No. 20-126

IN THE
Supreme Court of the United States

ANDALUSIAN GLOBAL DESIGNATED ACTIVITY COMPANY, ET AL.,
Petitioners,

v.

FINANCIAL OVERSIGHT AND MANAGEMENT BOARD FOR PUERTO RICO, ET AL.,
Respondents.

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

BRIEF IN OPPOSITION OF THE OFFICIAL COMMITTEE OF RETIREES FOR THE COMMONWEALTH OF PUERTO RICO

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QUESTION PRESENTED

Whether the First Circuit, applying Puerto Rico law in a Title III proceeding under the Puerto Rico Oversight, Management, and Economic Stability Act, ("PROMESA"), 48 U.S.C. §§ 2101-2241, properly concluded that Petitioners did not have a secured interest under 11 U.S.C. § 552(b)(1) in post-petition employer contributions to the Commonwealth's public pension system, when any obligation to pay post-petition contributions was subject to multiple contingencies known to the bondholders at the time of investment, and when those potential future contributions were neither in existence nor determinable prior to the Title III proceeding.

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INTRODUCTION

This is a case about the specific language in a set of documents setting forth the parameters of a bond offering, and the meaning of those terms under local Puerto Rico law. Petitioners are the holders of bonds issued in 2008 by the Employees Retirement System of the Government of the Commonwealth of Puerto Rico (the "System"), an independent agency that manages the Commonwealth's pension system for public employees. The terms of this particular bond issuance granted Petitioners an interest in employer contributions received by the System. As detailed in the bond documents and as prescribed by various Puerto Rico statutory provisions, several contingencies had to be met before the System's—and, therefore, Petitioners'—interest in the receipt of future contributions manifested as an actual property right backed by an obligation of employers to pay.

In June 2016, Congress enacted PROMESA, pursuant to which the Commonwealth entered quasi-bankruptcy proceedings nearly a year later. The core issue in the decision below was whether Petitioners' interest in roughly six weeks of employer contributions (from May 21, 2017 through June 30, 2017) is subject to the general rule of 11 U.S.C. § 552(a) that, after a bankruptcy proceeding begins, a creditor cannot maintain a "floating lien" in property acquired by the debtor post-petition. Or, alternatively, whether Petitioners' interest as set forth in the bond-issuance documents and governing Commonwealth statutes was actually pre-petition "property" or "proceeds" thereof, as defined by local Puerto Rico property law, such that

it falls within the narrow exception of § 552(b). The First Circuit correctly decided "narrowly, based on these specific facts," that the general rule applied. Pet. App. 38a.

Out of this localized, fact-bound dispute, the Petition attempts to craft a circuit split that allegedly undermines trillions of dollars in transactions and secured lending under the Bankruptcy Code, generally. This Court should not take the bait.

First, there is no division in the circuits for this Court to resolve. Petitioners attempt to manufacture a division in authority by mischaracterizing the reasoning of the First Circuit below, and then casting that mischaracterization as in conflict with decisions of other circuits. But as the First Circuit made clear, the decision below comports with both the cases cited in the Petition and with the First Circuit's own precedent, which in turn expressly adopts the approach of the decisions Petitioners cite as evidence of a conflict.

Second, the Petition asks this Court to resolve an issue that turns on local Puerto Rico property law, namely, whether the many known contingencies standing between Petitioners and any claim to not-yet-existing post-petition contributions rendered their interest an "expectancy" rather than a "property right" under Puerto Rico law. Decisions of local law—even local law incorporated as a matter of federal law—are not the foundations on which successful petitions are built.

Third, the Petition's warnings about the wide-ranging impact of the decision below are an inaccurate

distraction. In fact, the circumstances of this case are specific to the particular bond issuance here and are highly unlikely to recur. The First Circuit's fact-specific analysis was based on the enumerated contingencies in the bond documents themselves, not the least of which was the fact that the System was explicit in cautioning investors that the Commonwealth could enact legislation that would impair or eliminate the bondholders' collateral. All that is at issue here is six weeks of employer contributions.

Fourth, in relying upon the Bankruptcy Uniformity Clause of Article I, the Petition asks this Court to resolve, in the first instance, a constitutional question about the scope of Congress's authority under the Article IV Territories Clause upon which no court has previously passed and which is being actively litigated in the district court below.

Fifth, the decision below is correct. Section 552(b)'s narrow exception does not apply because the contributions that were paid post-petition, but that were not owed pre-petition, are not "proceeds" of pre-petition "property" under Puerto Rico law. But, in any event, a determination by this Court that the § 552(b)(1) exception is available does not mean that the outcome here would be any different, because a district court has the statutory authority to deny the exception based on the "equities of the case," which cut strongly against Petitioners.

STATEMENT

A. Statutory Background

Among other objectives, the Bankruptcy Code balances security for the fairly bargained-for interests of creditors, on one hand, with the need for debtors to rehabilitate and return to economic productivity following bankruptcy, on the other. One statute that helps strike this balance is 11 U.S.C. § 552. It provides that, as a general rule, "property acquired by the estate or by the debtor after the commencement of the [bankruptcy] case is not subject to any lien resulting from any security agreement entered into by the debtor before commencement of the [bankruptcy] case." 11 U.S.C. § 552(a). Thus, a debtor's "post-petition revenue is not cash collateral" that can be claimed by a creditor, "even if there is an 'after acquired' clause in the security agreement" with that creditor. *Far East Nat'l Bank v. U.S. Tr., San Diego, LP (In re Premier Golf Props.)*, 477 B.R. 767, 771 (B.A.P. 9th Cir. 2012).

