No. 15-255

IN THE

Supreme Court of the United States

MELBA ACOSTA-FEBO, AS GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO AGENT, AND JOHN DOE, IN HIS OFFICIAL CAPACITY AS EMPLOYEE OR AGENT OF THE GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO,

Petitioners,

v.

FRANKLIN CALIFORNIA TAX-FREE TRUST, BLUEMOUNTAIN CAPITAL MANAGEMENT, LLC, *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

PETITIONERS' REPLY BRIEF

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REPLY BRIEF FOR PETITIONER[1]

Respondents' attempts to downplay the importance of this case are unavailing. The contingent agreement between the Puerto Rico Electric & Power Authority ("PREPA") and some of its creditors will not resolve the crisis plaguing the Commonwealth and may not even solve the crisis at PREPA. (*See* BlueMountain Opp. 2, 10, 14-15; Franklin Opp. 2, 30-31.) The hypothetical possibility that Congress will pass legislation is no panacea to rely upon. And denials that the Commonwealth of Puerto Rico faces a severe financial crisis are simply not credible. To the contrary, the 3.5 million Americans who live there are potentially on the brink of a "humanitarian disaster."[2]

The First Circuit's ruling that chapter 9 of the Bankruptcy Code preempts the Puerto Rico Debt Enforcement and Recovery Act (the "Recovery Act") severely constrained Puerto Rico's ability to exercise its police powers to address its dire economic situation. The lower court swept to the side the long-standing principle that Congress must make "its intention 'clear and manifest' if it intends to pre-empt the historic powers of the States" and the Commonwealth, *Gregory v. Ashcroft*, 501 U.S. 452,

1. The Rule 29.6 Statement in the petition remains accurate.

2. Letter from Richard Blumenthal et al. to Charles Grassley (Sept. 30, 2015), *available at* http://www.puertoricoreport.com/wp-content/uploads/2015/10/Letter-to-Grassley-re-Puerto-Rico-9-30-15.pdf; *see also Addressing Puerto Rico's Economic and Fiscal Crisis and Creating a Path to Recovery: Roadmap for Congressional Action*, White House Report, Oct. 26, 2015, *available at* https://www.whitehouse.gov/sites/default/files/roadmap_for_congressional_action___puerto_rico_final.pdf.

461 (1991) (quoting *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947)), instead favoring an interpretation of the Bankruptcy Code that is not only plainly wrong, but consigns Puerto Rico to a remedial no-man's land. The decision left Puerto Rico in a double bind: unable to enforce its own restructuring solution, and ineligible for relief under chapter 9.

None of Respondents' arguments persuasively rebuts the presumption of validity nor makes sense of the statutory framework that Congress created in the Bankruptcy Code. It is not plausible that Congress intended to deny Puerto Rico all means to address its deep financial crisis. And Respondents' reading of the pertinent statutory provisions goes against the plain meaning, structure, and history of the Bankruptcy Code. This Court's intervention is urgently needed both to reaffirm the fundamental principles of preemption and to vindicate the Commonwealth's prerogative to pass desperately needed legislation.

ARGUMENT

I. This Case Presents a Question of Extraordinary Importance and Urgency.

Despite overwhelming evidence to the contrary, Respondents dismiss the debt crisis in Puerto Rico as "imaginary" and "alarmist." (*E.g.*, BlueMountain Opp. 12; Franklin Opp. 8.) Those characterizations are both inaccurate and irresponsible. There is no serious doubt that Puerto Rico and its public corporations lack the

means to pay their debt service in the coming months.[3] The Commonwealth's own debt exceeds $73 billion, and its municipalities have already missed debt payments. Although the Recovery Act covers only the debts of eligible municipalities, restructuring the $26 billion of debt that they carry would remove an enormous strain on the Commonwealth, which is spending hundreds of millions of dollars to keep the municipalities afloat. (Pet. 5-6.) If Puerto Rico cannot restructure that debt under the Recovery Act, essential services in the Commonwealth will be in peril. (Pet. 27-29.)

Respondents try various stratagems to downplay that grave reality. They trumpet a recent agreement between PREPA and some of its creditors as supposedly showing that the crisis is on the wane. But they mischaracterize the deal and grossly exaggerate its importance.

