UNITED STATES DISTRICT COURT
DISTRICT OF PUERTO RICO

CASE NO. 3:17-CV-2009-LTS-JGD

AUTONOMOUS MUNICIPALITY OF SAN JUAN,

Plaintiff,

-against-

THE FINANCIAL OVERSIGHT AND MANAGEMENT BOARD FOR PUERTO RICO, GOVERNMENT DEVELOPMENT BANK OF PUERTO RICO, and PUERTO RICO FISCAL AGENCY AND FINANCIAL ADVISORY AUTHORITY,

Defendants.

PLAINTIFF'S MEMORANDUM OF LAW IN OPPOSITION TO DEFENDANTS' MOTIONS TO DISMISS

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Plaintiff, Autonomous Municipality of San Juan ("San Juan" or "Plaintiff"), respectfully submits this Memorandum of Law in Opposition to the Corrected Motion to Dismiss of Defendants Government Development Bank for Puerto Rico ("GDB") and Puerto Rico Fiscal Agency and Financial Advisory Authority ("AAFAF"), ECF No. 101, and the Motion to Dismiss of Defendant Financial Oversight and Management Board for Puerto Rico ("Oversight Board"), ECF No. 96.

PRELIMINARY STATEMENT

This is an action to protect the rightfully owned property and other rights of San Juan for the benefit of its people. It is brought by San Juan in its capacity as beneficiary of a trust, owner of escrowed funds, and deposit holder at the GDB. While the Puerto Rico Oversight, Management, and Economic Stability Act ("PROMESA") permits debt to be restructured in Puerto Rico in response to the fiscal crisis, it does not grant institutions, like the GDB, the unfettered right to confiscate money that it does not own. Moreover, PROMESA permits impairment of bond claims only after following specific enumerated procedures, such as the establishment of separate voting pools for bondholders with different levels of priority interests. This has not occurred here.

Defendants flouted the transparency requirements of PROMESA and instead worked together behind closed doors to negotiate and certify an unlawful agreement—in defiance of federal law—to restructure the debts of the GDB (the "Restructuring Support Agreement" or "RSA"). Certain creditors of the GDB were invited to participate in these negotiations, including unsecured bondholders. San Juan was not permitted to participate or provide any input in the RSA negotiation and certification process, and its multiple requests for further information have been ignored or denied. As written, the RSA will provide the GDB's bondholders with an unlawful enhanced recovery that comes at the expense of San Juan and other municipalities of Puerto Rico.

Defendants' motions to dismiss fail on several grounds. Among other things:

- Defendants' repeated refrain that San Juan has no trust funds at the GDB is, for one thing, inconsistent with a holding by the Puerto Rico Supreme Court saying that San Juan does indeed own trust funds at the GDB, a case that is persuasive authority for this Court and binding on the GDB as a matter of *res judicata* and collateral estoppel. Indeed, Defendant Oversight Board has expressly admitted in its motion that this "is a situation where *GDB holds funds in trust, and is directed to have the trust place the funds on deposit with the GDB."* San Juan's trust funds are not the property of the GDB, and cannot be impaired under PROMESA.
- Even if the GDB somehow failed to maintain the character of the trust funds as required by law and the governing trust documents, this would not defeat San Juan's claims for breach of the trust instrument and breach of fiduciary duty. Rather, these facts would *support* such a cause of action.
- Defendants argue that they can impair San Juan's escrowed funds because these funds are allegedly in "general" deposits at the GDB without legal protection. But this assertion contradicts the allegations in the Amended Complaint, is bereft of any factual support, and ignores GDB documents listing such accounts as "Escrows." At this early stage of the case the Court must assume that San Juan's escrowed funds were deposited in separate trust accounts as alleged in the amended complaint.
- Defendants argue that San Juan is not entitled to a constructive trust by misconstruing the applicable law and by again taking liberties with the well-pled facts by asserting that the escrows are governed by a "contract" when no such contract is pled in the Amended Complaint.

- Defendants argue that San Juan has no setoff rights by asserting that the funds are *currently* subject to a third party claim, but fail to aver who is the third-party who possesses a claim against the MSJ and their only authority on the matter is a case that was dismissed with prejudice long before Defendants filed their motions. This denial flies in the face of repeated acknowledgments by the GDB, in words and actions, that such rights exist.
- Because the Oversight Board admits that the GDB is holding San Juan trust funds and none of the Defendants deny that a lien exists on those funds (indeed, the Oversight Board expressly admits that there is a "lien that results from establishing that trust") it necessarily follows that the failure to provide a separate voting pool with respect to the funds subject to that lien is a violation of PROMESA.
- Defendants cannot explain who, if anyone, will vindicate the rights of San Juan and other municipalities if, as they claim, San Juan has no standing to bring these claims and the protections of PROMESA afforded to affected "Bondholders" can simply be swept away by Commonwealth fiat. Thus, to the extent Act 109 is inconsistent with PROMESA, it is preempted.
- Finally, Defendants' arguments about ripeness (directed to only some of San Juan's claims) would turn the doctrine on its head. Courts have not required property to be finally disposed of before a conversion claims directed at that property will lie, and here San Juan should not have to wait until its funds are dissipated before bringing suit. All that is legally required is that a defendant improperly exercise dominion and control over the property to the detriment of plaintiff; here, the GDB has plainly done as much, to the detriment of San Juan and all of its residents.

RELEVANT FACTUAL BACKGROUND

Both motions improperly question facts that are pled in the Amended Complaint or invent additional "facts" that are not pled at all. At this stage of the case, creating factual disputes is improper and only demonstrates the weakness of the motions.[1] Once San Juan's well pled allegations are taken into account, it becomes clear that the motions should be denied in their entirety.

The Municipality of San Juan is the capital and most populous municipality in Puerto Rico. *See* ECF No. 88, ¶ 14. It is home to over 10,000 businesses and provides employment for over 195,000 individuals. *Id.* San Juan is responsible for providing essential services to its more than 340,000 inhabitants and the many other Puerto Ricans and visitors that travel to San Juan to work and receive services, such as health, education, and other assistance. *Id.* ¶¶ 2, 14. This responsibility increased after Hurricanes Maria and Irene hit the island in August and September 2017, greatly exacerbating financial, economic, and social problems. *Id.* ¶¶ 1-2, 117.

I. San Juan's Money at the GDB

Over its many years, the GDB has come to hold a substantial amount of funds belonging to San Juan. *Id.* ¶¶ 17, 25-26. The GDB is presently prohibiting San Juan from accessing any of its money so that the GDB can repay its own unsecured creditors in accordance with a proposed

[1] For purposes of evaluating the sufficiency of plaintiff's claims when ruling on a motion to dismiss, all allegations of material fact are taken as true and construed in the light most favorable to plaintiff. *Barron-Ruiz v. Am. Airlines, Inc.*, No. CIV. 08-1826 (DRD), 2009 WL 3160971, at *5 (D.P.R. Sept. 29, 2009). Therefore, the Court's inquiry is "limited to facts alleged in the complaint, incorporated into the complaint, or susceptible to judicial notice." *Lopez-Cruz v. Instituto de Gastroenterologia de P.R.*, 960 F. Supp. 2d 367, 369 (D.P.R. 2013) (citing *Young v. Lepone*, 305 F.3d 1, 11 (1st Cir. 2002) ("The fate of a motion to dismiss under Rule 12(b)(6) ordinarily depends on the allegations contained within the four corners of the plaintiff's complaint.")); *see also Vazquez-Marin v. Diaz-Colon*, No. CIV. 12-1177 PG, 2013 WL 6417448, at *1 (D.P.R. Dec. 9, 2013) (announcing similar standard for motion to dismiss under Rule 12(b)(1)). Subject to these narrow exceptions, material extrinsic to the Complaint cannot be considered on a motion to dismiss. *See Ortiz-Santiago v. Hosp. Episcopal San Lucas, Inc.*, No. CV 16-1099 (ADC), 2016 WL 7665778, at *1 (D.P.R. Nov. 29, 2016). *See* San Juan's accompanying Motion to Strike, which addresses some of these inappropriately injected facts.

agreement to restructure the GDB's debt. *Id.* ¶ 3. San Juan has several sources of money held at the GDB that it has used to pay for essential services, emergency assistance, capital work projects, and loan payments, including trust funds, escrowed funds, and deposits. *Id.* ¶¶ 4, 6, 26, 136.

A. CAE and Excess CAE Trust Funds

In 1991, the Legislative Assembly of Puerto Rico enacted various laws that reformed the municipal financing system of Puerto Rico, including a law that provided for the GDB to create a trust for the benefit of Puerto Rico's municipalities and a law that created the Municipal Revenue Collection Center (known as the "CRIM" to use its Spanish acronym). *Id.* ¶¶ 27-31. The CRIM is a municipal entity—independent and separate from any other agency or instrumentality of the Commonwealth—that provides municipalities a modicum of control over the collection of certain property tax revenue (known as "Special Additional Tax," "SAT," or "CAE," to use its Spanish acronym), for the benefit of different municipalities, including San Juan. *Id.* ¶¶ 4, 28. CAE that is collected on behalf of a municipality and exceeds what is required to service the annual debts of that municipality ("Excess CAE") must be disbursed to the municipality after the close of the relevant fiscal year. *Id.* ¶¶ 4, 81, 121.

In the wake of those legislative municipal financing reform enactments, San Juan requested in 1994 that the GDB remit to San Juan any CAE that was in excess of what was required to service San Juan's debt in accordance with the Municipal Loan Act in effect at the time. *Id.* ¶¶ 32-33. When the GDB refused to comply, San Juan brought suit against the GDB. *Id.* In ruling for San Juan, the Supreme Court of Puerto Rico concluded that San Juan had a property right to the Excess CAE trust funds and that neither the CRIM nor the GDB as a legal trustee had any authority to retain the Excess CAE. *Id.* ¶ 33; *see* Declaration of Julissa Reynoso, dated March 2, 2018 ("Reynoso Decl."), Exhibit ("Ex.") 1, *Mun. San Juan v. Banco Gub. Fomento*, 140 D.P.R. 873 (P.R. 1996). In pertinent part, the Puerto Rico Supreme Court explained that:

> The scheme in force at the present time, per Art. 13, *supra*, with regard to the authority of the C.R.I.M. or [GDB] to withhold the excess, is the same as what existed when the collection function was conducted by the Secretary of the Treasury. Having reviewed both the language of Art. 13 of the Municipal Loan Act, *supra*, as well as its development in recent years, we conclude that neither the C.R.I.M. nor the [GDB] as legal fiduciary have any authority whatsoever to withhold the "excess" of the C.A.E. imposed by the Municipality on its citizens, and that it therefore *lawfully belongs to said Municipality*.

Id. at 893 (emphasis added).

In 1996, as a continuation of the Legislative Assembly's enactment of reform laws created with an eye toward providing municipalities greater control over their finances, the Puerto Rico Municipal Financing Act of 1996 ("Act 64" or "MFA"), P.R. Laws Ann. tit. 21 §§ 6001-6029, was approved. *Id.* ¶¶ 27, 34. The MFA set forth the terms for a municipality to borrow money, and provided for a lien to be imposed on a municipality's CAE. *Id.* ¶¶ 34-36. The MFA required that there be a valid trust agreement in place to safeguard the municipal CAE for the benefit of municipalities. *Id.* ¶¶ 27-40. These protections were critical because of past attempts by the GDB to deprive San Juan of access to its monies. *Id.* ¶¶ 31-33, 41.

In 1997, a trust agreement was executed ("1997 Trust Agreement") by the CRIM, the Secretary of the Treasury, and the GDB. *Id.* ¶ 41-42. The 1997 Trust Agreement required the municipal CAE to be deposited in the GDB in individual accounts, corresponding to each municipality, including San Juan. *Id.* ¶ 42. This CAE would be dedicated to servicing San Juan's debt. *Id.* ¶¶ 4, 42. If the amount of CAE deposited in San Juan's trust account exceeded its debt service due that year, the GDB was required to disburse the Excess CAE to San Juan. *Id.* ¶¶ 37.

