No. 19-387

IN THE
Supreme Court of the United States

AMBAC ASSURANCE CORPORATION,
Petitioner,
v.
FINANCIAL OVERSIGHT AND MANAGEMENT BOARD FOR PUERTO RICO, ET AL.,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the First Circuit

REPLY BRIEF IN SUPPORT OF CERTIORARI

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RULE 29.6 DISCLOSURE STATEMENT

The Rule 29.6 disclosure statement in the petition remains accurate.

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INTRODUCTION

This case, in conjunction with *Assured Guaranty Corp.* v. *Financial Oversight & Management Board for Puerto Rico* ("*Assured*"), No. 19-391, presents two questions of surpassing importance for bondholders, the Commonwealth of Puerto Rico, and municipalities across the country. On both questions, the First Circuit departed from the legal consensus and badly mangled the text of the Bankruptcy Code and PROMESA. And its errors have destabilized the municipal bond market, leading to the downgrade of *$8.5 billion* of municipal bonds—with more downgrades expected to come if the decisions stand.

Unable to deny the importance of the questions presented or credibly defend the decision below, the Board simply denies outright that the First Circuit issued its principal holding. But while the desire to wish away that holding is understandable, the First Circuit's opinion unfortunately leaves no room for doubt. In plain terms, the First Circuit held—repeatedly—that "section 305 bars the Title III court from granting Ambac [the] relief" it sought "under section 303 of PROMESA" and "sections 922(d) and 928(a) of the municipal-bankruptcy code." Pet. App. 10a-11a. Once that clear holding is recognized, the Board's remaining arguments against certiorari collapse. And its reasons for opposing review on the second question presented mirror its arguments against certiorari in *Assured*, and fail for all the same reasons.

Certiorari should be granted.

ARGUMENT

I. THE FIRST CIRCUIT'S ERRONEOUS DECISION CREATED A CONFLICT OVER THE INTERPRETATION OF SECTION 904 OF THE BANKRUPTCY CODE AND SECTION 305 OF PROMESA.

As the petition explains, the First Circuit held that Section 305 of PROMESA and Section 904 of the Bankruptcy Code bar a bankruptcy court from enforcing the provisions of the Bankruptcy Code against a municipal debtor. Pet. 16-17. That remarkable holding splits from the decisions of other courts and plainly contravenes both the text and structure of the Bankruptcy Code as a whole. *Id.* at 17-25.

1. Rather than defend the decision below, the Board tries to rewrite it. The Board claims that, despite appearances, the First Circuit "did not hold that § 305 can prohibit a court from enforcing a Bankruptcy Code or PROMESA provision governing a Title III case." Opp. 12. Rather, it contends, the decision below rested solely on the conclusion that Section 922(d) "does not support any relief." *Id.* (emphasis omitted). That characterization serves as the linchpin of the Board's entire response to the first question presented. It is also self-evidently incorrect.

The First Circuit expressly held that "section 305 bars the Title III court from granting Ambac [the] relief" it sought. Pet. App. 11a. It then repeated that holding several more times, stating that Section 305 "prevent[s] the Title III court from granting the relief that Ambac requests," *id.* at 8a, and that "section 305 * * * preclude[s] us from affording [Ambac] the injunctive and declaratory relief that it seeks in this case," *id.* at 12a. It is undisputed—and the First Circuit explicitly recognized—that the relief Ambac requested included "a declaration that the Commonwealth's continued divergence of [special revenue] funds" is "preempted under section 303 of PROMESA, and in violation of sections 922(d) and 928(a) of the municipal-bankruptcy code." *Id.* at 10a. Inescapably, then, the First Circuit held that Section 305 of PROMESA (and, by extension, Section 904 of the Bankruptcy Code, *see* Pet. 20-21) bars a Title III or bankruptcy court from enforcing PROMESA Section 303 and Sections 922(d) and 928(a) of the Bankruptcy Code. *See* Pet. i.