To begin with, the PREPA agreement covers roughly one-third ($9 billion) of the debt borne by Puerto Rico's municipalities that could be eligible to restructure under the Recovery Act. It has no bearing on the other two-thirds ($17 billion) incurred by the half-dozen other public corporations—such as the highway and water authorities—that potentially could obtain relief under the Recovery Act. And even regarding that $9 billion, only a minority of PREPA's creditors have signed onto the agreement. Thus, as of today, even if the agreement touted by Respondents were fully performed by all parties, it

3. *See* Puerto Rico Fiscal and Economic Growth Plan Prepared by the Working Group for the Fiscal and Economic Recovery of Puerto Rico Pursuant to Executive Order 2015-022 (Sept. 9, 2015) at 14, *available at* http://www.bgfpr.com/documents/PuertoRicoFiscalandEconomicGrowthPlan9.9.15.pdf.

would make only a small dent in the Commonwealth's total municipal debt.[4]

Moreover, the mere signing of the deal still leaves PREPA miles away from actual debt relief. (*Contra* BlueMountain Opp. 10, 15; Franklin Opp. 31.) The agreement is subject to numerous contingencies, and each of those contingencies can unravel the deal. Among other things, the PREPA agreement provides that no portion of PREPA's debt will be restructured unless and until: (1) the monoline insurers, which insure $2.5 billion of PREPA's debt, and bondholders holding an additional $1.83 billion in uninsured bonds—none of whom are parties to the agreement—participate in the restructuring; (2) PREPA issues new securitization notes that receive an investment-grade rating; (3) the Puerto Rico Energy Commission (an independent body) agrees to a new rate structure for PREPA; and (4) the Commonwealth's legislature enacts a new law, including authorizing a transition surcharge to refinance PREPA's debt.[5] Each of those contingencies presents substantial hurdles and uncertainty.

If anything, the PREPA agreement underscores the need for a law like the Recovery Act. The Commonwealth faces an enormous collective-action problem as it seeks to dig out of its debt crisis. Despite PREPA's best efforts, the most favorable agreement that it could reach with some of its creditors still requires cooperation from third

4. *See* Notice to Holders (Sept. 28, 2015), *available at* http://emma.msrb.org/EP872020-EP675365-EP1077012.pdf.

5. *See* Restructuring Support Agreement, PREPA Public Disclosure (Nov. 5, 2015) at Annex A, *available at* http://emma.msrb.org/EP884716-EP684716-EP1086412.pdf.

parties, many of whom have little incentive to play ball in a voluntary debt restructuring. Even Respondents understand the value of the Recovery Act in solving the collective-action problem: The PREPA agreement (which Respondents signed onto) contemplates the possibility of implementing a "Recovery Plan" restructuring PREPA's debt under the Recovery Act, should the law become available. *See* Restructuring Support Agreement §§ 1(d), 2(c).[6]

Respondents' other attempts to minimize the crisis in Puerto Rico are likewise unpersuasive. The Franklin plaintiffs are incorrect that there can be no "race to the courthouse" if Puerto Rico's municipalities default on their debts. (Franklin Opp. 8.) To the contrary, without a mechanism for the orderly enforcement of municipal debts, each unpaid creditor will have the obvious incentive to quickly sue a defaulting public corporation in the hopes of getting paid before the money runs out—forcing the public corporation to defend against scores of lawsuits. Sovereign immunity is no solution because most of Puerto Rico's public corporations are not arms of the Commonwealth and therefore can be sued by creditors for money damages. *See, e.g.*, *Redondo Constr. Corp. v. P.R. Highway & Transp. Auth.*, 357 F.3d 124, 126 (1st Cir. 2004) (holding that Highway Authority is not immune from suit); *Riefkohl v. Alvarado*, 749 F. Supp. 374, 375 (D.P.R. 1990) (same for PREPA).

The Franklin plaintiffs also mistakenly argue that there is no risk that power will be shut off in the Commonwealth because PREPA can use revenues to

6. *See supra* note 5.

fund its operating expenses before paying its creditors. (Franklin Opp. 8, 30.) PREPA currently owes its fuel suppliers more than $700 million. If PREPA's agreement with its creditors falls through, suppliers of fuel are likely to stop extending credit and delivering fuel. Rolling blackouts could result in the face of fuel shortages.