Due to concerns that the 1997 Trust Agreement might be interpreted as not fully satisfying the requirements for a valid trust agreement under Puerto Rican law, the CRIM entered into a litigation with the GDB. *Id.* ¶ 43. After several months of negotiations, the GDB agreed to

constitute a new trust and subscribed to a 2015 trust agreement (the "2015 Trust Agreement"), which currently governs the municipal CAE held in trust for the benefit of San Juan. *Id.* ¶¶ 43-44.

San Juan is a Beneficiary of the 2015 Trust Agreement between the CRIM ("Trustor") and the GDB ("Trustee"). *Id.* ¶¶ 4, 18, 44-45. The MFA and the 2015 Trust Agreement require the GDB to hold CAE in trust funds maintained in special purpose deposits of GDB for San Juan's benefit, as well as for the GDB to place Excess CAE at the disposal of San Juan. *Id.* ¶¶ 4, 18, 45, 80-81; *see* ECF No. 88-1. Specifically, in reference to the disbursement of Excess CAE, the MFA provides:

> Once the reserve or the portion equivalent to the payment for the subsequent twelve (12) months of principal and interest of the loan is assured, and once the payment of the municipal public debt is guaranteed, as determined by the [GDB], in the event there is a surplus in the Municipal Public Debt Redemption Fund, *the [GDB] shall be bound to place said surplus at the disposal of the municipality.* The surplus can be requested once during each fiscal year. *Id.* ¶ 37 (emphasis added).

The 2015 Trust Agreement enumerates the responsibilities of the GDB as Trustee, how the CAE funds should be held in trust by the GDB, and how CAE trust funds and Excess CAE trust funds should be used to benefit the municipalities. *Id.* ¶¶ 45-48, 80-1, 158-60. The key provisions of the 2015 Trust Agreement include:

- Section 2, which states that it is an "irrevocable trust" created "to the benefit of the Beneficiaries" with an "indefinite" duration."[2] *Id.* ¶ 158.
- Section 5, which enumerates that the trust funds are totally autonomous property, separate from the property of the CRIM or the GDB, and exempt from action of creditors. *Id.* ¶¶ 46, 80.
- Section 6, which sets forth the responsibility of the Trustee to "keep separate accounts and books for each of the Funds and Sub-funds [of the Trust]." ECF No. 88-1 at 9.
- Section 10, which states that the GDB will remit any Excess CAE to San Juan. ECF No. 88 ¶¶ 121, 160.

[2] Section One of the 2015 Trust Agreement defines Beneficiaries as "the Municipalities of Puerto Rico and the State, but the State only in relation to the corresponding Assets that have been included in the State Redemption Fund."

B. Escrowed Funds

San Juan has approximately $83.3 million in undisbursed escrowed funds from approved loans from the GDB to San Juan. *Id.* ¶ 169. These escrowed funds are held at the GDB in various duly segregated "special accounts" set up to fund the development of particular capital work projects. *Id.* ¶¶ 38-39, 169. Payments for different projects are drawn from specific corresponding capital work project escrow accounts. *Id.*

Article 15 of Regulation 8749 of the GDB, Municipal Financing Regulation, dated April 18, 2016, reaffirms the existence and creation of special accounts at the GDB for San Juan's escrow monies: "GDB shall deposit the product of each Municipal Obligation in a ***special account*** duly segregated and identified for such obligation and for the purpose or purposes authorized in the resolution or ordinance." *Id.* ¶ 39 (emphasis added); Reynoso Decl., Ex. 2.

C. Deposits

In addition to its trust funds and special account escrows, San Juan has funds held in deposits at the GDB. *Id.* ¶¶ 6, 52.

II. GDB's Withholding of San Juan's Funds

The GDB has been withholding almost all of San Juan's funds, purportedly on the basis of various moratorium orders, since April of 2016. *Id.* ¶ 3, 49-52; Act 21-2016 ("Moratorium Act"). The Governor also issued two executive orders, OE 2016-10 and OE 2016-14, whose effective terms were subsequently extended, which the GDB has relied on to stop virtually all transfers and withdrawals of funds by municipalities out of the GDB. *Id.* ¶ 49.

III. The Proposed Restructuring of GDB Debt under PROMESA and the RSA

On June 30, 2016, President Barack Obama signed into law PROMESA 48 U.S.C. §§ 2101-2241, to assist U.S. territories and their instrumentalities with restructuring debt. *Id.* ¶¶ 53-57. PROMESA established the creation of the Oversight Board to oversee Puerto Rico's finances and

economic recovery. *Id.* ¶¶ 16, 54. This case involves one of PROMESA's restructuring tools: Title VI, a voluntary negotiation process for restructuring bond claims with less than unanimous support of affected bondholders. *Id.* ¶¶ 54-57. PROMESA outlines the discrete steps for a Title VI debt proposed "Modification" of bond debt, including a voting mechanism that requires creditors with different levels of security and priority vote in separate voting pools. *Id.* ¶¶ 59-65.

Defendants GDB and AAFAF worked with certain GDB creditors, which appear to consist almost entirely of the GDB's public, unsecured bondholders and a smaller group of Puerto Rico-based credit unions holding GDB bonds, to negotiate and execute the RSA to provide for a restructuring of GDB's debts under Title VI of PROMESA. *Id.* ¶¶ 3, 66-69; ECF No. 88-2. Defendants GDB and AAFAF excluded San Juan and other municipalities from the negotiations. *Id.* ¶¶ 7, 67. Defendants GDB and AAFAF also rejected San Juan's requests for information about the RSA. *Id.* ¶¶ 7, 97-102.

Defendants then attended and participated in a closed door executive session without any input from San Juan. *Id.* ¶¶ 103, 106. As a result, on July 14, 2017, the Oversight Board conditionally certified the RSA making it a "Qualifying Modification" under Title VI. *Id.* The Oversight Board subsequently published a Certification Resolution confirming that the Oversight Board did not undertake any independent review or valuation of the assets that were being transferred by the GDB, and revealing that the Oversight Board relied on challenged and unverified statements in AAFAF's undisclosed letter in its certification decision. *Id.* ¶¶ 103-04, 106-09.

Following the hurricanes that hit Puerto Rico, another round of RSA negotiations apparently took place. *Id.* ¶ 7. San Juan continued to be excluded from participation in the RSA negotiations. *Id.*

A. PROMESA Enumerated Voting Procedure for RSA Approval

PROMESA requires the establishment of separate voting pools to vote on whether the RSA should be approved "corresponding to the relative priority or security arrangements of each holder of Bonds." *Id.* ¶¶ 61-63; PROMESA § 601(d)(3)(a). The RSA groups San Juan and the other municipal depositors together with all the GDB's other creditors in one single voting pool irrespective of their priority, security arrangements or liens. *Id.* ¶¶ 8-9, 138-39.

B. Proposed Modification of San Juan's Money Under the RSA

The RSA appropriates San Juan's trust funds and escrowed funds to pay GDB creditors. *Id.* ¶ 5. The RSA provides for a "settlement" of Excess CAE trust funds that will give San Juan 55% of the Excess CAE funds it owns, and the exchange of CAE trust funds for new bonds worth a fraction of the value. *Id.* ¶¶ 5, 119. For San Juan to receive these proceeds, it must first execute a settlement agreement with the GDB releasing the GDB and the issuer from any related claims or causes of action, as well as to "voluntarily" elect to participate in one of the tranches of new bonds enumerated in the RSA. *Id.* ¶¶ 5, 82, 119. If San Juan refuses to satisfy these conditions, and the RSA becomes effective, all of San Juan's Excess CAE trust fund property will be impaired and its CAE funds held in trust will be compulsorily exchanged into the least valuable category of newly issued bonds. *Id.* ¶¶ 13, 72-78, 82-83.

The RSA does not acknowledge any right of San Juan to setoff its deposits at the GDB against the amount of its outstanding loans to the GDB, notwithstanding the fact that the GDB previously acknowledged and allowed such setoffs. *Id.* ¶ 89. Specifically, prior to the change in Puerto Rico's gubernatorial administration in 2017, the GDB did not ask municipalities to send money to the GDB when their payments came due. *Id.* Rather, the GDB regularly used money that was already at the GDB as a setoff to whatever loan payments were then due. *Id.* In November of 2016, for example, the GDB informed the CRIM Board that it would not be requiring the CRIM

to disburse funds for a payment due on July 1, 2017 because the monies for the payment were already at the GDB and therefore a setoff would be effected. *Id.*; *see also* ECF No. 88-3 (CRIM Board, Act 2017-05 at 41). Under the new gubernatorial administration, however, the GDB has shifted position (legally and politically). *Id.* ¶¶ 90-91. The GDB no longer permits municipalities to offset their deposits against loan payments, but instead takes the position that the only offset it will permit relates to undisbursed portions of municipal loans. *Id*. In other words, the GDB admits that undisbursed portions of loans to municipalities can be setoff against the municipality's debt to the GDB, thus acknowledging at least some setoff rights of San Juan. *Id.*

C. Puerto Rico Act 109

San Juan's original complaint against the Defendants was filed on July 26, 2017. *See* ECF No. 1. Approximately one month after San Juan commenced this action, the Governor signed into law Puerto Rico Act 109-2017 ("Act 109"), which provides, in part, that "[n]otwithstanding any other law of the Government of Puerto Rico, no Government entity shall have authority or standing to challenge this Act, the Restructuring Transaction, or the other transactions contemplated in this Act in any local or federal court." *Id.* ¶ 11. The GDB has taken the position that Act 109 prohibits San Juan from challenging the RSA. *Id.*

IV. Denial for Disbursement of San Juan's Funds to Provide Essential Services and Emergency Assistance in the Wakes of Hurricanes Irene and Maria

By October of 2017, in the wakes of Hurricanes Irene and Maria, San Juan had expended more than $46.7 million to provide essential public services and emergency assistance in response to the hurricanes. *Id.* ¶ 2. San Juan then requested a disbursement from the GDB in the amount of $21 million from its deposits in order to continue to fund these essential services and emergency assistance. *Id.* ¶ 117; *see* ECF No. 88-10. This request was consistent with San Juan's previous requests for such disbursements and GDB's past practice of fulfilling these requests as recently as

April 2017. *Id.* ¶¶ 115-16. Given the urgency of the humanitarian crisis, San Juan requested a prompt written response. *See* ECF No. 88-10. The GDB completely ignored San Juan's request. *See* ECF No. 88 ¶ 117.

STANDARDS OF LAW GOVERNING DEFENDANTS' MOTIONS TO DISMISS

Defendants move to dismiss Plaintiff's Amended Complaint pursuant to Rules 12(b)(1) and 12(b)(6) of the Federal Rules of Civil Procedure. There is no basis for granting the Motions to Dismiss under either Rule.

To survive a motion to dismiss under Rule 12(b)(6), a plaintiff's allegations must merely "raise a right to relief above the speculative level." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555 (2007); "There need not be a one-to-one relationship between any single allegation and a necessary element of the cause of action. What counts is the 'cumulative effect of the [complaint's] factual allegations.'" *Rodriguez-Reyes v. Molina-Rodriguez*, 711 F.3d 49, 55 (1st Cir. 2013). The Court must accept all non-conclusory factual allegations as true. *Ocasio-Hernández v. Fortuño-Burset*, 640 F.3d 1, 12 (1st Cir. 2011); *TLS Mgmt. v. Rodriguez-Toledo*, 260 F. Supp. 3d 154, 164 (D.P.R. 2016) ("factual dispute[s] may not be resolved when evaluating a motion to dismiss for failure to state a claim"); *see also* n. 1, *supra.* Dismissal is only appropriate "if it is transparently clear that the complaint, in light of the facts alleged, engenders no viable theory of liability." *Centro Medico del Turabo, Inc. v. Feliciano de Melecio*, 406 F.3d 1, 6 (1st Cir. 2005). A motion to dismiss under Rule 12(b)(1) is analyzed under a similar standard as a motion to dismiss under Rule 12(b)(6) because "the Court accepts the complaint's well-pled facts as true and views them—and inferences drawn from them—in a light most favorable to the pleader." *Mercado-Reyes v. Vazquez Home Care, CRL*, 254 F. Supp. 3d 316, 317 (D.P.R. 2017).