The Board tries to escape this straightforward conclusion by simply skipping the first half of the opinion, and starting its reading on page 14a—*after* the court had already issued its holding on the scope of Section 305. *See* Opp. 12-13. The Board notes that, there, the court stated that it did not need to resolve whether Section 305 would bar enforcement if it "directly conflicted with sections 922(d) or 928(a)," because it found no conflict: Those provisions, it reasoned, only exempt special revenues from the automatic stay, but "say nothing at all about the subject of section 305, *i.e.*, whether the Title III court itself has the power to turn over certain revenues to a creditor." Pet. App. 14a. In the Board's view, this means that the court rested its decision exclusively on what it perceived to be the limited scope of Section 922(d), and did not "actually rule" on the scope of Section 305. Opp. 12. That analysis is misconceived on multiple levels.

First, it simply ignores the court's earlier, unequivocal statements that "section 305" barred Ambac from obtaining a declaration that the Commonwealth's conduct was "in violation of sections 922(d) and 928(a)." Pet. App. 10a-11a. Litigants cannot "cherry pick[]" language from an opinion in this way. *Stokeling* v. *United States*, 139 S. Ct. 544, 553 (2019). And future panels and district courts in the First Circuit assuredly will not have the discretion to do so. They will be bound by the court's clear holding about the meaning of "the text of section 305." Pet. App. 11a.

Second, the language on which the Board stakes its case has no application to Ambac's claim for declaratory relief "under section 303 of PROMESA." *Id.* at

10a. Nothing in the panel opinion suggests that the purportedly limited scope of Sections 922(d) and 928 defeat this claim. Nor did the panel find that the text of Section 303 does not permit the relief Ambac sought. The sole basis the panel offered for rejecting Ambac's Section 303 claim was that it was precluded by the text of Section 305. Pet. App. 10a-11a.[1]

Third, the panel's reasons for finding no conflict between Sections 922(d) and 928, on one hand, and Section 305 of PROMESA (and thus, Section 904 of the Bankruptcy Code), on the other, would apply to the vast majority of the Bankruptcy Code. The court held that there was no conflict between these provisions because Sections 922(d) and 928 "say nothing" about "whether the Title III court itself has the power" to award a particular form of relief. *Id.* at 14a. But precious few provisions of the Bankruptcy Code do that; most of them simply set forth the rights and obligations of municipal debtors and creditors. Under the First Circuit's sweeping logic, then, any provision of the Bankruptcy Code that just affords rights and obligations—read: almost all of them—is unenforceable against a municipal debtor in bankruptcy. That remarkable holding is precisely what the first question presented asks this Court to review. *See* Pet. i.

2. Once the Board's erroneous construction of the decision below is rejected, its remaining arguments against certiorari collapse.

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[1] The Board's suggestion that the appeal did not present the question whether Section 305 barred relief under Section 303, *see* Opp. 13-14, is simply wrong; that issue was explicitly part of the court's holding. *See* Pet. App. 10a-11a.

Because the First Circuit held that Section 305 (and by extension Section 904) blocks a Title III court from enforcing provisions of the Bankruptcy Code and PROMESA, there is not just "daylight," Opp. 14, but a direct conflict between the decision below and the remaining body of case law construing Section 904. In *In re City of Detroit*, 841 F.3d 684 (6th Cir. 2016), for instance, the Sixth Circuit held that Section 904 barred the relief plaintiffs sought only because that relief was *not* grounded in the provisions of the Bankruptcy Code. *Id.* at 697-698; *see* Pet. 18-19. Here, by contrast, the First Circuit held that Section 305 prohibited a request for relief *even though* it was grounded in the provisions of the Code. Pet. App. 10a-11a. Likewise, in *In re City of Stockton*, 478 B.R. 8 (Bankr. E.D. Cal. 2012), the bankruptcy court held that by filing a Chapter 9 case, a municipality "consents, within the meaning of § 904, to interference by a federal court as to the Bankruptcy Code provisions that apply in chapter 9 cases." *Id.* at 22. Here, the First Circuit held just the opposite, explicitly "reject[ing] the argument that the mere filing of a Title III petition might constitute * * * consent." Pet. App. 16a.[2]

