

IN THE UNITED STATES DISTRICT COURT  
DISTRICT OF PUERTO RICO

-----X	:	
U.S. Bank Trust National Association,	:	
	:	
Plaintiff,	:	Civil No. 16-cv-2150
	:	
v.	:	
	:	
THE COMMONWEALTH OF PUERTO	:	
RICO,	:	
	:	
ALEJANDRO GARCÍA PADILLA,	:	
in his official capacity as Governor of the	:	
Commonwealth of Puerto Rico,	:	
	:	
UNIVERSITY OF PUERTO RICO,	:	
	:	
-and-	:	
	:	
DR. CELESTE FREYTES GONZÁLEZ,	:	
in her official capacity as President of the	:	
University of Puerto Rico,	:	
	:	
Defendants.	:	
-----X	:	

**MEMORANDUM OF LAW IN SUPPORT OF PLAINTIFF’S MOTION FOR  
RELIEF FROM THE AUTOMATIC STAY AND FOR A PRELIMINARY  
INJUNCTION UNDER THE PUERTO RICO OVERSIGHT,  
MANAGEMENT AND ECONOMIC STABILITY ACT**

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Plaintiff U.S. Bank Trust National Association (“Trustee”), as successor trustee under a Trust Agreement among its predecessor First National City Bank as trustee, Banco Popular de Puerto Rico as Co-Trustee, and the University of Puerto Rico (“UPR”) dated as of June 1, 1971, as amended (the “Trust Agreement”), authorizing and securing University of Puerto Rico University System Revenue Bonds (the “UPR Bonds”) in the outstanding principal amount of \$431,790,000, by and through its undersigned attorneys, submits this memorandum of law in support of its motion (the “Motion”) for relief from the stay and preliminary injunctive relief.

### **PRELIMINARY STATEMENT**

By the Motion, the Trustee seeks

- (i) relief from the stay (“PROMESA stay”) under the Puerto Rico Oversight, Management and Economic Security Act of 2016, P.L. 114-187 (“PROMESA”); and
- (ii) a preliminary injunction against the Commonwealth’s diversion and expropriation of pledged revenues, including approximately \$89 million in pledged tuition and fees, that constitute the UPR Bonds’ collateral.<sup>1</sup>

On June 30, 2016, the Governor of the Commonwealth of Puerto Rico issued Executive Order 31, pursuant to Section 201(d) of Puerto Rico’s Moratorium Act (Act No. 21 of 2016). Among other things, Executive Order 31 suspends UPR’s obligation to transfer to the Trustee “Pledged Revenues,” including tuition and fees.

UPR collects tuition and fees from 57,000 students out of their own funds or from Pell grants or other aid received from the federal government on the students’ behalf. Tuition and

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<sup>1</sup> Concurrently with the filing of the Motion, the Trustee has filed a complaint seeking relief from the PROMESA stay, as well as injunctive and declaratory relief. *See* PROMESA § 405(e)(2) (authorizing relief from stay “[o]n motion of *or action filed by* a party in interest”) (emphasis added). In an abundance of caution, the Trustee asks that the Court consider relief from the PROMESA stay prior to consideration of the additional relief requested herein.

The Trustee has also filed two declarations in support of the Motion, by Philip Bentley (“Bentley Decl.”) and by Laura L. Moran (“Moran Decl.”). References herein to “Ex. \_\_\_” are to exhibits to the Bentley Declaration.

fees comprise the best and most certain UPR Bonds' collateral, as they are paid by third parties and are not subject to the funding of Commonwealth budgets or to any diversion under the Puerto Rico Constitution.

Pledged tuition and fees alone are sufficient to pay the entire \$42.6 million annual debt service on the UPR Bonds – indeed, they are approximately double the debt service. However, tuition and student fees for each academic year are payable in installments, heavily weighted towards the start of each academic semester, with the bulk of the year's tuition and fees payable prior to February 15, 2017, when the PROMESA stay expires. If UPR and the Commonwealth divert and expropriate pledged revenues, including tuition and fees, to meet expenses other than debt service, the diverted revenues will be lost to the Trustee and bondholders forever.

Unless injunctive relief is granted on or before the end of December 2016 – to preserve the Trustee's lien on enough Spring semester tuition and fees to pay principal and interest due June 1 – the Commonwealth and UPR's diversion and expropriation of Pledged Revenues will force the Trustee to deplete its Reserve Account, which UPR pledged to bondholders as separate security for the twenty-year life of their bonds. This harm is irreparable. Any damages remedy would merely substitute, for hard collateral, an unsecured claim that the Commonwealth or UPR cannot pay.

UPR and the Commonwealth cannot justify expropriation of pledged revenues. Tuition and student fees comprise only about 6% of UPR's total expenses (and matching revenues) projected in UPR's budget for fiscal year 2017, and pledged revenues used to pay UPR Bonds comprise approximately 3.0% of budgeted expenses (and matching revenues).

The harm soon to befall the Trustee and bondholders – the permanent loss of collateral pledged to secure the UPR Bonds – constitutes cause to lift PROMESA’s stay pursuant to PROMESA § 405(e)(2).

Moreover, PROMESA terminates the stay no later than 45 days after relief is requested, unless the Court finds, after notice and a hearing, that the party opposing stay relief has a reasonable likelihood of prevailing at a final hearing for stay relief – a finding that would be unwarranted here.

The Trustee further requests that, at the same time that it grants stay relief, the Court enter a preliminary injunction compelling UPR to transfer pledged tuition and student fees to the Trustee to the extent necessary to satisfy the Bond Service Account Requirement and the Reserve Account Requirement, pending the final disposition of this case and subject to reversion to the extent required by any final order of this Court. A preliminary injunction is necessary to preserve the status quo during the pendency of this action, and it is amply warranted:

- The Trustee is likely to prevail on the merits of its claims: Executive Order 31’s diversion and expropriation of Pledged Revenues violates the Takings Clause of the United States Constitution. The order and Moratorium Act § 201 are preempted by PROMESA § 303(1), and the order is also preempted by § 303(3).
- Diversion and expropriation of Pledged Revenues constitutes irreparable harm: the permanent loss of collateral.
- The balance of equities favors interim relief; UPR will suffer little or no burden, since tuition and fees constitute only a tiny portion of UPR’s total revenues.
- A preliminary injunction serves the public interest by preserving meaningful final relief and averting unlawful and irreparable conduct.