ARGUMENT

I. THE AMENDED COMPLAINT SETS FORTH A CLAIM THAT THE GDB BREACHED THE TRUST AGREEMENT AND ITS FIDUCIARY DUTIES AS TRUSTEE

A. The Amended Complaint Establishes the Existence of CAE Funds and Excess CAE Funds Held in Trust for the Benefit of San Juan

In an attempt to justify the confiscation of money that belongs to the people living in Puerto Rico's storm-ravaged municipalities, Defendants argue that the 2015 Trust Agreement "show[s] that the Redemption Fund [at the GDB] was never designed to hold [CAE and Excess CAE] funds in trust," (ECF No. 101 at 26), and that San Juan's trust funds are really "loans" in the nature of "general deposits" that are subject to restructuring for the benefit of GDB's creditors. *Id.* at 18-19; ECF No. 96 at 20. As a threshold matter, this argument flies in the face of the decision of the Puerto Rico Supreme Court, ***rendered against the GDB and in favor of San Juan,*** holding that indeed Excess CAE funds "lawfully belongs to [San Juan]." Reynoso, Decl., Ex. 1, *Mun. San Juan*, 140 D.P.R. at 893. Not only is this decision persuasive authority for the Court based on principles of federalism[3] and binding on the GDB based on principles of *res judicata* and collateral estoppel,[4] but the trust protections over the Excess CAE funds in favor of San Juan have only ***increased*** since the date of the 1996 Puerto Rico Supreme Court decision.

Among other things, the parties have now executed the 2015 Trust Agreement. San Juan has alleged that the parties to the 2015 Trust Agreement expressly intended to create a valid trust (ECF No. 88, ¶¶ 43-44) with the further intent that the funds be used solely for the express purposes

[3] *See Ondine Shipping Corp. v. Cataldo*, 24 F.3d 353, 357 (1st Cir. 1994) ("a state's highest court is the best authority on the meaning of a state statute"); *United States v. Deya*, 369 F. Supp. 1113, 1115 (D.P.R. 1974) ("Rules of property ownership fall under the realm of state law to which the federal courts must normally defer. These courts are also bound to follow the authoritative construction of such rules by state courts.").

[4] *See Ramallo Bros. Printing v. El Dia, Inc.*, 490 F.3d 86, 89–90 (1st Cir. 2007) ("when an issue of ultimate fact has once been determined by a valid and final judgment, that issue cannot again be litigated between the same parties in any future lawsuit").

of: 1) servicing San Juan's debt to the GDB; and (2) disbursing any amounts not needed to service the debt for the subsequent 12 months ("Excess CAE") to San Juan. *See* ECF No. 88, ¶ 4. Specifically, to ensure the creation of a valid trust, the CRIM brought suit against the GDB on June 29, 2015. *See* ECF No. 88, ¶ 43. That suit ended only after the parties reached a negotiated settlement, whereby the GDB entered into the 2015 Trust Agreement providing that the Trust assets "constitute a *totally autonomous property*, separate from the personal properties of the Trustor, the Trustee and the Beneficiaries," (ECF No. 88-1 at 38 (Sec. V)), and that "the Trustee shall keep separate accounts and books for each of the Funds and Sub-funds." ECF No. 88-1 at 31 (Sec.VI). Given this history, Defendants' internally inconsistent[5] assertion that trust funds are not actually trust funds not only ignores binding case law but at best raises disputed issues of material facts as to how the parties intended to treat the funds.

Defendants next argue that the trust funds were invested in the GDB as *general* deposits, and that this action eviscerated the trust nature of the funds (ECF No. 101 at 18-19; ECF No. 96 at 19-20). The fundamental, and fatal, problem with this argument is that this "fact" is fabricated out of whole cloth and is unsupported by any citation to any allegation in the Amended Complaint. What is worse, this invented "fact" is entirely inconsistent with contrary allegations in the Amended Complaint. Indeed, it is even inconsistent with the admission of the Oversight Board in its brief that the combination of the MFA and the 2015 Trust Agreement creates a "situation where GDB holds funds in trust . . . ." ECF No. 96 at 24.

San Juan specifically alleged that the GDB "holds *special deposits held in trust* at the GDB pursuant to Act 64 [the MFA] and the 2015 Trust Agreement." ECF No. 88, ¶ 26 (emphasis

[5] At one point the Oversight Board plainly concedes that the funds held by the GDB for San Juan are indeed trust funds, admitting that this "is a situation where *GDB holds funds in trust, and is directed to have the trust place the funds on deposit with the GDB.*" ECF No. 96 at 24 (emphasis added).

added). The GDB agreed that it would hold San Juan's monies for, among other things, the specific purpose of ensuring "payment of the debt service on loans whose source of payment is CAE that have been granted and are in the [GDB] financial portfolio," (ECF No. 88, ¶ 45), and also disbursing Excess CAE. *See* ECF No. 88-1. As a result, San Juan's trust funds were never available to be payable on demand or withdrawn at will. *Id*. Under Puerto Rican law with respect to such deposits "the depositor continues as owner and . . . it may be recognized as a trust deposit." *See* Reynoso Decl., Ex. 3, *Treasurer v. Banco Comercial de Puerto Rico*, 46 P.R.R. 298, 306 (P.R. 1934); *see In re Almacenes Gigante, Inc.*, 159 B.R. 638, 643 (Bankr. D.P.R. 1993) (emphasis added). This is because "[w]hen the bank assumes the obligation of dedicating the funds to the intended purpose, there can be no transfer of title, for the bank lacks authority to dispose of the funds." *Treasurer,* 46 P.R.R. at 306; *see also In re K.D. Builders, Inc.*, 382 B.R. 1, 5 (Bankr. D. Mass. 2008) ("Where a depositor pays funds to a bank with an expressed purpose that the funds shall be used for a particular purpose, then the funds may be deemed to be held in trust."). In light of the foregoing, San Juan has pled sufficient facts showing that the monies deposited in the GDB in connection with the 2015 Trust Agreement are special deposits that remain San Juan's property. *See Treasurer,* 46 P.R.R. at 306; *In re Almacenes Gigante, Inc.*, 159 B.R. at 643.

While Defendants rely upon *Portilla v. Banco Popular de Puerto Rico*, 75 D.P.R. 100 (1953), and *Santos de Garcia v. Banco Popular*, 172 D.P.R. 759 (2007), in arguing that San Juan's trust funds should not be treated as trust assets, neither of these cases is apposite, as they both involved checking accounts with funds not designated for particular purposes. In stark contrast, here, the facts alleged show that "[t]he essential element of a general deposit, that it should be payable on demand, is absent." *See Taylor v. Picher*, 13 F. Supp. 857, 859 (D. Me. 1936). Under such circumstances, "[h]aving expressly undertaken to act as trustee, and having so acted for many

years . . . the bank cannot properly deny the beneficiary the protection [it] had at the time of the closing of the bank," and the Court should reject Defendants' attempt to recharacterize the trust monies. *Id.* Invention of facts aside, Defendants' argument that there are no trust funds fails to give effect to the CRIM's intent in executing the 2015 Trust Agreement on behalf of the municipalities of Puerto Rico, and would render the 2015 Trust Agreement a nullity. And it is precisely the intention and understanding of the parties that determines the character of deposit (general or otherwise). *Taylor*, 13 F. Supp. at 859. The parties, as memorialized in the Trust Fund, clearly never intended for trust funds to be invested in *general* deposits of the Bank or to lose their protection as trust assets. *See Cassedy v. Johnstown Bank*, 246 A.D. 337, 339–40 (App. Div. 1936) (explaining that it was "for the depositor to determine whether [the deposits] were for a special or general purpose").

Attempting to counter the evident intent that the Excess CAE funds were to be held in trust, Defendants rely upon a provision of the 2015 Trust Agreement that provides that trust funds shall be "maintained invested in deposits of the bank [GDB]." ECF No. 101 at 18 n. 9; ECF No. 96 at 19. But Defendants take this language out of context from the relevant provision of the 2015 Trust Agreement, which provides as follows:

> Section VII: Initial Capital of the Trust: The Bank hereby contributes and *irrevocably transfers to the Trust* all funds deposited with the Bank and which correspond to the SAT [CAE], . . . The parties agree that said funds, derived from the SAT [CAE], which, upon the execution of this instrument, are deposited with the Bank, shall immediately be transferred to the SAT-GDB Sub-fund and be maintained invested in deposits of the Bank until such time as the MRCC [CRIM] and the Bank agree otherwise.

ECF No. 88-1 at 39 (emphasis added). Given this language providing for the creation of a separate "Sub-fund" to accept the transfer "to the Trust," it would be rank speculation to suppose, as

Defendants do, that CAE funds were intended to be (and were) placed only in general deposits.[6] In this regard, Defendants' contention that the trust funds are "general deposits" would require the Court to ignore the pled facts and the governing trust agreement language in contravention of the principles governing motions to dismiss. *See Solis-Alarcon v. United States*, 432 F. Supp. 2d 236, 252 (D.P.R. 2006) ("[T]he applicable standard requires that we turn to the allegations in the complaint, and not the allegations in a motion to dismiss, to decide whether dismissal pursuant to Rule 12(b)(6) is warranted."). Defendants' motions as to the trust fund monies thus fail for their disregard of well-pled facts regarding the intent of the parties creating the trust, the governing trust document, and the nature of the funds where the trust monies were invested.[7] At a minimum, if for any reason the Court determines that any legal requirements for the formal formation of the trust were lacking (which San Juan does not believe can be done in the context of a motion to dismiss), the Court should grant San Juan leave to plead that it has a constructive trust with respect to the CAE and Excess CAE funds held at the GDB (with expert legal opinion on the law of Puerto Rico if it would assist the Court).

[6] Indeed, even if the funds were placed in general deposits that would not defeat San Juan's claims. For one thing, The Puerto Rico Trust Act, Act 209-2012, Section 24, provides that the trustee representing a trust shall have the power to invest the trust money and "deposit trust money in any bank, even when the bank selected is operated by the trustee" in its administration of a trust. And there is no provision in the Trust Act that suggests that doing so will eviscerate the trust nature of the funds. For another thing, if it turns out (after discovery) that the GDB in fact failed to maintain the required Trust-Sub Fund, this would ***further support*** San Juan's causes of action as to the GDB's breach of contract and of its fiduciary duty rather than defeating those claims.

[7] The Defendants' position that the monies are not really trust fund monies is also contrary to the GDB's prior recognition that CAE funds and Excess CAE funds were held in trust in a letter to San Juan, dated June 20, 2017, appending an account statement from the GDB reflecting trust funds pertaining to San Juan that the GDB represented it was holding as of May 31, 2016. *See* ECF No. 35-6. *See Roach v. Option One Mortg. Corp.*, 598 F. Supp. 2d 741, 747 n. 8 (E.D. Va, 2009) ("It is well-settled, of course, that judicial notice… may be taken of facts 'not subject to reasonable dispute,' including party admissions and other statements in public court records.")

B. The Amended Complaint Establishes that the GDB Has Breached its Contractual and Fiduciary Duties

Defendants' sole argument in support of dismissing Counts VII and VIII is based on the invented "fact" that San Juan only has "general" deposits at the GDB. *See* ECF No. 101 at 26. For the reasons discussed above, the Court cannot disregard San Juan's pleadings to the contrary. Assuming, *arguendo*, that San Juan's funds were indeed placed into "general" deposits by the GDB, however, this would not assist Defendants with their motions. Rather, it would preclude dismissal of San Juan's claims for GDB's breach of the trust agreement and its fiduciary duty.

Pursuant to the 2015 Trust Agreement, the GDB agreed that "as trustee of the [Fondo], [it] shall pay the principal and interest of the municipal general obligation bonds or promissory notes and the interest of all promissory notes in anticipation of municipal general obligation bonds of the municipality from the [CAE] funds deposited into the account of the municipality in the [Fondo]." ECF No. 88-1 at 42. Plaintiff has alleged that the GDB has refused to use the monies in the trust fund for this purpose and that the GDB has no intention of complying with its fiduciary and contractual duties to Puerto Rico's municipalities. ECF No. 88, ¶¶ 161, 162, 166. The GDB's response admits just that, taking the position that these funds are just loans. ECF No. 101 at 19.