Prohibiting such "a 'floating lien,'" with which creditors could otherwise claim post-petition revenue as their pre-petition collateral, makes good sense. *See N.H. Bus. Dev. Corp. v. Cross Baking Co. (In re Cross Baking Co.)*, 818 F.2d 1027, 1029 (1st Cir. 1987). This rule "allow[s] a debtor to gather into the estate as much money as possible to satisfy the claims of *all* creditors." *Philip Morris Capital Corp. v. Bering Trader, Inc. (Bering Trader)*, 944 F.2d 500, 502 (9th Cir. 1991) (emphasis added). It also enables a debtor to survive the bankruptcy process, as "a debtor reorganizing his business has a compelling need to use cash collateral

[to] rehabilitate its business," *Marathon Petroleum Co. v. Cohen (In re Delco Oil, Inc.)*, 599 F.3d 1255, 1258 (11th Cir. 2010), and encumbered revenues impede a debtor's ability to receive future financing.

Section 552 also contains "a *narrow* exception to the rule of 552(a)." *Bering Trader*, 944 F.2d at 502 (emphasis in original). This exception may be available, depending on a district court's view of the equities, when a pre-petition security agreement provides the creditor a security interest in "property of the debtor acquired *before* commencement of the [bankruptcy] case *and* to proceeds" of that property. 11 U.S.C. § 552(b)(1) (emphasis added). Stated differently, the exception is not available for "property" acquired after the petition date, only "proceeds" of "property" that actually existed and was actually acquired by the debtor prior to bankruptcy.

But the § 552(b) exception does not apply "to any extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise." *Id.* Thus, "a bankruptcy court may choose not to apply a pre-petition security interest to post-petition proceeds 'based on the equities of the case,'" even if the terms of the exception are otherwise met. *United Va. Bank v. Slab Fork Coal Co.*, 784 F.2d 1188, 1191 (4th Cir. 1986). This statutory choice to "give[] the bankruptcy court considerable latitude in applying pre-petition security interests to post-petition proceeds" reflects Congress's intent "to find an appropriate balance between the rights of secured creditors and the rehabilitative purposes of the bankruptcy [c]ode." *Id.*

Although whether a party holds a qualifying

interest in "property" and "proceeds" under § 552(b) is "ultimately a question of federal law," the "answer to this federal question … largely depends on state law." *United States v. Craft*, 535 U.S. 274, 278 (2002). And the party asserting an interest in such "property has the burden of proof on the issue of the validity, priority, or extent of such interest." 11 U.S.C. § 363(p)(2); *In re Premier Golf*, 477 B.R. at 772.

B. Factual Background

This case arises from the unique circumstances facing Puerto Rico at the time that Congress enacted PROMESA, including Puerto Rico's specific statutory scheme for public pension funding. Puerto Rico created the System in 1951 to provide pensions and retirement benefits for employees of various public entities in the Commonwealth. Pet. App. 11a. The System is "independent and separate" from other Commonwealth agencies. *Id.* (quoting P.R. Laws Ann. tit. 3, § 775). Until July 2017, the System was funded by investment income and by mandatory contributions from employees and employers. But, by statute, the contributions were not received by the System until the Puerto Rico legislature allocated them to the System through the Commonwealth's annual appropriations process. *Id.* (citing P.R. Law Ann. tit. 3 § 781(g)).

In January 2008, the System's Board of Trustees adopted a resolution ("Bond Resolution") allowing the issuance of $2.9 billion in bonds. *In re Fin. Oversight & Mgmt. Bd. of Puerto Rico ("Altair")*, 914 F.3d 694, 704 (1st Cir.), *cert. denied*, 140 S. Ct. 47 (2019). Bondholders under this issuance, including Petitioners,

were granted a security interest in "Pledged Property." Pet. App. 12a. The Bond Resolution defines "Pledged Property" to include, among other things, "All revenues," "All right, title and interest of the System in and to Revenues, and all rights to receive the same," and "Any and all cash and non-cash proceeds, products, offspring, rents and profits from any of the Pledged Property." *Id.* The Bond Resolution defines "Revenues" to include "Employers' Contributions," which are in turn defined as "the contributions paid from and after the date hereof that are made by the Employers … which are payable to the System pursuant to" Puerto Rico statute. Pet. App. 12a-13a.

The Employers' Contributions have three components, computed monthly on the basis of a statutory formula. Pet. App. 19a. The first component is a regular percentage of the employer's payroll, which necessarily varies based on the compensable labor performed by employees in a given pay period. Pet. App. 71a. The second component varies based on the number of the employer's current pensioners at the time of computation. Pet. App. 71a. And the third component depends on "the proportion of total employer contributions corresponding to each employer in a particular year," which varies annually. Pet. App. 72a. By statute, an employer is not required to make any contribution until the employer's contribution is determinable pursuant to the calculation of these components. Pet. App. 19a.