The Trustee also seeks relief from the PROMESA stay to apply funds currently in its UPR Bond trust accounts in accordance with the terms of the Trust Agreement. The Commonwealth does not appear to want such application stayed, since Executive Order 31 itself permits the application of trust account funds to the payment of bonds.

**FACTUAL BACKGROUND**

**A. The Parties**

Plaintiff U.S. Bank Trust National Association is a national banking association organized under the laws of the United States and trustee, as successor to First National City Bank, under the Trust Agreement.

Defendant Commonwealth of Puerto Rico (“Commonwealth”) is a United States territory subject to the laws of the United States and the United States Constitution. Defendant Governor Alejandro García Padilla (the “Governor”) is Governor of the Commonwealth. Defendant UPR is a public corporation organized under the laws of the Commonwealth of Puerto Rico. Upon information and belief, defendant Dr. Celeste Freytes González (“Freytes González”) is President of UPR. The Trustee sues the Governor and Freytes González in their official capacities.

**B. The UPR Bonds**

UPR issued the UPR Bonds in 2006 under a 1971 trust agreement (see Ex. A, “Trust Agreement”). The outstanding principal amount is \$431,790,000. Declaration of Laura L. Moran, (“Moran Decl.”) ¶ 6.

The UPR Bonds pay 5% interest semi-annually, on December 1 and June 1, and principal in annual installments on June 1, so that the next payments are as follows:

December 1, 2016: \$10,794,750 (interest)

June 1, 2017: \$31,759,750 (interest and principal)

*Id.* ¶¶ 11-12.



**C. Pledged Revenues and UPR's Finances**

Under the Trust Agreement, UPR pledges to the Trustee certain "Pledged Revenues," defined as follows:

The term "Pledged Revenues" shall mean the proceeds, receipts, profits and other income derived or to be derived by or in behalf of the University from

- (i) **tuition fees collected from all students of the University;**
- (ii) **student fees collected from all students of the University;**
- (iii) rentals and other charges received for the right of use or occupancy of the facilities in the University System;
- (iv) bookstore receipts (gross sales less cost of books and supplies sold);
- (v) interest on investment of University funds, excluding funds invested pursuant to Article VI of this Agreement;
- (vi) funds paid to the University in respect of overhead allowances on Federal research projects;
- (vii) Other Income; and
- (viii) amounts received by the University through any debt service grant programs of the United States Government or any agency thereof

Ex. A (Trust Agreement) § 101 (emphasis added).

The Trust Agreement requires UPR to transfer all Pledged Revenues to the Trustee, to be deposited in a Sinking Fund pledged to secure all obligations under the Trust Agreement, including the Trustee's expenses, all future installments of interest and \$431,790,000 of outstanding principal. *Id.* § 503.

The Sinking Fund comprises several sub-accounts, including the Bond Service Account and the Reserve Account. The Trust Agreement requires that Pledged Revenues be transferred into the Bond Service Account in an amount (the "Bond Service Account Requirement") equal to interest due in the next 6 months plus principal due in the next 12 months. *Id.* The Bond Service Account Requirement is about \$31.8 million for the current fiscal year, 2017. Moran Decl. ¶¶ 11-12.

After satisfying the Bond Service Account Requirement, the Trustee must deposit Pledged Revenues into the Reserve Account until it holds an amount equal to the maximum

annual debt service for any remaining fiscal year for all outstanding UPR Bonds (such calculated amount, the “Reserve Account Requirement”). Ex. A (Trust Agreement) § 503. The Reserve Account Requirement is approximately \$42.6 million for the current fiscal year, 2017. Moran Decl. ¶ 13.

Until June 2016, UPR had transferred Pledged Revenues to the Trustee for deposit into the Bond Service Account at the rate of approximately \$4,000,000 per month, but has made no transfers to the Trustee since. *Id.* ¶ 7. When the Trustee paid principal and interest on June 1, 2016, it emptied the Bond Service Account. *See Id.* ¶¶ 7, 9. Accordingly, the current balance in the Bond Service Account is zero and the Reserve Account is the only account within the Sinking Fund with any money.

The current balance of the Reserve Account is approximately \$55 million. *Id.* ¶ 10. This is approximately \$12 million more than the Reserve Account Requirement, but barely enough to cover the next interest installment, without taking into account any of the Trustee’s expenses.

In its most recent financial report, UPR reported annual “Pledged Revenues” of \$137,946,000, of which tuition and fees were approximately \$89 million.<sup>2</sup> The remaining \$49 million included (in round numbers):

- \$25 million in gambling tax revenues levied by the Commonwealth’s Puerto Rico Tourism Company (“PRTC”) – *but* such revenues may be subject to appropriation by PRTC<sup>3</sup> and their pledge may be challenged under the Puerto Rican

<sup>2</sup> Ex. B, *Univ. of P.R. Annual Financial Information, Fiscal Year 2015*, Appendix I: Annual Financial Information and Operating Report at 57 available at <http://emma.msrb.org/ES1012059.pdf> (posted on website on Apr. 29, 2016) (“2015 Operating Report”).

<sup>3</sup> UPR’s 2015 Operating Report states as follows:

***Appropriations*** from the Commonwealth ***also include unremitted distributions of income received by the University from the Puerto Rico Tourism Company (“PRTC”)***, a component unit of the Commonwealth, under the Gambling Law (slot machines and others) by virtue of Act No. 36 of 2005 ***which are payable upon demand***. PRTC ***appropriations*** for the years ended June 30, 2015 and 2014 amounted to \$63.5 million and \$64.4 million, respectively . . . .