Under Puerto Rican law, a trustee has a fiduciary duty to "[a]dminister the trust in good faith in accordance with the terms and purposes thereof, the provisions of this chapter, and the best interest of the beneficiary . . . ." 32 L.P.R.A. § 3352. As such, a trustee who is in the position to control trust assets and does not preserve them for the beneficiary has breached a fiduciary duty. *Id.* Any failure of the GDB to maintain San Juan's trust funds in appropriate accounts to protect their status as such would create an issue of fact as to whether GDB's actions created a breach of its basic fiduciary duty to administer the trust in the best interest of its beneficiary, rendering this Court unable to resolve these issues in the context of a motion to dismiss.

Similarly, any failure by the GDB to segregate the trust funds in the SAT-GDB Sub-fund, as required by the 2015 Trust Agreement, would constitute a violation of its contractual obligations. *See* ECF No. 88-1. In any event, by attempting to use the trust monies to pay its own debts under the RSA, the GDB has violated its contractual obligation to use the monies in the trust fund to pay the principal and interest of the municipal general obligation bonds and promissory notes. In light of the foregoing, the Court should reject Defendants' arguments for dismissal of Counts VII and VIII of the Amended Complaint.

C. The Amended Complaint Properly Establishes that the RSA Unlawfully Takes CAE and Excess CAE Trust Funds

As with the counts discussed above, Defendants' principal argument for dismissal of Counts I and II is that San Juan's deposits are not "trust funds" and are therefore "loans" subject to restructuring under Title VI of PROMESA. *See* ECF No. 101 at 18-19; ECF No. 96 at 20. For the reasons set forth above, that argument does not justify dismissal of Counts I and II.

II. THE AMENDED COMPLAINT SETS FORTH A CLAIM THAT ESCROWED FUNDS AT THE GDB ARE THE PROPERTY OF SAN JUAN AND NOT SUBJECT TO RESTRUCTURING

A. San Juan Has Adequately Pled the Existence of Escrowed Funds Held in Special Accounts at the GDB

The GDB has also refused to release San Juan's escrowed funds (*i.e.*, undisbursed proceeds from loans that the GDB has purportedly made to San Juan but are sitting in accounts at the GDB, who will not release them). ECF No. 101 at 27-28. As alleged in the Amended Complaint, however, San Juan's escrowed funds are the property of San Juan. *See* ECF No. 88, ¶ 170. That is because escrowed funds, similar to trust funds, are not the property of an estate for purpose of an ordinary restructuring procedure. *See, e.g.*, *In re NTA, LLC*, 380 F.3d 523, 531 (1st Cir. 2004). The GDB argues that the escrowed funds, like San Juan's trust funds, are mere "general" deposits without legal protection and thus subject to impairment under the RSA. *See* ECF No. 101 at 28.

To accept this argument, however, the Court would have to determine both that San Juan did not intend to create special deposit escrow accounts with the GDB, and that the GDB did not in fact create such accounts in accordance with that intent, contrary to the allegations in the Amended Complaint. This is a bridge too far for the Court to cross on a motion to dismiss.

Here, San Juan alleged the existence of escrowed funds deposited in special accounts at the GDB, from which payments related to capital works projects for the benefit of the people of San Juan would be made. *See* ECF No. 88, ¶ 169. These escrowed funds were deposited into different special accounts with the GDB "for each obligation from which advancements [were] requested" for the very specific purpose of ensuring that "payments pertinent to the purposes of said obligation [were] drawn from said account." ECF No. 88, ¶¶ 38-39; 21 L.P.R.A. § 6008a(d); Reynoso Decl., Ex. 2, Art. 15 of Regulation 8749 of the GDB ("GDB shall deposit the product of each Municipal Obligation in a special account duly segregated and identified for such obligation and for the purpose or purposes authorized in the resolution or ordinance.").

The GDB contends that these monies are not actually escrowed funds because they were deposited in an "ordinary checking account" and "checking accounts . . . do not create a trust relationship and that a bank may use the funds in these accounts for any purpose." *See* ECF No. 101 at 28. But the GDB cites no support for the proposition that the mere fact that checking privileges may be associated with a special account thereby causes that account to lose its escrow status. The case law is to the contrary. *See, e.g.*, *U. S. Nat. Bank of Or. v. Am. Escrow, Inc.*, 250 F. Supp. 302, 304–05 (D. Or. 1965) (holding that funds deposited in a commercial checking account for specific purposes were deposited in escrow).

Defendants' argument also improperly ignores allegations in the Amended Complaint that San Juan's escrowed funds were deposited into ***specific*** accounts at the GDB, which the GDB, as

the escrow agent/depository, was to disburse only for particular capital work projects pursuant to the MFA. *See* ECF No. 88, ¶169. It is this fact, not the manner in which funds may be accessed (*e.g.*, by wire transfer, check or otherwise), that matters to the escrow status. For instance, Black's Law Dictionary simply defines an escrow account in banking as "a special account for holding specific monies for disbursement under specific conditions." Under the MFA, the GDB, as the escrow agent/depository, had the responsibility to maintain different escrow accounts corresponding to San Juan's different capital work projects. *See* ECF No. 88, ¶¶ 38-39, 169; 21 L.P.R .A. § 6008a(d). The money in the different accounts could not be commingled and funds from one escrow account could not be disbursed for any purpose except to fund the specific project the escrow account was created to fund. *Id.* Indeed, the GDB is collecting interest from San Juan on these escrowed funds, acting as if the funds belong to San Juan. And the GDB previously acknowledged the escrow nature of many of the accounts at issue in correspondence with San Juan, detailing approximately $83.3 million in 25 different accounts labeled "Escrows" with specific escrow account numbers. *See* ECF No. 88, ¶ 172; ECF No. 35-6. These admissions and well-pled facts show that the escrowed funds are the property of San Juan, directly contrary to Defendants' argument (bereft of any factual support) that the GDB was permitted to "use the funds in those accounts for any purpose." ECF No. 101 at 28; *see, e.g., Treasurer*, 46 P.R.R. at 306; *In re Almacenes Gigante, Inc.*, 159 B.R. at 643.

B. San Juan is Entitled to a Constructive Trust

Apart from a straightforward application of the law, San Juan is also entitled to its escrowed funds under principles of equity, which, at a minimum, require the imposition of a constructive trust over such funds. To attempt to defeat this claim, Defendants rely on an unsupported reading of Act 219-201 ("the Trust Act") to argue that the constructive trust remedy is no longer viable under Puerto Rican law. *See* ECF No. 101 at 27; ECF No. 96 at 33. But this is an inaccurate

understanding of Puerto Rican law. To begin with, the Trust Act had *nothing whatsoever to do with constructive trusts.* Rather, this Act replaced articles 834 to 874 of the Civil Code, which concerned the formation of *express* trusts. It did not alter Article 7 of the Civil Code, which serves as the basis of the constructive trust remedy under Puerto Rican law. *See* § 71 of Act 219-2012, available at http://www.oslpr.org/download/en/2012/A-0219-2012.pdf.

Defendants do not point to a single provision in the Trust Act suggesting that there was an intent to abolish the constructive trust remedy.[8] Nor would such a provision be expected in that context, given that constructive trusts, by their very nature, are not based on statutes but on principles of equity. *See* 31 L.P.R.A. § 7 ("When there is no statute applicable to the case at issue, the court shall decide in accordance with equity."); *Puerto Rico Tourism Co. v. Priceline.com, Inc.*, No. 3:14-CV-01318 JAF, 2015 WL 5098488, at *7 (D.P.R. Aug. 31, 2015) ("constructive trust, under the right circumstances, is authorized under P.R. Laws Ann. tit. 31, § 7"); ECF No. 96-4, *Ruiz v. Ruiz*, 61 P.R.R. 794, 799 (P.R. 1943). Under well-established rules, constructive trusts are devices employed in equity to prevent unjust enrichment where express remedies are not available. *See* The Restatement First, Restitution § 160 (Constructive Trust) ("Where a person holding title to property is subject to an equitable duty to convey it to another on the ground that he would be unjustly enriched if he were permitted to retain it, a constructive trust arises."). They are "not a conventional formal trust established with a named trustee, named beneficiary and a specific object . . . [but] a court-imposed device, essentially remedial in purpose, to achieve

[8] Indeed, to the contrary, Act 209-2012 includes a provision comparable to Article 7 of the Civil Code that would allow this Court to recognize the continued vitality of the constructive trust doctrine. *See* 32 L.P.R.A. § 3355 ("Should there be any issue that this chapter fails to provide for, or if any of its provisions require interpretation, U.S. doctrines and case law regarding trusts shall govern unless something else is necessarily inferred from any of the provisions of this Act or if there is an express referral to Puerto Rico legislation.").

equitable restitution . . . ." *Zimmermann v. Epstein Becker & Green, P.C.*, 657 F.3d 80, 83 (1st Cir. 2011). As explained by the First Circuit, "[t]he central objective [of constructive trusts] is to prevent unjust enrichment . . . commonly if not invariably based on the possessor's improper acquisition of the claimant property." *Id.*

Given this legal framework, it is not surprising that courts continue to find that constructive trust claims are actionable since the 2012 reform. *See Puerto Rico Tourism Co.*, 2015 WL 5098488, at *7 (noting that constructive trusts continue to be authorized under Puerto Rican law after the Trust Act). Puerto Rican courts have a long history of recognizing constructive trusts as a means of protecting a party's interests where there was no protection under statutory law. *See, e.g., In re Garcia*, 484 B.R. 1, 16-17 (Bankr. D.P.R. 2012), *rev'd*, 507 B.R. 32 (B.A.P. 1st Cir. 2014) (noting the Supreme Court of Puerto Rico "circumscribed the use of constructive trusts to 'situations not foreseen by strict law'" and "[p]ursuant to Puerto Rican jurisprudence, a constructive trust doctrine is only applicable to 'situations not foreseen by strict law'"); *Corporacion Insular de Seguros v. Reyes-Munoz*, 849 F. Supp. 126, 135 (D.P.R. 1994) (writing that imposition of constructive trust is an appropriate remedy for unjust enrichment "because it protects the true property owner's interest," and noting that "Puerto Rico also recognizes the creation of constructive trusts"); Reynoso Decl., Ex. 4, *Porrata v. Fajardo Sugar Company of P.R.*, 57 P.R.R. 615, 629-30 (P.R. 1940). Defendants' request for this Court to interpret the Trust Act as eliminating this important right by mere implication runs contrary to basic norms of statutory interpretation, and should be rejected. *See Whitman v. American Trucking Association*, 531 U.S. 457, 468 (2001) (Congress does not "hide elephants in mouseholes"); *Soba, v. Fitzgerald, et al.*, No. RE-88-283, 1992 WL 754947 (P.R. Mar. 2, 1992) ("our system does not favor tacit repeals").

The GDB asserts a secondary argument: even if establishment of a constructive trust was a viable remedy under Puerto Rican law, it should fail because Plaintiffs supposedly have failed to plead the necessary elements of a constructive trust. To that end, the GDB first argues that the constructive trust remedy should not be available, as there is a contract governing the property at issue. For support, the GDB cites to *In re Garcia*, *supra*, wherein the court found that a constructive trust claim was inappropriate because there were written contracts between the parties and the party seeking the constructive trust had failed to raise the constructive trust equitable remedy in its pleadings. The GDB's reliance on *Garcia,* however, fails for two reasons.

First, San Juan has, of course, properly pled the equitable remedy of a constructive trust in the Amended Complaint. *See* ECF No. 88, ¶ 173. San Juan has alleged the existence of at least $83.3 million that can be traced to escrow accounts held at the GDB. *See* ECF No. 88, ¶ 169.[9] Pursuant to the MFA, the GDB, acting as the escrow agent, had the responsibility to maintain different escrow accounts and make disbursements to San Juan for particular capital work projects in accordance with the specific terms of each escrow account. *Id.* ¶ 38; Reynoso Decl., Ex. 2, Art. 15 of Regulation 8749 of the GDB. The RSA, as drafted, unjustly enriches the GDB by improperly treating San Juan's escrowed funds—San Juan's property—as part of GDB's estate for purposes of restructuring. *See* ECF No. 88, ¶ 171. To prevent such unjust enrichment, a constructive trust should be imposed to protect San Juan's interest in its property. *See Reyes-Munoz*, 849 F. Supp. at 135; *Porrata*, 57 P.R.R at 629-30.

