrect.[27]

As the Supreme Court has held, the right of a "federal-court litigant [to] pursu[e] his right to federal-court remedies . . . was granted by Congress and cannot be taken away by [a] State." *Donovan v. City of Dallas*, 377 U.S. 408, 413 (1964); *see also Riggs v. Johnson Cnty.*, 73 U.S. 166, 195-96 (1867) ("State laws, whether general or enacted for the particular case, cannot in any manner limit or affect the operation of the process or proceedings in the Federal courts."). Defendants argue that *Donovan* should be limited to acts of state courts (as opposed to state legislatures). (Mot. at 35-36.) But *Donovan* contains no such limitation and, instead, reflects a "well-established general rule of constitutional law that the Supremacy Clause of the United States Constitution prevents states from unilaterally prohibiting federal courts from exercising the jurisdiction which Congress has granted to them."[28]

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[26] As demonstrated in Plaintiffs' Response in Opposition to Defendants' "Notice of Automatic Say" [Dkt. No. 36], the PROMESA stay likewise does not apply to this action because—as Defendants now admit—National does not seek to enforce creditor rights but rather seeks judgment declaring that the Moratorium Act is federally preempted and unconstitutional.

[27] Defendant's reference to sovereign immunity is a red herring. (Mot. at 36.) Defendants have not asserted that defense, nor could they have. *See*, *e.g.*, *Town of Barnstable v. O'Connor*, 786 F.3d 130, 141 (1st Cir. 2015) (sovereign immunity did not bar claim for injunctive and declaratory relief against public officials based on approval and continued enforcement of unconstitutional contract) (citing *Ex parte Young*, 209 U.S. 123, 28 (1908)).

[28] *U.S. Fin. Corp. v. Warfield*, 839 F. Supp. 684, 687 (D. Ariz. 1993); *see generally* 28 U.S.C. § 1331. Defendants' citations are readily distinguishable. *See Christopher v. Harbury*, 536 U.S. 403, 418 (2002) (government's failure to provide information allegedly needed to bring lawsuit); *Wolff v. McDonnell*, 418 U.S. 539, 579 (1974) (prison's obligations to provide legal assistance); *Boivin v. Black*, 225 F.3d 36, 42-43 (1st Cir. 2000) (statute limiting inmates' attorneys' fees).

Finally, the Commonwealth's attempt to enjoin federal proceedings is not, as Defendants contend, an "appropriate exercise of police power." (Mot. at 37.) Neither of Defendants' citations supports that contention, as neither involved a state law that purported to bar federal proceedings. *See Blaisdell*, 290 U.S. at 416; *Ropico*, 425 F. Supp. at 977. As a matter of federal supremacy, no state power can defeat the jurisdiction of the federal courts.

CONCLUSION

Nationally respectfully requests that the Court deny Defendants' Motion.

RESPECTFULLY SUBMITTED, in San Juan, Puerto Rico, this 12th day of August, 2016.

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

ADSUAR MUÑIZ GOYCO
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