Ex. B (2015 Operating Report) at 57 (emphasis added). Compare UPR’s 2006 Official Statement: “Act 36 of 2005 restored previous sources of funding to the University and **assigned 45.45% of the income received by the**

Constitution;<sup>4</sup> and

- \$16 million in “research overhead allowance on federal projects” – *but* such revenue depends on federal budgets and UPR’s continued qualification for grants, which is by no means assured: the National Science Foundation suspended UPR in 2013, costing UPR approximately \$13 million in funding. Ex. B (2015 Operating Report) at 57.

Thus, tuition and fees comprise an overwhelming percentage of the Pledged Revenues on which the Trustee and the UPR Bondholders can rely. Only tuition and fees are not subject to Commonwealth budgets, not threatened by litigation, and not contingent on grant qualification. For that reason, the requested preliminary injunction is limited to tuition and student fees.

The \$89 million in tuition and fees is payable in installments heavily weighted towards the start of each academic semester: early August for the fall, early January for the spring.<sup>5</sup>

This tuition and fee revenue includes Pell grants from the federal government, which pursuant to federal regulations will be released to UPR this fiscal year on the same schedule as the student tuition payments<sup>6</sup> – i.e., mostly in the next five months.

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**Commonwealth** under the Gambling Law to the University.” Ex. C, Official Statement for Series P and Series Q Bonds (Nov. 30, 2006) (“2006 Official Statement”) at 39 (emphasis added).

<sup>4</sup> Article VI Section 8 of the Puerto Rico Constitution provides that if Puerto Rico’s “available resources” are insufficient to pay all of its expenses, “interest on the public debt and amortization thereof shall first be paid . . . .” The Commonwealth has asserted that this clause of its Constitution allows it to divert rum taxes, convention center taxes and gas taxes from their pledgees for use in the payment of the Commonwealth’s operating expenses, while certain general obligation bondholders have sued to compel the diversion of such taxes for use in the payment of their bonds. It is not clear whether such assertions have been or will be made about the gambling tax revenues pledged to the UPR Bonds. Holders of general obligation bonds have also filed suit in relation to these “available resources.” See Complaint, Jacana Holdings I LLC v. Puerto Rico, No. 6-cv-04702 (S.D.N.Y. June 21, 2016). The Trustee takes no position on these arguments at this time.

<sup>5</sup> See, e.g., Academic Calendar 2016-2017, Semester 1, Univ. of P.R. Río Piedras, *available at* <http://www.uprrp.edu/wp-content/uploads/2016/05/calendario-acad-primer-semester-2016-2017.pdf> (stating tuition payment deadline of August 4, 2016 for fall semester); Academic Calendar 2016-2017, Semester 2, Univ. of P.R. Río Piedras, *available at* <http://www.uprrp.edu/wp-content/uploads/2016/05/calendario-acad-segundo-semester-2016-2017.pdf> (stating tuition payment deadline of January 10, 2017 for payment by bank deposit and by January 13, 2017 for other payment methods for spring semester); Academic Calendar 2016-2017, Univ. of P.R. Mayagüez, *available at* <http://www.uprm.edu/cms/index.php?a=file&fid=12222> (stating that spring semester tuition is due on January 12, 2017).

<sup>6</sup> See 34 C.F.R. 668.164(a)-(b) (requiring university to disburse the amount of Pell grants for which student is eligible to receive, either by crediting student’s account ledger for tuition and fees or by paying student directly, during the “payment period”); 34 C.F.R. § 668.4(b)(1) (defining “payment period” as the “academic term” with

Thus, if the relief sought herein is not granted promptly, the lion's share of this fiscal year's tuition and fees will be lost.

**D. The Moratorium Act**

Act No. 21 of 2016 (as amended, the "Moratorium Act") was signed into law on April 6, 2016. The Moratorium Act authorizes the Governor to issue executive orders (i) declaring a "state of emergency" with respect to the Commonwealth or its instrumentalities, including UPR, and (ii) suspending payment of principal and interest on "covered obligations," including the UPR Bonds, during a "covered period" through January 31, 2017, extendable to March 31, 2017. Ex. D (Moratorium Act) §§ 103(l) & (m), 201(a).

Section 201(b) permits the Governor to "expropriat[e] property or rights in property interests" and provides that "just compensation or other relief may be sought in the Court of First Instance" – but eliminates the century-old requirement (in Puerto Rico's Expropriation Act) that the Commonwealth must deposit funds with the court before expropriating property, *Id.* § 201(b)(iv), rendering any judgment for just compensation an unpayable unsecured claim.<sup>7</sup>

Section 201(d) permits the Governor to unilaterally suspend or modify any statutory or other obligation (defined as an "enumerated obligation") to transfer money for the payment of, or to secure, any covered obligation, so that instrumentalities subject to the Moratorium Act can pay for "essential services." *Id.* § 201(d)(ii).

On May 5, 2016, the Commonwealth enacted Act No. 40, amending Section 108 of the Moratorium Act to direct the Government to prioritize "the safety, soundness and stability of

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respect to Pell grants); 34 C.F.R. § 668.162(b) (requiring institutions to "disburse" Pell grants within 3 business days of receipt, if institution requests Pell grant from the federal government in advance).

<sup>7</sup> See P. R. Const. art. VI § 8; 23 L.P.R.A. § 104(c) (judgments for compensation are paid only after payment of debt service on the Commonwealth's general obligation bonds, which the Commonwealth has said it cannot pay.)

depository financial institutions,” including the Government Development Bank (“GDB”). Ex. E (P.R. Act. No. 40 of 2016) § 9; Ex. D (Moratorium Act) § 103(kk).

UPR’s most recent Operating Report lists approximately \$82,427,000 due to GDB under credit agreements that are subordinated to the UPR Bonds. Ex. B (2015 Operating Report) at 36. Therefore the amended Moratorium Act authorizes payments ahead of the UPR Bonds even though the GDB’s notes are subordinated to the UPR Bonds – and Executive Order 31, while suspending transfers of revenues pledged to pay the UPR Bonds, “does *not* suspend payment of *other* obligations of UPR.” See Ex. F (“Executive Order 31”) ¶ 9 (emphasis added).