Second, the GDB's argument assumes "facts" that are not pled. While the GDB baldly asserts that "there are written contracts between GDB and Plaintiff" governing the escrow funds at issue here, their only citation for this alleged "fact" is paragraph 35 of the Amended Complaint.

[9] The GDB has admitted the existence of 25 different escrow accounts held at the GDB. *See* ECF No. 35-6.

But paragraph 35 says no such thing, alleging simply that "[t]o borrow under Act 64, a municipality approves an *ordinance* which sets forth the terms of the bond." ECF No. 88, ¶ 35. The GDB does not provide any factual or legal support for the proposition that such municipal ordinances are "contracts" that are capable of defeating constructive trusts.

Defendants also attempt to graft a tracing requirement onto Puerto Rican law. *See* ECF 101 at 28. But the case that they rely upon expressly notes that such requirement is imposed in federal bankruptcy proceedings as a matter of *federal law*. *See Connecticut Gen. Life Ins. Co. v. Universal Ins. Co.*, 838 F.2d 612, 618–19 (1st Cir. 1988) (noting "because [tracing] pertains to distribution of assets from an entity in federal bankruptcy proceedings, [it] is exclusively a question of federal law"). Defendants cite no authority showing that such a tracing requirement is imposed under the applicable Puerto Rican law. Even if tracing were a requirement, however, San Juan has pled sufficient facts to demonstrate that the GDB created and maintained separate accounts for each of the escrows. *See* ECF No. 88, ¶169; *see, e.g., Stanton v. Couturier*, No. 2:05-CV-02046-RRB-KJ, 2007 WL 4570699, at *3 (E.D. Cal. Dec. 26, 2007) (holding issue of tracing of funds could only be determined after plaintiff had an opportunity to conduct discovery and fully develop the facts). Defendants' baseless assumption that such escrow funds were commingled with other accounts therefore cannot support their motion to dismiss.

III. THE AMENDED COMPLAINT SETS FORTH A CLAIM UNDER PROMESA THAT TRANSACTIONS UNDER THE RSA VIOLATE TITLE VI'S POOLING REQUIREMENTS

PROMESA provides that holders of claims against the GDB with different levels of priority interests are entitled to separate voting pools, corresponding to their priority. PROMESA § 601(d)(3)(a), 48 U.S.C. § 2231(d)(3)(a). Plaintiff has properly pled that the proposed RSA improperly violates these requirements by disregarding San Juan's security arrangements. *See* ECF No. 88, ¶¶ 131-140. Nonetheless, Defendants argue that Plaintiff's claims fail because it

lacks setoff rights and a statutory lien under Puerto Rican law. *See* ECF No. 101 at 28-30; ECF No. 96 at 27-33. Both arguments fail.

A. Plaintiff Has Properly Pled that Defendants' Refusal to Honor Plaintiff's Setoff Rights Is In Violation of Puerto Rico Civil Code

Under PROMESA § 601(d)(3)(a), 48 U.S.C. § 2231(d)(3)(a), San Juan's deposit claims that are secured, in part, through setoff rights cannot be pooled with the claims of unsecured creditors, such as the GDB's general bondholders. *See* 11 U.S.C § 506; 5 Collier on Bankruptcy ¶ 506.03[1][b] at 506-16 ("a right to setoff has been described as 'security of the most perfect kind'").[10] Nonetheless, that is precisely what the RSA does. *See* ECF No. 88, ¶ 138; *see also* ECF No. 88-2.

Puerto Rico's Civil Code recognizes that two persons who are reciprocally debtors and creditors of the other may setoff obligations owed to one another. *See* 31 L.P.R.A. §§ 3221 ("When Compensation Takes Place"), 3222 ("Requisites");[11] *Ramos v. Caparra Dairy, Inc.*, 116 D.P.R. 60 (P.R. 1985) (recognizing setoff rights under Puerto Rican law).

Defendants argue that San Juan fails to meet two of the criteria for setoff, to wit, that both loans are "due" and that none of the loans are "subject to any retention or suit instituted by a third person, and of which due notice has been given the debtor." ECF No. 96 at 21-22; ECF No. 101 at 21. Neither of these arguments can defeat the setoff claim on a motion to dismiss.

Taking the second argument first, the only support Defendants cite for the proposition that the funds are subject to another claim is *Brigade Leveraged Capital Structures Fund Ltd. v. Gov't Dev. Bank for P.R.*, No. 3:16-cv-01610-FAB (D.P.R. Apr. 4, 2016), as a case "seeking to enjoin

[10] Defendant Oversight Board argues that 11 U.S.C. § 506 has no application to Title VI cases. ECF No. 96 at 28. Even if that is so, 11 U.S.C. § 506 is nonetheless an appropriate reference point to interpret the phrase "security arrangement."

[11] Compensation is "the Commonwealth equivalent of setoff." *See Phico Ins. Co. v. Pavia Health, Inc.*, 413 F. Supp. 2d 76, 83 n.5 (D.P.R. 2006).

GDB from making payments to creditors, including municipal bondholders." ECF No. 101 at 21, n.10. What Defendants conveniently fail to tell the Court is that the case was dismissed with prejudice five months before Defendants filed their motion. *See Brigade Leveraged*, No. 3:16-cv-01610-FAB (D.P.R. Aug. 1, 2017); ECF No. 160.

As to Defendants' argument that setoff is inappropriate here because both debts are purportedly not "due" given that Plaintiff's loans "come due on a biannual basis over the next twenty-plus years," again only one case is cited in both motions to attempt to defeat San Juan's claim under Puerto Rico Civil Code: *FDIC v. De Jesús Vélez*, 514 F. Supp. 829 (D.P.R. 1981). ECF No. 101 at 21. But the facts and holding in *Velez* are far removed from the situation at hand. For one thing, the attempt in *Velez* was to avoid a payment *presently* due on a promissory note by offsetting debentures owing to a *different party* at *some time in the future*. Here, by contrast, the parties to the debts are the same and, contrary to the Oversight Board's contention, San Juan does not seek a present setoff of the "full amount of their outstanding loans." ECF No. 96 at 22 n.9. Rather, San Juan only seeks a setoff of the portion of its debt that has become due during the pendency of this litigation.[12] There is nothing in the Civil Code or the cited cases that precludes this commonsensical result.

Indeed, the fact that only a portion of San Juan's debt to the GDB becomes due biannually has never in the past hindered GDB's recognition of San Juan's setoff rights as those payments came due. For example, as noted above, a GDB representative informed the CRIM Board that it would not be requiring the CRIM to disburse funds for a payment by San Juan otherwise due on

[12] For example, pursuant to the payment schedule referenced in the Amended Complaint,(ECF No. 88, ¶ 88), part of San Juan's debts with the GDB was due and payable as of early January 2018, after the date of the filing of the Amended Complaint. Under its setoff claims, San Juan should be deemed to have exercised its offset right at that time. *See* ECF No. 88, ¶ 88. *See Ramos v. Caparra Dairy, Inc.*, 116 D.P.R. 60 (P.R. 1985). If the Court requires, San Juan is prepared to file a supplemental pleading with additional information concerning events following the Amended Complaint.

July 1, 2017 because the monies for the payment were at the GDB. ECF No. 88 at 89; *see also* ECF No. 88-3 (CRIM Board, Act 2017-05 at 41). Indeed, this Court has recognized this historical setoff practice by the GDB, which the GDB did not dispute. ECF No. 72 at 7 (citing Vega Decl., ¶¶ 15-16)[13] (noting that "it appears that, in practice, GDB has historically debited the municipalities' deposits to cover biennial payments on the municipal loans as payments come due").

In short, San Juan has adequately pled that it and other Puerto Rican municipalities have a legal right to setoff the value of their deposits at GDB against their outstanding loan repayment obligations with the GDB and that such rights would be impermissibly impaired by the RSA.

B. Defendants Do Not Contest That a Lien Exists On The Trust Funds

San Juan has alleged that a lien exists on its trust funds and that, therefore, under PROMESA, at a minimum (assuming those funds are not returned outright to San Juan) the Oversight Board is required to establish a separate voting pool for the bonds subject to such lien. *See* ECF No. 88, ¶ 13, 94-95; PROMESA §601(d)(3)(a), 48 U.S.C. §2231(d)(3)(a).

None of the Defendants contest that a lien on the trust funds exists. Indeed, the Oversight Board in its brief even admits as much, merely arguing that the lien at issue results from a ***combination*** of the MFA and the 2015 Trust Agreement. The Oversight Board writes, "Thus, ***the lien that results from establishing that trust*** does not arise 'solely by force of' the statute." ECF No. 96 at p. 24. Similarly, the GDB brief focuses on arguing that any such lien is not a "statutory"

[13] While the Court, in the context of its decision denying a preliminary injunction to San Juan, noted that this practice was "just as consistent with a convenient method of payment under circumstances in which each party is confident that the other is able to uphold its part of the bargain at the time as it is with a right to setoff of mutual obligations," (ECF No. 72 at 16), San Juan is entitled to discovery to show that, in fact, the GDB's words, intentions and actions in honoring such setoff requests were party admissions as to the existence of the right of setoff rather than simply a professional "courtesy." At best, the GDB's historical actions in permitting setoffs create a factual issue as to the intent of the parties with respect to the existence of this right that cannot be resolved against San Juan on a motion to dismiss.

lien. ECF No. 101 at 22. But these admissions that a lien exists are fatal to Defendants' Motion on this issue, and their arguments are a red herring. The statutory obligation under PROMESA to create separate voting pools does not depend on the existence of a "statutory" lien. 48 U.S.C. §2231(d)(3)(a). Rather, all that the statute requires is that the funds at issue have "specific provisions governing priority or security arrangements."[14] *Id.* Because the Defendants do not contest that there are indeed trust funds being held by the GDB, (ECF No. 96 at 24 ("[I]t is a situation where GDB holds funds in trust . . . ."), and that such trust funds are indeed subject to such security arrangements, by virtue of a combination of the 2015 Trust Agreement and the MFA, then separate voting pools are required and the RSA violates PROMESA by not providing for them.

While Defendants also argue that any "[s]tatutory liens created by Section 6016(c) secure a municipality's obligations to creditors (including GDB)—not GDB's obligations to Plaintiff," (ECF No. 101 at 22; ECF No. 96 at 25-26), PROMESA's statutory requirement does not depend on the identity of the beneficiary of the lien, only the lien's existence, which is here conceded.[15] In any event, the MFA and 2015 Trust Agreement make clear that the lien covering San Juan's trust funds is for the purpose of ensuring that the funds will be used for the *payment of San Juan's creditors* and not for the benefit of the GDB's creditors.

Given Defendants' failure to contest the existence of a lien over the trust funds (and, indeed, the Oversight Board's admission that such a lien exists), at a minimum, the RSA must

[14] *See, e.g., In re Approximately Forty Acres in Tallmadge Township*, 223 Mich. App. 454, 566 N.W.2d 652, 657 (1997) ("A lien is a security interest for money owed by one party to another, and is separate from an underlying cause of action." (internal citation omitted)); *see* Black's Law Dictionary 933 (7th ed. 1999) (defining a lien as "[a] legal right or interest that a creditor has in another's property, lasting usu[ally] until a debt or duty that it secures is satisfied").

[15] ECF No. 96 at 24 ("Thus, the lien that results from establishing that trust does not arise 'solely by force of' the statute."); ECF No. 101 at 22 (admitting existence of lien).

create a separate voting pool based on the funds subject to that lien. Its failure to do so violates PROMESA Section 601(d)(3)(A), 48 U.S.C. § 2231(d)(3)(A), and renders the transactions contemplated by the RSA ineligible for certification as a Qualifying Modification.

