UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF PUERTO RICO

THE GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO,	PROMESA Title VI
	Case No. 18-1561 (LTS)
Applicant.	

PRELIMINARY OBJECTION OF OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF ALL PUERTO RICO TITLE III DEBTORS (OTHER THAN COFINA) TO PROPOSED PROMESA TITLE VI MODIFICATION OF GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

TABLE OF CONTENTS

Page

PRELIMINARY STATEMENT ... 1

BACKGROUND ... 7

I. OVERVIEW OF GDB AND ITS CREDITORS ... 7

II. GDB'S FAILINGS AS FISCAL AGENT AND LENDER AND POTENTIAL LIABILITY TO TITLE III DEBTORS ... 10

III. GDB'S WIND DOWN AND REPLACEMENT BY AAFAF ... 13

IV. OVERVIEW OF TITLE VI ... 15

V. NEGOTIATION OF GDB RESTRUCTURING ... 17

VI. OVERVIEW OF GDB RESTRUCTURING ... 21

VII. BINDING EFFECT OF GBD RESTRUCTURING AND ITS RELEASE OF CLAIMS ... 24

VIII. PROCEDURAL HISTORY ... 26

I. TITLE III DEBTORS HOLD CLAIMS AGAINST GDB THAT GDB RESTRUCTURING PURPORTS TO ELIMINATE ... 28

II. QUALIFYING MODIFICATION IS PREDICATED ON ENACTMENT OF GDB RESTRUCTURING ACT, WHICH IS UNCONSTITUTIONAL PURSUANT TO U.S. CONSTITUTION AND PREEMPTED BY PROMESA ... 32

III. QUALIFYING MODIFICATION CANNOT BE APPROVED UNDER TITLE VI BECAUSE IT TREATS IDENTICAL BOND CLAIMS DIFFERENTLY ... 35

IV. EVEN IF QUALIFYING MODIFICATION IS PERMISSIBLE WITHIN STATUTORY FRAMEWORK OF TITLE VI, IT IS UNCONSTITUTIONAL UNDER DUE PROCESS CLAUSES OF THE U.S. AND PUERTO RICO CONSTITUTIONS ... 38

V. GDB RESTRUCTURING'S BROAD RELEASES VIOLATE PROMESA AND BANKRUPTCY CODE ... 42

- A. Releases Are Prohibited by Section 601(m)(2) ... 43
- B. GDB/AAFAF and Oversight Board Have Ignored Potentially Insidious Consequences of GDB Restructuring Act's Releases ... 45
- C. Court Should Reject Oversight Board's Indemnification Argument ... 47

VI. GDB RESTRUCTURING VIOLATES SECTION 303 OF PROMESA ... 49

- A. GDB Restructuring Act Provides for a Composition of GDB's Indebtedness that Prohibits Payment of Interest and Principal to Title III Debtors ... 49

TABLE OF CONTENTS
(continued)

Page

B. Section 303(1)'s Carve-Out Does Not Apply to GDB, Which Is Not a Bank 50

C. Title III Debtors Have Not Consented to Composition of Indebtedness 52

VII. TO THE EXTENT GDB HOLDS DEPOSITS IN TRUST FOR TITLE III DEBTORS, GDB RESTRUCTURING VIOLATES PROMESA 54

VIII. GDB RESTRUCTURING VIOLATES SECTION 201(B)(1)(M) OF PROMESA 57

IX. COURT SHOULD NOT APPROVE PAYMENT OF TRANSACTION COSTS INCURRED IN CONNECTION WITH GDB RESTRUCTURING 59

TABLE OF AUTHORITIES

Page(s)

Cases

Assured Guar. Corp. v. Garcia-Padilla,
214 F. Supp. 3d 117 (D.P.R. 2016)....................47

Autonomous Municipality of San Juan v. Fin. Oversight & Mgmg. Bd.,
301 F. Supp. 3d 314 (D.P.R. 2017)....................15, 36

Avis Budget Car Rental, Inc. v. JD2 Envtl., Inc.,
No. 12-CV-5010 (PKC)(ST), 2018 U.S. Dist. LEXIS 36496
(E.D.N.Y. Mar. 6, 2018)....................44

In re Bank of New Engl. Corp.,
364 F.3d 355 (1st Cir. 2004)....................32

Bessette v. Avco Fin. Servs., Inc.,
230 F.3d 439 (1st Cir. 2000)....................32

In re Boston Reg'l Med. Ctr., Inc.,
265 B.R. 838 (B.A.P. 1st Cir. 2001)....................32

Brigade Leveraged Capital Structures Fund Ltd. v. Padilla,
No. 16-01610 (FAB) (D.P.R. May 20, 2016)....................34

In re Cash Currency Exch., Inc.,
762 F.2d 542 (7th Cir. 1985)....................49

In re Cohen,
263 B.R. 724 (Bankr. D.N.J. 2001)....................51

In re Commonwealth of Puerto Rico,
No. 17-3283 (Bankr. D.P.R. Sept. 5, 2018).................... *passim*

Czyzewski v. Jevic Holding Corp.,
137 S. Ct. 973, 197 L. Ed. 2d 398 (2017)....................40

Eastern Equip. & Servs. Corp. v. Factory Point Nat'l Bank,
236 F.3d 117 (2d Cir. 2001)....................32

In re Eureka S. R. Co.,
177 B.R. 323 (Bankr. N.D. Cal. 1995)....................49

Examining Bd. of Engineers, Architects & Surveyors v. Flores de Otero,
426 U.S. 572, 96 S. Ct. 2264, 49 L. Ed. 2d 65 (1976)....................38

TABLE OF AUTHORITIES
(continued)

Page(s)

Franklin Cal. Tax-Free Tr. v. Puerto Rico,
85 F. Supp. 3d 577 (D.P.R.), *judgment entered,* No. 14-1518 FAB, 2015 WL 574008 (D.P.R. Feb. 10, 2015), and *aff'd,* 805 F.3d 322 (1st Cir. 2015), *aff'd*, 136 S. Ct. 1938, 195 L. Ed. 2d 298 (2016) 34

Gamble v. Daniel,
39 F.2d 447 (8th Cir. 1930) 49

In re Garcia,
484 B.R. 1 (Bankr. D.P.R. 2012) *reversed on other grounds* 53

Gonzalez v. Padilla,
No. 16-02257 (FAB) (D.P.R. June 30, 2016) 34

Hiskes v. Sancha,
Civ. No. 10-2246 (JAG), 2012 WL 1110204 (D.P.R. Mar. 30, 2012) 38

Int'l Shoe Co. v. Pinkus,
278 U.S. 261 (1929) 32

Jaap Corp. v. Dep't of State,
187 D.P.R. 730 (2013) 53

In re JMK Constr. Grp., Ltd.,
441 B.R. 222 (Bankr. S.D.N.Y. 2010) 44

Keppel v. Tiffin Sav. Bank,
197 U.S. 356, 25 S. Ct. 443 (1905) 37

Kuehner v. Irving Trust Co.,
299 U.S. 445 (1937) 37, 38, 39

Local Loan Co. v. Hunt,
292 U.S. 234 (1934) 32

In re Mata,
115 B.R. 288 (Bankr. D. Colo. 1990) 32

Municipality of San Sebastian v. Puerto Rico,
89 F. Supp. 3d 266 (D.P.R. 2015), on reconsideration in part, 116 F. Supp. 3d 49 (D.P.R. 2015) 40

Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson,
390 U.S. 414 (1968) 40

In re Prudence Co.,
79 F.2d 77 (2d Cir. 1935) 49

TABLE OF AUTHORITIES
(continued)

Page(s)

Puerto Rico v. Franklin Cal. Tax-Free Tr.,
136 S. Ct. 1938, 195 L. Ed. 2d 298 (2016) 19, 32

Sampsell v. Imperial Paper & Color Corp.,
313 U.S. 215, 85 L. Ed. 1293, 61 S. Ct. 904 (1941) 37

In re Standard Brands Paint Co.,
154 B.R. 563 (Bankr. C.D. Cal. 1993) 51

Stellwagen v. Clum,
245 U.S. 605 (1918) 31, 32, 34, 38

Sturges v. Crowninshield,
17 U.S. 122 (1819) 31, 32

In re Trade Fin. Bank,
163 B.R. 558 (Bankr. D.S.D. 1994) 50

In re WM Distribution, Inc.,
571 B.R. 866 (Bankr. D.N.M. 2017) 51

Statutes

7 L.P.R.A.
§ 563 45
§ 1281 53

11 U.S.C.
§ 109(b) 49
§ 109(b)(2) 47, 48, 49, 50
§ 510 32
§ 510(b) 46
§ 553 28
§ 553(a) 30
§ 553(a)(1) 28
§ 726 38
§ 926 43
§ 926(a) 6, 43, 44
§ 1129(a)(7) 38
§ 1129(b) 38

48 U.S.C.
§ 2103 33
§ 2141(b)(1)(M) 55

Bankruptcy Act 32, 49

TABLE OF AUTHORITIES
(continued)

Page(s)

GDB Enabling Act....7, 30, 45, 50

GDB Restructuring Act, art.
102....55
103....23, 24
302....48
303....21, 31, 48
401....31
702....24, 42, 43, 44
703....25

N.Y. GEN. OBLIG. LAW § 15-108....44

1948 P.R. Laws 17, art. 18....45

2014 P.R. Laws 24, § (9)(1)(a)....7

PROMESA
§ 4....28, 33, 42, 55
§ 5....15, 16
§ 101(d)(1)(A)....18
§ 106(e)....27, 55, 56
§ 201(b)(1)(M)....6, 55, 56
§ 301....28, 30, 43
§ 303....6, 47, 48, 52
§ 304....1, 51
§ 601.... *passim*

Puerto Rico Corporation Debt Enforcement and Recovery Act....19

Other Authorities

$3,500,000,000 Commonwealth of Puerto Rico General Obligation Bonds of 2014, Series A, dated March 11, 2014 (*available at* http://www.gdbpr.com/investors_resources/documents/CommonwealthPRGO2014SeriesA-FinalOS.PDF)....12, 19

FINANCIAL OVERSIGHT & MANAGEMENT BOARD FOR PUERTO RICO, Independent Investigator, *Final Investigative Report* (Aug. 20, 2018) (*available at* https://drive.google.com/open?id=19-lauVo3w9MPS03xYVe0SWhQin-Q6FEf)....8

GDB Fiscal Plan, dated April 28, 2017 (available at: http://www.aafaf.pr.gov/assets/fiscal-plan---government-development-bank.pdf)....37

TABLE OF AUTHORITIES
(continued)

Page(s)

Hedge Papers No. 61: The Golden Revolving Door, at 16, Hedge Clippers(August 2018)(*available at* http://hedgeclippers.org/hedgepaper-no-61-the-golden-revolving-door/) 19

P.R. CONST., art.
II. § 7 41
VI. § 9 53

U.S. CONST.
amend. V 37, 38, 41, 56
amend. XIV 37, 38, 41, 56
art. I § 8 31

U.S. GAO, Puerto Rico: Factors Contributing to the Debt Crisis and Potential Federal Actions to Address Them ("GAO Report"), at 33-34 (May 2018), available at https://www.gao.gov/assets/700/691675.pdf....................8

The Official Committee of Unsecured Creditors of all Puerto Rico Title III Debtors[1] (other than COFINA) (the "Committee") hereby submits this preliminary objection (the "Preliminary Objection") to the *Application of the Government Development Bank for Puerto Rico and the Puerto Rico Fiscal Agency and Financial Advisory Authority for Approval of the Qualifying Modification for GDB* [Docket No. 1] (the "Title VI Application"),[2] and transactions related thereto (collectively, the "GDB Restructuring"). The Committee reserves the right to revise, supplement, or otherwise modify the bases for its objection prior to the deadline for filing a final objection in accordance with the scheduling order entered by the Court. The Committee further reserves the right to challenge the GDB Restructuring by other means, including through the filing of motions or adversary proceedings in the Title III cases. In support of the Preliminary Objection, the Committee respectfully represents as follows:

PRELIMINARY STATEMENT

1. GDB and AAFAF (together, the "Applicants") assert in their Title VI Application that the Qualifying Modification "has . . . been endorsed by all key stakeholders and is the epitome of a consensus driven transaction."[3] This statement could not be further from the truth. Of course the GDB creditors who are receiving all of GDB's valuable assets support the GDB Restructuring, but they are the only ones who do. The reality is that the GDB Restructuring is an

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[1] On May 3, 2017, a voluntary petition for relief under section 304(a) of PROMESA was filed in the United States Bankruptcy Court for the District of Puerto Rico for the Commonwealth of Puerto Rico (the "Commonwealth") (Bankruptcy Case No. 17-BK-3283 (LTS)). Thereafter, Title III cases were commenced for (i) Employees Retirement System of the Government of the Commonwealth of Puerto Rico ("ERS") (Bankruptcy Case No. 17-BK-3566 (LTS)), (ii) Puerto Rico Highways and Transportation Authority ("HTA") (Bankruptcy Case No. 17-BK-3567 (LTS)), and (iii) Puerto Rico Electric Power Authority ("PREPA") (Bankruptcy Case No. 17 BK 4780 (LTS)). The Office of the United States Trustee for the District of Puerto Rico has appointed the Committee in the Title III cases of the Commonwealth, ERS, HTA, and PREPA (collectively, the "Title III Debtors").

[2] Capitalized terms not otherwise defined herein have the meanings ascribed to them in the Title VI Application.

[3] Title VI Appl. ¶ 2.

insider deal that transfers all of GDB's valuable assets away from the Title III Debtors to these supporting unsecured creditors, all while granting comprehensive releases of liability to GDB insiders who played a central role in Puerto Rico's fiscal downfall. The only reason the Title III Debtors are not objecting to this brazenly one-sided deal is that they have no independent representation; rather, they are controlled by AAFAF, which is represented by the **same counsel and advisors as GDB**. Thus, there is no real "consensus" at all—just one set of conflicted advisors negotiating an attractive deal for certain preferred creditors, with no regard for the interests of the Title III Debtors. Under these circumstances, the Committee is duty-bound to object to the GDB Restructuring on behalf of the Title III Debtors and their unsecured creditors.[4]

2. To be clear, the Committee's solitary goal in raising this objection is to bring **real and substantial monetary value to the Title III Debtors' estates and to protect against the loss of valuable claims**. The Committee is not objecting for the sake of generating fees or needlessly complicating the Title VI process. The value the Committee seeks to generate (or the avoided costs if the Committee's position is upheld) would dwarf any fees incurred as a result of the Committee's opposition to this process. This value may be realized by, among other things:

(a) Preventing GDB from transferring virtually all of its several billion dollars in assets to a newly formed entity for the exclusive benefit of select consenting creditors. Allowing the claims of the Title III Debtors to be satisfied from these assets would more than justify the Committee's opposition to this process;

(b) Preventing the approval of the sweeping global releases that the GDB Restructuring purports to provide to GDB and its current and former insiders who advised the Title III Debtors on the major transactions that led to their fiscal demise. Claims against these persons could generate significant value for the Title III Debtors and their creditors, but if the GDB Restructuring is approved, the claims will be forever lost;

4 As the Court is aware, although the Committee believes it has direct standing to be heard in this Title VI case on behalf of unsecured creditors, it has also filed a motion for derivative standing in the Title III cases, asking for the right to appear in this case on behalf of the Title III Debtors. The Court has not yet ruled on the derivative standing motion.