Both the Bond Resolution and the Official Statement for the bonds expressly set forth several additional contingencies that could impact or prevent

payment of future employer contributions. The Bond Resolution states that the Legislature of the Commonwealth could reduce the Employer Contribution rate or make other changes in existing law that "adversely affect" the amount of Employer Contributions. Pet. App. 21a. The Official Statement for the bonds also puts bondholders on notice that if the Commonwealth's fiscal condition is such that it cannot cover approved appropriations for contributions, it may prioritize paying public debt over those contributions. Pet. App. 22a. And, as sophisticated investors, Petitioners and other bondholders were well aware that the legislature could amend statutory contribution obligations at any time.

And that is precisely what happened. In 2013, the Puerto Rico legislature responded to the Commonwealth's fiscal crisis by, among other things, freezing the accrual of pension benefits for active government employees as of the date of the 2013 statutory amendment. Pet. App. 13a.

The Puerto Rico legislature was not the only government body to respond to the severe finance crisis facing the Commonwealth. In June 2016, Congress enacted PROMESA. *See generally Fin. Oversight & Mgmt. Bd. for Puerto Rico v. Aurelius Inv., LLC*, 140 S. Ct. 1649, 1655 (2020) (describing enactment of PROMESA). PROMESA established the Financial Oversight and Management Board for Puerto Rico (the "Board") "to provide a method for [Puerto Rico] to achieve fiscal responsibility and access to the capital markets." 48 U.S.C. § 2121(a). In doing so, Congress stated that PROMESA would "prevail over

any general or specific provisions of territory law, State law, or regulation that is inconsistent with this chapter." *Id.* § 2103. The Board's authority includes commencing debt restructuring proceedings under Title III, which applies "with respect to debts, claims, and liens . . . created before, on, or after [June 30, 2016.]" *Id.* § 2101(b)(2). PROMESA incorporated § 552 of the Bankruptcy Code into its Title III quasi-bankruptcy proceedings.

On May 21, 2017, the Board filed a petition under Title III of PROMESA on behalf of ERS. Pet. App. 66a. Following the Title III petition, the legislature passed another statute restructuring the obligations of Commonwealth employers to provide pensions. Under this new Pay-Go system, the governmental employers' obligations to make employer contributions to the System were eliminated and instead the Commonwealth's general fund paid pensions. Pet. App. 14a. As of July 1, 2017, the System stopped receiving employer contributions. Pet. App. 66a.

C. The Decisions Below

The issue decided below was whether some six weeks of employer contributions made to the System between May 21 and June 30, 2017 qualify as "proceeds" under § 552(b)(1) subject to Petitioners' liens, or constitute after-acquired property that is not subject to any lien under § 552(a). *See Altair*, 914 F.3d at 708.[1]

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[1] As the district court noted, as of July 1, 2017, the System stopped receiving Employers' Contributions due to the implementation of

After a remand from the First Circuit on a separate question not at issue here, the district court concluded on summary judgment that "Bankruptcy Code Section 552 prevents any security interest resulting from liens granted in [bondholders] favor prior to the commencement of [the] Title III case from attaching to revenues received by [the System] during the post-petition period." Pet. App. 84a. The district court held that because the System's right to receive contributions only "comes into existence as the result of and contemporaneously with post-petition acts," any proceeds of that right arise from "post-petition property" and therefore do not qualify for the exception under § 552(b). Pet. App. 73a. Citing Puerto Rico law and the specific language of the Bond Resolution, the district court distinguished the Petitioners' interests from pre-petition property rights that already exist without material contingencies prior to bankruptcy.

The First Circuit affirmed. It explained that "[t]he key to resolving the § 552 argument in this case is the limited definition of 'Employers' Contributions'" under the Bond Resolution because it incorporates several critical limitations to and contingencies on the System's (and, therefore, bondholders') interest in these contributions. Pet. App. 18a. These contingencies include the formula for calculating monthly

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the Commonwealth's 2017 Pay-Go statute. Pet. App. 66a. The validity of the Pay-Go legislation is the subject of a separate adversary proceeding and was not before the First Circuit. Pet. App. 14a n.4.

contributions, the statutory provision that no employer is obligated to make contributions "until the Employers' Contributions are determinable" under that formula, and the fact that allocation of funds to the System was dependent upon "future appropriations by the legislature." Pet. App. 19a.

As a result, the court concluded "that the System's statutory authority to receive post-petition Employers' Contributions constituted merely an expectancy and not a property 'right'" under Puerto Rico law, "as it is clear that the payment and the amounts of the Contributions depended on work occurring on and after the petition date." Pet. App. 20a. Supporting this conclusion were the further contingencies, explicitly laid out in the Bond Resolution and the bonds' Official Offering Statement, that "the payment of future Contributions was contingent on Puerto Rico's future fiscal status and the decisions of future Puerto Rico legislatures," including warnings that "the legislature of the Commonwealth might reduce (or, by implication, eliminate) Employers' Contributions," and that "if faced with insufficient funds to pay approved appropriations, the Commonwealth would prioritize paying public debt over funding Employers' Contributions." Pet. App. 20a-21a.

ARGUMENT

Contrary to the Petition's assertions, the First Circuit did not split from decisions of other circuits, but rather accepted and distinguished them when applying the specific facts and the local Puerto Rico law at issue here. Given the factbound nature of the decision below, there is no basis for Petitioners' warnings of dire

consequences for all secured lending under the Bankruptcy Code. Indeed, it is Petitioners who invite this Court to enter unchartered territory by addressing the application of the Article I Bankruptcy Uniformity Clause to PROMESA, an issue that is not yet fully briefed in the district court. And, in any event, the decision below is correct. This Court should not grant review.