IV. THE AMENDED COMPLAINT PROPERLY SETS FORTH A CLAIM THAT THE OVERSIGHT BOARD VIOLATED PROMESA AT THE EXECUTIVE SESSION AT WHICH IT CERTIFIED THE RSA

San Juan alleges the Oversight Board certified the RSA at a closed-door executive meeting with individuals in attendance in addition to "the Board's members and any professionals of the Board, including staff and advisors, the Board deems necessary," in violation of PROMESA's transparency requirements and the Oversight Board's Bylaws. *See* ECF No. 88, ¶¶ 103, 106, 146; ECF No. 88-11, ¶ 144; Board's Bylaws, approved on September 30, 2016 and, as amended, October 14, 2016 and January 28, 2017. In their motion, Defendants quibble as to whether the phrase "professionals of the Board" must mean professionals employed or retained by the Board, or whether it should be given a broader interpretation to also include outside professionals and advisors. *See* ECF No. 101 at 23; ECF No. 96 at 29. But this argument is a red herring. What Defendants ignore are San Juan's allegations that such attendees at the executive session included "representatives of AAFAF and GDB," (ECF No. 88, ¶ 106), that the Oversight Board relied on the representations by the GDB and AAFAF in approving certification at that executive session, (ECF No. 88, ¶¶ 107-108), and that the Unanimous Written Consent Approving Certification of the RSA expressly noted that "the Board has reviewed the RSA and has discussed it with the Board's advisors ***and with representatives of AAFAF and GDB.***" ECF No. 88, ¶ 145; ECF No. 88-1 (Certification Resolution) (emphasis added). Plainly, if the Board considered the AAFAF and GDB representatives to be its advisors (as Defendants speculate), they would not have phrased the Unanimous Written Consent the way they did; instead, they would have said "the Board's advisors, ***including*** representatives of AAFAF and GDB." Thus, the Board's own document

demonstrates that the Board did not consider the AAFAF and GDB representatives to be Board "professionals" or "advisors." Their attendance was therefore improper.

In any event, it strains credulity to believe that the GDB was there as an impartial advisor to the Board. Rather, the GDB was interested in seizing as much money as it could to ensure payment of its own debts. San Juan was injured by this improperly convened executive session given that it presented a confidential forum to certain individuals who were not permitted to be in attendance (including at least the GDB representatives) yet did not include San Juan representatives. Consequently, San Juan was not able to voice its objections or concerns, including that the RSA as drafted was based upon unverified financial information, violated various provisions of PROMESA, and unlawfully took money that belonged to San Juan. *See* ECF No. 88, ¶¶ 96-110. San Juan thus has sufficiently pled an injury to San Juan in support of its request for a declaration that the RSA is invalid for failure to comply with PROMESA's executive session requirements.

V. THE GDB IS USING AN UNLAWFUL MORATORIUM FOR RESTRUCTURING

Defendants argue that PROMESA Section 303 does not support Plaintiff's claim that the Moratorium Act is illegal. ECF No. 96 at 30; ECF No. 101 at 25. But by its very terms, PROMESA preempts "unlawful executive orders that alter, amend, or modify rights of holders of any debt of the territory or territorial instrumentality, or that divert funds from one territorial instrumentality to another or to the territory, shall be preempted by this Act." 48 U.S.C § 2163(3).

San Juan has alleged that the executive orders issued in 2016 have been responsible for stopping all municipal transfers and withdrawals out of the GDB, (ECF No. 88, ¶¶ 49, 52), and that subsequent executive orders have been responsible for maintaining the status quo. *Id*. ¶ 51. These executive orders have effectuated a prolonged moratorium that has altered/modified the right of San Juan to access its monies, thus diverting funds from one territorial instrumentality to

another in an unlawful manner. *See, e.g., Seawall Assocs. v. City of New York*, 74 N.Y.2d 92, 113, 542 N.E.2d 1059, 1069 (1989) (finding unlawful a multi-year moratorium that negatively affected plaintiffs' right over their property).

VI. SAN JUAN HAS STANDING TO SEEK RELIEF

San Juan's standing to bring some of its claims is not disputed (Counts V, VI, VII, VIII, IX, and X). *See* ECF No. 96 and ECF No. 101. Defendant Oversight Board contends San Juan does not have standing to bring its first three causes of actions challenging the RSA (Counts I, II, and III). *See* ECF No. 96 at 10-12. Defendants GDB and AAFAF, in turn, argue that San Juan does not have standing to bring its first four causes of actions challenging the RSA and the improperly convened Executive Session at which the RSA was certified (Counts I, II, III, and IV). *See* ECF No. 101 at 9-14.[16]

Article 703 of Puerto Rico Act 109-2017 ("Act 109") provides: "[n]otwithstanding any other law of the Government of Puerto Rico, no Government entity shall have authority or standing to challenge this Act, the Restructuring Transaction, or the other transactions contemplated in this Act in any local or federal court." ECF No. 88, ¶ 11. Defendants rely on this provision to argue that Act 109 divests San Juan of all standing to challenge the RSA, including challenges to preliminary procedures to approve the RSA prior to RSA implementation. *See* ECF No. 96 at 11-12; ECF No. 101 at 9-10. Defendants additionally contend that Act 109 is not preempted by PROMESA. *See* ECF No. 96 at 12-14; ECF No. 101 at 11-14.

[16] Defendants' apparent inability to agree on whether San Juan has standing to bring Count IV demonstrates the weakness of their standing arguments.

A. San Juan Has Standing As a Municipality to Invoke the Supremacy Clause to Challenge Violations of PROMESA

To the extent that Act 109 purports to prevent Plaintiff from exercising its rights under PROMESA, the Amended Complaint has properly alleged that San Juan has standing to assert that Act 109 is preempted by PROMESA under the Supremacy Clause and therefore does not bar San Juan's claims in this action.

PROMESA is a federal statute that expressly provides a cause of action to affected parties like San Juan to challenge violations of its provisions. Defendant Oversight Board suggests that San Juan did "not allege which specific provision of PROMESA conflicts with Act 109 nor how such a provision would lead to such a conflict," (ECF No. 96 at 13), and Defendants GDB and AAFAF's contend that "a state or territory's traditional authority to control and restrict its municipalities' power to sue or be sued is preempted only where Congress has evidenced a 'clear and manifest' intent to do so," (ECF No. 101 at 11). But these arguments fail to take into account San Juan's allegations that: 1) PROMESA expressly provides that "[t]he provisions of this chapter shall prevail over any general or specific provisions of territory law, State law, or regulation that is inconsistent with this chapter," (ECF No. 88, ¶ 150); and 2) PROMESA preempts Act 109 "[t]o the extent Act 109 is deemed to preclude Plaintiff from exercising its rights under PROMESA, including without limitation, the right to vote on any proposed impairment of Plaintiff's security arrangements by means of the RSA, and the right to assert objections to the RSA," (ECF No. 88, ¶ 151).

Federal courts have repeatedly determined that political subdivisions have standing to sue their states. In *Santiago Collazo v. Franqui Acosta*, the Court held that political subdivisions can sue their states on political grounds when the right asserted is protected. 721 F. Supp. 385, 393 (D.P.R. 1989). The *Acosta* decision has since been followed. *See Municipality of San Juan v.*

Calderon, No. CIV. 04-1727 (JP), 2005 WL 1641388, at *2–3 (D.P.R. July 8, 2005); *Municipality of San Sebastian v. Puerto Rico*, 89 F. Supp. 3d 266, 275 (D.P.R.), *on reconsideration in part*, 116 F. Supp. 3d 49 (D.P.R. 2015).

Defendants rely on *Burbank-Glendale-Pasadena Airport Auth. v. City of Burbank*, 136 F.3d 1360, 1363-64 (9th Cir. 1998), to support their proposition that municipalities do not have standing to invoke the Supremacy Clause. ECF No. 101 at 13. But *Burbank* is not governing law for this Court, as conceded by the Defendant GDB and AAFAF, and reflects the minority view among circuits. *See Palomar Pomerado Health Sys. v. Belshe*, 180 F.3d 1104, 1110 (9th Cir. 1999) (Hawkins, J., concurring) ("Certainly the Ninth Circuit is alone in having barred Supremacy Clause challenges by political subdivisions against their parent states."). Other Courts of Appeals have found municipal standing to challenge violations of the Supremacy Clause. *See Branson Sch. Dist. RE-82 v. Romer*, 161 F.3d 619, 628-630 (10th Cir. 1998); *Rogers v. Brockette*, 588 F.2d 1057, 1068 (5th Cir. 1979); *see also* 13B Fed. Prac. & Proc. Juris. § 3531.11.1 (3d ed.) ("Decisions ruling that state-created municipalities . . . lack Fourteenth Amendment rights against the states creating them do not apply to suits brought to challenge state activities under the Supremacy Clause."). Moreover, the Supreme Court itself has refused to permit the strict and narrow view of municipality standing that defendants espouse. *See Lawrence Cty. v. Lead-Deadwood Sch. Dist.*, No. 40-1, 469 U.S. 256, 270 (1985) (holding that "the attempt of [state] legislation to limit the manner in which local counties or other qualified local governmental units may spend federal [] payments . . . runs afoul of the Supremacy Clause").

Denying standing here would be particularly inappropriate because municipalities such as San Juan are the only ones with the vested interests and incentives to pursue the claims at issue here. The RSA directly targets and impacts municipal bondholders and municipalities with funds

held in trust and escrow accounts, discriminating against them to the benefit of other bond holders. If Act 109 were interpreted to prohibit San Juan from challenging the procedures to certify the RSA, the improper voting mechanism to approve the RSA, and the transactions contemplated by the RSA, then who would advocate for the rights of the municipalities? Certainly not other creditors of the GDB, as they would stand to benefit from the RSA's violations of PROMESA.

B. To the Extent Act 109 is Interpreted to Bar Objections to the RSA, It is Preempted by PROMESA

Section 601(n)(2) of PROMESA provides "a private right of action to challenge the unlawful application of Title VI." ECF No. 101 at 11; ECF No. 88, ¶ 12. Defendants GDB and AAFAF interpret this provision as creating a private right of action for parties "that have the capacity to sue under state law,"[17] and not as "preclud[ing] Puerto Rico from establishing or controlling its municipalities' capacity to sue (and therefore exercise that private right of action) or be sued." ECF No. 101 at 11. But this argument is circular and flawed. Under Defendants' view, all that Section 601(n)(2) does is say, in effect, "if you have the right to sue then you can sue." But that can hardly have been the intent of the framers of the statute. Under that reading, the Commonwealth of Puerto Rico would be able to strip ***anyone*** of the right to challenge an RSA promulgated under PROMESA—including any and all holders of "Bonds" that the RSA purports to modify on a "voluntary" basis. That proves too much. States do not have "power to do as they will" with municipalities regardless of consequences, *Gomillion v. Lightfoot*, 364 U.S. 339, 344-45 (1960) ("Legislative control of municipalities, no less than other state power, lies within the

[17] Defendants cite to Fed. R. Civ. P. 17(b) for support that municipalities have no right to sue because state law, Act 109, governs the capacity to sue. ECF No. 101 at 11. But this contention fails to recognize that one of the primary disputes in this case is whether Act 109 is constitutional. *See Geft Outdoor LLC v. Consol. City of Indianapolis & Cty. of Marion, Indiana*, 187 F. Supp. 3d 1002, 1012 (S.D. Ind. 2016) ("A party derives no rights based on an unconstitutional statute; '[a]n unconstitutional law is void, and is as no law.'").

scope of relevant limitations imposed by the United States Constitution"), and Puerto Rico does not have the power to deprive municipalities of protections that Congress has granted them.

The Supreme Court, in *Gomillion*, 364 U.S. at 347, made clear that states may not attempt to diminish federally protected rights.[18] Thus, Defendants' contentions that "Plaintiff only has the rights bestowed upon it by the Commonwealth, and the Commonwealth has chosen to divest Plaintiff of the right to assert any cause of action challenging the RSA," ECF No. 101 at 13-14, completely ignore the federal statutory rights granted to San Juan as an impacted bondholder under PROMESA to challenge the RSA under Title VI. ECF No. 88, ¶ 12. It is inconceivable and illogical that Congress would have intended to draft PROMESA to allow "modifications" to Bond Claims by consent, and provide for a cause of action to challenge such "modifications," while at the same time permitting the Government of Puerto Rico, pursuant to its whims, to decide to favor certain Bond Claims over others by divesting certain classes of Bond Holders of the right to sue under PROMESA. It is hard to imagine a more pernicious way to undermine a federal statute.