Moreover, although PREPA is permitted to prioritize operating expenses over debt repayment, other critical public corporations like the water and highway authorities are not.[7] As a result, essential services provided by utilities other than PREPA are not safe from interruption because those public corporations will likely lack sufficient resources to pay operating expenses after making their debt payments.

The Franklin plaintiffs' suggestion that a receiver could solve all of PREPA's debt problems and "keep the lights on" by simply "increas[ing] revenues, cut[ting] costs and collect[ing] debts," is highly disingenuous. (Franklin Opp. 8-9.) Under PREPA's Trust Agreement, a receiver can be appointed by a court to manage PREPA's assets upon default. But a receiver is not a magician; its powers would not exceed those that PREPA currently possesses. *See* P.R. Laws Ann. tit. 22, § 207(b). For example, a receiver could not increase revenues by unilaterally raising electricity rates because by law those rates are set by an independent commission. *See* P.R. Act 57-2014, §§ 6.4(a)(1), 6.25, *available at* http://www.oslpr.org/

7. *See, e.g.*, Puerto Rico Aqueduct and Sewer Authority, Master Agreement of Trust §§ 2.11(b), 8.06, *available at* http://acueductospr.com/INVESTORS/download/Master%20Agreement%20of%20Trust/PRASA%20Amended%20Master%20Agreement%20of%20Trust.pdf.

download/en/2014/A-057-2014.pdf. A receiver would also be incapable of raising the capital needed to upgrade PREPA's infrastructure to keep it operational, and it could not make any significant dent in PREPA's mammoth debt, absent the consent of creditors. In short, a receiver would be no more equipped to solve the intractable problems facing the utility than PREPA itself.

Finally, Respondents' fallback position is that Congress will come to the Commonwealth's rescue. They argue that pending legislation would permit Puerto Rico to restructure its municipal debt under chapter 9 and therefore would moot the petition. (Franklin Opp. 2.) It hardly bears mention, however, that unpassed legislation is the shakiest ground possible on which to argue against judicial review.[8]

II. This Case is an Appropriate Vehicle.

Respondents argue that this case is a poor vehicle for deciding the fundamental question presented about preemption because the Recovery Act will ultimately be held to violate the Contract Clause. Indeed, BlueMountain goes so far as to assert that, based on the district court's ruling, the "writing is on the wall" that it will prevail on its Contract Clause claim. (BlueMountain Opp. 16-17.) But the district court held only that Respondents had adequately

8. Indeed, contrary to Respondents' account, a Senate committee recently gave the proposed legislation a "chilly reception." *See* Mary Williams Walsh, *A Chilly Reception*, N.Y. Times, Oct. 23, 2015, at B1. Moreover, it is ironic that Respondents have been actively lobbying *against* the new legislation that they tout as a panacea.

pled a claim under the Contract Clause. That is a far cry from a ruling that the claim will carry the day.[9]

The Recovery Act was specifically designed to pass muster under the Contract Clause by enshrining various protections for creditors that are absent from chapter 9. *See, e.g.*, Pet. 8-9; *see also* App. 220a, Recovery Act § 128 (titled "Compliance with Commonwealth Constitution and U.S. Constitution"). Among those protections is a guarantee that creditors will receive at least what they would have received if all creditors had enforced their claims. App. 261a, Recovery Act § 315(d). Those protections ensure that any change to contractual obligations under the Recovery Act will not run afoul of the Contract Clause. *See Neblett v. Carpenter*, 305 U.S. 297, 303-05 (1938) (sustaining in the face of a Contract Clause challenge a state-law restructuring under which creditors would receive as much as they would have received upon liquidation). Indeed, as BlueMountain acknowledges, this Court has previously upheld a state-law restructuring of municipal debt against a Contract Clause challenge. (BlueMountain Opp. 6 (citing *Faitoute Iron & Steel Co. v. City of Asbury Park*, 316 U.S. 502, 505, 505-06 & n.1 (1942)).) There is no reason to believe that the outcome of

9. BlueMountain misleadingly quotes the district court's decision when it suggests that the court held that "the Recovery Act 'imposes a 'drastic impairment' when several other 'moderate courses' are available to address Puerto Rico's financial crisis." (BlueMountain Opp. 16-17.) What the district court actually said was that it "*infers from plaintiffs [sic] well-pled and numerous factual allegations* that the Recovery Act imposes a 'drastic impairment' when several other 'moderate courses' are available to address Puerto Rico's financial crisis." (App. 139a (emphasis added).)

the Contract Clause claim here will be any different than it was in *Faitoute*.