#### **E. Executive Order 31**

On June 30, 2016, the Governor issued Executive Order 31, which addressed UPR in paragraph 9 as follows:

Pursuant to Sections 201 and 202 of the Act, I hereby declare the University of Puerto Rico (“UPR”) to be in a state of emergency and announce the commencement, as of the date of this Executive Order, of an Emergency Period for UPR. I further declare that any obligation of UPR, pursuant to the Trust Agreement, dated as of June 1, 1971, as amended, to transfer Pledged Revenues to the Trustee (each, as defined in such Trust Agreement) is an Enumerated Obligation, and is hereby suspended.

Ex. F (Executive Order 31) ¶ 9.

Executive Order 31 thus diverted and expropriated Pledged Revenues to pay for “essential services” on the ground that UPR is in a “state of emergency.” Yet the Order makes no particular findings as to the alleged state of emergency at UPR. It does not explain how \$89 million in tuition and fees so diverted and confiscated are material to UPR’s \$1.4 billion budget,<sup>8</sup> or how suspending debt service of \$42.6 million per year – about 3.0% of UPR’s annual budget

<sup>8</sup> UPR’s budget for 2016-17 projects total expenses (and, as required, matching revenues) of \$1,408,116,000. Ex. I (Univ. of P.R. Budget, 2016-2017 Academic Year) at 4. These budgeted expenses are overwhelmingly funded by appropriations from the Commonwealth (\$872,432,000 in the budget approved by the Puerto Rico legislature for the current fiscal year) and federal grants (approximately \$115 million as reported in the most recent audited financials). Ex. G (2016 P.R. Joint Res. No. 894) § 1.73; Ex. H (2014 Audited Financial Statements) at 21.

– is required to allow UPR to provide “essential services.” Because Act 40 deemed payments to GDB to be “essential services,” Executive Order 31 also has the effect of diverting Pledged Revenues to repay GDB’s subordinated loans.

#### **F. PROMESA**

On June 30, 2016, President Obama signed into law the Puerto Rico Oversight, Management, and Economic Stability Act, or PROMESA. PROMESA provides that the Commonwealth and its public corporations, including UPR, must implement operational, fiscal and financial reforms in a fiscal plan or plans approved by the Oversight Board. PROMESA § 201. Only after the Oversight Board has approved a fiscal plan for UPR can UPR commence a bankruptcy restructuring in this Court of some or all of its debts under Title III. *Id.* §§ 206(b) & 302(2).<sup>9</sup>

Prior to commencement of a Title III restructuring, PROMESA Section 405 provides for the creation – and in appropriate circumstances, the lifting – of an automatic stay modeled on Section 362 of the Bankruptcy Code (the “PROMESA stay”):

- Section 405(b) stays the commencement or continuation of court proceedings and the exercise of other creditor remedies.
- PROMESA § 405(e)(2) lifts the stay after a creditor’s request “for cause shown.”
- PROMESA § 405(f) automatically terminates the stay 45 days after a request, unless the court finds, after notice and a hearing held within that 45-day period, that the party opposing stay relief has a reasonable likelihood of prevailing at a final hearing.
- PROMESA § 405(d) terminates the stay on February 15, 2017.<sup>10</sup>

However, PROMESA also protects creditors, such as the Trustee and UPR Bondholders, during the automatic stay:

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<sup>9</sup> UPR can go forward with *voluntary* restructuring of its bonds without a fiscal plan if the Oversight Board certifies that the restructuring provides for an acceptable level of debt. PROMESA §§ 104(i)(2) & 601((g)(2).

<sup>10</sup> The stay can be extended for limited periods to implement a voluntary restructuring under Title VI.

- PROMESA § 405(k) provides, “This section [i.e., the automatic stay] does not discharge an obligation of the Government of Puerto Rico or release, invalidate, or impair any security interest or lien securing such obligation.”
- PROMESA § 407(a) makes transferees liable for the unlawful transfer of creditors’ collateral.

Finally, PROMESA expressly preempts Commonwealth law:

- PROMESA § 4: “The provisions of this Act shall prevail over any general or specific provision of [Commonwealth law] that is inconsistent with this Act.”
- PROMESA § 303(1) specifically preempts composition and moratorium laws:

A territory law prescribing a method of composition of indebtedness or a moratorium law, but solely to the extent that it prohibits the payment of principal or interest by an entity not described in section 109(b)(2) of title 11, United States Code, may not bind any creditor of a covered territory or any covered territorial instrumentality thereof that does not consent to the composition or moratorium

- Section 303(3) provides that “unlawful executive orders that alter, amend, or modify rights of holders of any debt of the territory or territorial instrumentality, or that divert funds from one territorial instrumentality to another or to the territory, shall be preempted by this Act.”

## ARGUMENT

### **I. Cause Exists To Lift the PROMESA Stay**

PROMESA § 405(e)(2) states: “On motion of or action filed by a party in interest and after notice and a hearing, the United States District Court for the District of Puerto Rico, for cause shown, shall grant relief from the stay provided under subsection (b) of this section.” PROMESA § 405(e)(2).

As noted, PROMESA § 405 is explicitly modeled on Bankruptcy Code § 362, and cases under the nearly identical bankruptcy statute hold that a secured creditor’s loss of collateral constitutes “cause” to lift the stay. *See, e.g., In re Lopez*, 446 B.R. 12, 20 (Bankr. D. Mass. 2011) (lifting stay where value of secured creditor’s collateral was diminishing); *In re Anchorage Boat Sales, Inc.*, 4 B.R. 635, 642 (Bankr. E.D.N.Y. 1980) (lifting stay where debtor’s

commingling of cash proceeds posed “undue risk of harm,” namely, that creditor could lose its security interest in those proceeds); *Le Sannom Bldg. Corp. v. Nathanson*, No. 92 Civ. 8716 (LAP), 1993 U.S. Dist. LEXIS 11677, at \*10 (S.D.N.Y. Aug. 17, 1993) (lifting stay where mismanagement of collateral was jeopardizing secured creditors’ interests).