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[2] The Board cites several other cases (at 18), but none is consistent with the First Circuit's holding. Indeed, not one of those cases involved a request for relief under provisions of the Bankruptcy Code itself. *In re New York City Off-Track Betting Corp.*, 434 B.R. 131, 140-141 (Bankr. S.D.N.Y. 2010) (suit to recover fees required by state statute, not to enforce provisions of the Bankruptcy Code); *In re Richmond Unified Sch. Dist.*, 133 B.R. 221, 225 (Bankr. N.D. Cal. 1991) (no discussion of suits to enforce the Bankruptcy Code); *In re Sanitary & Im-*

The Board also makes no effort to defend the First Circuit's interpretation of Section 305 on the merits. *See* Opp. 19 (stating, without elaboration, that Ambac is "wrong"). And for good reason. It strains credulity to imagine that a debtor can initiate Title III debt adjustment proceedings yet withhold the consent required for the court to ensure compliance with the laws governing those proceedings. And such a reading would render nugatory large swaths of the Bankruptcy Code, in violation of basic canons of statutory construction and the established understanding of the statutory text. Pet. 21-25. This Court's review is warranted to resolve this clear conflict, and to reverse the First Circuit's flawed interpretation of Sections 305 and 904.

II. THE DECISION BELOW UPSET THE ESTABLISHED UNDERSTANDING OF SECTION 922(d).

The Court should also grant certiorari to review the First Circuit's erroneous construction of Section 922(d). The panel made clear that, even had it concluded that Section 305 allowed the court to award relief (which it did not), it would nonetheless deem the Commonwealth's actions in compliance with Section 922(d). Pet. App. 14a-16a. That holding departs from the settled understanding of Section 922(d), contravenes its clear text, and has contributed to the downgrade of over $8.5 billion of special revenue bonds so far. *See* Pet. 25-33; *infra* pp. 8-9. This Court should grant review on both

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provement Dist. No. 7, 96 B.R. 967 (Bankr. D. Neb. 1989) (same).

questions, in conjunction with the petition in *Assured*, to ensure that it addresses the full breadth of the First Circuit's reasoning and disposes of this case fully.

The Board's reasons for opposing certiorari on this question simply repeat in condensed form the reasons it gives for opposing certiorari in *Assured*. *See* Br. in Opposition at 10-29, *Assured*, No. 19-391 (Nov. 25, 2019). For the reasons set forth in the reply brief in that case, those arguments lack merit. The Board incorrectly minimizes the widespread consensus that the First Circuit opinion disturbed, and its construction of Section 922(d) flouts the statutory text, defeats its purpose, and would render the provision virtually inoperative. *See* Reply Br. in Support of Certiorari at 8-11, *Assured*, No. 19-391 (Dec. 11, 2019) ("*Assured* Reply").

III. THIS CASE IS A CLEAN VEHICLE TO RESOLVE THE IMPORTANT QUESTIONS PRESENTED.

Both questions presented are of immediate and surpassing importance. *See* Sec. Indus. & Fin. Mkts. Ass'n (SIFMA) Amicus Br. 2-5. The decision below has already convulsed the special revenue bond market: In direct response to the First Circuit's novel interpretation of Section 922(d), Moody's Investors Service has downgraded over $8.5 *billion* in existing special revenue bonds to date. *Assured* Reply at 5-8. And contrary to the Board's assertion (at 29), these downgrades are directly linked to the decision in this case. As Moody's has explained, the market is reacting to the First Circuit's "ruling that the Commonwealth of Puerto Rico * * * is not required to pay debt service on 'special revenue' bonds

of [the Puerto Rico Highways and Transportation Authority (PRHTA)] * * * during the pendency of the bankruptcy proceedings." *See, e.g.*, *Rating Action: Moody's Downgrades Cleveland, OH's Senior Lien Water Revenue Bonds to Aa2; Outlook Stable*, Moody's Investors Service (July 29, 2019), https://www.moodys.com/research/Moodysdowngrades-Cleveland-OHs-senior-lien-waterrevenue-bonds-to--PR_905922284. That is the holding of both *Ambac* and *Assured*.