Regardless, the Contract Clause claim necessarily turns on facts not yet in the record. Respondents will prevail only if a restructuring under the Recovery Act causes a substantial impairment of contractual relations and the restructuring is not "reasonable and necessary to serve an important public purpose" under Puerto Rico's police power. *U.S. Trust Co. v. New Jersey*, 431 U.S. 1, 25 (1977); *see also Gen. Motors Corp. v. Romein*, 503 U.S. 181, 186 (1992) (explaining that only "substantial" contractual impairments raise constitutional concerns). Both prongs of the Contract Clause analysis—substantial impairment and reasonableness—are highly fact-driven. Any guarantee of victory under the Contract Clause is therefore speculative at best and will be proven false if the case proceeds to discovery.

III. Respondents' Statutory Construction Arguments are Unpersuasive.

Respondents argue at length that the decision below was correctly decided and, as a result, this Court should deny review. For the reasons explained in the petition, however, the First Circuit's construction of § 903 contravenes the plain language, structure, and history of the Bankruptcy Code, and undercuts important principles of federalism. (Pet. 11-27.) A few points bear emphasis here.

Contrary to Respondents' assertion, Commonwealth laws governing debt restructuring are entitled to a presumption of validity. (Pet. 12-16.) Respondents'

contention that the presumption of validity does not apply to State laws governing "municipal bankruptcy" parses the relevant field far too narrowly. Once States have a history of regulating within a particular field of law, any statute that falls within that field receives the presumption—even if the statute addresses only a particular subset of the broader field. *See, e.g.*, *Hillman v. Maretta*, 133 S. Ct. 1943, 1950 (2013) (State statute governing life insurance designations is presumed valid because "[t]he regulation of domestic relations . . . is traditionally the domain of state law"); *California v. ARC Am. Corp.*, 490 U.S. 93, 101 (1989) (State statute allowing indirect purchasers to bring antitrust claims presumed valid on account of "the long history of state common-law and statutory remedies against monopolies and unfair business practices"). States have a long history of regulating in the field of bankruptcy (Pet. 14-16), and Puerto Rico's statute governing the subset of municipal bankruptcy is therefore entitled to deference.

Respondents' statutory construction arguments fail to grapple with the incongruity of barring Puerto Rico from any form of relief. Their reading of § 903 would make municipalities in Puerto Rico and the District of Columbia the only entities in the history of the United States to be ineligible for bankruptcy relief under either federal or state law. (Pet. 24-26.) It is simply unfathomable that Congress would have taken that revolutionary step without any legislative history or deliberation, merely by amending the Bankruptcy Code's definition of "State" in 1984. (*Id.*)

Respondents' sole retort—that municipalities that have not been authorized by their States to

file under chapter 9 are in the same boat as Puerto Rico's municipalities—completely misses the point. (BlueMountain Opp. 15-16; Franklin Opp. 22-23.) There is a fundamental difference between municipalities that are *eligible* for federal bankruptcy once State authorization is procured, and Puerto Rico's municipalities, which under the First Circuit's ruling are categorically *excluded* from seeking bankruptcy protection under either State or Federal law. History proves that municipalities easily secure State authorization to file under chapter 9 if and when it becomes necessary. For example, Michigan granted Detroit authorization soon before it declared bankruptcy. *See* Local Financial Stability and Choice Act, Mich. Pub. Act No. 436 of 2012, § 141.1558. That is categorically different from the situation facing Puerto Rico's municipalities, which under the First Circuit's ruling can never be authorized to declare bankruptcy under either Federal or State law.

Moreover, Respondents have no viable explanation for how § 903 can apply to Puerto Rico when chapter 9 as a whole does not apply to the Commonwealth or its municipalities. (Pet. 16-21.) Similarly, Respondents mischaracterize Petitioners' argument when they claim that it could lead to every State passing municipal debt restructuring laws. (BlueMountain Opp. 23-25; Franklin Opp. 17-18, 21-22.) To the contrary, States would still be preempted from passing their own municipal bankruptcy laws by § 903 because States (unlike Puerto Rico) can authorize their municipalities to invoke chapter 9. (Pet. 24-25.)

CONCLUSION

The petition for a writ of certiorari should be granted.

November 9, 2015

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