I. There Is No Division in the Circuits for This Court to Resolve.

In petitioning for this Court's review, Andalusian asserts that the decision below reads additional requirements into § 552(b) and conflicts with decisions in other circuits. Neither assertion is correct.

The Petition claims that the First Circuit "narrowed Section 552(b)(1) as applicable *only* when those future proceeds are fixed and calculable at the time the petition is filed." Pet. 2. But the First Circuit did no such thing. Instead, the decision below considered several factors in its analysis of whether, under Puerto Rico law, the Petitioners had a secured property interest in the post-petition Employer Contributions, or merely an expectancy. One consideration was that employers' obligations to make the contributions post-petition were not fixed pre-petition; indeed, under Puerto Rico law, employers had no obligation to make contributions until the amount of contribution was determined. Another was that, under Puerto Rico law, the employer contributions were regularly calculated on the basis of multiple components that were unknowable pre-petition. Further, under Puerto Rico law, these contribution obligations arose not from a

private contract but under statutes that could be—and were—unilaterally amended by the legislature. And, moreover, any interest in future contributions was subject to multiple known contingencies and risks set out in the Bond Resolution and the Official Statement themselves, including the risk that Puerto Rico would face fiscal challenges rendering it unable to make the contributions. *See* Pet. App. 21a-24a.

Once the actual reasoning of the First Circuit is clarified, Petitioners' claimed conflicts evaporate. Petitioners assert first a conflict with the Fourth Circuit's opinion in *United Virginia Bank v. Slab Fork Coal Co.*, 784 F.2d 1188 (4th Cir. 1986), which the First Circuit has previously cited approvingly and has relied upon when analyzing § 552(b)(1). *See Cadle Co. v. Schlichtmann*, 267 F.3d 14, 20 (1st Cir. 2001) (applying *Slab Fork Coal* to an "analogous situation" under § 552(b)). In *Slab Fork Coal*, the debtor mining company supplied coal to a buyer pursuant to a contract in which the creditor, a bank, had a pre-petition security interest. 784 F.2d at 1189. Facing financial challenges, the debtor shut down its mining operation and filed for bankruptcy. But, rather than breach what was a profitable contract, after filing for bankruptcy the debtor engaged another mining company to supply the coal "for the account of [the debtor]" on the pre-petition contract, while the debtor continued to be paid by the buyer under that original contract. *Id.*

The issue before the Fourth Circuit was whether, for the purposes of § 552(b), the bank held a pre-petition property interest in the net receipts from the second supply contract, *i.e.*, the difference between

what the debtor paid the new mining company and what it received from the buyer. *Id.* The Fourth Circuit held that the exception applied. The court reasoned that the shipping of coal by the new supplier "post-petition was done pursuant to and in performance of the original supply contract," which constituted an already-existing "underlying asset" of the debtor at the time of bankruptcy. *Id.* at 1190-91. Therefore, any payments on the original contract were simply proceeds from a property right that was already fully formed and enforceable prior to the bankruptcy.

As the First Circuit explained in adopting the reasoning of *Slab Fork Coal* in its 2001 *Cadle* decision, the bank's pre-petition interest in the original supply contract is "analogous" to a pre-petition interest in accounts receivable. 267 F.3d at 20. As with the pre-petition supply contract in *Slab Fork Coal*, the obligations giving rise to the post-petition payments on the *Cadle* accounts receivable were existing and enforceable before the debtor filed for bankruptcy. *Id.* at 21. Therefore, in the First Circuit's view, the § 552(b)(1) exception was available just as in *Slab Fork Coal*.

The First Circuit has never disavowed its approval of *Slab Fork Coal* or its own precedent in *Cadle*. In the decision below, the First Circuit analyzed both *Slab Fork Coal* and *Cadle* but concluded, correctly, that "[t]he facts here differ considerably." Pet. App. 23a. Unlike in *Slab Fork Coal*, which involved pre-petition obligations on a private, enforceable contract, the revenue here was contingent on "known risks of alteration" pre-petition, which "distinguish the instant

case from the cases the [Petitioners] cite[d] regarding liens on pre-petition contracts." Pet. App. 22a (citing *Slab Fork Coal*, 784 F.2d at 1191). Specifically, the express language of the Bond Resolution and the bonds' Official Statement made clear to Petitioners and other sophisticated bond investors that "the payment of future Contributions was contingent on Puerto Rico's future fiscal status and the decisions of future Puerto Rico legislatures" in multiple respects. Pet. App. 20a.

Moreover, by Puerto Rico statute, "an employer is not obligated to contribute anything until the Employers' Contributions [as defined in the Bond Resolution] are determinable." Pet. App. 19a. As discussed above, the three components of Employers' Contributions under the Bond Resolution are calculated based on factors that shift month to month and year to year and, therefore, were "yet-to-be-calculated or contributed." Pet. App. 23a. "Unlike the [asset] in *Cadle*," which was "fixed pre-petition and payable at any time," the Contributions at issue are only determinable post-petition…[and] are not payable until they are determined post-petition." Pet. App. 23a-24a. In light of these material factual differences—known legislative contingencies, the lack of a fixed and existing pre-petition property right, a local statutory requirement that contributions be determined based on post-petition variables before there is any obligation to pay them—the decision below conflicts with neither *Slab Fork Coal* nor First Circuit precedent that adopted the Fourth Circuit's approach.