(c) Preserving for the Title III Debtors hundreds of millions of dollars in federal funds that the GDB received from the federal government for the benefit of the Title III Debtors but failed to remit to the Title III Debtors; and

(d) Preventing the payment of millions of dollars in closing costs and transaction fees by GDB to representatives of certain creditor groups who have executed the RSA. Of course, everyone understands that GDB would be precluded from paying fees to unsecured creditors in a Title III case.

3. There is thus ample economic justification not only for this objection, but for every other effort the Committee has undertaken to date to stop this restructuring from going forward. The oft-repeated assertion by the Applicants and the Oversight Board that the Title III Debtors have nothing at stake here because they "do not even have net positive claims against GDB"[5] is the conclusion reached by hopelessly conflicted advisors who have "assumed" a set of facts that fits within the narrative they are selling. The Applicants and the Oversight Board arrive at this conclusion through a series of dubious setoff transactions that violate the Bankruptcy Code and account for only a small fraction of the potential claims that the Title III Debtors hold against GDB. When all potential claims of the Title III Debtors are considered, and setoff is calculated properly, it is clear that the Title III Debtors may have substantial net positive claims against GDB. But more importantly, the Court cannot rely on the statements from the Oversight Board or GDB that the Title III Debtors are not owed anything because the Oversight Board and GDB have shown their true colors: they will sacrifice the Title III Debtors' interest in order to make sure the GDB Restructuring happens.

4. The first question the Court should ask itself when evaluating the GDB Restructuring is why the Applicants have chosen to use the Title VI process for GDB, whereas all the other Puerto Rico entities have commenced Title III cases. The answer is that the

Applicants are seeking to use Title VI as a Trojan horse to accomplish a restructuring they could never accomplish under Title III. Indeed, because GDB is not operating, no legal or practical reason exists as to why GDB cannot liquidate by filing a Title III case in which all stakeholders, the Title III Debtors included, have an unquestioned right to participate. The only reason for using the Title VI is to implement, with the aid of the GDB Restructuring Act, one-sided deal for the unsecured consenting creditors without ever involving the Title III Debtors in the process.

5. Although the Applicants say the GDB Restructuring Act is not before this Court, it is in fact the lynchpin of the entire transaction. Passed in 2017 by the Puerto Rico legislature and amended in 2018, the GDB Restructuring Act purports to allow GDB to do under territory law that which it could never do under PROMESA or a valid territory law: **transfer all of GDB's valuable assets away from the Title III Debtors for the benefit of other creditors while simultaneously discharging the Title III Debtors' claims**. This result is forbidden by the U.S. Constitution. Under the Bankruptcy and Contract Clauses, a state or territory has no authority to enact a *de facto* bankruptcy law that discharges creditor claims in an area already occupied by a federal bankruptcy regime. The GDB Restructuring Act is unquestionably such a law that expressly discharges the Title III Debtors' claims (not to speak of the claims of the other disfavored depositors) against GDB, in conflict with PROMESA. The GDB Restructuring Act is therefore unconstitutional and invalid.

6. Once the GDB Restructuring Act is invalidated, the entire GDB Restructuring falls apart. Indeed, the Title VI Application expressly states that the transactions contemplated by the GDB Restructuring Act are conditions precedent to the proposed Qualifying Modification

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[5] *See Obj. of Fin. Oversight & Mgmt.t Bd. for P.R as the Admin. Supervisor of the Gov't Dev. Bd. for P.R. to the Official Comm. of Unsecured Creditors' Notice of Intention to Object to Qualifying Modification for Gov't Dev. Bank* (the "Oversight Bd. Obj. to Comm. Standing") ¶ 2 [Docket. No. 111].

ever becoming effective. In other words, without the GDB Restructuring Act, there is no GDB Restructuring. But even if the GDB Restructuring Act is not invalidated, the GDB Restructuring is unlawful for a number of other reasons.

7. As an initial matter, the proposed treatment of the Title III Debtors' claims does not comply with Title VI. A fundamental component of any consensual restructuring under Title VI is that all "Bond" claims, which include bank deposits, must be placed into "Pools" with all other claims that have identical security and priority, and then all the claims in each Pool must receive the same consideration. The Applicants have disregarded this requirement with respect to the deposit claims of the Title III Debtors by first declining to "pool" the claims at all and then treating them differently from other claims of identical security and priority. Specifically, while the Title III Debtors will receive essentially valueless claims against a newly created "Public Entity Trust" in the restructuring, the unsecured consenting creditors, who like the Title III Debtors hold only unsecured claims against GDB, will receive new bonds issued by the "Recovery Authority," backed by all of GDB's revenue-generating assets. This structure runs afoul of Title VI.

8. Moreover, even assuming the GDB Restructuring were permissible under Title VI (and it is not), it is unconstitutional. As established by Supreme Court precedent, the Due Process clauses of the U.S. and Puerto Rico Constitutions prevent a restructuring law from providing unreasonable and arbitrary treatment to similarly situated creditors. The disparate treatment of the Title III Debtors under the GDB Restructuring is both arbitrary and unreasonable and therefore flies in the face of due process.

9. The broad releases that the GDB Restructuring purports to provide to GDB and its current and former insiders are also unlawful. The releases of the Title III Debtors' claims are

purportedly contained in the GDB Restructuring Act. But as PROMESA makes clear, no territory law—the GDB Restructuring Act included—can impose a right or obligation that conflicts with a provision of PROMESA. As is relevant here, at least two specific provisions of PROMESA—section 601(m)(2), which includes a prohibition on third-party releases, and section 926(a) of the Bankruptcy Code (as incorporated into PROMESA), which allows creditors to seek the appointment of a trustee to pursue avoidance claims—prohibit the releases that the GDB Restructuring Act contemplates. The releases are therefore invalid.

10. Finally, the GDB Restructuring violates various additional provisions of the Bankruptcy Code and PROMESA, including, but not limited to, (i) the automatic stay, by utilizing in the GDB Restructuring property that GDB holds in trust for the Title III Debtors, including federal funds; (ii) section 303(1) of PROMESA, which prohibits non-consensual territory laws that purport to modify a creditor's claims; and (iii) section 201(b)(1)(M) of PROMESA, which states that any Fiscal Plan must ensure that the assets of a territorial instrumentality, such as GDB, not be transferred to any other territorial instrumentality. The Committee also takes issue with the GDB Restructuring's apparent payment of more than $40 million in closing costs and transaction fees incurred by advisors to GDB and certain creditor groups who have executed the RSA.

* * * *

11. The Committee firmly believes that the GDB Restructuring is unlawful for all the reasons set forth herein, including that it violates the U.S. and Puerto Rico Constitutions and various provisions of PROMESA, including the requirements of Title VI itself. Therefore, the Committee would ask the Court to deny the Title VI Application in its current form. In the alternative, the Committee believes the Court should at least delay consideration of the Title VI

Application until such time as the Committee has been able to conduct a reasonable investigation into certain critical factual issues. These factual issues include, among others, (i) the manner in which the GDB Restructuring was negotiated, including the effect of any conflicts of interest; (ii) the value of the consideration that the Title III Debtors and other creditors of GDB will receive in the GDB Restructuring; and (iii) the nature and extent of the claims against GDB and its insiders that the GDB Restructuring purports to release.

12. The Committee to date has received very limited, if any, information on these topics. The Committee respectfully requests that it be permitted to complete this diligence before the rights of the Title III Debtors and their unsecured creditors are modified by the GDB Restructuring. Indeed, although the Committee has expressed concerns[6] with respect to the final report issued by the Oversight Board's investigator, it is difficult to conceive that the Oversight Board would ignore the identification of probable claims by its own investigation and allow for the grant of broad releases to dozens of individuals and entities.

BACKGROUND

I. OVERVIEW OF GDB AND ITS CREDITORS

13. GDB is a public corporation and instrumentality of the Commonwealth created pursuant to Act No. 17-1948 (the "GDB Enabling Act") to aid the government in the performance of its fiscal duties and to develop the economy of Puerto Rico. Historically, GDB served multiple roles within the Puerto Rico government, including acting as fiscal agent, paying agent, and financial advisory authority for all government entities. GDB was the effective financial "brain trust" of Puerto Rico. Among other things, GDB:

[6] The Committee filed the *Creditors' Comm.'s Informative Mot. Regarding Kobre & Kim Final Report* (the "Informative Mot."), *In re Commonwealth of Puerto Rico*, No. 17-3283 (Bankr. D.P.R. Sept. 5, 2018)[Docket No. 3866] discussing deficiencies in the Kobre & Kim Report (as defined herein) and identifying areas in which potential litigation claims may exist.

(a) served as a depository of funds for Puerto Rico government entities. Until early 2017, when GDB wound down its operations, the Title III Debtors were, upon information and belief, required to deposit all of their funds with GDB.[7]

(b) served as a "financial advisor" in all government debt offerings, controlling practically every aspect of those offerings, including the selection of underwriters and counsel.[8] According to a report of the U.S. General Accounting Office, GDB was responsible for "facilitating rising debt levels [that] enabled Puerto Rico to continue to use debt to finance operations."[9]

(c) issued debt and provided inter-government financing for the Commonwealth and its public corporations, instrumentalities, and municipalities.[10] According to the GAO report, the "GDB provided loans to government entities valued at up to 60 percent of GDB's total assets."[11]

14. Over time, GDB's financial condition deteriorated. According to the GDB Fiscal Plan, as of December 31, 2017, GDB's primary liabilities consisted of deposits of approximately $3.5 billion and unsecured bond debt, including accrued interest, of over $4 billion.[12] Also as of December 31, 2017, GDB's most significant assets consisted of loans of approximately $6.1 billion, including $2.4 billion in municipal loans and $6.2 billion in public sector loans, less

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[7] *See* 2014 P.R. Laws 24, § (9)(1)(a) ("Government Development Bank for Puerto Rico may require any agency, department, public corporation, instrumentality, board, commission, authority, and political subdivision of the Debtors of Puerto Rico (hereinafter denominated as 'government entities') to deposit and maintain the total or a portion of their funds in deposit accounts, certificates or other instruments issued by the Government Development Bank for Puerto Rico.").

[8] *See* FINANCIAL OVERSIGHT & MANAGEMENT BOARD FOR PUERTO RICO, Independent Investigator, *Final Investigative Report* (the "Kobre & Kim Report"), at 43 (Aug. 20, 2018) (*available at* https://drive.google.com/open?id=19-lauVo3w9MPS03xYVe0SWhQin-Q6FEf).

[9] U.S. GAO, Puerto Rico: Factors Contributing to the Debt Crisis and Potential Federal Actions to Address Them ("GAO Report"), at 33-34 (May 2018), available at https://www.gao.gov/assets/700/691675.pdf.

[10] Title VI Appl. ¶ 9.

[11] GAO Rep., at 36-37.

[12] *Decl. of Suzzanne S. Uhland, Esq. in Support of the Appl. of the Gov't Dev. Bank for P.R. and the P.R. Fiscal Agency & Fin. Advisory Auth., Pursuant to Section 601(m)(D) of the P.R. Oversight, Mgmt. & Econ. Stability Act, for Approval of the Qualifying Modification* (the "Uhland Decl."), Ex. O, Ex. F (the "GDB Fiscal Plan"), at F-9. [Docket No. 5]

adjustments.[13] According to the Solicitation Statement, as of July 1, 2018, GDB held approximately $624.8 million in cash and cash equivalents.[14]

15. The creditors of GDB include (i) the holders of approximately $3.8 billion in outstanding senior notes, all of which are unsecured and more than $100 million of which are guaranteed by the Commonwealth (the "GDB Bondholders"),[15] (ii) the municipalities that have purported net deposits at GDB of approximately $80 million (the "Municipal Depositors"),[16] (iii) certain private entities that deposited funds with GDB (the "Private Entity Depositors"), and (iv) the Title III Debtors and other non-municipal government entities (the "Non-Municipal Government Entities") that deposited public funds with GDB.

16. As of December 31, 2017, the outstanding loans to and deposits of the Title III Debtors were purportedly as follows:[17]

Debtor	Loans	Deposits
Commonwealth[18]	$1,637,950,311.42	$779,508,707.81
ERS	-	$32,948,612.00
HTA	$1,993,697,449.20	$30,586,756.88
PREPA	$35,845,876.09	$151,761,488.68

17. In addition to taking deposits from other government entities, GDB has been the indirect recipient of approximately $312 million in loans and grants from the U.S. federal

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13 Uhland Decl. Ex. O, GDB Fiscal Plan, at F-9.

14 Uhland Decl. Ex. O (the "Solicitation Statement"), at 29.

15 *See* Uhland Decl. Ex. C, RSA, Sched. 1.

16 *See* Uhland Decl. Ex. C, RSA, Sched. 1.

17 As discussed further below, the Title III Debtors may hold significant litigation and other claims against GDB in addition to deposit claims.

government (the "Federal Funds") designated for use by the Commonwealth and its municipalities and instrumentalities, including the Title III Debtors.[19] Upon information and belief, GDB failed to transmit some or all of the Federal Funds to the instrumentalities, agencies, or departments for which they were intended and instead spent the Federal Funds elsewhere and/or reallocated them to pay existing bondholders.

II. GDB'S FAILINGS AS FISCAL AGENT AND LENDER AND POTENTIAL LIABILITY TO TITLE III DEBTORS

18. GDB's efforts to serve multiple, conflicting roles within the government of Puerto Rico proved to be highly problematic. As fiscal agent, GDB failed to provide sound advice and responsible oversight on Puerto Rico's issuance of billions of dollars in bond debt.[20] Many of these bond issuances were used to repay older debt in a practice commonly known as "scoop and toss."[21] This practice, which Puerto Rico's current governor has described as a "Ponzi scheme,"[22] was unsurprisingly not sustainable and led to the current fiscal crisis.[23] GDB had the tools and ability to better monitor the Title III Debtors' indebtedness, but it neglected to do so.[24]

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[18] Includes the Government of Puerto Rico and its public agencies and departments. In addition to the deposit amounts listed, the Puerto Rico Energy Commission also holds approximately $6 million in deposits.

[19] Uhland Decl. Ex. O, Solicitation Statement, at 30.

[20] Kobre & Kim Rep., at 71.

[21] *Id.*

[22] *See* Public Broadcasting Service, Frontline, *How Banks Responded to "Blackout in Puerto Rico"* (May 1, 2018) (available at https://www.pbs.org/wgbh/frontline/article/how-banks-responded-to-blackout-in-puerto-rico/); *see also* Laura Sullivan, National Public Radio, *How Puerto Rico's Debt Created A Perfect Storm Before The Storm* (May 2, 2018) (available at https://www.npr.org/2018/05/02/607032585/how-puerto-ricos-debt-created-a-perfect-storm-before-the-storm) ("Looking back, Rosselló said at this point in the financial crisis it seemed like 'the government of Puerto Rico was run as a big Ponzi scheme.'").

[23] *Id.*

[24] *See id.* at 85 ("Despite its responsibility for helping the Puerto Rico-Related Entities to make sound financial decisions, we found no meaningful evidence that GDB had an effective process in place to oversee important aspects of their fiscal health, or to impose accountability for repayment of debts.").