Here, the Trustee faces a far greater threat to its collateral than mere undue risk or declining value of collateral. Moratorium Act § 201 and Executive Order 31 have terminated the flow of all Pledged Revenues through at least January 31, 2017<sup>11</sup> – expropriating most of the tuition and fees pledged to the Trustee for this fiscal year. Given the Commonwealth’s assertions that it (and UPR) cannot pay their debts, the Pledged Revenues are the only reliable source of repayment for the UPR Bonds.

Lifting the stay will not “unduly” harm the Defendants, because they will lose access to Pledged Revenues only to the extent necessary to satisfy the Bond Service Account Requirement and the Reserve Account Requirement – an amount less than 3% of their projected 2017 budget. *See Marder v. Turner (In re Turner)*, 161 B.R. 1, 3 (Bankr. D. Me. 1993) (“Cause may exist for lifting the stay whenever the stay harms the creditor and lifting the stay will not *unduly* harm the debtor.”) (emphasis added).

Moreover, the automatic stay does not shield the unlawful actions of the Commonwealth or UPR.

PROMESA § 204(c)(3)(A) specifically provides that, prior to appointment of all members of the Oversight Board, Puerto Rico (or any other covered territory) “shall not enact new laws that either permit the transfer of any funds or assets outside the ordinary course of

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<sup>11</sup> Executive Order 31 remains in effect, unless the Governor revokes it, until the expiration of the “Covered Period,” which the Moratorium Act defines as extending to January 31, 2017 subject to extension by the Governor for an additional two months. Ex. D (Moratorium Act) § 103(m).



business or that are inconsistent with the constitution or laws of the territory as of the date of enactment of this Act.”

Executive Order 31 is dated on the exact date PROMESA was signed into law. If Executive Order 31 became effective after PROMESA, it violates the letter of PROMESA § 204(c)(3)(A). If it became effective minutes or hours before, it remains in violation of PROMESA’s spirit and defeats its overall objective.

Either way, Executive Order 31 takes the Trustee’s collateral outside the ordinary course of business and without just compensation, and is an “unlawful” order preempted under PROMESA § 303(3). Absent relief from the stay, the Trustee and UPR Bondholders will have no effective remedy for this unlawful order.

The canon of constitutional avoidance provides further support for a lifting of the stay. Absent relief from the stay, Defendants’ unconstitutional taking of the Trustee’s and the UPR Bondholders’ property would go unredressed. This lack of a remedy would itself violate Due Process. *See Battaglia v. General Motors Corp.*, 169 F.2d 254, 257 (2d Cir. 1948) (holding federal statute precluding all judicial review was unconstitutional: “while Congress has the undoubted power to give, withhold, and restrict the jurisdiction of courts other than the Supreme Court, it must not so exercise that power as to deprive any person of life, liberty, or property without due process of law or to take private property without just compensation”).

To avoid such a result, courts have declined to interpret statutes in a manner that forecloses parties from pursuing a constitutional claim in any legal venue. *See, e.g., Goncalves v. Reno*, 144 F.3d 110, 122 (1st Cir. 1998).

For these reasons, the stay should be lifted to permit the Trustee to prosecute this action and to obtain the injunctive relief sought by the Motion.

**II. Prompt Stay Relief Is Warranted Under PROMESA § 405(f)**

PROMESA § 405(f) provides that, 45 days after the filing of a request for relief from the PROMESA stay, the stay is terminated unless the court, after notice and a hearing, orders the stay continued pending a final hearing – and the court may do so only “if there is a reasonable likelihood that the party opposing relief from such stay will prevail at the conclusion of such final hearing.” PROMESA § 405(f).

As discussed in Point I above, the grounds for lifting the stay are strong, and there is no basis to find that Defendants are reasonably likely to defeat the Trustee’s request to lift the stay. Consequently, PROMESA § 405(f) requires that the stay be lifted no later than 45 days after the filing of the Motion – i.e., on or before October 3.

**III. A Preliminary Injunction Requiring UPR To Segregate Pledged Tuition and Fees Is Necessary and Appropriate.**

A preliminary injunction requiring Defendants to hold tuition and fees in a segregated account pending the conclusion of this case is necessary to avoid the diversion and dissipation of these revenues.

Under the governing four-part standard for issuance of an injunction, the Court should issue the requested relief because: (1) the Trustee is likely to prevail on the merits of its Takings Clause and preemption claims; (2) the Trustee and bondholders will suffer irreparable harm if Defendants are permitted to divert their collateral; (3) the balance of equities favors granting this limited relief, which will preserve the status quo while causing no cognizable harm to UPR; and (4) this relief will serve the public interest. *See Sindicato Puertorriqueño de Trabajadores v. Fortuño*, 699 F.3d 1, 10 (1st Cir. 2012).<sup>12</sup> “Likelihood of success is the main bearing wall of the

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<sup>12</sup> To preserve the status quo that existed prior to the issuance of Executive Order 31, the Trustee seeks a narrowly tailored preliminary injunction that fits squarely within the scope of a *prohibitory* injunction. Therefore the standard

four-factor framework.” *Ross-Simons of Warwick, Inc. v. Baccarat, Inc.*, 102 F.3d 12, 16 (1st Cir. 1996).

**A. Moratorium Act § 201 and Executive Order 31 Are Unlawful.**

Moratorium Act § 201 and Executive Order 31 are unlawful: They violate the Takings Clause of the United States Constitution, and they are preempted by PROMESA.