Petitioners then turn to the Tenth Circuit's decision in *Valley Bank & Trust Co. v. Spectrum Scan, LLC (In*

re Tracy Broadcasting Corp.), 696 F.3d 1051 (10th Cir. 2012), another case that the First Circuit expressly considered and distinguished in the decision below. *See* Pet. App. 24a & n.9. In *Tracy*, the pre-petition property at issue was a radio broadcast license from the Federal Communications Commission ("FCC"). Prior to filing for bankruptcy, the debtor radio station had executed a promissory note with a security agreement granting the creditor bank a security interest in the debtor's "general intangibles and their proceeds," include proceeds from a future sale of the license. *Tracy*, 696 F.3d at 1052. To determine whether this claimed interest in future sale proceeds was protected by § 552(b), the Tenth Circuit considered, first, whether the debtor had authority to assign such an interest given the FCC's authority to approve license sales, and, if so, whether creditor had sufficient rights in the license proceeds under Nebraska law. The Tenth Circuit answered both questions affirmatively. *Id.* at 1065.

The Petition asserts that the decision below conflicts with *Tracy* because the First Circuit found intervening government approvals relevant to whether bondholder interests were fixed or contingent, whereas, according to petitioners, FCC approval was not an impediment to the outcome in *Tracy*. This misrepresents the Tenth Circuit's reasoning in that case. The Tenth Circuit did consider the contingency of a future FCC approval, but did so in its analysis of whether the security agreement was *valid to begin with*. *See Tracy*, 696 F.3d at 1054-56.

Once the Tenth Circuit established that the security

agreement was permissible under federal law governing FCC licenses, the court "look[ed] to Nebraska law" "to determine whether [the creditor] had a property interest … in the right to proceeds of a future sale of [the] license" under § 552(b). *Id.* at 1060. And, under Nebraska law, the court concluded that "the right to the proceeds of a potential sale of a license" was "not a right too speculative" for a security interest to attach to those proceeds under § 552(b). *Id.* at 1061. In reaching this result, the Tenth Circuit specifically relied upon commercial practice regarding sales of licenses and a Nebraska statutory revision that "overrides state licensing laws that would bar the creation, attachment, and perfection of security interests in state-issued licenses." *Id.*

Nothing in the Tenth Circuit's decision conflicts with the decision below. To the contrary, the Tenth Circuit and the First Circuit took the same approach: Each analyzed whether the creditor's interest in pre-petition "property" was afflicted with material contingencies, and then each decided how the applicable state or territorial law treated those contingencies for the purposes of § 552(b). The fact that the federal Communications Act and Nebraska law make some contingencies immaterial to interests in existing licenses says nothing about how very different contingencies under Puerto Rico law affect interests in future obligations to pay pension contributions that are not yet enforceable or calculable. *See* Pet. App. 24a n.9 ("In *Tracy*, the FCC license already existed, so the right to its sale proceeds was more analogous to uncalculated accounts receivable than the 'right to

receive' Employers' Contributions, which arise post-petition from employee labor and salary every month."). Federal bankruptcy law in these circuits is not different, only the facts of the cases are.

Petitioners' reliance on *In re Sunberg*, 729 F.2d 561 (8th Cir. 1984), and *Jones v. Salem National Bank (In re Fullop)*, 6 F.3d 422 (7th Cir. 1993), fares no better. In *Sunberg*, the proceeds at issue were benefits under a federal payment-in-kind program under which farmers agreed not to use acreage for crops, in exchange for the benefits. *Sunberg*, 729 F.2d at 563. The Eighth Circuit relied on Iowa law to reject a debtor's argument that a security interest could not attach to post-petition benefits that were contingent on the debtor's future performance. This was because, under a specific provision of the Iowa Commercial Code, a security interest may attach to "a right to payment for services rendered 'whether or not it has been earned by performance.'" *Id.* at 562 (quoting Iowa Code Ann. § 554.9106)).

Fullop, which was not cited by Petitioners in their First Circuit briefing, is similarly distinguishable. That case involved the debtor's grant of a "working interest" in oil and gas extractions from a leased plot of land. The Seventh Circuit's holding reached only "the requirements a secured creditor must meet to perfect its interest in the oil extracted under such a lease" pursuant to Illinois law. *Fullop*, 6 F.3d at 424. But in dicta, the court asserted that oil extracted post-petition is the "product or profits of the working interest" as defined by Illinois law and, therefore, falls within the exception of § 552(b) for after-acquired property.

Although the Seventh Circuit's aside is nonbinding, it comports with *Slab Fork Coal* and the First Circuit's decision in *Cadle*, and is consistent with the decision below, in recognizing a § 552(b) exception when the property interest was fixed and enforceable prior to bankruptcy.

Finally, the Petition's assertion that "the First Circuit expressly declined to follow precedent from other circuits" is simply false. Pet. 9. The Petition selectively quotes the First Circuit's acknowledgment that *Tracy* is "not binding on us" but fails to provide the rest of the same sentence, which states that *Tracy* is "*distinguishable*." Pet. App. 24a n.9 (emphasis added). The Petition also neglects to provide the rest of the same footnote, which proceeds to distinguish the material facts of *Tracy*. Nor did the decision below "refuse[] to apply the Fourth Circuit's decision in [*Slab Fork Coal*]," as the Petition inaccurately claims. Pet. 9. Rather, the First Circuit expressly "distinguish[ed]" the facts of *Slab Fork Coal* as not involving "known risks of alterations" to claimed post-petition interests. Pet. App. 22a. As for *Sunberg* and *Fullop*, the lower court's decision does not discuss those cases, Petitioners did not even cite *Fullop* in the First Circuit proceedings below. The First Circuit can hardly be accused of "expressly declin[ing]" to follow decisions that Petitioners either did not present or that the decision below did not mention.