19. GDB also failed in its role as intra-government lender. GDB lent money to other government entities to, among other things, help them complete bond issuances and fund operating deficits. Before issuing these loans, however, GDB often neglected to perform necessary due diligence, instead turning itself into an effective government "piggy bank."[25] For example, GDB once approved a multi-million dollar loan to HTA within hours.[26] On another occasion, it approved PREPA's entry into an emergency $260 million line of credit with virtually no questions asked—even though PREPA sought approval just one month earlier for another $150 million line of credit without mentioning the potential need for additional financing.[27] To make matters worse, GDB failed to hold government entities accountable when they defaulted on their loans, thus offering such entities no incentive to implement fiscally responsible measures that may have improved their long-term viability.[28]

20. GDB also failed in its oversight and management of to Puerto Rico's risky derivative swap transactions. As observed by the Kobre & Kim Report, GDB was the entity "acting as the main advisor and agent" for the Title III Debtors with respect to all derivative swaps, and "took the lead" on all swap transactions—many of which were complicated and extremely risky.[29] Even though GDB had this advisory responsibility (and promulgated an internal "Master Swap Policy"), GDB officials essentially had no idea what swaps had been entered into by the Title III Debtors. Indeed, in order to inventory its total exposure, GDB had to hire an outside swap advisor in 2009 who **literally called swap counterparties on the phone**

[25] *Id.* at 43.

[26] *Id.* at 92.

[27] *Id.* at 87.

[28] *Id.* at 95, 101.

[29] Kobre & Kim Rep., at 568 & 570–71.

<u>over the course of months to "ask[] if they had trades with Puerto Rico-Related Entities."</u> [30] GDB also failed to meaningfully consider whether swap termination fees should count toward the constitutional debt limit.[31]

21. Another area in which GDB representatives may have acted improperly is in connection with the $3.5 billion GO bond issuance in 2014. Available information shows that GDB hired restructuring advisors ***before*** this bond issuance; therefore, GDB appeared to direct the Commonwealth to borrow the additional funds at a time when both GDB and the Commonwealth were, at a minimum undercapitalized, if not insolvent.[32] This series of events is troubling for a variety of reasons, including that the GDB officials who controlled and managed the 2014 GO offering utilized the proceeds to repay debt owed to ***their*** institution, GDB, so that GDB and its directors and officers would be off the hook from any liability.[33] It is unclear, to say the least, what benefit the Commonwealth (an entity which was at the time at least undercapitalized, if not insolvent) received for taking on new debt for the purpose of repaying insiders and affiliates (which were themselves undercapitalized, if not insolvent). Upon

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[30] Kobre & Kim Rep., at 569 (emphasis added).

[31] *See* Kobre & Kim Rep., at 565–67 (noting that "there does not seem to be a meaningful reason" why termination fees were not counted toward debt limit and termination fees were not referenced in official statements until 2011).

[32] GDB hired prominent restructuring firms Cleary Gottlieb Steen & Hamilton LLP ("<u>Cleary</u>") and Proskauer Rose LLP ("<u>Proskauer</u>") on January 29, 2014, and Millstein & Co., L.P. ("<u>Millco</u>") on February 5, 2014. Kobre & Kim Rep., at 103. The 2014 GO bonds were issued on March 11, 2014. *See* $3,500,000,000 Commonwealth of Puerto Rico General Obligation Bonds of 2014, Series A, dated March 11, 2014 (*available at* http://www.gdbpr.com/investors_resources/documents/CommonwealthPRGO2014SeriesA-FinalOS.PDF).

[33] The Kobre & Kim Report indicates that these decisions may have been animated by fear of **<u>criminal</u>** liability when they hired restructuring advisors, because "[e]vidence reflects that [in 2014] the GDB Board also became concerned that, under the criminal code, GDB Board members could be held responsible for negligence in the performance of their duties if an action or omission were to cause loss or damage to the public." Kobre & Kim Rep., at 104.

information and belief, however, GDB kept accepting deposits while insolvent until 2016, which gives rise to criminal liability under Puerto Rico law.[34]

22. The Title III Debtors may hold a variety of claims against GDB and its representatives as a result of this incompetence and/or misconduct.[35] The Committee has attempted for over a year to obtain discovery in order to further investigate these potential claims, but numerous requested documents have not been provided. Based on the limited information available, however, it is clear that GDB played an integral role in the events leading to the current fiscal crisis and that the Title III Debtors may hold substantial claims against GDB and its current and former executives as a result, including claims for breaches of fiduciary duty and recovery of avoidable transfers. The Committee intends to present further information on these potential claims in its final objection.

III. GDB'S WIND DOWN AND REPLACEMENT BY AAFAF

23. The financial condition of GDB declined over time as a result of its irresponsible borrowing practices and failure to implement reasonably rigorous lending standards. By 2013, GDB began expressing concerns about its liquidity, including in a letter to then Governor Garcia Padilla recommending the implementation of fiscally responsible measures.[36] In 2014, GDB lost its investment grade rating and the resulting loss of market access left GDB with limited liquidity.[37]

24. In April 2016, the Fiscal Agency and Financial Advisory Authority ("AAFAF"), was created to take over from GDB the roles of fiscal agent, financial advisor, and disclosure

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[34] It is important to note that the Oversight Board has alleged that certain payments by GDB to PREPA in 2014 and 2015 were made while GDB was insolvent. *See* Oversight Bd. Obj. to Comm. Standing ¶ 2 n. 4.

[35] *See generally* Informative Mot.

[36] *See* Kobre & Kim Rep., at 102.

agent of the Commonwealth.[38] In early 2017, the Puerto Rico legislature expanded AAFAF's authority, designating it as the only government entity authorized to renegotiate, restructure, and reach agreements with creditors in connection with government-issued debt.[39]

25. Based on its fiscal challenges, GDB leadership found no clear path to achieve long term viability and therefore concluded that an orderly wind-down of operations was the best path forward.[40] GDB eventually completed an operational wind-down and ceased all fundamental operations or transferred them to other entities.

26. Since GDB ceased its operations, many of its executives have taken new positions at AAFAF, the Oversight Board, or other entities that have absorbed GDB's former functions or otherwise play roles in Puerto Rico's restructuring, including in connection with the GDB Restructuring. The following list is illustrative, though not comprehensive:

- The current GDB President is the Executive Director of AAFAF, and serves as the Commonwealth's non-voting *ex officio* member of the Oversight Board
- Two former GDB Presidents serve on the Oversight Board
- A former GDB President is the Executive Director of a bondholder group that is a signatory to the RSA (defined below)
- Multiple former GDB executives work for Ankura, the financial advisor to AAFAF on the GDB Restructuring
- Current officers of GDB held high-ranking positions at GDB during the years leading up to the fiscal crisis.

27. As described below, the GDB Restructuring purports to provide comprehensive releases to these and all other current or former officers, directors, employees, agents, or

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[37] Title VI Appl., at ¶ 10.

[38] Title VI Appl. ¶ 11.

[39] Title VI Appl. ¶ 11-12.

[40] Uhland Decl. Ex. O, GDB Fiscal Plan, at F-6.

representatives of GDB (the "GDB Releasees")[41] from any and all claims arising from their conduct while employed by GDB.

IV. OVERVIEW OF TITLE VI

28. In June 2016, Congress enacted PROMESA, which provides for two types of restructuring cases. As the Court is aware, Title III of PROMESA creates a Court-supervised process similar to a case under chapter 9 of the Bankruptcy Code.[42] Title VI, by contrast, purports to provide for the consensual out-of-court restructuring of bond debt through "Creditor Collective Action," subject to approval by the Oversight Board and the Court.[43] The key to a Title VI restructuring, unlike a restructuring under Title III, is consent by affected creditors.

29. The restructuring authorized by Title VI is referred to as a "Modification," and the debt to which it applies is all "Bond" debt. The term "Modification" is defined to include "any modification, amendment, supplement, or waiver affecting one or more series of Bonds, including those effected by way of exchange, repurchase, conversion, or substitution."[44] The term "Bond" is defined expansively to include any "bond, loan, letter of credit, other borrowing title, obligation of insurance, or other financial indebtedness for borrowed money . . . of which the issuer, obligor, or guarantor is the territorial government."[45] This Court has held that bank deposits are Bonds subject to Modification under Title VI.[46]

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[41] It is unclear whether GDB and AAFAF will take the position that these releases extend to former counsel and other advisors (e.g., underwriters) to GDB.

[42] PROMESA §§ 301-317.

[43] PROMESA § 601.

[44] PROMESA § 601(a)(9).

[45] PROMESA § 5(2).

[46] *Autonomous Municipality of San Juan v. Fin. Oversight & Mgmg. Bd.*, 301 F. Supp. 3d 314, 321 n.7 (D.P.R. 2017).

30. For purposes of voting on a Modification, the Oversight Board, as Administrative Supervisor under Title VI, must establish separate "Pools" of Bonds corresponding to the relative priority or security arrangements of each bondholder.[47] Section 601(d) sets forth a list of requirements for the composition of such Pools, including that Bonds of the same issuer that have identical rights in security or priority not be placed in separate Pools.[48] In addition, section 601(g)(1)(B) provides that each holder in a given Pool must be offered the same consideration on account of such holder's claim, on a pro rata basis, as all other holders in such Pool.[49]

31. Once the Oversight Board certifies a Modification as a "Qualifying Modification," it may be solicited for approval by the holders of outstanding Bonds. In order to be approved, all Pools must vote to accept the Qualifying Modification. A Pool is deemed to have accepted the modification if it receives support from (a) two-thirds of the principal amount outstanding that voted and (b) more than half of the total principal amount outstanding.[50]

32. Finally, to become binding on all bondholders, the Oversight Board must certify the Qualified Modification after the vote has occurred, and the Court must enter an order approving it as satisfying the requirements of section 601.[51] Once approved by the Court, the "Qualifying Modification will be full, final, complete, binding, and conclusive as to the territorial government Issuer, other territorial instrumentalities of the territorial government Issuer, **and any creditors of such entities**, and should not be subject to any collateral attack or

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[47] PROMESA § 601(d)(3)(A).

[48] PROMESA § 601(d)(3)(E).

[49] PROMESA § 601(g)(1)(B).

[50] PROMESA § 601(j).

[51] PROMESA § 601(m).

other challenge by any entities in any court or other forum."[52] The term "Issuer" as used in PROMESA includes the Government of Puerto Rico, or the Commonwealth.[53] Thus, any Qualifying Modification is, by its terms, binding on the Title III Debtors' creditors.

V. NEGOTIATION OF GDB RESTRUCTURING

33. GDB and AAFAF began negotiating GDB's restructuring in the spring of 2017 with a limited subset of creditors—including the ad hoc group of GDB bondholders (the "Ad Hoc Group"), a number of on-island credit unions or "cooperativas" (the "Cooperativas"), and the so-called "Bonistas del Patio," an organization that advocates for bondholders who are Puerto Rico residents.[54] These negotiations resulted in the execution of a Restructuring Support Agreement (the "RSA") on May 15, 2017,[55] which has since been restated and amended several times, most recently on August 3, 2018.[56] The signatories to the RSA who have consented to the GDB Restructuring are the "Participating Bondholders." These bondholders, together with the municipalities that are also receiving favored treatment in the GDB Restructuring (collectively, the "Favored Unsecured Creditors"), hold only unsecured claims against GDB. The Oversight Board has certified the RSA as a Qualifying Modification under Title VI.[57]

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52 PROMESA § 601(m)(2) (emphasis added).

53 The term "territorial government" in section 601(m)(2) is defined in PROMESA as the "government of a covered territory." PROMESA § 5(18). Title VI of PROMESA defines "Issuer" as, among other things, a "Territory Government Issuer" (PROMESA § 601(a)(8)), which, in turn, means the "Government of Puerto Rico." PROMESA § 601(a)(15). Moreover, approximately $110 million of aggregate principal amount and approximately $19 million in accrued and unpaid interest with respect to the GBCP benefits from a guarantee from the Commonwealth of Puerto Rico.

54 Title VI Appl., at ¶ 19.

55 Uhland Decl., Ex. C.

56 Uhland Decl., Ex. I.

57 *See* Uhland Decl., Ex. L (the "Unanimous Written Consent"). It is interesting to note that the two ex-GDB presidents who sit on the Oversight Board and who would get a release if the Court approves the Qualifying Modification voted in favor of the certification.

34. The nature of the negotiations giving rise to the RSA raise a number of concerns relating to the overall fairness of the GDB Restructuring. To start with, AAFAF and GDB were represented by the **same counsel and financial advisors** during the course of the negotiations; thus, no arm's length negotiations occurred. No separate counsel or advisors advocated for the interests of the Commonwealth, the other Title III Debtors, or their creditors.

35. The Committee could have served as an independent advocate for the Title III Debtors, but it did not participate in meaningful aspects of the negotiations, because the RSA was already signed by the time the Committee was appointed. Despite several Committee requests, GDB and AAFAF have refused to make any changes to the fundamental structure of the GDB Restructuring as set forth in the RSA. Moreover, not all documents underlying the proposed Modification have been provided to the Committee and other parties who are evaluating the restructuring for the first time.

36. Most troubling of all, those who negotiated the transaction on the part of the Oversight Board, AAFAF, and other parties to the transaction are in some cases current and former GDB insiders, who would receive a full "free" release if the Court approves the GDB Restructuring. For example, among the financial advisor personnel advising GDB and AAFAF are (i) a senior managing director who was president of GDB from 2011 to 2012 and Senior Vice President and Director of Investment Banking at Santander Securities Corporation, which advised GDB on numerous government debt offerings, and (ii) a senior managing director who was an executive director of GDB from 2009 to 2011 and then CEO and vice chairman of Santander Securities LLC. The financial advisor engagement team also included a managing director who served as a senior vice president and special advisor to the president of GDB from 2013 to 2016. All would get a release for their prior GDB conduct pursuant to the GDB

Restructuring. Furthermore, at the time the GDB Restructuring was being orchestrated, the executive director of AAFAF was a former vice president of investment banking at Santander Securities LLC, which acted as an underwriter in numerous Puerto Rico debt offerings, all of which were controlled (from the government's vantage point) by GDB.

37. The Oversight Board, which certified the relevant terms of the RSA as a "Qualifying Modification," is also conflicted, as is its counsel. The Oversight Board is conflicted because two of its members are former GDB presidents (who both would get a release pursuant to the GDB Restructuring) and because it is the statutory representative of the Title III Debtors and, at the same time, oversees the GDB (which was designated as a covered territorial instrumentality in accordance with section 101(d)(1)(A) of PROMESA). In fact, on April 20, 2018, the Oversight Board certified GDB's fiscal plan, which requires, among other things, the transfer of GDB's valuable assets to the Recovery Authority, thereby placing such assets out of reach of the Title III Debtors. In addition, counsel to the Oversight Board was engaged by GDB starting in January 2014 "to provide specialized legal services with respect to the evaluation of potential liability management transactions as may be requested by the [GDB]."[58] These "liability management transactions" (i.e., restructuring and/or bankruptcy services) included drafting the Puerto Rico Corporation Debt Enforcement and Recovery Act[59]—the Commonwealth bankruptcy statute that was ultimately struck down by the U.S. Supreme Court.[60] Such engagement, which was signed **<u>prior</u>** to the Commonwealth's $3.5 billion general

[58] See *Agreement for Professional Services*, dated April 15, 2014 between GDB and Proskauer Rose LLP.