**1. Moratorium Act § 201 and Executive Order 31 Expropriate Bondholders’ Collateral in Violation of the Takings Clause of the United States Constitution.**

The Fifth Amendment to the United States Constitution provides that “private property [shall not] be taken for public use without just compensation” (the “Takings Clause”). U.S. CONST. amend. V. The Takings Clause applies to the states, and to the Commonwealth, by virtue of Section 1 of the Fourteenth Amendment. U.S. CONST. amend. XIV, § 1; *Fideicomiso De La Tierra Del Caño Martin Peña v. Fortuño*, 604 F.3d 7, 12 (1st Cir. 2010).

Moratorium Act § 201 and Executive Order 31 effect an unconstitutional taking of the Pledged Revenues, which, as collateral for the UPR Bonds, are property of the Trustee and Bondholders protected by the Takings Clause. *See, e.g., United States v. Sec. Indus. Bank*, 459 U.S. 70, 75-76 (1982) (a lien is “property” protected by Fifth Amendment); *Louisville Jt. Stock Land Bank v. Radford*, 295 U.S. 555, 589-91 (1935).

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four-factor test applies. *AFL-CIO v. Textron, Inc.*, 836 F.2d 6, 10 (1st Cir.1987) (Breyer, J.) (injunction requiring defendant to continue making regular premium payments was properly viewed “not as mandatory, but as prohibitory” where the last uncontested status prior to the controversy was a status in which the defendant paid the necessary premiums.).

Should this Court determine that the relief sought by the Trustee constitutes a *mandatory* injunction, then the same four factors should be applied and the injunction issued because “the exigencies of the situation” demand alteration, rather than preservation, of the status quo. *Braintree Labs., Inc. v. Citigroup Glob. Markets Inc.*, 622 F.3d 36, 40 (1st Cir. 2010); *see also W. Holding Co. v. AIG Ins. Co.-Puerto Rico*, 748 F.3d 377, 383 (1st Cir. 2014) (issuing a mandatory preliminary injunction “depends on the exigencies of the situation,” yet depends on the same four-factor test, most notably the likelihood of success). As discussed in Points III.B – III.D below, the nature and timing of the tuition and fees pledged to the Trustee present exigencies that support granting the requested preliminary injunction.

In addition, the Trustee and Bondholders have a contractual right to receive payment from the Pledged Revenues, which right constitutes a property interest protected by the Takings Clause. *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.”).

The Moratorium Act and Executive Order 31 provide no meaningful compensation to the Trustee or the Bondholders for the expropriation of their property.

Section 201(b) of the Moratorium Act permits parties whose property has been expropriated to seek “just compensation or other relief” in Commonwealth court – but the Act does not require the Commonwealth to deposit funds with that court before expropriating property. *See* Ex. D (Moratorium Act) § 201(b)(iv). Consequently, any such suit would result only in a judgment that, under the Commonwealth’s Constitution, would be junior in priority to general obligation debt claims, which the Commonwealth says it cannot pay. *See* P.R. CONST. art. VI, § 8; P.R. Admin. Bulletin No. EO-2016-30 (June 30, 2016) (Commonwealth “will have insufficient funds to make the total debt service payments on the Public Debt . . . due on July 2, 2016”); *see also Wal-Mart P.R. Inc. v. Zaragoza-Gómez*, No. 15-CV-03018, 2016 WL 1183091, at \*1 (D.P.R. Mar. 28, 2016) (“*Wal-Mart*”), *appeal docketed*, No. 16-1406 (1st Cir. Apr. 15, 2016) (finding that the Commonwealth is already “insolvent”).

Section 204(b) of the Moratorium Act purports to offer the remedy of “adequate protection” but is subject to similar, if not greater, defects. Adequate protection requires substitute collateral. As noted above, the Trust Agreement promises solid collateral that assures full payment of the UPR Bonds: tuition and fees payable by 57,000 private citizens, and not subject to the vagaries of government budgets, grant qualifications or claw-back litigation. As

“protection” for the taking of this collateral, the only substitute collateral UPR can offer are future revenues that it hopes to receive from the Commonwealth – revenues that are entirely dependent on the Commonwealth’s ability to pay and willingness to pay, both of which are doubtful at best. UPR has no other collateral to offer, since all revenues of UPR that are not already pledged to the Trustee are subject to appropriation by the Commonwealth or the federal government.

Nor does the remedy offered by PROMESA § 407 – a potential damages claim against the recipient of unlawfully transferred collateral – provide meaningful compensation. As discussed above, an unsecured damages claim against the Commonwealth would have only speculative value, given the Commonwealth’s asserted inability to pay even its constitutional first priority general obligation debts. Nor would a damages claim against UPR, as the pledgor of the collateral, or against other financially distressed instrumentalities of the Commonwealth, provide an adequate remedy for the Trustee’s loss of hard collateral.

Consequently, the Moratorium Act and Executive Order 31 permanently deprive the Trustee and the Bondholders of their property interest in Pledged Revenues during the emergency period without just compensation in violation of the Takings Clause of the United States Constitution.

**2. Executive Order 31 Is Preempted by PROMESA § 303(3).**

PROMESA § 303(3) provides that “unlawful executive orders that alter, amend, or modify rights of holders of any debt of the territory or territorial instrumentality, or that divert funds from one territorial instrumentality to another or to the territory, shall be preempted by this Act.”

As just noted, Executive Order 31 violates the Takings Clause. In addition, it modifies the rights of UPR Bondholders and diverts funds from UPR to the Commonwealth and/or its instrumentalities. Executive Order 31 therefore is preempted by PROMESA § 303(3).

**3. Moratorium Act § 201 And Executive Order 31 Are Preempted by PROMESA § 303(1).**

Moratorium Act § 201 and Executive Order 31 issued thereunder are preempted by PROMESA § 303(1) as a matter of both express preemption and conflict preemption.

**i. Express Preemption**

“Express preemption occurs when congressional intent to preempt state law is made explicit in the language of a federal statute.” *Tobin v. Federal Exp. Corp.*, 775 F.3d 448, 452 (1st Cir. 2014). PROMESA § 303(1) expressly preempts all non-consensual territorial laws that either (i) “prescrib[e] a method of composition of indebtedness” or (ii) constitute “a moratorium law, but solely to the extent that it prohibits the payment of principal or interest.”