II. The Petition Asks This Court to Grant Certiorari to Resolve a Question of Local Puerto Rico Law.

This Court's review is unwarranted because the determinative question in this case is, at base, an issue of local Puerto Rico law. *See Craft*, 535 U.S. at 278. This Court "ha[s] long recognized that the basic federal rule in bankruptcy is that state law governs the substance of claims, Congress having generally left the determination of property rights in the assets of a bankrupt's estate to state law." *Travelers Cas. & Sur. Co. of Am. v. Pac. Gas & Elec. Co.*, 549 U.S. 443, 450-51 (2007) (internal quotation marks omitted).

The key conclusion of the decision below was that the various "known risks" and contingencies in Puerto Rico law, the Bond Resolution, and the Official Statement meant that "the Bondholders did not have a pre-petition property right in any post-petition contributions that might be made. At most, the Bondholders had an expectation….Puerto Rico law recognizes that the mere expectancy of property is not itself a property interest." Pet. App. 21a & n.7 (citing cases distinguishing between expectations and vested property interests under Puerto Rico law).

Indeed, that is no surprise—as noted above, see *supra* Part I, the cases on which Petitioners rely for the purported split turn on issues of local law, not a uniform federal law. *See, e.g.*, *Tracy*, 696 F.3d at 1060 (construing Nebraska law); *Sunberg*, 729 F.2d at 562 (construing Iowa law); *Fullop*, 6 F.3d at 424 (construing Illinois law). *See also* Pet. 22 (acknowledging that "[s]tate law determines … which sticks are in a

person's bundle" (quoting *Craft*, 535 U.S. at 278)). That Petitioners seek review only of local law—not uniform federal law—is fatal to the Petition.

Nor can Petitioners prevail by suggesting that this Court treat the term "general intangibles" from Article 9 of the Uniform Commercial Code as a universally applicable, federally imposed definition of "property" under § 552(b). *See* Pet. 22-23. The Petition's approach would turn bankruptcy law on its head. Congress has made the intentional choice of incorporating state and territorial substantive law—including the definition of property rights and procedures for property perfecting security interests under § 552—into the Bankruptcy Code. *See Travelers Cas. & Sur. Co. of Am.*, 549 U.S. at 450-51 ("Congress … generally left the determination of property rights in assets of a bankrupt's estate to state law."); *Butner v. United States*, 440 U.S. 48, 54-55 (1979) (holding that, in bankruptcy, "[p]roperty interest are created and defined by state law"). Contrary to Petitioners' assertions, this Court has held for over a century that the resulting jurisdiction-specific analysis poses no problem under the Constitution's Bankruptcy Uniformity Clause. *Stellwagen v. Clum*, 245 U.S. 605, 613 (1918) ("Nothwithstanding this requirement as to uniformity the bankruptcy acts of Congress may recognize the laws of the state in certain particulars, although such recognition may lead to different results in different states."). It is therefore not the job of this Court to iron out wrinkles among the laws of various states and territories, even if variations among those

laws may affect outcomes under the federal Bankruptcy Code.

III. The Fact-Specific, Narrow Decision Below Has Not Resulted, and Will Not Result, in the Petition's Parade of Horribles.

As the Petition tells it, the decision below has upset nearly all of secured lending, threatening trillions of dollars in transactions involving security interests in future revenue streams. *See, e.g.*, Pet. 28. But the Petition is long on rhetoric and short on evidence (and short on the amici one might expect to see if its dire predictions were credible). As is clear from the face of the statute, § 552(a) is the default rule, and § 552(b)(1) the unusual exception—not a foundational support for secured lending in general. In addition, any analysis of whether § 552(b) applies is necessarily highly fact-specific, turning on the definition of the purported collateral at issue and on local law. Petitioners ask this Court to rewrite the narrow § 552(b) exception to swallow the § 552(a) rule and to turn a fact- and jurisdiction-specific inquiry into an abstract application of a bright-line rule—requests both the district court and the First Circuit properly refused.

The Petition describes the question presented as one of "enormous importance" with "far-reaching and destabilizing practical consequence." Pet. 27. This statement grossly overstates, and misapprehends, the First Circuit's narrow and fact-specific holding that post-petition "Employers' Contributions"—as that phrase is defined in the specific Bond Issuance at issue—are not "proceeds" of Petitioners' pre-petition

collateral, and therefore do not fit within the narrow exception to § 552(a).