[59] *See* Kobre & Kim Rep., at 538 ("On June 28, 2014, the Recovery Act was enacted, establishing a restructuring regime for certain Issuers, including the public corporations. Witnesses told us that Cleary and Proskauer helped draft this legislation."); Informative Mot. ¶ 2.

[60] *See Puerto Rico v. Franklin Cal. Tax-Free Tr.*, 136 S. Ct. 1938, 195 L. Ed. 2d 298 (2016).

obligation bond offering in March 2014, was never disclosed to the general market prior to the offering.[61]

38. Even the GDB Bondholders that are signatories of the RSA are tainted by conflict. The executive director of Bonistas (the bondholder advocacy group that represented bondholders in the restructuring negotiations) was president of GDB from 2007 to 2008, and therefore is entitled to releases under the GDB Restructuring.[62] He was also an executive director at Morgan Stanley, which played an instrumental role in several Puerto Rico bond offerings with which he was directly involved. Moreover, the board of directors of the Corporacion Publica para Supervision y Seguro de Cooperativas ("COSSEC"), which regulates and supervises the Cooperatives and signed the RSA, authorized and encouraged them to buy GDB bonds in 2009 and then authorized them to buy more in 2012. COSSEC's board of directors includes representatives of GDB and previously included two of the former GDB officers who have been advising GDB and AAFAF as financial advisors.

39. These individuals on all sides of the transaction who have clear conflicts of interest, including the GDB Bondholders and the individuals at COSSEC, are all receiving releases of liability for their conduct at GDB. Thus, once the Modification is approved, the very people who orchestrated the GDB Restructuring will have succeeded in absolving themselves, GDB, and others of any liability to the Title III Debtors relating to GDB's role in Puerto Rico's financial crisis, including any liability based on "unknown" facts. These individuals cannot be relied upon to have negotiated a deal that is fair and reasonable to the Title III Debtors.

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[61] *See* $3,500,000,000 Commonwealth of Puerto Rico General Obligation Bonds of 2014, Series A, dated March 11, 2014 (*available at* http://www.gdbpr.com/investors_resources/documents/CommonwealthPRGO2014SeriesA-FinalOS.PDF); Kobre & Kim Rep., at 535-39.

VI. OVERVIEW OF GDB RESTRUCTURING

40. To effectuate the GDB wind-down, AAFAF (which now employs many of the former officers and other employees of GDB) proposed a scheme pursuant to the terms of the RSA between AAFAF, GDB, and certain GDB creditors, as well as a legislative framework for that RSA that became the GDB Restructuring Act. To implement the RSA and the GDB Restructuring, GDB filed its Title VI Application on August 10, 2018.

41. The GDB Restructuring will be implemented in two parts. First, the GDB Bondholders, the Municipal Depositors, and Private Entity Depositors will be allowed to participate in and vote on a Title VI "Qualifying Modification."[63] Upon consummation of the Title VI case, these favored, but thus far unsecured, creditor groups will exchange their old claims for new notes with a face of value of 55%, secured by all the assets of a new governmental entity called the GDB Debt Recovery Authority (the "Recovery Authority").[64] The Recovery Authority will receive substantially all of the liquid assets held by GDB, including GDB's municipal loan portfolio, a portion of its public entity loan portfolio, its real estate owned assets, and its unencumbered cash.[65]

42. Second, the Commonwealth and its other instrumentalities, including the other Title III Debtors (referred to in the Title VI Application as "Non-Municipal Government Entities"), will not be able to participate in the Title VI case and will not be able to receive notes

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62 *Hedge Papers No. 61: The Golden Revolving Door*, at 16, Hedge Clippers(August 2018)(*available at* http://hedgeclippers.org/hedgepaper-no-61-the-golden-revolving-door/).

63 *See* Title VI Appl. ¶ 53.

64 *Id.* ¶ 28-30.

65 *Id.* ¶ 29.

backed by the assets of the Recovery Authority.[66] The disfavored Non-Municipal Government Entities (which hold claims of the same priority as the claims of the Favored Unsecured Creditors) will have any deposits held by GDB set off against purported loan balances owed to GDB, and those holding net claims against GDB will receive, pursuant to the GDB Restructuring Act, a pro rata share of interest in the "Public Entity Trust" that holds a single asset—GDB's alleged claim against the Commonwealth.[67] This unliquidated interest in the Public Entity Trust (it may be worthless because neither the Commonwealth nor GDB's fiscal plan makes provision for payment of such yet-to-be-allowed claim) will be deemed to be in full satisfaction of any and all claims Non-Municipal Government Entities may have against GDB.[68] In other words, the Title III Debtors' deposit claims against GDB are being subordinated to the claims of the Favored Unsecured Creditors.

43. As a result of the setoff calculations under the GDB Restructuring Act, all of the Title III Debtors, with the exception of ERS and PREPA, purportedly owe net loan balances to GDB, with the Commonwealth purportedly owing a net loan balance of $890.6 million. For the reasons discussed in section I of the argument below, however, these setoff calculations are inaccurate for a variety of reasons, including that they (i) assume that GDB's loan claims will be allowed in the Title III Cases and (ii) fail to take into account other, non-deposit claims that the Title III Debtors assert against GDB.

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[66] The Qualifying Modification creates two "Pools" of creditors for voting and establishing treatment of creditor claims: the Guaranteed Bond Claims Pool, and the GDB Bond Claims Pool. The Non-Municipal Government Entities are not included in either Pool.

[67] *See* Title VI Appl., at ¶ 36. At the same time, all ***assets*** relating to the Non-Municipal Government Entities—i.e., any claims by GDB against such entities to recover net loan balances (other than the $890.6 million claim against the Commonwealth)—will be transferred to the Recovery Authority for the benefit of the Participating Bond Claimants.

44. In addition, under the GDB Restructuring, the Commonwealth will be assuming approximately $312 million in liabilities to the federal government on account of Federal Funds granted to the Commonwealth and municipalities pursuant to federal programs and deposited at GDB.[69] The Title III Debtors' and other Non-Municipal Government Entity deposit claims with respect to Federal Funds will also be eliminated in exchange for the potentially worthless interest in the Public Entity Trust, leaving all Federal Funds to be paid from future appropriations by the Commonwealth.[70] Consequently, any cash remaining at GDB from Federal Funds deposits will be part of the assets allocated to the Recovery Authority or retained by GDB. It will not, however, be distributed to the intended beneficiary. Thus the favored GDB creditors are allowed to transfer their claims to the Recovery Authority and will not suffer any dilution as a result of the "disappearance" of the Federal Funds.

45. As a legal and practical matter, the purported Qualifying Modification and the GDB Restructuring Act cannot be separated because the transactions relating to the purported Qualifying Modification (e.g., the creation of the Recovery Authority, the irrevocable transfer to that entity of GDB's cash, performing loans, and real estate, and the creation of statutory liens on those assets) are also being effectuated solely pursuant to the GDB Restructuring Act.[71] As GDB acknowledges in its Title VI Application, the transactions contemplated under the GDB Restructuring Act are express conditions precedent to the Qualifying Modification.[72] The Oversight Board has all but conceded in a related filing that the Qualifying Modification and

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[68] Article 303 of the GDB Restructuring Act provides that upon the transfer of the Public Entity Trust Asset to the PET, and the assumption by the PET of the Designated Deposits, the Non-Municipal Government Entities shall "immediately and forever" be deprived of "any right, interest or claims against GDB or any of its assets."

[69] *See* Uhland Decl. Ex. O, Solicitation Statement, at 30.

[70] *Id.*

[71] *See* Title VI Appl. ¶ 27, 34-43.

GDB Restructuring Act are inextricably intertwined, arguing that the Qualifying Modification "**includes and integrates**" the transactions contemplated by the GDB Restructuring Act.[73]

46. In addition, the provisions of the GDB Restructuring Act relating to the Public Entity Trust become effective on the "Closing Date," which the Act defines as the effective date of the "Restructuring Transaction," which, in turn, is defined as "the transactions contemplated by, or in furtherance of, the Qualifying Modification," including the transactions relating to the Recovery Authority and its issuance of bonds.[74] The "Effective Date" of those transactions is defined as "the date on which the Qualifying Modification becomes conclusive and binding pursuant to Section 601(m) of PROMESA," i.e., the date on which the purported Qualifying Modification is approved.[75]

VII. BINDING EFFECT OF GBD RESTRUCTURING AND ITS RELEASE OF CLAIMS

47. Once approved by the Court, the Qualifying Modification "will be full, final, complete, binding, and conclusive as to the territorial government Issuer, other territorial instrumentalities of the territorial government Issuer, and any creditors of such entities, and should not be subject to any collateral attack or other challenge by any entities in any Court or other forum."[76] In other words, it will bind the Title III Debtors and their creditors. Moreover, the GDB Restructuring Act purports to (i) release all the Title III Debtors' claims against GDB, the Recovery Authority and the Public Entity Trust, and the GDB Releasees, (ii) eliminate the standing of the Title III Debtors to challenge the GDB Restructuring or GDB Restructuring Act,

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72 *Id.* ¶ 34 n. 4.

73 *See Obj. of Oversight Bd. to Urgent Mot. of Comm. to Confirm Appl. of Automatic Stay*, ¶ 28, *In re Commonwealth of Puerto Rico*, No. 17-3283 (Bankr. D.P.R. Aug. 31, 2018) [Docket No. 3845].

74 GDB Restructuring Act Art. 103.

75 *Id.*

and (ii) exculpate any person for actions in accordance with the GDB Restructuring Act or Qualifying Modification.

48. Article 702 of the GDB Restructuring Act—entitled "Binding Effect of Restructuring Transaction on Government Entities"—provides that:

> [a]ll transactions effected pursuant to this Act (including, without limitation, pursuant to determinations made by AAFAF or GDB under this Act) **shall be valid and binding with respect to all Government Entities as of the Closing Date**. Other than as expressly provided in this Act, in the Ancillary Agreements and the Public Entity Deed of Trust, **no Government Entity shall have any further rights or claims against GDB**, the Recovery Authority and the Public Entity Trust, **and any officers, directors, employees, agents and other representatives thereof, of whatsoever nature and kind, whether now existing or hereinafter arising, based, in whole or in part, on facts, whether known or unknown, existing or occurring on or prior to the Closing Date**. Each Government Entity is hereby deemed to **forever waive, release and discharge GDB**, the Recovery Authority and the Public Entity Trust, **and any officers, directors, employees, agents and other representatives thereof** from any and all such claims (emphasis added).[77]

49. Like the transactions relating to the Public Entity Trust, Article 702's release of rights and claims becomes effective on the "Closing Date," which, as set forth above, is the date on which the purported Qualifying Modification is approved by the Court.[78] Accordingly, if this Court approves the purported Qualifying Modification, any rights or claims of the Title III Debtors against GDB or its current or former officers, directors, employees, agents, or representatives relating to GDB's role in the Puerto Rico's financial crisis, including its role as financial advisor to the Title III Debtors, will be automatically extinguished.

50. Furthermore, Article 703 of the GDB Restructuring Act provides that, "[n]otwithstanding any other law of the Government of Puerto Rico, no Government Entity shall

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[76] PROMESA § 601(m)(2).

[77] GDB Restructuring Act, Art. 702.

have the authority or standing to challenge [the] Act, the Restructuring Transaction, or the other transactions contemplated by [the] Act in any local or federal court."[79] Thus, the GDB Restructuring eliminates the Title III Debtors' claims against GDB, eliminates the Title III Debtors' claims against the GDB Releasees, and subordinates the Title III Debtors' claims by transferring all of the valuable assets at GDB to the Recovery Authority, an entity which was created to shield GDB's assets from distribution to the Title III Debtors.

VIII. PROCEDURAL HISTORY

51. On August 9, 2018, GDB and AAFAF began soliciting votes on the Qualifying Modification from the holders of Participating Bond Claims by transmitting copies of the Solicitation Package to each holder.[80] The next day, on August 10, 2018, the GDB and AAFAF commenced this action by filing the Application pursuant to section 601(m)(1)(D) of PROMESA seeking approval of a Qualifying Modification for GDB.[81]

52. Along with the Application, GDB and AAFAF filed a motion seeking an order approving proposed procedures and setting a schedule for approval of the Qualifying Modification (the "Procedures Motion") [Docket No. 4].[82] The Procedures Motion contemplates a separate briefing and hearing schedule for any standing objections, as well as the opportunity to

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[78] *Id.*

[79] GDB Restructuring Act, Art. 703.

[80] Title VI Application, at ¶ 44.

[81] *See generally* Title VI Application.

[82] The Committee objected to GDB/AAFAF's motion for an order approving procedures and setting a schedule for consideration of the purported Qualifying Modification (the "Committee Objection to Procedures Motion"). In that objection, the Committee indicated that "out of an abundance of caution, the Committee will also seek entry in the Title III cases of an order granting it standing to appear in the Title VI case for limited purposes, in the event that the Court holds that, absent such specific authorization from the Court, the Committee does not have standing to appear in the Title VI case." Comm. Obj. to Procedures Mot. ¶ 1, Aug. 24, 2018 [Docket No. 69].

file a supplemental objection after the conclusion of discovery.[83] In accordance with these procedures, this Preliminary Objection does not discuss the Committee's standing, nor does it encompass all arguments that may be developed following the discovery process.

53. On August 22, 2018, the Committee filed its *Notice of Intention to Object Regarding Purported Qualifying Modification for Government Development Bank* (the "Objection Notice"), describing a variety of the bases on which it intended to object to the Qualifying Modification. The Objection Notice expressly reserved the Committee's right to identify additional grounds for objection and to challenge the GDB Restructuring by other means including through the commencement of an adversary proceeding and motions filed in the Title III cases of the Commonwealth of Puerto Rico and its related Title III debtors.

54. On September 6, 2018, the Committee filed a motion in the Title III Cases for derivative standing to act on behalf of the Title III Debtors in challenging the GDB Restructuring.[84] Thus, to the extent the Court determines that the Committee lacks standing to pursue the objections herein on behalf of the Title III Debtors' unsecured creditors, the Committee believes it should instead be allowed to raise these and other objections on behalf of the Title III Debtors.

PRELIMINARY OBJECTION

55. Section 601 of PROMESA sets forth the requirements for a Qualifying Modification pursuant to Title VI. Section 601(m)(2) provides that "[n]otwithstanding section 106(e) [of PROMESA, which states that no court has jurisdiction to review challenges to

[83] Procedures Motion, at 5.

[84] *See Official Comm. of Unsecured Creditors' Mot. for Order Granting Derivative Standing to Act on Behalf of Title III Debtors for Certain Limited Purposes and Other Related Relief with Respect to Restructuring of Gov't Dev. Bank for P.R.*, *In re Commonwealth of Puerto Rico*, No. 17-3283 (Bankr. D.P.R. Sept. 6, 2018) [Docket No. 3881].

Oversight Board determinations], there shall be a cause of action to challenge unlawful application of this section." The GDB Restructuring is an unlawful application of section 601 for numerous reasons, including that it violates the constitutional rights of the Title III Debtors and their unsecured creditors and runs afoul of various sections of PROMESA and the Bankruptcy Code. The Title VI Application should therefore be denied.[85]

I. TITLE III DEBTORS HOLD CLAIMS AGAINST GDB THAT GDB RESTRUCTURING PURPORTS TO ELIMINATE

56. A fundamental issue that bears addressing upfront is the repeated assertion by the Applicants and the Oversight Board that neither the Committee's constituents nor the Title III Debtors will be harmed by the GDB Restructuring because the Title III Debtors do not have net positive claims against GDB.[86] This is entirely untrue. In making this claim, the Applicants and the Oversight Board consider only deposit claims—and not any other claims that the Title III Debtors may hold—and rely on the erroneous setoffs that GDB purports to effectuate pursuant to the GDB Restructuring Act. When all claims of the Title III Debtors are properly accounted for, and setoff is calculated in an appropriate manner, it is clear that the Title III Debtors in fact have substantial net **positive** claims against GDB.