Moratorium Act § 201 is preempted by both of these provisions – i.e., it imposes a non-consensual composition of UPR’s debts *and* a moratorium that effectively prohibits the payment of principal and interest on the UPR Bonds.

Moratorium Act § 201, like the Recovery Act previously struck down by this Court, is a non-consensual debt composition law. It authorizes the Governor to divert and permanently deprive the Trustee of Pledged Revenues. Without Pledged Revenues, the Trustee will be unable to pay principal and interest on the Revenue Bonds when due, and bondholders will be forced to accept partial or no payment. By limiting Bondholders’ recoveries in this fashion, Moratorium Act § 201 imposes a non-consensual composition on the UPR Bondholders, which is expressly preempted by § 303(1).

The Moratorium Act and Executive Order 31, by suspending the transfer of Pledged Revenues required to pay the UPR Bonds, also effect a “moratorium” on the payment of principal and interest explicitly pre-empted by PROMESA § 303(1).

**ii. Conflict Preemption**

“Even where an express preemption provision does not apply, federal law preempts state laws that stand as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.” *Franklin Cal. Tax-Free Trust v. Puerto Rico*, 805 F.3d 322, 343 (1st Cir. 2015), *aff’d*, 136 S. Ct. 1938 (2016).

Moratorium Act § 201 stands as an obstacle to the purposes and objectives of PROMESA. As discussed above, PROMESA establishes a process for the Commonwealth and its instrumentalities, including UPR, to address their financial distress. The process begins with the appointment of an Oversight Board charged with considering and approving operational, fiscal and financial reforms. Only after the Oversight Board has approved a fiscal plan for UPR is UPR permitted to impose a *non*-consensual debt restructuring on its creditors through the commencement of a PROMESA Title III case.

Moratorium Act § 201 purports to permit UPR to side-step PROMESA’s carefully crafted debt restructuring process. Section 201 authorizes UPR to unilaterally take Bondholders’ collateral without first implementing the operational, fiscal and financial reforms approved by the Oversight Board *and* without satisfying the requirements of Title III.

**B. The Trustee and Bondholders Will Suffer Irreparable Harm If UPR Diverts Pledged Revenues in Violation of the Trust Agreement.**

Moratorium Act § 201 and Executive Order 31 divert Pledged Revenues. Once diverted, these Pledged Revenues are lost forever – an obvious case of irreparable harm.

Each fiscal year, Pledged Revenues are transferred to the Trustee for the payment of principal and interest. On every June 1, the Bond Service Account must have *precisely* the amount of money to satisfy the scheduled principal and interest payment; that payment reduces the account to zero, to be rebuilt by the next year's Pledged Revenues. On every December 1, the Bond Service Account must have *at least* enough money to satisfy the scheduled interest payment and the next principal payment – approximately \$31.8 million in 2016.

Because Executive Order 31 stopped UPR from transferring Pledged Revenues to the Trustee, the Bond Service Account balance is now zero and will stay at zero. The interest payment due December 1, 2016, and the interest and principal payments due June 1, 2017, will be paid not from 2016-2017 Pledged Revenues but instead from the Reserve Account – depleting the Bondholders' collateral.

In this context, each dollar of Pledged Revenues that is diverted represents collateral that is lost to the Trustee forever.

Depriving a secured creditor of contractually bargained-for collateral constitutes irreparable harm that justifies issuance of a preliminary injunction. *See, e.g., First Tennessee Bank Nat. Ass'n v. Pac. Am. Grp., Inc.*, No. 07-2664B, 2008 WL 269537, at \*3 (W.D. Tenn. Jan. 29, 2008) (potential misappropriation of collateral constituted irreparable harm to plaintiff secured creditor); *Textron Fin. Corp. v. Unique Marine, Inc.*, No. 08-10082-CIV, 2008 WL 4716965, at \*8 (S.D. Fla. Oct. 22, 2008) (same); *see also Int'l Fid. Ins. Co. v. Waterfront Grp. NC, LLC*, No. 3:11-CV-00116-W, 2011 WL 4715155, at \*4 (W.D.N.C. Oct. 6, 2011) (“Courts routinely recognize that a surety’s loss of its right to collateralization cannot be adequately remedied through monetary damages.”) (quotations omitted); *Marine Midland Trust Co. v.*



*Alleghany Corporation*, 28 F. Supp. 680 (S.D.N.Y. 1939) (granting preliminary injunction to enforce covenant to maintain a 150% collateral ratio).

While the loss of collateral would be sufficient to prove irreparable harm, UPR's admitted insolvency further supports a preliminary injunction. Failure to grant a preliminary injunction would leave the Trustee and the UPR Bondholders with the inadequate remedy of an unsecured damage claim against defendants who by admission<sup>13</sup> or adjudication<sup>14</sup> are unable to pay their debts. *See Int'l Fid. Ins. Co.*, 2011 WL 4715155, at \*4; *Marine Midland*, 28 F. Supp. at 684; *see also In re Williams*, 61 B.R. 567, 575 (Bankr. N.D. Tex. 1986) ("Once cash collateral has been dissipated and spent, court-fashioned sanctions such as retroactive adequate protection . . . can be hollow victories for a secured creditor and do not rise to the level of a 'remedy.'").

### **C. The Balance of Equities Favors Granting the Injunction.**

The relief the Trustee seeks is very limited: a preliminary injunction requiring UPR to honor its contractual obligations to transfer pledged tuition and fees to the Trustee to the extent necessary to satisfy the Bond Service Account Requirement and the Reserve Account Requirement (subject to the reversion of such funds to the extent required by any final decision of the Court). These amounts constitute a tiny fraction of UPR's total revenues.<sup>15</sup> Indeed, debt

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<sup>13</sup> Executive Orders 30 & 31.