The First Circuit made no sweeping pronouncements about whether future revenue streams are or are not "proceeds, products, offspring, or profits" of pre-petition property under § 552(b), as the Petition suggests. To the contrary, the First Circuit was explicit as to the narrow scope of its ruling: "We emphasize that we decide each of these three claims narrowly, based on these specific facts." Pet. App. 38a. And, with respect to the First Circuit's decision that post-petition Employers' Contributions are not "proceeds," the "specific facts" that informed its decision included the limitations and contingencies in the Bond Offering and the bonds' Official Offering Statement. These contingencies included the Bond Offering's caution that the System's (and thus the bondholders') rights to future Employers' Contributions were "contingent on Puerto Rico's future fiscal status and the decisions of future Puerto Rico legislatures," including warnings that "the legislature of the Commonwealth might reduce (or, by implication, eliminate) Employers' Contributions," and that "if faced with insufficient funds to pay approved appropriations, the Commonwealth would prioritize paying public debt over funding Employers' Contributions." Pet. App. 21a-22a.[2]

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[2] As the First Circuit noted, Petitioners were paid for these risks, receiving an "interest rate that exceeded the then-market municipal borrowing rate" and also received the additional benefits of the bonds being tax-exempt under certain

These specific contingencies—the known ability of the Commonwealth to eliminate Employers' Contributions and thus eliminate any right to future Employers' Contributions, the unpredictability of the sheer existence of Employers' Contributions, the statutory provision that no employer is obligated to make contributions "until the Employers' Contributions are determinable" under the formula prescribed in the Bond Offering—are sui generis. The First Circuit's decision did not narrow the reach of § 552(b)(1)'s exception or differ with other courts' reading of that statute, it simply applied the unique facts of this case to the relevant territorial law and concluded that post-petition Employers' Contributions are not proceeds of pre-petition property. Indeed, if the First Circuit's decision is of any precedential value, it is for the uncontroversial point that a court should carefully review the loan agreements and collateral descriptions to determine the nature of a debtor's, and thus a lienholder's, property interest (if any) in the collateral at issue.

The Petition's concern that the First Circuit's decision adds uncertainty to the Bankruptcy Code's protections for special revenue bonds is also misplaced. *See* Pet. 30-33. Section 902(2) sets forth a precise definition for "special revenues," and § 928 makes § 552(a) inapplicable to liens on special revenues. The fact that both lower courts easily found that Employers' Contributions do not fit within the § 902(2) definitions,

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circumstances. Pet. App. 12a n.2.

and thus that § 928 is in applicable, changes nothing. If a municipality desires to issue bonds secured by "special revenues," and the special revenues are of the type set forth in § 902(2); section 552(a) never even comes into play.

Any purported impact of the decision below is further limited by the fact that, unlike other municipal bond issuances, the bond issuance here was made by an "independent and separate" agency, not a municipal or state authority. *Altair*, 914 F.3d at 704 (quoting P.R. Laws Ann. tit. 3, § 775). This fact creates an additional contingency—the dependence of the bond issuer on the third-party decision-making of the Puerto Rico legislature for the issuer's statutory expectancy in future contributions—that distinguishes this case from a municipal bankruptcy of the bond issuer itself. Thus, unlike a typical municipal bankruptcy, in this Title III proceeding the System has no future revenue sources other than future contributions, which the Petitioners knew full well depended on the independent decisions of a third party.

In sum, the First Circuit's holding threatens neither secured lending in general, nor the municipal bond market. Indeed, notwithstanding the Petition's abundance of rhetoric about the "havoc" that will result from the decisions below, the Petition fails to identify a single adverse effect that the lower courts' decisions have had on secured lending or the municipal bond market in the time since the district court first issued its opinion. The First Circuit's decision has little impact even in the System's Title III case given that the post-petition employer contributions at issue

ceased to exist as of July 1, 2017 and thus, what is at issue are only those contributions made between May 21, 2017 and June 30, 2017. *See supra* n.1. Certiorari is not needed.

IV. The Petition Asks This Court to Address Unresolved Questions Regarding Whether the Article I Bankruptcy Uniformity Clause Applies to Territorial Legislation and to PROMESA, in Particular, Constitutional Issues Not Raised Below and Not Yet Resolved by Any Lower Court.

The petition insists this Court should review the decision below because the First Circuit has purportedly "undermine[d] the constitutional imperative of uniform bankruptcy laws." Pet. 18. In doing so, the petition necessarily assumes that the Bankruptcy Uniformity Clause of Article I applies when Congress legislates under the Territories Clause of Article IV, which Congress did when enacting PROMESA. *See Aurelius Inv., LLC*, 140 S. Ct. 1649. But no court has ever held that the Constitution's Article I grant of congressional authority to enact "uniform Laws on the subject of Bankruptcies throughout the United States," U.S. Const. art. I, § 8, cl. 4, affects the plenary nature of Congress's separate Article IV power to legislate for the territories. Nor has any court yet addressed whether, or how, the Bankruptcy Uniformity Clause specifically affects PROMESA's scope and Title III proceedings thereunder, even if it does apply.

Indeed, Congress specifically recognized these open constitutional questions when enacting PROMESA.

The statute includes both a general severability clause and a specific "[u]niformity" severability clause. The latter provides that if a court finds PROMESA invalid "on the ground that the provision fails to treat similarly situated territories uniformly," the provision is not severed but rather shall "be extended to any similarly situated territory" that requests the establishment of an oversight board. 48 U.S.C. § 2102(b).