57. Any contention to the contrary is belied by the basic structure of the deal the RSA parties negotiated: if the Title III Debtors truly were net obligors to GDB (as the Oversight Board claims), then there would be no rational basis for the proposed two-entity structure in which the

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[85] To the extent GDB, AAFAF, or the Oversight Board takes the position that the Committee must file a complaint to challenge the GDB Restructuring, this argument should be rejected. These parties moved for and have established a process purporting to allow parties to challenge the GDB Restructuring by filing preliminary and final objections. For them to now argue that such objections are procedurally deficient would allow them to effectively insulate the GDB Restructuring from challenge, which of course they cannot do. The Committee nevertheless reserves the right to file a complaint in the Title VI case if necessary.

[86] *See* Oversight Bd. Obj. to Comm. Standing ¶ 2; *GDB and AAFAF's Obj. to the Official Comm. of Unsecured Creditors' Standing to Object to the Approval Appl.* [¶ 30 n. 12 Docket No. 112].

Title III Debtors (and the Non-Municipal Government Entities) receive "claims" against the Public Entity Trust, while the Favored Unsecured Creditors receive claims against the Recovery Authority. Indeed, if the Title III Debtors were net debtors to GDB, then GDB could simply transfer these net obligations (which would be assets of GDB) to the Recovery Authority to serve as additional collateral for the new notes and allow all GDB creditors to share, on a pro rata basis, in all of GDB's assets—as should be the case in a proper liquidation. But, of course, the deal was not structured in this way precisely because the Favored Unsecured Creditors are, in reality, very concerned that the Title III Debtors have significant net claims against GDB, which would dilute their recoveries. Protecting GDB's valuable assets for the benefit of favored creditors by placing them beyond the reach of the Title III Debtors is the principal rationale of the entire two-entity structure.

58. The flaws in the purported setoff calculations are numerous. As an initial matter, setoff is premature. Pursuant to section 553 of the Bankruptcy Code, which applies in the Title III Cases and prevails over any contrary territory law,[87] a claim against a Title III Debtor may not be used for setoff to the extent it is disallowed.[88] The claims that GDB purports to set off against the Title III Debtors' deposit balances are claims that GDB asserts on loans to the Title III Debtors. These claims have not been allowed. Once the Committee and other parties in interest have been able to investigate these inter-government claims, defenses may be identified that could result in their full or partial disallowance. To the extent the claims are disallowed, they can no longer be used for setoff under section 553.

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[87] PROMESA § 301 (incorporating section 553 of the Bankruptcy Code); § 4 (providing that PROMESA supersedes contrary territory laws).

[88] 11 U.S.C. § 553(a)(1).

59. The conclusion that the Title III Debtors do not have net positive claims against GDB is also flawed because it considers only the Title III Debtors' deposit claims and not any other claims they have against GDB. As noted above and explained further in the Committee's Informative Motion, the Title III Debtors may possess a variety of litigation claims against GDB arising out of its role in the events leading to the current fiscal crisis, including claims for recovery of avoidable transfers. Although these claims require further investigation, information available to date suggests that they could have significant value. In any event, it should be **the burden of the Oversight Board** (as representative of the Title III Debtors), not the burden of the Committee, to demonstrate that it has investigated these claims and determined their value. Once these additional claims are incorporated into the setoff calculation, then some or all of the Title III Debtors may have net positive claims against GDB.

60. In addition, GDB and AAFAF fail to properly account for claims that the Title III Debtors hold against GDB on account of Federal Funds. GDB received Federal Funds from the U.S. government over time for the specific purpose of funding certain programs and operations of the Title III Debtors and other Puerto Rico entities. Upon information and belief, GDB failed to make some or all of the Federal Funds available to their intended beneficiaries, instead using the funds for GDB's own purposes. Nevertheless, GDB now appears to ***deduct*** such funds from the Title III Debtors' account balances, effectively treating them as liabilities of the Title III Debtors for purposes of establishing their net balances with GDB.[89] Worse yet, under the Fiscal Plan, the Commonwealth is required to cover any "loss" associated with the Federal Funds. Assuming the Commonwealth covers this loss, it may obtain subrogation claims against GDB on

[89] GDB claims in its Title VI Application that "[f]ederal funds held on deposit at GDB . . . will not be subject to the setoffs contemplated by the GDB Restructuring Act." Title VI Appl. ¶ 35 n. 5. The Committee was told

behalf of the intended beneficiaries of the Federal Funds relating to GDB's misuse of the funds. These postpetition claims would not be subject to set off against prepetition loan balances.[90]

61. Finally, even assuming the accuracy and appropriateness of GDB's setoff calculations under the GDB Restructuring Act, at least two Title III Debtors—PREPA and ERS—hold significant net deposit balances with GDB. The RSA lists PREPA and ERS as holding net deposit claims of more than $114 million and $32 million, respectively.[91] The Oversight Board has recently taken the position that, notwithstanding the RSA, PREPA in fact ***owes*** GDB more than $324 million on purported preference claims that GDB holds against PREPA under the GDB Enabling Act.[92] No such preference claims, however, have ever been asserted against PREPA, much less resulted in a judgment. Accordingly, for purposes of the Qualifying Modification, both PREPA and ERS presently hold net positive claims against GDB. These claims have every right to be paid on a *pari passu* basis with the claims of the Favored Unsecured Creditors.

62. In summary, assertion by the proponents of the GDB Restructuring that the Title III Debtors will not be harmed by the restructuring because they are net obligors to GDB is factually and legally untrue. To the contrary, the Title III Debtors likely hold substantial positive claims against the GDB that the GDB Restructuring would eliminate to the detriment of the Title III Debtors and their unsecured creditors. More fundamentally, the assertion belies the fact that

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otherwise previously. Moreover, the notion that Federal Funds are not subject to setoff is belied by Schedule 6 to the RSA, which does not reflect such deposits as claims against the PET.

[90] *See* PROMESA § 301; 11 U.S.C. § 553(a) (permitting setoff only of ***prepetition*** claims against ***prepetition*** debts).

[91] Uhland Decl. Ex C, RSA Sched. 7.

[92] *See* Oversight Board Obj. to Comm. Standing ¶ 2 n. 4.

the parties making such determinations are on "both sides" of the issue and therefore hopelessly conflicted.

II. QUALIFYING MODIFICATION IS PREDICATED ON ENACTMENT OF GDB RESTRUCTURING ACT, WHICH IS UNCONSTITUTIONAL PURSUANT TO U.S. CONSTITUTION AND PREEMPTED BY PROMESA

63. Although the proponents of the GDB Restructuring state that they do not seek Court approval of the GDB Restructuring Act, the transactions contemplated thereunder are conditions precedent to the Qualifying Modification and are thus integral to its implementation. Indeed, the GDB Restructuring Act contains arguably the most critical components of the entire transaction by creating the Recovery Authority and the Public Entity Trust, transferring GDB's valuable assets to those entities, and then discharging creditors' claims.[93] By seeking to accomplish key restructuring objectives already covered by PROMESA, the GDB Restructuring Act—a statute passed by the legislative assembly of Puerto Rico—violates the Bankruptcy and Contract Clauses of the U.S. Constitution and is preempted by PROMESA.

64. The Bankruptcy Clause empowers Congress to establish "uniform laws on the subject of bankruptcies throughout the United States."[94] Neither a state nor territory may pass insolvency laws that "have the effect of a bankruptcy discharge as to creditors in other States."[95] State insolvency laws may be enacted "in aid" of bankruptcy laws, rules, or policy, but only if they do not result in a discharge of claims and only if Congress has not already exercised its authority in the same area.[96] As explained by the Supreme Court in *Sturges v. Crowninshield*, in discussing both the Bankruptcy Clause and the Contract Clause of the U.S. Constitution:

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93 GDB Restructuring Act, Art. 303, 401.

94 U.S. CONST., art. I, § 8.

95 *Stellwagen v. Clum*, 245 U.S. 605, 615 (1918).

96 *Id.*

> the states may, until [the bankruptcy power is] exercised by congress, pass laws concerning bankrupts; yet they cannot constitutionally introduce into such laws a clause which discharges the obligations the bankrupt has entered into.[97]

65. In sum, the States (including Puerto Rico)[98] are constitutionally barred from passing any law that provides for the discharge of debts,[99] but may pass other insolvency laws that aid the federal bankruptcy system as long as Congress has not exercised the bankruptcy power.[100] Once Congress has exercised the bankruptcy power, the authority to pass local laws concerning bankruptcy has been preempted.[101] As explained by the Supreme Court, "Congress did not intend to give insolvent debtors seeking discharge, or their creditors seeking to collect claims, choice between the relief provided by [federal bankruptcy law] and that specified in state insolvency laws."[102] Indeed, courts have invalidated many acts of local legislation, finding them preempted by federal bankruptcy law pursuant to the Bankruptcy Clause.[103]

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97 *Surges v. Crowninshield*, 17 U.S. 122, 196, 199 (1819).

98 *See Puerto Rico v. Franklin Cal. Tax-Free Tr.*, 136 S.Ct. 1938, 1946 (2016) (holding that Puerto Rico is a state for purposes of the pre-emption provision of Chapter 9 of the Bankruptcy Code).

99 *Stellwagen*, 245 U.S. at 613. *See also Int'l Shoe Co. v. Pinkus*, 278 U.S. 261, 263-64 (1929) ("A State is without power to make or enforce any law governing bankruptcies that impairs the obligation of contracts or extends to persons or property outside its jurisdiction or conflicts with the national bankruptcy laws.").

100 *In re Bank of New Engl. Corp.*, 364 F.3d 355, 364 (1st Cir. 2004) (holding that Congress' reference to "nonbankruptcy law" in section 510 of Bankruptcy Code "leaves no room for state legislatures or state courts to create special rules pertaining strictly and solely to bankruptcy matters"); *In re Boston Reg'l Med. Ctr., Inc.*, 265 B.R. 838, 852 (B.A.P. 1st Cir. 2001) ("No provision of Massachusetts law can change this distinction or alter the distribution scheme or statutory priorities established by Congress. Accordingly any provision of Massachusetts law which would alter the distinction between BRMC and the Estate or would alter the distribution policies of the Bankruptcy Code is preempted and unenforceable.").

101 *See Local Loan Co. v. Hunt*, 292 U.S. 234, 245 (1934) (holding that local rules subversive of the general purpose and policy of the Bankruptcy Act could not be accepted as controlling).

102 *Int'l Shoe Co. v. Pinkus*, 278 U.S. 261, 265 (1929) (holding that the state insolvency law was preempted by the Bankruptcy Act).

103 *See e.g., Eastern Equip. & Servs. Corp. v. Factory Point Nat'l Bank*, 236 F.3d 117, 120 (2d Cir. 2001) (affirming the district court's finding that state tort law claims were preempted by the Bankruptcy Code); *In re Mata,* 115 B.R. 288, 291 (Bankr. D. Colo. 1990) (holding that a Colorado statute creating a state-created bankruptcy exception was invalid under uniformity requirement of the Bankruptcy Clause); *Bessette v. Avco Fin. Servs., Inc.*, 230 F.3d 439, 447-48 (1st Cir. 2000) (finding a state law cause of action for unjust enrichment preempted by the Bankruptcy Code).

66. Here, Congress exercised its bankruptcy powers over the territories, including the Commonwealth of Puerto Rico, with the passage of PROMESA, a general bankruptcy law. Section 4 of PROMESA provides that "[t]he provisions of this Act shall prevail over any general or specific provisions of territory law, State law, or regulation that is inconsistent with this Act."[104] Title III of PROMESA provides the means for a Puerto Rico government entity to restructure its debts and/or liquidate its assets. Accordingly, PROMESA prohibits the Puerto Rico legislature from enacting its own laws that govern the restructuring of a Puerto Rico government entity's liabilities or the liquidation of its assets.

67. The GDB Restructuring Act seeks to adjust the claims of GDB's creditors and effectively liquidate its assets—two bankruptcy functions covered squarely by PROMESA. Moreover, the provisions of the GDB Restructuring Act are inconsistent with PROMESA because, among other things, they purport to transfer all of GDB's most valuable assets, which today could be used to satisfy claims of the Title III Debtors, to the Restructuring Authority for the exclusive benefit of the Favored Unsecured Creditors, leaving the Title III Debtors and other Non-Municipal Government Entities with potentially valueless claims. No similar restructuring could be accomplished under Title III. Moreover, even if the GDB Restructuring Act were not inconsistent with PROMESA, it would still be invalid under the Bankruptcy and/or Contract

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[104] 48 U.S.C. § 2103.

Clauses of the Constitution because it purports to discharge creditor claims—something a state or territory law cannot do.[105]

68. For these reasons, the GDB Restructuring Act is unlawful and cannot be used to transfer GDB's assets to newly created entities or discharge claims of GDB's creditors.[106] In turn, the Qualifying Modification, which relies on the transactions called for by the GDB Restructuring Act as conditions precedent, cannot be effectuated. Accordingly, this Court should deny approval of GDB's Title VI Application.

III. QUALIFYING MODIFICATION CANNOT BE APPROVED UNDER TITLE VI BECAUSE IT TREATS IDENTICAL BOND CLAIMS DIFFERENTLY

69. The plain language of Title VI and PROMESA does not permit a Modification to treat identical Bond Claims differently, but that is exactly what the Qualifying Modification seeks to accomplish. By giving one group of unsecured creditors (the Title III Debtors) claims against the Public Entity Trust and another group of unsecured creditors (the Favored Unsecured Creditors) new bonds issued by the Recovery Authority, the Qualifying Modification treats unsecured claims of the same priority differently. For this reason, the Qualifying Modification violates Title VI and cannot be approved.

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[105] *Stellwagen v. Clum*, 245 U.S. 605, 615, 38 S. Ct. 215, 218, 62 L. Ed. 507 (1918) ("It is settled that a state may not pass an insolvency law which provides for a discharge of the debtor from his obligations, which shall have the effect of a bankruptcy discharge as to creditors in other states, and this although no general federal bankruptcy act is in effect."); *see also Franklin Cal. Tax-Free Tr. v. Puerto Rico*, 85 F. Supp. 3d 577, 606 (D.P.R.) ("The United States Supreme Court has long held that the Contract Clause prohibits states from passing laws, like the Recovery Act, that authorize the discharge of debtors from their obligations."), *judgment entered,* No. 14-1518 FAB, 2015 WL 574008 (D.P.R. Feb. 10, 2015), and *aff'd,* 805 F.3d 322 (1st Cir. 2015), *aff'd*, 136 S. Ct. 1938, 195 L. Ed. 2d 298 (2016).