The First Circuit Court of Appeals has held that to the extent Puerto Rican law permits the governor to interfere with the operation of a federal act, such law is preempted. *See Hernandez-Colon v. Sec'y of Labor*, 835 F.2d 958, 963-64 (1st Cir. 1988) (prohibiting Puerto Rico's governor from refusing, under Puerto Rican law, to permit two Puerto Rico municipalities to receive job training assistance for their citizens after qualifying for such aid under a federal statute). The same should hold true here. Act 109, which—perhaps not coincidentally—was passed a month after San Juan brought this lawsuit, should be preempted from interfering with the operation of PROMESA.

[18] Municipalities have been permitted to participate in constitutional challenges to state enactments since *Gomillion*. *See, e.g., Romer v. Evans*, 517 U.S. 620 (1996); *Washington v. Seattle School District No. 1*, 458 U.S. 457 (1982).

C. San Juan Has Standing to Challenge the RSA's Improper Pooling of Claims for RSA Voting Purposes

For the reasons set forth above, Act 109 cannot be read to prohibit any challenges that are contemplated by PROMESA, including a challenge to the Court after an RSA has been approved by a vote of the bondholders. In any event, as detailed in the Amended Complaint, a textual reading of Act 109 (apart from preemption issues) demonstrates that it does not on its face preclude challenges to preliminary procedural mechanisms leading up to approval of the RSA, such as the voting pool structure. ECF No. 88, ¶ 12. This is so because the statutory definition of "Restructuring Transaction" in Act 109 includes only the substantive transactions contemplated by the RSA—not the process for obtaining approval of those transactions. *See* Act 109 ("Restructuring Transaction—means the transactions contemplated by, or in furtherance of, the Qualifying Modification . . . ."). Indeed, the Defendant Oversight Board concedes as much in its brief, noting that the Act 109 definition of "Restructuring Transaction" means "the Restructuring Support Agreement dated May 17, 2017—i.e., the RSA at issue here." ECF No. 96 at 11. Thus, Act 109 does not deprive San Juan of standing to challenge procedural aspects of the RSA prior to final approval of the Restructuring Transaction.

VII. SAN JUAN HAS PRESENTED RIPE CLAIMS

As an initial matter, Defendants do not challenge the ripeness of six of San Juan's causes of actions (Counts V, VI, VII, VIII, IX, and X). *See* ECF No. 96 and ECF No. 101. They part ways, however, with respect to San Juan's remaining claims. Defendants GDB and AAFAF challenge the ripeness of San Juan's first four causes of actions seeking declaratory judgments related to the provisions of the RSA, as well as the process that led to its approval before the Oversight Board (Counts I, II, III, and IV). *See* ECF No. 101 at 14-17. Defendant Oversight

Board, in turn, challenges the ripeness of San Juan's first three causes of actions seeking declaratory judgments (Counts I, II, and III). *See* ECF No. 96 at 10-12.

Ripeness has constitutional and prudential components. *See Mangual v. Rotger-Sabat*, 317 F.3d 45, 59 (1st Cir. 2003) ("the doctrine of ripeness has roots in both the Article III case or controversy requirement and in prudential considerations"). Defendants dispute both elements, stating that San Juan's challenges "concern a Qualifying Modification that may not occur as anticipated or may not occur at all," (ECF No. 101 at 15), present constitutional issues that may never need to be decided, (ECF No. 101 at 16), and would not cause San Juan to suffer any harm if the Court withheld judgment (ECF No. 96 at 18). Such contentions fail to recognize the present harm that San Juan currently is suffering as Defendants continue trapping San Juan's monies pursuant to an unlawful moratorium, the significant harm San Juan will suffer if a vote on the Qualifying Modification proceeds under an improper mechanism, and the benefit declaratory relief would provide. The time to decide these issues is now. Defendants' past and present conduct is strongly indicative that they will continue to proceed with actions in furtherance of the unlawful Qualifying Modification in violation of San Juan's rights. San Juan's claims present real and immediate controversies for this Court to decide, and are presently ripe for review.

A. San Juan's Challenge to the Oversight Board's Improper Use of an Executive Session is Ripe

San Juan alleges that the public transparency and participation requirements of PROMESA were violated when the RSA was improperly hammered out, behind closed doors, with interested participants (like the GDB) who were not permitted to be there. ECF No. 88, ¶¶ 106, 145-146. The illegal acts and injury to San Juan—namely, the creation of a one-sided RSA without the participation or input of the municipal creditors—have already occurred. Thus, the claim is ripe. *See Riggs v. Curran*, 863 F.3d 6, 12 (1st Cir. 2017) ("[A]lthough the contract dispute between the

parties raised the likely possibility that the case would be moot in the future, that possibility did not implicate whether the precise issue currently before the court was ripe for decision"); *Arroyo-Delgado v. Dep't of Educ. of Puerto Rico*, 199 F. Supp. 3d 548, 554 (D.P.R. 2016) ("[A]cts from the past that are alleged to create liability meet the fitness requirements of the ripeness doctrine."). Moreover, "because the actions creating liability occurred in the past and the injury is ongoing, neither the parties nor the Court benefit from denying judicial review." *Id.* at 555. Accordingly, the Court should reject GDB's and AAFAF's contention that Count IV is not ripe.

B. Judicial Review of San Juan's Challenges to Procedures for Approving the Qualifying Modification and Legality of the Qualifying Modification is Available Prior to the Final Court-Approval Stage

Defendants contend claims challenging the procedures for approving the RSA and the legality of the Qualifying Modification are not ripe for adjudication because creditors are only permitted to challenge the Qualifying Modification at the court-approval stage and not before. ECF No. 96 at 3; ECF No. 101 at 17. Defendants rely on Section 601 of PROMESA for this faulty assertion, but PROMESA contains no such restriction. *Id.*, *see* PROMESA § 601(m)(1)(D).

There is no prohibition in PROMESA prohibiting challenges to procedures for approving a Qualifying Modification, or to the legality of a Qualifying Modification, before the final approval stage. Defendants' contention that Congress intended the RSA judicial-approval stage to be the "exclusive avenue for creditors to bring challenges" to the RSA results from a piecemeal reading of PROMESA. ECF No. 96 at 15; ECF No. 101 at 17. In reality, PROMESA is drafted to provide creditors with specific mechanisms and rights to safeguard creditors' interests during the process for approval of the Qualifying Modification and to challenge a Qualifying Modification. As detailed previously, PROMESA requires:

1) the establishment of separate voting pools for bondholders with different security interests, *see* PROMESA § 601(d), 48 U.S.C. § 2231(d); and

2) a mechanism to challenge the RSA under Title VI, *see* PROMESA §106(a)("any action against the Oversight Board, and any action otherwise arising out of this Act, in whole or in part, shall be brought in a United States district court for the covered territory"), PROMESA § 601(n)(2) ("there shall be a cause of action to challenge unlawful application of this section"), and PROMESA § 601(n)(3) (detailed above).

The likely reason for this is obvious. Determinations on challenges to the Qualifying Modification and on challenges to the process for voting on the approval of the Qualifying Modification could impact how bondholders vote and the ultimate character of the Qualifying Modification submitted to the Court for final approval.

Declaratory judgment determinations before the vote on the RSA and final submission to the Court could also potentially obviate the necessity of a revote. *See, e.g..*, *In re Cushman*, No. 14-10692, 2017 WL 818254, at *7 (Bankr. D. Me. Mar. 1, 2017) ("Although the issuance of a declaratory judgment in this proceeding will not resolve all of the disputes between the parties, a judgment may help the parties get back to the negotiating table.").

Defendants contend that the disputes between the parties are "uncertain" and "hypothetical" because: the GDB has yet to make requisite disclosures under Title VI; the Oversight Board has yet to establish the voting pools; the voting process has not begun; the Oversight Board has yet to certify that the voting process complied with Title VI; the RSA may not receive the necessary votes for approval; and the RSA as a Qualifying Modification has not yet been submitted to the Court for final approval. *See* ECF No. 96 at 15-17, ECF No. 101 at 15-16. But Defendants have already taken substantial concrete steps to proceed with each of these events to implement the RSA—with the GDB and AAFAF negotiating the development of the RSA without input from San Juan and seeking the approval of investor-bondholders and of the unlawful RSA as a Qualifying Modification, as well as with the Oversight Board rubber stamping

this illegal agreement in a closed door meeting without providing San Juan an opportunity to weigh in on the plan. ECF No. 88, ¶¶ 66-68, 103-104, 106.

There is no reason to believe that Defendants GDB and AAFAF plan to diverge from their intention, and contractual obligation, (ECF No. 88-2), to establish only one voting pool instead of creating a separate voting pool for secured interests, such as the trust and lien interests they now admit exist. Nor is there any reason to believe that Defendants will relinquish their unlawful confiscation of San Juan's CAE and Excess CAE trust funds or abandon features of the RSA designed to coerce Plaintiff and other municipalities into entering settlement agreements with the GDB. As the Court is aware, Defendants have already lamented the harms that would befall them if there was any setback or delay in moving forward with the Qualifying Modification, including "losing the power to hold signatories to their contractual commitments to support the current restructuring," the collapse of the RSA "leaving open the potential for chaotic litigation," or the GDB being led "into the much more complicated and expensive process of restructuring under Title III of PROMESA." ECF No. 72 at 18. When a defendant is taking particularized steps to inflict injury, as is the case here, there is a definite and concrete dispute that is ripe for adjudication. *See, e.g., Novell, Inc. v. Gribben*, 168 F.3d 500 (9th Cir. 1999).

Defendants' actions present "definite and concrete" questions of whether federal and Commonwealth statutory provisions would permit: 1) the inappropriate restructuring of funds owned by San Juan in trust, and/or 2) the creation of only a single pool of claims including both claims subject to liens and unsecured claims for voting purposes.[19] Accordingly, San Juan seeks

[19] *See, e.g.*., *Clarus Therapeutics, Inc. v. Lipocine Inc.*, No. CA 15-1004-RGA-MPT, 2016 WL 3519888, at *4 (D. Del. June 27, 2016), *report and recommendation adopted as modified*, No. CV 15-1004-RGA-MPT, 2016 WL 5868065 (D. Del. Oct. 6, 2016) (finding subject matter jurisdiction in a declaratory judgment action after determining defendant's conduct was indicative of "meaningful preparation for the making, launch, and use [of a patent]" and that defendant has taken "significant, concrete steps to conduct infringing activity" even though infringement had not yet occurred).

a declaration that the Qualifying Modification, and the acts enacted in furtherance of the Qualifying Modification, are invalid under, and are inconsistent with, federal and Commonwealth laws, (ECF No. 88, ¶¶ 13, 151), because they directly interfere with San Juan's existing property interests in its trust funds, San Juan's federal statutory right to vote on the RSA as part of a secured bondholder voting pool, and San Juan's federal statutory right to challenge proposed Qualifying Modifications. These inconsistencies between the governing laws and the path that Defendants have embarked upon are the very "inconsistencies" that Defendants submit are the *sine qua non* of a preemption claim.

Defendants are correct that the CAE trust funds and Excess CAE trust funds cannot ultimately be restructured until the Qualifying Modification receives approval from creditors and the Court issues an order approving the Qualifying Modification. Defendants are wrong, however, that this Court lacks jurisdiction simply because this has not yet happened. *See MedImmune, Inc. v. Genentech*, 549 U.S. 118, 133–34 (2000) ("The rule that a plaintiff must destroy a large building, bet the farm, or . . . risk . . . the loss of 80 percent of its business before seeking a declaration of its actively contested legal rights finds no support in Article III."); *Thomas v. Union Carbide Agr. Prod. Co.*, 473 U.S. 568, 571 (1985) ("One does not have to await the consummation of threatened injury to obtain preventive relief. If the injury is certainly impending, that is enough. Nothing would be gained by postponing a decision, and the public interest would be well served by a prompt resolution of the constitutionality of [the statute's] scheme.") (internal citations omitted).

This is particularly so where the GDB continues to violate the terms of the 2015 Trust Agreement by exercising dominion over what the Oversight Board admits are trust funds and where the GDB has committed itself to giving those funds to its creditors. *See also Garcia-Rubiera v. Calderon*, 570 F.3d 443, 454 (1st Cir. 2009) (holding that declaratory and injunctive relief

takings claims were ripe after finding that fiduciary had appropriated the funds for public purposes where plaintiff had a property interest in the funds under Puerto Rico law, and noting "the Declaratory Judgment Act allows individuals threatened with a taking to seek a declaration of the disputed governmental action before potentially uncompensable damages are sustained.") (internal citations omitted). Given that, there is no need to wait until the unlawful harm is finally consummated. *See Rose v. Volvo Const. Equip. N. Am., Inc.*, 412 F. Supp. 2d 740, 745 (N.D. Ohio 2005) ("[T]here is no need to wait until the [] Trust runs out to estimate the scope and amount of [] liability.").