The Board contends (at 29) that the municipal-bond market "hardly blinked" in response to the decision below. That is a curious way of describing the downgrade of $8.5 billion in assets. And the already sizable market response is just the beginning. As other ratings agencies have explained, if the First Circuit's erroneous interpretation of Section 922(d) stands, more downgrades will follow, and the market will begin looking for other, safer investments. *Assured* Reply at 6-8; *see* Opp. 29 (acknowledging that "efficient markets are supposed to react to information"). That response will only accelerate if and when the economy weakens, and more municipalities are at risk of insolvency. Furthermore, the importance of revenue bonds as a secure source of financing has substantially increased "in recent years" due to Detroit's bankruptcy, which undermined investors' faith in general obligation bonds and caused a flight to the relative safety of revenue bonds. Cooper Howard, *Understanding General Obligation Municipal Bonds*, Charles Schwab (Aug.

13, 2019).[3] If revenue bonds are themselves deemed effectively unenforceable in bankruptcy, the attractiveness of municipal bonds to investors, and the capacity of distressed municipalities to raise funds, will be dramatically diminished. The Court should intervene now to prevent these severe and unwarranted consequences.

This case presents a clean vehicle to resolve these important issues. The Board suggests that Ambac's claims will ultimately fail on the merits. That contention takes many forms—that Ambac's constitutional and statutory claims will fail, that its liens do not properly qualify as special revenues, or that PRHTA's operating expenses will swallow up all revenues. Opp. 32-36. But, as the Board admits, the First Circuit did not reach these issues, *id.* at 34, which are vigorously disputed by the parties, and which the courts below can decide on remand. This Court routinely grants certiorari to resolve threshold questions, and remands for additional proceedings. *See, e.g.*, *Manuel* v. *City of Joliet*, 137 S. Ct. 911, 922 (2017); *Nautilus, Inc.* v. *Biosig Instruments, Inc.*, 572 U.S. 898, 913 (2014).

The remainder of the Board's vehicle-related objections boils down to the assertion that, if successful,

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[3] https://www.schwab.com/resource-center/insights/content/understanding-general-obligation-municipal-bonds; *see* Anna M. Rice, *Investing in Detroit: Automobiles, Bankruptcy, and the Future of Municipal Bonds*, 103 Geo. L.J. 1335, 1352-53 (2015); Yvette Shields, *Fitch: Detroit May Herald Broader Rating Impact on GOs*, Bond Buyer (Sept. 19, 2013), https://www.bondbuyer.com/news/fitch-detroit-may-herald-broader-rating-impact-on-gos.

Ambac will recover only a small dollar amount. That is wrong, but it is also immaterial at this stage: A dispute over "even a small amount of money" is justiciable. *See Czyzewski* v. *Jevic Holding Corp.*, 137 S. Ct. 973, 983 (2017). And this case presents two consequential questions on which the First Circuit split with a consensus position. Even if the particular dispute between the parties did not involve large sums, the decision below—if allowed to stand—threatens to upend the multi-trillion-dollar municipal bond market, and to jeopardize the ability of all municipalities to finance future public works projects. It will also have serious implications for the relationship between bankruptcy courts, sovereign debtors, and creditors. This case presents a prime opportunity for the Court to weigh in on these tremendously important issues, which are rarely litigated to this point. Pet. 21; Petition for a Writ of Certiorari at 19 n.5, *Assured*, No. 19-391 (Sept. 20, 2019). It is thus vital for this Court to act on these questions, and to do so now.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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