[106] Notably, certain of the GDB Bondholders themselves filed civil proceedings in 2016 arguing that the Puerto Rico Emergency Moratorium and Financial Rehabilitation Act (the "Moratorium Act"), Law 21 of 2016, violated the Bankruptcy Clause. *See* Am. Compl., *Brigade Leveraged Capital Structures Fund Ltd. v. Padilla*, No. 16-01610 (FAB) (D.P.R. May 20, 2016), [Docket No. 52]; Compl. *Gonzalez v. Padilla,* No. 16-02257 (FAB) (D.P.R. June 30, 2016) [Docket No. 1]. The Moratorium Act does not contain nearly the same hallmarks of a *de facto* bankruptcy law as the GDB Restructuring Act.

70. Under Title VI, the Oversight Board must establish "Pools" of Bonds. Pursuant to section 601(d)(3), these Pools must adhere to certain requirements, including that Bonds having "identical rights in security or priority" must be placed into the same Pool:

> For each Issuer that has issued multiple Bonds that are distinguished by specific provisions governing priority or security arrangements . . . **separate Pools shall be established corresponding to the relative priority or security arrangements of each holder of Bonds against each Issuer**, as applicable, provided, however, that the term "priority" as used in this section shall not be understood to mean differing payment or maturity dates.[107]

The statute is clear that "[t]he Administrative Supervisor **shall not place into separate Pools** Bonds of the same Issuer that have identical rights in security or priority."[108]

71. Section 601(g)(1)(B) of Title VI further requires that each bondholder in a Pool affected by the Modification be offered the same amount of consideration:

> [E]each exchanging, repurchasing, converting, or substituting holder of Bonds of any series in a Pool affected by that Modification [must be] offered the **same amount of consideration per amount of principal, the same amount of consideration per amount of interest accrued but unpaid and the same amount of consideration per amount of past due interes**t, respectively, as that offered to each other exchanging, repurchasing, converting, or substituting holder of Bonds of any series in a Pool affected by that Modification[109]

Thus, sections 601(d)(3) and 601(g)(1)(B) of PROMESA together make clear that all Bond Claims of identical security and priority **must receive equal consideration**, and simply ignoring certain pools of bonds is not a permitted way to get around these restrictions. Otherwise, an

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[107] PROMESA § 601(d)(3)(A) (emphasis added).

[108] PROMESA § 601(d)(3)(E) (emphasis added).

[109] PROMESA § 601(g)(1)(B) (emphasis added).

entity could effectuate a Title VI modification that denies any recovery to entire parts of its capital structure by transferring all of its assets to one creditor group.

72. As this court has previously recognized, under Puerto Rico law, bank deposits are "Bonds" subject to modification under Title VI.[110] Therefore, the outstanding Bond Claims against GDB include not only traditional bond claims (e.g., the Participating Bond Claims) but also claims held by municipalities and the Non-Municipal Government Entities. All of these Bond Claims are unsecured claims having identical priority. Therefore, sections 601(d)(3) and 601(g)(1)(B) require that all non-guaranteed Bond Claims be placed into the same Pool and receive the same consideration.

73. The Qualifying Modification, however, turns a blind eye to these requirements by creating only two pools: (i) the Guaranteed Bond Claims Pool, consisting of Participating Bond Claims that benefit from a Commonwealth Guarantee, and (ii) the GDB Bond Claims Pool, consisting of all other Participating Bond Claims. These Pools inexplicably exclude the Bond Claims of the Title III Debtors and other Non-Municipal Government Entities, despite the fact that such claims are identical in security and priority to the GDB Bond Claims, and even though the Proposed Modification plainly "modifies" the claims by "mandatorily exchang[ing]" them for interests in the Public Entity Trust.[111]

74. The Qualifying Modification also provides that the Title III Debtors and other Non-Municipal Government Entities will receive vastly different consideration in exchange for their claims against the Public Entity Trust than those creditors who will receive claims against

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[110] *Autonomous Municipality of San Juan v. Fin. Oversight & Mgmt. Bd.*, 301 F. Supp. 3d 314, 321 n.7 (D.P.R. 2017). Indeed, the RSA classifies a subset of deposit claims against GDB as "Participating Bond Claims" subject to modification. *See* RSA Schedule 1.

[111] *See* Uhland Decl. Ex. O, Solicitation Statement at 8.

the Recovery Authority. This disparity in consideration cannot be seriously disputed. Indeed, the original GDB Fiscal Plan states that "Municipality Loans, select Revenue/Public Corporation Loans, and the sale of real estate owned assets are the only sources of revenue to GDB after [June 30, 2017]."[112] All of those assets are assigned to the Recovery Authority. Therefore, the GDB and AAFAF effectively concede that no assets of Public Entity Trust will be "sources of revenue to GDB" going forward.

75. As such, because the Proposed Modification (i) fails to pool all Bond Claims and (ii) gives unequal consideration to similarly situated holders of Bond Claims, it fails to satisfy Title VI's requirements of equal consideration for similarly situated creditors. The Modification is therefore inconsistent with Title VI and cannot be approved.

IV. EVEN IF QUALIFYING MODIFICATION IS PERMISSIBLE WITHIN STATUTORY FRAMEWORK OF TITLE VI, IT IS UNCONSTITUTIONAL UNDER DUE PROCESS CLAUSES OF THE U.S. AND PUERTO RICO CONSTITUTIONS

76. The GDB Restructuring violates the U.S. and Puerto Rico Constitutions for the same reason it violates Title VI: it provides for the arbitrary and inequitable treatment of similarly situated creditors. For over a century, courts have recognized the principle of equitable distributions in plans of reorganization.[113] The principle can be traced as far back as the railroad reorganizations at the turn of the 20th Century[114] and stems from the Due Process Clause of the

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[112] *See GDB Fiscal Plan*, dated April 28, 2017 (available at: http://www.aafaf.pr.gov/assets/fiscal-plan---government-development-bank.pdf).

[113] *See e.g.*, *Keppel v. Tiffin Sav. Bank*, 197 U.S. 356, 378, 25 S. Ct. 443, 451 (1905) ("In view of the purpose of the bankruptcy act to make an equal distribution of the bankrupt's estate among creditors of the same class…[t]he law looks to a prompt, equal and inexpensive distribution of the estate among those entitled thereto."); *Kuehner v. Irving Trust Co.*, 299 U.S. 445, 451 (1937) ("[T]he object of bankruptcy laws is the equitable distribution of the debtor's assets amongst his creditors."); *Sampsell v. Imperial Paper & Color Corp.*, 313 U.S. 215, 219, 85 L. Ed. 1293, 61 S. Ct. 904 (1941) (stating that the central theme of the bankruptcy laws is "equality of distribution").

[114] *See* 7 Collier on Bankruptcy ¶ 1129.03 (16th 2018).

5th Amendment, which is incorporated into the 14th Amendment and applies to the States, including Puerto Rico.[115] Bankruptcy laws, including PROMESA and the Bankruptcy Code, have codified this principle by providing for "a fair distribution of the assets of the insolvent."[116]

77. In *Kuehner v. Irving Trust Co.*, 299 U.S. 445 (1937), the Supreme Court addressed the interplay between Congress' power to enact bankruptcy laws and the requirements of due process. The Court explained that, although bankruptcy laws may of course impair a debtor's contractual obligations through the adjustment of creditors' claims, such laws must be fair, reasonable, and non-arbitrary:

> While . . . the Fifth Amendment forbids the destruction of a contract it does not prohibit bankruptcy legislation affecting the creditor's remedy for its enforcement against the debtor's assets, or the measure of the creditor's participation therein, **if the statutory provisions are consonant with a fair, reasonable, and equitable distribution of those assets. . . . The question is whether the remedy is circumscribed in so unreasonable and arbitrary a way as to deny due process**.[117]

78. The specific issue before the Court in *Kuehner* was whether the former Bankruptcy Act's limitation on damages for rejection of a lease to three years' rent was consistent with due process, even though it would necessarily deprive landlords of certain contractual rights.[118] The Court noted that Congress, in enacting the limitation, "was bound by the Fifth Amendment not to be arbitrary in the allotment of [shares of the debtor's assets] or to

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[115] *See Examining Bd. of Engineers, Architects & Surveyors v. Flores de Otero*, 426 U.S. 572, 600, 96 S. Ct. 2264, 2280, 49 L. Ed. 2d 65 (1976) ("[i]t is clear . . . that the protections accorded by either the Due Process Clause of the Fifth Amendment or the Due Process and Equal Protection Clauses of the Fourteenth Amendment apply to residents of Puerto Rico."); *see also Hiskes v. Sancha*, Civ. No. 10-2246 (JAG), 2012 WL 1110204, at *4 (D.P.R. Mar. 30, 2012) (Fifth Amendment applies to federal actions, while Fourteenth Amendment applies to actions by state and local governments, including Puerto Rico).

[116] *See Stellwagen v. Clum*, 245 U.S. 605, 615 (1918); *see, e.g.,* PROMESA 601(d)(3)(E); 601(g)(1)(B) (as applied to the Voluntary Agreement Process of 601(g)(2)(A)); 11 U.S.C. §§ 726, 1129(a)(7), 1129(b).

[117] *Kuehner v. Irving Trust Co.*, 299 U.S. 445, 451 (1937) (emphasis added).

[118] *Kuehner*, 299 U.S. 445 at 447.

discriminate between landlords and other creditors and between individual landlords."[119] Ultimately, the Court decided that the limitation did not violate due process because Congress had reasonably concluded that a fixed mechanism for calculating lease rejection damages was preferable to the uncertainty and complexity that individual state law damages calculations would introduce. In reaching this conclusion, however, the Supreme Court stressed the **uniformity** of the statute's application to all landlords and its **fairness** to creditors.[120]

79. In contrast to the statute at issue in *Kuehner*, the GDB Restructuring is neither uniform in its application nor fair to creditors. Rather, the GDB Restructuring discriminates against the Title III Debtors and other Non-Municipal Government Entities by providing them with drastically lower recoveries than the Participating Bondholders, even though both creditor groups hold claims of identical security and priority. To analogize to *Kuehner*, the result sought by the GDB Restructuring is akin to giving some landlords damages claims equal to ten years' rent, while all other landlords receive claims for only three years' rent (or, perhaps more accurately, zero years' rent, given that the prospect of the Public Entity Trust assets generating any recovery is speculative at best). The Supreme Court would almost certainly find such a statute unconstitutional in accordance with its reasoning in *Kuehner*.

80. That the GDB Restructuring is consensual with respect to some creditors in no way lessens its offensiveness to the principles of fairness and equity that underlie federal bankruptcy laws. Indeed, the Supreme Court has made clear that a bankruptcy court has a duty to ensure that all settlements are "fair and equitable"—a standard that incorporates the

[119] *Id.* at 454.

[120] *Id.* at 455 (stating that, in judgment of Congress, statute set "a ***uniform limit*** upon landlords' claims [that] w[ould], in the long run, ***be fair*** to [landlords], to other creditors, and to the debtor.") (emphasis added).

Bankruptcy Code's priority rules.[121] In *Czyzewski v. Jevic Holding Corp.*, the Supreme Court recently considered the permissibility of structured dismissal of a chapter 11 case pursuant to a settlement that gave money to low-priority general unsecured creditors who consented to the dismissal but skipped certain dissenting higher-priority creditors who did not consent.[122] The Court decided that the bankruptcy court had no "legal power to order this priority skipping kind of distribution scheme," even though the Bankruptcy Code does not specifically impose any priority rules on structured dismissals.[123] The Court reasoned that the proposed settlement would violate the "basic underpinning of business bankruptcy law" that priority rules be respected.[124]

81. The GDB Restructuring, although purportedly consensual among certain creditors, is impermissible for the same reason as the settlement at issue in *Jevic*: the Recovery Authority, a new entity created by the GDB Restructuring Act that has no claims of any kind against GDB, will receive all of GDB's valuable assets before the Commonwealth and other Title III Debtors receive any recovery on their unsecured claims. By preferring the Recovery Authority—an entity with ***no interest*** in GDB—to unsecured creditors, this proposal violates the basic tenet of bankruptcy law that priority rules be respected.

82. Finally, the principle that an instrumentality of the state has no standing to assert a due process violation against its creating state[125] is no bar to the Committee's due process claim here. This is so because, as the Committee has discussed in its separate briefing on the issue of

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[121] *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 441 (1968).

[122] *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973, 977, 197 L. Ed. 2d 398 (2017).

[123] *Id*. at 978.

[124] *Id*. at 983.

[125] *Municipality of San Sebastian v. Puerto Rico*, 89 F. Supp. 3d 266, 277 (D.P.R. 2015), on reconsideration in part, 116 F. Supp. 3d 49 (D.P.R. 2015).

standing,[126] the Committee has direct standing to object to the GDB Restructuring due to its binding, harmful effect on the Title III Debtors' unsecured creditors. The Committee is therefore asserting a due process violation on behalf of unsecured creditors, not merely the Title III Debtors. Because the unsecured creditors of the Title III Debtors are not creations of the Puerto Rico government, the Committee is free to assert a due process violation against the Puerto Rico government on their behalf. [127]

V. GDB RESTRUCTURING'S BROAD RELEASES VIOLATE PROMESA AND BANKRUPTCY CODE

83. As discussed above, the GDB Restructuring contains broad releases that would prevent the Title III Debtors and their creditors from pursuing claims of any kind against the GDB Releasees, which includes all current and former GDB executives and other insiders, in connection with their conduct at GDB. Although these potential claims have yet to be fully investigated, all indications are that they may be significant. Indeed, the Kobre & Kim Report, despite its many shortcomings, identifies numerous examples of troubling GDB conduct that may give rise to substantial liability by GDB and those who acted on its behalf. The potential claims may include claims against GDB and/or its current and former executives and other representatives (i.e., any of the GDB Releasees) for, among other things, negligence, breach of fiduciary duty, and recovery of avoidable transfers.[128] The release of these potentially valuable claims violates PROMESA and should not be permitted.

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[126] *See generally Omnibus Resp. of Official Comm. of Unsecured Creditors to GDB/AAFAF's and Oversight Board's Standing Objs.* [Docket No. 131].

[127] The Puerto Rico Constitution contains a due process clause that mirrors the due process clauses of the Fifth and Fourteenth Amendments. *See* P.R. CONST., art. II. § 7 ("No person shall be deprived of his liberty or property without due process of law. No person in Puerto Rico shall be denied the equal protection of the laws.") Therefore, the GDB Restructuring Act violates both the U.S. Constitution and the Puerto Rico Constitution.

[128] *See generally* Kobre & Kim Report, Pt. XVI, "*Independent Investigator's Overview of Potential Causes of Action*."

A. Releases Are Prohibited by Section 601(m)(2)

84. Section 601(m)(2) of PROMESA (which controls over any territory law to the contrary[129]) includes a prohibition on third-party releases and a limitation on releases in general. Specifically, section 601(m)(2) states that "[u]pon the entry of an order [approving a Qualifying Modification], the conclusive and binding Qualifying Modification shall be valid and binding on any person or entity asserting claims or other rights . . . **[but] no claim or right that may be asserted by any party in a capacity other than holder of a Bond affected by the Qualifying Modification shall be satisfied, released, discharged, or enjoined by this provision**."[130] In effect, section 601(m)(2) means that no party that is not participating in (i.e., not "affected by") the Qualifying Modification can have its claims released. For a bondholder who is participating in the Qualifying Modification, only the claims it holds against the issuer in its capacity as a bondholder can be released. Section 4 of PROMESA makes clear that section 601(m)(2) supersedes all territory laws to the contrary.[131]

85. The GDB Restructuring Act, which as discussed above forms a critical component of the GDB Restructuring, directly violates section 601(m)(2) by purporting to broadly release any and all claims that the Title III Debtors may hold against the GDB Releasees. Specifically, Article 702 of the GDB Restructuring Act provides:

> "[As of the closing date,] **no Government Entity [including the Title III Debtors] shall have any further rights or claims against GDB, the Recovery Authority and the Public Entity Trust, and any officers, directors, employees, agents and other representatives thereof, of whatsoever nature and kind, whether now existing or hereinafter arising, based, in whole or in part, on facts, whether known or unknown, existing or**

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[129] PROMESA § 4.