There are legions of cases in analogous contexts in which suit was able to proceed on the basis of events suggestive that unlawful or tortious activity was afoot, even though the ultimate injury had not yet occurred. *See N. A. A. C. P., Boston Chapter v. Harris*, 607 F.2d 514, 525 n.13 (1st Cir. 1979) ("While it is true . . . that plaintiffs' asserted injuries have not yet occurred, we do not on the basis of this complaint view the possibility of their occurring as mere speculation. Plaintiff does not have to allege a completed injury, only that there is an imminent threat of injury. And in determining the issue of imminence, 'past wrongs are evidence bearing on whether there is a real and immediate threat of repeated injury.'"); *Purdue Pharm. Prod., L.P. v. Actavis Elizabeth, LLC*, No. CIV.A. 12-5311 JLL, 2014 WL 1394178, at *9 (D.N.J. Apr. 9, 2014) (finding ripeness satisfied for claim involving patent infringement while patent was still pending before the FDA for approval). Here, there is no need for San Juan to wait to pursue its claims until the RSA is submitted to the Court for final approval. Unless the RSA means something other than what it very clearly says, the restructuring process detailed in the RSA expressly authorizes municipal funds—including funds that the Oversight Board concedes are trust funds—to be wrongly confiscated and restructured.

Last, Defendants' conjectures that resolving San Juan's claims now would potentially require the Court to resolve Supremacy Clause issues "that might never need to be decided" are misplaced. ECF No. 101 at 16-17. As an initial matter, Defendants GDB and AAFAF have been – and are currently – using the Moratorium Act and related executive orders as a barrier to San Juan accessing its funds at the GDB. *See* ECF No. 88, ¶ 155. That Act and the related executive orders are causing present injury to San Juan. And given the GDB's commitment to implementing the RSA and the support that it has obtained, this Court will invariably be faced with the constitutionality of Act 109.

Defendants' conduct to date favors judicial review by making the disputes far from hypothetical and uncertain.

C. Hardship considerations weigh heavily in favor of review

Hardship considerations turn on the extent and immediacy of the harms plaintiff has suffered or is likely to suffer. *See Riva v. Com. of Mass.*, 61 F.3d 1003, 1010 (1st Cir. 1995). Defendant GDB's own actions leave no doubt San Juan's claims are ripe.

Defendants fail to acknowledge the significant hardship San Juan will suffer if the Court denies review of the Oversight Board's plan for establishing voting pools. The GDB and AAFAF's improper proxy solicitation and any announcement of flawed voting results create a risk of inaccurate perception that unsecured bondholders have an overwhelming voting advantage. *See, e.g., AHI Metnall, L.P. by AHI Kansas, Inc.*, 891 F. Supp. at 1359. Even if the Court were later to order a revote with separate voting pools as outlined in PROMESA, the outcome of a second vote after a first flawed vote was already taken would be tainted. *See, e.g., Morris v. Int'l Bhd. of Locomotive Eng'rs*, 165 F. Supp. 2d 662, 672 (N.D. Ohio 2001); *Bank of New York Co. v. Irving Bank Corp.*, 528 N.Y.S.2d 482, 484 (N.Y. Sup. Ct. 1988). Denying judicial review would force San Juan to accept an incorrect voting procedure that violates PROMESA and risks tainting

the voting process and future votes. Such a result is especially harsh considering it would not be based on a substantive ruling. *See, e.g.*, *Arroyo-Delgado*, 199 F.Supp. at 554 (finding hardship would result from withholding court consideration on an issue without a decision "made on substantive grounds.").

Moreover, as noted above, the GDB has taken steps in furtherance of the Qualifying Modification in a manner that harms San Juan's existing rights. San Juan presently is unable to access or use its funds held in trust for the benefit of its people, because the GDB has contractually committed itself to violating San Juan's rights. For this reason alone, San Juan's claim will not "be moot if the Qualifying Modification is voted down by creditors" as this harm is happening prior to the vote by the creditors. ECF No. 101 at 18. Moreover, San Juan's trust funds and setoff deposits remain in jeopardy of being dissipated while this issue remains pending. *See Riva*, 61 F.3d at 1010 ("And, even when the direct application of such a statute is subject to some degree of contingency, the statute may impose sufficiently serious collateral injuries that an inquiring court will deem the hardship component satisfied."). It would be difficult, if not impossible, for San Juan to recover its trust funds and deposits if they were confiscated and exchanged unlawfully pursuant to the RSA given that the GDB would be left without funds. *See, e.g., United States v. Michigan*, 781 F. Supp. 492, 499 (E.D. Mich. 1991) (recognizing the importance in maintaining status quo and enjoining transfer of funds so that funds would be available to provide the city a remedy if it prevailed).

VIII. THE AMENDED COMPLAINT PROPERLY SETS FORTH A CLAIM FOR INJUNCTIVE RELIEF DIRECTING THE GDB TO DISBURSE SAN JUAN'S FUNDS SO SAN JUAN CAN PROVIDE ESSENTIAL SERVICES IN A TIME OF DIRE NEED

San Juan alleged in the Amended Complaint that the GDB arbitrarily refused to allow San Juan access to its own much-needed funds at the GDB, in violation of Act 5 of 2017 ("Act 5"),

when it ignored, without explanation, San Juan's request for disbursement of $21 million to fund essential services in the wake of Hurricanes Irene and Maria. *See* ECF No. 88, ¶¶ 2-3, 117, 177-78. By October 2017, San Juan had incurred more than $46.7 million to provide essential public services in response to the hurricanes, and continues to incur millions more providing emergency assistance to its residents. *Id.* ¶ 2. The GDB's denial of San Juan's request has hampered San Juan's ability to provide emergency assistance to its residents in response to the hurricanes and essential public services that it always has provided. *Id.* ¶¶ 2-3, 117, 177-178. The GDB's recent refusal to disburse San Juan's funds for the provision of essential services—by failing to acknowledge or to respond to San Juan's request—is in stark contrast to the GDB's past practices, given that San Juan previously received a disbursement of its funds from the GDB for the provision of essential services pursuant to its request on April 11, 2017. *Id.* ¶ 116.

Defendants contend that compliance with Plaintiff's $21 million disbursement request is prohibited by Act 5. *See* ECF No. 101 at 29-30. This assertion relies on a mischaracterization of that statute, however. Act 5 permits the GDB to disburse funds for the payment of essential services, noting that "subject to the availability of funds and the aggregate disbursements established by the Governor, the Bank shall honor any request to withdraw or transfer any deposit held by, or request to honor any check written by . . . a municipality of the Territory; provided however, that . . . such funds will be used for the payment of essential services." ECF No. 88, ¶ 115. Act 5 additionally provides that the GDB "shall not disburse any loans or credit facility unless authorized by the Governor." *See* Act 5 of 2017. As Defendants recognize, the Governor authorized the GDB to disburse funds for the provision of essential services in Executive Order 2016-10 (OE 2016-10). ECF No. 101 at 29. The Governor also permitted the GDB to impose weekly limits on the aggregate amount of these disbursements. *Id.* A plain reading of Act 5 and

OE 2016-10 thus make it clear that the GDB has been provided discretion to determine *reasonable and appropriate* limits on withdrawals. *See* ECF No. 88, ¶ 115.

As detailed in San Juan's Amended Complaint, the GDB never challenged San Juan's essential services disbursement request or informed San Juan that it considered its request to be unreasonable or inappropriate. *Id.* ¶ 117. *See* Reynoso Decl., Ex. 5, *John Leicht v. Southwest Carpenters Pension Plan*, No. SAVC 12-00354 SJO (PLAx) (C.D. Cal. June 20, 2012) ("Determining an abuse of discretion is an inherently contextual inquiry, and at the pleading stage of litigation, such factual context is lacking."). Nor can Defendants legitimately argue (as they seem to do in their Motions) that an unexplained refusal to provide *any* funds whatsoever in response to a $21 million request is, as a matter of law to be determined on a motion to dismiss, both a "reasonable" and "necessary" exercise of discretion. *See, e.g., Lockrey v. Leavitt Tube Employees' Profit Sharing Plan*, No. 88 C 8017, 1989 WL 165067, at *2 (N.D. Ill. Dec. 21, 1989) ("To determine, as defendants urge . . . that defendants' actions were not an abuse of discretion, as a matter of law, is to say that there is no conceivable evidence which plaintiff could submit which could convince the Court otherwise. This Court is not prepared to go so far.").

Defendants, for the first time in this litigation, now contend that this claim should be dismissed because of two non-public Resolutions that have purportedly been issued by the GDB's Board of Directors subsequent to OE 2016-10. *See* ECF 101 at 29-30. These Resolutions should be stricken and not considered in evaluating Defendants' Motion for the reasons set forth in San Juan's accompanying Motion to Strike.[20] In any event, even if they are considered, they do not defeat San Juan's claim that the GDB acted unreasonably, and contrary to law, in ignoring its

[20] Rule 12(b)(6) does not contemplate such evidentiary submissions. *In re Asbestos Prod. Liab. Litig. (No. VI)*, 822 F.3d 125, 133 (3d Cir. 2016) (district court erred in relying on extrinsic evidence because it "may consider *only* the allegations contained in the pleadings to determine its sufficiency") (emphasis in original and citations omitted).

request for disbursement of essential services funds. Defendants rely on the August 30, 2016 resolution, ECF No. 101-10, for the proposition that at that time the GDB limited disbursements for such services to $2 million a week and on the August 23, 2017 resolution (ECF No 101-11) to assert it then "suspend[ed] disbursements altogether . . . ." ECF No. 101 at 30. But the fact that the GDB may have internally resolved not to make such payments obviously does not absolve it of liability for the decision. And the resolutions give the GDB more discretion than Defendants suggest. The resolution setting the $2 million weekly limit, (ECF No. 101-10), expressly provided that the Interim President of the GDB could, in his discretion, "increase or decrease the established weekly disbursement limit," subject to later Board ratification. Similarly, the resolution purportedly suspending payments altogether, (ECF No. 101-11), provided that disbursements could indeed be made "if approved by the Board of Directors of the GDB of the Executive Committee and under applicable legal norms." *Id.* Thus, the GDB had discretion to make disbursements, and San Juan's claim is that it abused that discretion in violation of law. This Court cannot hold otherwise in the context of a motion to dismiss. If San Juan's allegations are taken as true, they at least raise issues of fact as to whether the GDB abused the discretion it had been granted by the Governor and Act 5 in refusing to disburse San Juan's own much-needed funds for essential services.

IX. SAN JUAN SHOULD BE GRANTED LEAVE TO AMEND IF THE AMENDED COMPLAINT IS DISMISSED

If the Court elects to dismiss San Juan's complaint, it should do so without prejudice and with leave to amend. A district court abuses its discretion by denying leave to amend unless amendment would be futile or the plaintiff has failed to cure the complaint's deficiencies despite repeated opportunities. *See generally* Fed. R. Civ. P. 15(a); *Foman v. Davis*, 371 U.S. 178, 182 (1962); *Adams v. Watson*, 10 F.3d 915, 925 (1st Cir. 1993) (reversible error not to grant leave to

amend to overcome defendant's motion to dismiss based on no standing). Amendment here would not be futile.

WHEREFORE, it is respectfully requested that the Motion to Dismiss of Defendants GDB and AAFAF, and the Motion to Dismiss of Defendant Oversight Board be denied in their entirety, together with such other and further relief as the Court may deem just and proper.

RESPECTFULLY SUBMITTED.

In New York, New York, this 2nd day of March 2018.

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CERTIFICATE OF SERVICE

The undersigned counsel hereby certifies that the instant document has been filed with the Court's CM/ECF System, which will simultaneously serve notice on all counsels of record to their registered e-mail addresses.

In New York, New York this 2nd day of March, 2018.

RESPECTFULLY SUBMITTED,

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