<sup>14</sup> *Wal-Mart*, 2016 WL 1183091, at \*1.

<sup>15</sup> The Trust Agreement requires the Trustee to deposit Pledged Revenues into the Bond Service Account and Reserve Account until those accounts reach the Bond Service Account Requirement and the Reserve Account Requirement, respectively. Those two requirements currently total \$74,319,500, which is \$19,474,500 more than the current combined balance (\$54,845,000) of those two accounts. Moran Decl. ¶¶ 10-13. On December 1, 2016, after the Trustee makes the interest payment due that day, this shortfall will increase by the amount of that interest payment, i.e., \$10,794,750. *Id.* ¶ 11. This will bring the total shortfall – i.e., the total amount of Pledged Revenues that UPR will be required to transfer to the Trustee – to \$30,269,250, which is only 2.1% of UPR's \$1.4 billion 2016-2017 budget. Ex. I (Univ. of P.R. Budget, 2016-2017 Academic Year) at 4. If at any time the account balances meet the Bond Service Account Requirement and the Reserve Account Requirement, Trust Agreement § 503 directs the Trustee to return all Pledged Revenues back to UPR. As stated in the Proposed Order, the Trustee does not seek to modify this obligation in Section 503.

service on the UPR Bonds of \$42.6 million per year constitutes only 3.0% of UPR's total expenses (and matching revenues) budgeted for the current fiscal year.

Payment of these sums will impose no meaningful burden on UPR. UPR's chief financial officer has said that UPR prepared and received legislative approval of a budget that provided for the full payment of debt service on the UPR Bonds for this fiscal year, but that UPR is not making required transfers to the Trustee because of Executive Order 31. *See University of Puerto Rico Has Cash, but Not Authority, To Make Bond Payments*, DebtWire (July 21, 2016).

In any event, compelling UPR to honor its contracts and averting the expropriation of collateral is not a "burden." *See, e.g., Storer Commc'ns, Inc. v. Mogel*, 625 F. Supp. 1194, 1203 (S.D. Fla. 1985) ("Defendants will suffer no harm if an injunction is issued which simply requires them to obey the law.").

**D. An Injunction Serves the Public Interest.**

The public interest will be well served by an order requiring Defendants to comply with their contractual commitments during the pendency of this case. *First Nat. Ins. Co. of Am. v. Sappah Bros. Inc.*, 771 F. Supp. 2d 569, 576 (E.D.N.C. 2011) ("There is a public interest in enforcing the terms of a valid contract."). Such an order will preserve the status quo and thereby preserve the Court's ability to effect meaningful final relief at the end of the case.

**E. The Trustee Should Not Be Required To Post Security.**

Although Rule 65(c) of the Federal Rules of Civil Procedure states that the Court must require that the party seeking an injunction give security "for the damages that might be sustained by the issuance of the order" (Fed. R. Civ. P. 65(c)), courts have discretion to determine that no security is warranted. *Watchtower Bible Tract Soc'y of New York, Inc. v. Municipality of Aguada*, No. 16-CV-1207, 2016 WL 552348, at \*7 (D.P.R. Feb. 10, 2016)

(district court has discretion to waive security bond including in cases that involve the public interest.).

No security is warranted in this case. As just noted, an order requiring UPR to contribute tuition and student fees up to the amount of debt service on the UPR Bonds will have minimal financial impact on UPR. Moreover, no bond should be required where the requested injunction simply requires UPR to honor its contractual commitments pending the final outcome of the case. *Stansbury v. Hopkins Hardwoods, Inc.*, No. 4:15-CV-00016-JHM, 2016 WL 3619616, at \*10 (W.D. Ky. June 24, 2016) (declining to require bond where preliminary injunction simply required party to honor contract); *Eastman Kodak Co. v. Collins Ink Corp.*, 821 F. Supp. 2d 582, 590 (W.D.N.Y. 2011) (no need for bond because compelling defendant to honor contractual obligations “hardly constitutes a cognizable harm”).

**IV. The Stay Should Be Lifted to Permit the Trustee To Apply Trust Funds Pursuant to the Terms of the Trust Agreement.**

The Trustee holds funds securing the UPR Bonds pursuant to the Trust Agreement in the Sinking Fund or sub-accounts thereunder “subject to a lien and charge in favor of the holders of the UPR Bonds.” Ex. A (Trust Agreement) § 503. Ample cause exists to lift the stay pursuant to PROMESA § 405(e)(2) to permit the Trustee to apply the funds in accordance with the Trust Agreement, including to fund Trustee expenses that UPR is obligated to pay but has not paid. *Id.* §§ 902, 905.

The Commonwealth itself does not appear to have any objection to the Trustee’s application of funds in its possession. The Moratorium Act excludes from its scope funds that have been “deposited with a trustee or other custodian prior to the commencement of the emergency period for such obligor.” Ex. D (Moratorium Act) § 103(l) (definition of “covered

obligation”). The Court should therefore lift the stay pursuant to PROMESA § 405(e)(2) to permit the trustee to apply Sinking Fund money in accordance with the Trust Agreement.

**CONCLUSION**

For the foregoing reasons, the Court should issue an order in the form attached hereto (i) granting relief from the PROMESA stay to permit the filing of the Complaint and the Motion, briefing and argument concerning the injunctive relief requested in the Motion, and entry of such relief; (ii) compelling Defendants to transfer, or cause to transfer, pledged tuition and student fees to the Trustee, to the extent necessary to satisfy the Bond Service Account Requirement and the Reserve Account Requirement, subject to reversion to the extent required by any final judgment in this matter; and (iii) granting relief from the PROMESA stay to allow the Trustee to apply funds in its trust accounts in accordance with the terms of the Trust Agreement.

**RESPECTFULLY SUBMITTED.**

In San Juan, Puerto Rico, today August 19, 2016.

**INDIANO & WILLIAMS, P.S.C.**

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**CERTIFICATE OF SERVICE**

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

*/s/ Leticia Casalduc-Rabell*

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