[130] PROMESA § 601(m)(2).

[131] PROMESA § 4.

> **occurring on or prior to the Closing Date**. Each Government Entity is hereby deemed to forever waive, release and discharge GDB, the Recovery Authority and the Public Entity Trust, and any officers, directors, employees, agents and other representatives thereof from any and all such claims."[132]

The RSA also states that, upon transfer of the assets to the Public Entity Trust, the Title III Debtors shall "cease to have any right, interest or claim against GDB or any of its assets, or any successors or assigns thereof (other than the Public Entity Trust)."[133]

86. These broad releases are inconsistent with section 601(m)(2) of PROMESA for at least two reasons. First, they purport to release the Title III Debtors' claims against the GDB Releasees even though the Title III Debtors are given no right to participate in the proposed Qualifying Modification and will purportedly not have their Bond claims "affected" by it.[134] Second, even if the Title III Debtors were participants in the Qualifying Modification (which they are not), the proposed releases extend far beyond those permissible under section 601(m)(2). The releases extend not just to claims that the Title III Debtors hold in their capacity as holders of Bond claims, but to all claims "of whatsoever nature and kind" that may exist against GDB. The releases also cover GDB's current and former "officers, directors, employees, agents, and other representatives thereof." Although unclear, this language may purport to extend even to former counsel and advisors to GDB's officers, directors, and employees—i.e., **to representatives of representatives**. Regardless of how the language is interpreted, these extremely broad releases are not permitted by section 601(m)(2) and cannot be approved.

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[132] GDB Restructuring Act, art. 702.

[133] Uhland Decl. Ex. C, RSA, Ex. A, at 5.

[134] *See* Uhland Decl. Ex. C, RSA, Ex. A at 3 ("For the avoidance of doubt, the liabilities of GDB that are not Participating Bond Claims will not be the subject of the Qualifying Modification . . . .").

87. The releases separately run afoul of section 926(a) of the Bankruptcy Code.[135] Section 926(a) allows a creditor of a Title III debtor to seek the appointment of a trustee to pursue avoidance actions on the debtor's behalf, providing that, "[i]f the debtor refuses to pursue a cause of action under section 544, 545, 547, 548, 549(a), or 550 of this title [an "Avoidance Claim"], then on request of a creditor, the court may appoint a trustee to pursue such cause of action."[136] As discussed above, the Title III Debtors may hold valuable Avoidance Claims against GDB and the other GDB Releasees, and these claims would be among those released by section 702 of the GDB Restructuring Act. Thus, if the GDB Restructuring Act is approved, and the Title III Debtors' Avoidance Claims are extinguished, then the right of unsecured creditors to seek the appointment of a trustee to pursue such claims will be rendered illusory. The releases are therefore preempted by section 926(a) of the Bankruptcy Code.

B. GDB/AAFAF and Oversight Board Have Ignored Potentially Insidious Consequences of GDB Restructuring Act's Releases

88. The release provisions of the GDB Restructuring Act could have insidious effects beyond the release of valuable claims against GDB and the GDB Releasees for woefully inadequate consideration. As a general rule, when multiple parties act together in the commission of a tort (e.g., breach of fiduciary duty), they are jointly and severally liable to the plaintiff.[137] Thus, each joint tortfeasor is liable to the plaintiff for 100% of the damages, and the plaintiff can collect 100% of the damages from any joint tortfeasor. In other words, while a joint tortfeasor that has paid a judgment can seek contribution from the other joint tortfeasors, it

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[135] Section 301 of PROMESA incorporates section 926 of the Bankruptcy Code.

[136] 11 U.S.C. § 926(a).

[137] *See, e.g., In re JMK Constr. Grp., Ltd.*, 441 B.R. 222, 232 (Bankr. S.D.N.Y. 2010) ("When two or more tortfeasors act concurrently or in concert to produce a single injury, they may be held jointly and severally liable.").

cannot raise the culpability of the other joint tortfeasors as a defense to the plaintiff's claim.[138] However, although variations exist from jurisdiction to jurisdiction, when some joint tortfeasors are released, the plaintiff's claims against the remaining joint tortfeasors are generally subject to reduction in proportion to the released joint tortfeasors' share of culpability. For example, under New York law, the release of some joint tortfeasors generally "reduces the claim of the releasor against the other tortfeasors to the extent of any amount stipulated by the release or the covenant [not to sue], or in the amount of the consideration paid for it, or in the amount of the released tortfeasor's equitable share of the damages . . . whichever is the greatest."[139] The Committee's preliminary analysis indicates that a similar rule could apply in Puerto Rico, at least under certain circumstances.

89. Here, if the Qualifying Modification is approved and the GDB Restructuring Act becomes effective, GDB and the GDB Releasees will be released from any liability to the Title III Debtors for their roles in Puerto Rico's financial crisis. Assuming that the financial institutions and others that facilitated and profited from Puerto Rico's GDB-controlled debt offerings are not released as GDB "agents" or "representatives" (as they will undoubtedly argue they are, although the Committee believes otherwise), the Title III Debtors' claims against those solvent entities could be reduced in proportion to the share of culpability allocable to GDB and/or the GDB Releasees, thereby dramatically reducing the value of those claims. In any event, one thing is clear: GDB/AAFAF and the Oversight Board have not gone to the trouble of analyzing (because their sole focus is getting the GDB Restructuring approved) the potential

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[138] *See Avis Budget Car Rental, Inc. v. JD2 Envtl., Inc.*, No. 12-CV-5010 (PKC)(ST), 2018 U.S. Dist. LEXIS 36496, at *6 (E.D.N.Y. Mar. 6, 2018) ("[A] joint tortfeasor [may] be held liable for the entire judgment, regardless of its share of culpability.") (internal quotations marks omitted).

[139] N.Y. Gen. Oblig. Law § 15-108.

consequences of the releases in the GDB Restructuring Act under applicable law (which may not be New York law). Indeed, during the September 7, 2018 hearing on GDB/AAFAF's Title VI procedures motion, counsel for GDB/AAFAF stated: "I literally don't understand the concept of how joint releases to one party and joint and several potential liability would cause negative ramifications for actions that may exist against banks. Maybe they exist, maybe they don't. But the whole concept of joint and several liability is that if one party's released you go pursue everybody else."[140]

C. Court Should Reject Oversight Board's Indemnification Argument

90. The Oversight Board has taken the position that the GDB Releasees are entitled to indemnification by GDB for any claims asserted against them in their capacity as former GDB representatives and, therefore, investigating and/or pursuing claims against these individuals would be pointless.[141] This position both misstates the applicable law and misunderstands the economic impact that any purported indemnification claims may have on GDB.

91. As an initial matter, the statute the Oversight Board cites—the GDB Enabling Act—states that only those parties who have acted in good faith and without gross negligence are entitled to indemnification.[142] It is far from certain, if not highly unlikely, that all of the current and former officers, employees, agents and advisors to GDB (among others) who are receiving releases at all times acted in good faith and were not grossly negligent in connection with any conduct that may give rise to claims against them. Thus, many of the GDB Releasees may have no indemnification rights whatsoever.

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[140] Sept. 7, 2018 Hr'g. Tr., at 36:10-15.

[141] *See* Oversight Bd. Obj. to Comm.'s Standing ¶ 5.

[142] *See* 1948 P.R. Laws 17, art. 18, GDB Enabling Act, as amended, 7 L.P.R.A. § 563 (indemnifying GDB directors, officers, and employees for actions taken or not taken in good faith in their capacity and authority absent proof of gross negligence).

92. But even assuming that some GDB Releasees are entitled to indemnification, this does not mean that such indemnification claims would not have a negative economic impact on GDB and its creditors. Any indemnification claims that GDB Releasees hold against GDB based on their **prepetition** conduct would give rise only to **prepetition** indemnification claims. Thus, such claims would not be paid out in whole dollars, which is what GDB and AAFAF purport to accomplish under the GDB Restructuring, but rather mere cents on the dollar. In addition, any indemnification claims that the GDB Releasees have against GDB may be subject to section 510(b) of the Bankruptcy Code, which states that any claims arising out of a securities transaction are subordinated to the claims of holders of the security involved in that transaction. Many of the causes of action that GDB may possess against the GDB Releasees relate to the 2014 GO bond offering, a securities transaction; therefore, section 510(b) would apply, and any indemnification claims of the GDB Releases would be subordinated to GO bond claims. In this situation, the GDB Releasees would receive **no recovery** on their indemnification claims unless the GO bonds are repaid in full.

93. The Oversight Board, GDB, and AAFAF may contend that section 510(b) and any limitations on distributions to creditors would only apply in a Title III case, but this argument, although technically accurate, rings hollow. The GDB and the Oversight Board control how to pursue GDB's restructuring. If commencing a Title III case is necessary to ensure that those who have liability to GDB for past wrongful actions are held accountable for those actions, then GDB should commence a Title III case for that purpose. GDB should not be allowed to effectively absolve former insiders of liability through Title VI. In pursuing its restructuring, GDB should have its own best interests in mind, not those of the individuals and advisors who have harmed GDB in the past.

94. In summary, the releases are unlawful and, therefore, must be removed from any Court-approved Qualifying Modification. At a minimum, the Committee and other parties should be given the opportunity to further investigate the nature and extent of the potential claims being released before the GDB Restructuring is approved. To date, there has been a remarkable lack of transparency by GDB and AAFAF on this front. Not only has the Committee not been allowed to investigate potential claims against the GDB Releasees, but it is also unclear whether GDB and AAFAF themselves ever conducted such an investigation. It is inappropriate for GDB and AAFAF to seek approval of the GDB Restructuring without providing this critical information.

VI. GDB RESTRUCTURING VIOLATES SECTION 303 OF PROMESA

95. The GDB Restructuring is also invalid because it violates section 303 of PROMESA. Section 303 of PROMESA bars any territory law that (1) "prescrib[es] a method of composition of indebtedness [that]prohibits the payment of principal or interest," (2) by any entity not enumerated in section 109(b)(2) of the Bankruptcy Code, and (3) where the affected creditor does not consent.[143] The GDB Restructuring Act meets all three of these elements. Therefore, both the GDB Restructuring Act and the Qualifying Modification that is conditioned on its approval are invalid as to non-consenting creditors.

A. GDB Restructuring Act Provides for a Composition of GDB's Indebtedness that Prohibits Payment of Interest and Principal to Title III Debtors

96. As this Court has previously recognized, to qualify as a composition of indebtedness, a law must "dispense of or reduce an[] . . . obligation[.]"[144] The GDB

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[143] PROMESA § 303.

[144] *Assured Guar. Corp. v. Garcia-Padilla*, 214 F. Supp. 3d 117, 127 (D.P.R. 2016) (quoting Black's Law Dictionary 346 (10th ed. 2014)).

Restructuring Act plainly purports to both reduce and dispense of GDB's obligations to the Title III Debtors. Specifically, Article 302 of the GDB Restructuring Act provides a mechanism for adjusting downward the "balance of liabilities" owed by GDB to the Title III Debtors through purported setoff calculations, while Article 303 provides that, after the designated assets and claims of GDB are transferred to the Public Entity Trust, the Title III Debtors shall "cease to have any right, interest or claim against GDB or any of its assets."[145] In addition, Article 702 provides that the Title III Debtors shall not have "any further rights or claims against GDB" following the closing date.[146]

97. These same provisions of the GDB Restructuring Act also serve to prohibit the payment of principal and interest. Indeed, once any liabilities owed to the Title III Debtors on account of deposit claims or otherwise are reduced pursuant to Article 302 and eliminated pursuant to Article 303, the Title III Debtors necessarily will never receive principal or interest payments on such obligations. Moreover, to the extent the Title III Debtors are given claims against the Public Entity Trust that survive the restructuring, the Public Entity Trust will have no meaningful assets that it can monetize to satisfy such claims, as all revenue-generating assets of GDB are being transferred to the Recovery Authority, outside the reach of the Title III Debtors.

B. Section 303(1)'s Carve-Out Does Not Apply to GDB, Which Is Not a Bank

98. Section 303 contains a carve-out for territorial laws that prohibit payment of principal or interest only by "entit[ies] . . . described in section 109(b)(2) of the Bankruptcy Code."[147] Such laws may be enacted notwithstanding PROMESA. GDB, however, does not fit

[145] GDB Restructuring Act, art. 302, 303.

[146] GDB Restructuring Act, art. 702.

[147] PROMESA § 303.

within that carve-out, and thus cannot avail itself of the exception in section 303 permitting otherwise prohibited compositions of indebtedness.

99. GDB and AAFAF may argue that GDB fits within the carve-out because section 109(b)(2), which lists certain entities that may not be debtors under chapter 7 of the Bankruptcy Code, includes, among other entities, "a bank, savings bank, [or] cooperative bank."[148] GDB, however, is not a "bank" for purposes of the statute. At the time that Congress enacted the predecessor to section 109(b)(2) under the former Bankruptcy Act, "the ordinary conception of a bank was of a business which was based primarily on the receipt of deposits (general or special), which deposits were used by the bank for loans, discounts, buying and selling commercial paper, and other business purposes."[149] The Eighth Circuit held that the receipt of deposits was the *sine qua non* of qualifying as a bank under the predecessor to section 109(b)(2): "In short, while there may be other attributes which a bank may possess, yet a necessary one is the receipt of deposits which it may use in its business."[150] The Second Circuit likewise regarded "the legal power to receive deposits as the essential thing" that constitutes a bank.[151] The importance of being able to accept deposits as a core and necessary function of a bank has persisted under the Bankruptcy Code.[152] Importantly, an entity's classification under section 109(b) is determined at the time such entity's classification is challenged.[153]

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[148] 11 U.S.C. § 109(b)(2).

[149] *Gamble v. Daniel*, 39 F.2d 447, 450 (8th Cir. 1930).

[150] *Id.* at 451.

[151] *In re Prudence Co.*, 79 F.2d 77, 79 (2d Cir. 1935).

[152] *In re Cash Currency Exch., Inc.*, 762 F.2d 542, 552 (7th Cir. 1985) ("[t]he institutions listed [in section 109(b)(2)] all accept deposits, the essential function of a banking institution.").

[153] *See In re Eureka S. R. Co.*, 177 B.R. 323, 324 (Bankr. N.D. Cal. 1995) (noting that many courts determine eligibility as of the petition date, but that section 109(b) speaks in the present tense).

100. GDB is not a bank under section 109(b)(2) because it no longer accepts deposits and thus does not function as a bank. GDB's ability to accept deposits was suspended in 2016 under Executive Order 2016-14, which triggered the emergency period moratorium for GDB under the Emergency Moratorium and Financial Rehabilitation Act (the "Moratorium Act").[154] Additionally, any banking authority that GDB previously possessed passed to the "bridge bank" under the Moratorium Act.[155] Indeed, as described above, as of April 2016 GDB has ceased any operations authorized under the GDB Act, with such operations handed over to AAFAF, the Recovery Authority, or the Public Entity Trust, as applicable.[156] Thus, regardless of whether GDB may have in the past qualified as a bank under section 109(b)(2), it no longer does today.

101. GDB also does not qualify as a bank under the so-called "state classification test" that some courts apply, which examines how state law classifies the entity in question.[157] GDB is not classified as a bank under Puerto Rico law. In fact, it is expressly excluded from the application of the Puerto Rico Banking Law.[158] Moreover, although GDB at one time possessed a few of the powers of banks listed in the Puerto Rico Banking law (e.g., the ability to make loans and accept deposits), it no longer possesses those powers today.

C. Title III Debtors Have Not Consented to Composition of Indebtedness

102. GDB and AAFAF may contend that the Title III Debtors have consented to their treatment under the GDB Restructuring Act because it was passed by the Puerto Rico legislature

[154] Uhland Decl. Ex. A, Puerto Rico Emergency Moratorium and Financial Rehabilitation Act, 2016 P.R. Leyes 21.

[155] *Id*. at § 401(B).

[156] *See supra*, ¶ 21-23.

[157] *See In re Trade Fin. Bank*, 163 B.R. 558, 563 (Bankr. D.S.D. 1994).

[158] GDB Enabling Act, § 566.

and because AAFAF ostensibly negotiated and consented to the GDB Restructuring on the Title III Debtors' behalf. Any such consent, however, is illusory in light of the conflicts of interest that permeate all aspects of the GDB Restructuring.

103. As discussed in the Committee's motion for derivative standing in the Title III cases, it is a bedrock bankruptcy policy that, absent substantive consolidation,[159] each affiliated debtor in a multi-debtor case must be treated as a standalone entity.[160] The trustee or debtor-in-possession of each estate (or, in a case under PROMESA, the Oversight Board as the representative of a debtor) owes a fiduciary duty to that debtor's creditors and to those creditors alone. No debtor's recovery (and, by extension, the recoveries of its creditors) can be sacrificed for the overall good of the enterprise (or, in a case under PROMESA, the "covered Territory").

104. A corollary and no less fundamental policy is that, when adversity arises between affiliated debtors and their respective creditors, the same officers and counsel cannot represent both sides.[161] Rather, each debtor estate must be represented by independent fiduciaries, or else other mechanisms must be established for resolving interdebtor disputes that cannot be resolved consensually among the affected stakeholders.

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[159] Section 304(f) of PROMESA states that "[t]he Oversight Board, on behalf of debtors under this title, may file petitions or submit or modify plans of adjustment jointly if the debtors are affiliates," which was done here. However, while section 304(f) provides that "nothing in this title shall be construed as authorizing substantive consolidation of the cases of affiliated debtors," section 304(f) does not mean that substantive consolidation is prohibited by PROMESA. Instead, this stands for the proposition that substantive consolidation cannot be presumed, and that until substantive consolidation is sought and ordered, the various debtors are separate, and the court is obligated to treat them as such.

[160] *See In re Cohen*, 263 B.R. 724, 726 (Bankr. D.N.J. 2001) ("In joint cases each debtor presumptively has a separate estate . . . [e]ach of the joint estates, therefore, is a separate entity . . . .").

[161] *See generally, In re WM Distribution, Inc.*, 571 B.R. 866, 872 (Bankr. D.N.M. 2017) ("Simultaneous representation of two related debtors presents a potential for an actual conflict of interest. Often inter-company transfers will exist, resulting in each debtor holding a claim against the other. Courts often find such dual representation a disqualifying actual conflict."); *see also In re Standard Brands Paint Co.*, 154 B.R. 563, 571 (Bankr. C.D. Cal. 1993) ("absent substantive consolidation, one debtor might need to object to the claims of other debtors against it, and vice versa, or seek to collect on guarantees from one debtor to another [creating] a conflict so that separate counsel would have to be employed for each of the five debtors . . . .").

105. The negotiations that occurred here reflect the opposite of this policy. The same counsel and advisors purported to negotiate the GDB Restructuring on behalf of not only GDB but also the Title III Debtors. The Title III Debtors had no independent counsel or advisor advocating for their interests or the interests of their creditors. Moreover, many of the individuals who negotiated the GDB Restructuring on behalf of AAFAF, GDB, and other parties are receiving broad releases as part of the deal, thus negating any semblance of disinterestedness. Under these circumstances, any "consent" the Title III Debtors may have given to the treatment of their claims under the GDB Restructuring Act can hardly be considered valid. In any event, GDB and the Oversight Board are not arguing that the Title III Debtors consented, but merely that the GDB Restructuring Act reflects such "consent."

106. For these reasons, the GDB Restructuring violates PROMESA section 303(1) to the extent it incorporates and gives effect to the GDB Restructuring Act. Therefore, the GDB Restructuring cannot be approved.

VII. TO THE EXTENT GDB HOLDS DEPOSITS IN TRUST FOR TITLE III DEBTORS, GDB RESTRUCTURING VIOLATES PROMESA

107. Due to the Committee's inability to obtain meaningful information from GDB, it has not been able to investigate a variety of issues that may provide further grounds for invalidating the GDB Restructuring. One such issue relates to whether and the extent to which GDB held deposits of the Title III Debtors in trust (or as "special deposits") for their benefit. If it did, then such deposits are not property of GDB that can be used by GDB as part of its restructuring.

108. The Committee has filed a motion in the Title III cases (the "Stay Motion") addressing this very issue.[162] As discussed in the Stay Motion, the Committee has reason to believe that some or all of the deposits of the Title III Debtors may be held in trust as special deposits, including because (i) GDB was a trustee for public funds held in trust for the investment needs of the government, pursuant to Puerto Rico statute;[163] (ii) public funds remain the Title III Debtors' property pursuant to the Puerto Rico Constitution,[164] which restricts the disposition of public funds such that they can only be used for public purposes and for maintaining the operation of the Commonwealth as authorized by law;[165] and (iii) public funds may be subject to a constructive trust.[166]

109. In their opposition to the Stay Motion, GDB and AAFAF deny that GDB holds any of the Title III Debtors' funds in trust or other fiduciary capacity, despite the specific statutory authorization given to GDB to act as trustee of public funds at 7 L.P.R.A. § 1281.[167] It is unclear why the Committee and other parties should be forced to rely on this denial, however, given that GDB has not provided the disclosure necessary to verify it. For example, GDB

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162 *Urgent Mot. of Official Comm. of Unsecured Creditors, Pursuant to Bankr. Code Sections 105(a) and 362, for Entry of Order Enforcing Automatic Stay and Court's June 29, 2017 Order Confirming Appl.of Automatic Stay with Respect to GDB Restructuring, In re Commonwealth of Puerto Rico*, No. 17-3283 (Bankr. D.P.R. Aug. 22, 2018) [Docket No. 3797].

163 *See* 7 L.P.R.A. § 1281 (naming GDB trustee of trusts for the investment of public fund).

164 *See* P.R. CONST. art. VI, Section 9.

165 This provision has been interpreted by the Puerto Rico Supreme Court as requiring that public funds be managed with the "highest ethical and fiduciary standards." *See* Stay Mot. Ex. B (*Jaap Corp. v. Dep't of State,* 187 D.P.R. 730, 739 (2013) (citing various)).

166 *See In re Garcia,* 484 B.R. 1, 16 (Bankr. D.P.R. 2012) *reversed on other grounds* (holding that a "constructive trust may be imposed in Puerto Rico [in connection with] property in possession of third persons that has been acquired with funds wrongfully or fraudulently obtained."(quoting *United States v. Garcia*, 532 F. Supp. 325, 332 (D.P.R. 1981)).

167 *Obj. of the Gov't Dev. Bank for P.R. and the P.R. Fiscal Agency and Fin.l Advisory Auth. to the Urgent Mot. of Official Comm. of Unsecured Creditors, Pursuant to Bankr. Code Sections 105(a) and 362, for Entry of Order Confirming Appl.of Automatic Stay with Respect to GDB Restructuring* ¶ 23 n.8, *In re Commonwealth of Puerto Rico*, No. 17-3283 (Bankr. D.P.R. Aug. 29, 2018)[Docket No. 3826].

account agreements may have created trustor-trustee relationships with "special deposit" depositors, but GDB has not provided these for the Committee's review.

110. Moreover, the attempt by GDB and AAFAF in their opposition to distinguish *Jaap Corp.*[168] is unconvincing—*Jaap's* conclusion that public funds must be managed with the "highest ethical and fiduciary standards" was not, as GDB and AAFAF assert, based on the existence of government procurement requirements, but on the text of the Puerto Rico Constitution. GDB and AAFAF fail to address the fundamental point that public funds are treated as funds held in a fiduciary capacity, and GDB cannot therefore do whatever it wants with those funds to benefit a few favored creditors.

111. In addition to any ordinary cash deposits that GDB may hold in trust for the Title III Debtors, it may also hold on deposit Federal Funds that were granted to the Title III Debtors pursuant to various federal programs. Although the Title VI Application suggests that these Federal Funds will "not be used to effect the restructuring of GDB,"[169] there is no mechanism in the GDB Restructuring for the transfer of Federal Funds from GDB to the intended beneficiaries of those funds. Rather, GDB will apparently retain and use any Federal Funds it currently holds to pay the Participating Bondholders and the closing expenses of the Title VI case. This must be so because no cash is proposed to be allocated to the Public Entity Trust for the benefit of the Title III Debtors and other Non-Municipal Government Entities. To the extent GDB holds cash relating to Federal Funds, it should not be transferred to the Recovery Authority but should instead be preserved for its intended beneficiaries.

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[168] *Jaap*, 187 D.P.R. 730.

[169] Title VI Appl. ¶ 35 n.5.

112. In summary, to the extent GDB holds funds in trust (or pursuant to "special deposit" agreements) for the Title III Debtors (whether in the form of Federal Funds or otherwise), the GDB Restructuring's use of those funds is unlawful. The Committee should at a minimum be given the opportunity to fully investigate the manner in which GDB holds the Title III Debtors' deposits before the GDB Restructuring is approved and the Title III Debtors' rights are extinguished.

VIII. GDB RESTRUCTURING VIOLATES SECTION 201(B)(1)(M) OF PROMESA

113. One of the most critical aspects of the GDB Restructuring—its proposed transfer of GDB's revenue-generating assets to the Recovery Authority for the benefit of the Participating Bondholders—violates a provision of PROMESA relating to the requirements of the Title III Debtors' fiscal plan. Specifically, section 201(b)(1)(M) of PROMESA provides that "[a] Fiscal Plan shall . . . ensure that **assets, funds, or resources of a territorial instrumentality are not loaned to, transferred to, or otherwise used for the benefit of a covered territory or another covered territorial instrumentality of a covered territory**, unless permitted by the constitution of the territory, an approved plan of adjustment under Title III, or a Qualifying Modification approved under Title VI."[170] Like all other provisions of PROMESA, section 201(b)(1)(M) supersedes any conflicting territory laws.[171]

114. The GDB Restructuring is not itself a "Fiscal Plan." Nevertheless, as recited in Article 102 of the GDB Restructuring Act, one of the key purposes of the GDB Restructuring is "to ensure compliance with the GDB Fiscal Plan."[172] In turn, the GDB Fiscal Plan (which was certified by the Oversight Board) states that it relies on the GDB Restructuring Act to effectuate

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[170] 48 U.S.C. § 2141(b)(1)(M) (emphasis added).

[171] PROMESA § 4.

the transfer of GDB's most valuable assets to the Recovery Authority, which is also a Commonwealth instrumentality.[173] In this way, the GDB Restructuring Act directly causes the Fiscal Plan to violate the prohibition on inter-government asset transfers set forth in section 201(b)(1)(M). Moreover, contrary to what the Oversight Board may contend, the Fiscal Plan is not immune from challenge under section 106(e) of PROMESA. Section 601(n)(2) of PROMESA expressly states that a Qualifying Modification is subject to challenge notwithstanding section 106(e).

115. Finally, none of the limited circumstances in which such a transfer may be allowed under section 201(b)(1)(M) are present here. First, the transfers are not permitted by the Puerto Rico Constitution, which as noted above contains a Due Process clause mirroring those set forth in the Fifth and Fourteenth Amendments to the U.S. constitution, which the GDB Restructuring violates. Second, GDB purportedly does not seek approval of these transfers in its Title VI case—indeed, GDB goes out of its way to insist that the opposite is true.[174] Third, the Commonwealth has not obtained approval of these transfers in the Title III cases.

116. Accordingly, the GDB Restructuring, to the extent it uses the GDB Restructuring Act as a basis for carrying out transactions built into the GDB Fiscal Plan, results in a violation of section 201(b)(1)(M) of PROMESA and is therefore invalid.

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[172] GDB Restructuring Act, art. 102.

[173] Uhland Decl. Ex. O, GDB Fiscal Plan, at F-7.

[174] *See* Title VI Appl., at ¶ 3 ("The PET transaction is not a component of the Qualifying Modification and GDB and AAFAF are not seeking relief or Court approval with respect to that aspect of the transaction by this Application.").

IX. COURT SHOULD NOT APPROVE PAYMENT OF TRANSACTION COSTS INCURRED IN CONNECTION WITH GDB RESTRUCTURING

117. As part of the GDB Restructuring, GDB and AAFAF seek to use approximately $80 million in cash to pay certain "transaction costs."[175] The Committee believes these transaction costs include approximately $15 million in payments on outstanding vendor claims and approximately $21 million in Excess CAE payments.[176] The remaining transaction costs of nearly $45 million presumably will be used to pay the professional fees and expenses of advisors to GDB and certain creditor groups who have executed the RSA.[177]

118. GDB and AAFAF have provided no justification for the payment of these proposed transaction costs, which notably, as to the fees of the Favored Unsecured Creditors, could not be approved in a case pending under Title III of PROMESA, and no showing has been made as to the reasonableness of the professional fees. Due to the fact that an operational wind-down of GDB has long been completed, the fees appear to be excessive. The Court should either deny approval of payment of the proposed transaction costs or, at a minimum, require GDB and AAFAF to justify the reasonableness of such costs before the GDB Restructuring is approved.

[Remainder of page intentionally left blank.]

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[175] *See* Uhland Decl. Ex. O, GDB Fiscal Plan at F-16 (showing total transaction costs of approximately $80 million).

[176] *See* Uhland Decl. Ex. O, Solicitation Statement, at E-110 (showing Excess CAE payments of approximately $21 million), 30 (showing payments to vendors of approximately $15 million).

[177] *See* Uhland Decl. Ex. C, RSA, Ex. A, at 8 (providing for payment of "professional fees and expenses of GDB, AAFAF, and the professionals to be paid pursuant to the RSA").

WHEREFORE, the Committee respectfully requests that this Court enter an order denying the Title VI Application for the reasons stated herein and granting the Committee such other and further relief as this Court deems appropriate.

Dated: September 14, 2018
San Juan, Puerto Rico

/s/ Luc A. Despins

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CERTIFICATE OF SERVICE

I hereby certify that on September 14, 2018 I electronically filed the foregoing document with the United States District Court for the District of Puerto Rico using the CM/ECF system, which electronically served a copy on all counsel of record. A copy of the foregoing document was also served by e-mail on the following parties:

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