Whether the Bankruptcy Uniformity Clause applies in Puerto Rico, and to legislation like PROMESA, is presently being briefed in an adversary proceeding in the Bankruptcy Court for the District of Puerto Rico. *See* Compl., *Fin. Mgmt. Oversight Bd. v. Ambac Assurance Corp.*, No. 20-00068 (Bankr. D.P.R. 2020), ECF No. 1. At issue in that litigation is whether the Bankruptcy Uniformity Clause applies when Congress legislates for Puerto Rico and other territories under Article IV; if so, whether PROMESA satisfies the requirements of that clause; and, if the clause applies and PROMESA as enacted does not meet its requirements, whether either of the statute's severability clauses can save it from the allegedly offending provisions.[3] This Court should not accept the

[3] As the Committee has argued in the ongoing litigation in the district court, the Bankruptcy Uniformity Clause does not, in fact, apply when Congress enacts territorial legislation, and even if it did, PROMESA satisfies the clause's uniformity requirements. *See* Proposed Motion to Dismiss, *Fin. Mgmt. Oversight Bd. v. Ambac Assurance Corp.*, No. 20-00068 (Bankr. D.P.R. 2020), ECF No. 12-1.

petition's invitation to consider these issues before they have even been fully briefed in the district court.

Petitioners' exhortation that this Court provide "uniformity" among the circuits by applying the Bankruptcy Uniformity Clause to PROMESA—and in a proceeding that turns on territorial law—therefore only proves what a poor vehicle this case provides for the question presented. Even if there were a circuit split—and there is not—this case arises in a unique posture implicating novel constitutional issues that should not be passed upon for the first time by this Court, in this context.

V. The First Circuit Correctly Decided That Petitioners Have No Secured Interest Here.

The First Circuit correctly concluded that the Petitioners do not have a secured interest in employer contributions received by the System between May 21, 2017 and June 30, 2017.

As discussed in Part III, *supra*, the decision below properly focused its analysis on the specific provisions of the Bond Resolution, the Official Statement, and provisions of local law that define the bondholders' interests pre- and post-petition. Considering a multiplicity of case-specific factors—the nonexistence of the future contributions pre-petition, the inability to determine each of the three statutory components of any contribution stream prior to future labor to generate those contributions, the legal bar on employers having any obligation to make contributions prior to their calculation, the ability of the Puerto Rico legislature to decline to appropriate the contributions

to the System including during a fiscal crisis, the stated potential for legislative amendment to the contribution formula or employer obligations generally—both the district court and the First Circuit correctly concluded that the Petitioners' contingent expectancy did not qualify as "property" under § 552(b). *See* Pet. App. 20a.

The post-petition contributions are most analogous to post-petition accounts receivable, which courts of appeals have consistently held "generally do not constitute 'proceeds' of pre-petition receivables under section 552(b)." *In re Cross Baking Co.*, 818 F.2d at 1032; *see also Arkison v. Frontier Asset Mgmt., LLC (In re Skagit Pac. Corp.)*, 316 B.R. 330, 336 (B.A.P. 9th Cir. 2004) ("Proceeds of post-petition accounts receivable do not fall within the § 552(b) proceeds exception."). This is because, like the post-petition contributions here, post-petition accounts are attributable to post-petition labor and services, "[a]nd what [wa]s produced by the debtor's added value by its labor (or the value added by others' labor) throughout the process of the reorganization effort w[ould] likewise not be subject to a creditor's pre-petition interest." *Arkinson*, 316 B.R. at 336. Section 552(b) applies only to "proceeds *generated by pre-petition collateral*, and not … property acquired by the debtor or the estate post-petition or proceeds of the same." *Cross Baking*, 818 F.2d at 1032 n.6 (quotation marks omitted).

Further, as the First Circuit properly recognized, the outcome here depends not just on the specific provisions of the Bond Resolution and Official statement but also on how those provisions operate under local territorial law. Without an existing

obligation for employers to pay contributions pre-petition, neither the System nor the Petitioners could have a vested property right in those contributions. Under Puerto Rico law, a property right does not vest based on an expectation of a right that does not yet exist but may come into being in the future, following the failure or manifestation of multiple known contingencies. In a longstanding precedent applying both the Bankruptcy Code and Puerto Rico law, the First Circuit specifically held that a "debtor's pre-petition authorization of deductions [of three percent] from future wages" is not a vested property right and, therefore, cannot be the subject of a lien that survives a petition under the Bankruptcy Code, including § 552(a). *In re Miranda Soto*, 667 F.2d 235, 236 (1st Cir. 1981). As the First Circuit explained by quoting this Court's opinion in *Local Loan Co. v. Hunt*: "The earning power of an individual is the power to *create* property, but it is not translated into property within the meaning of the bankruptcy act until it has brought earnings into existence." *Id.* at 237 (quoting *Local Loan Co. v. Hunt*, 292 U.S. 234, 243 (1934)) (emphasis added). The Act does not "permit[] the creation of an enforceable lien upon a subject … brought into being solely as the fruit of the subsequent labor of the bankrupt." *Id.* (quoting *Local Loan Co. v. Hunt*, 292 U.S. at 243).

Like Petitioners here, the creditors in *Mirando Soto* unsuccessfully sought to redirect the court's attention from this aspect of the Bankruptcy Code and local law to Article 9 of the Uniform Commercial Code. *Id.* But the First Circuit responded that regardless of whether Article 9 were part of Puerto Rico law, it was "of no

help to [the creditor" seeking to place a lien on contributions from post-petition income that had not yet been earned. *Id.* at 237. Petitioners are therefore similarly barred by § 552(a) from attaching an Article 9 "floating lien" to post-petition contributions arising from income that had not yet been earned and contribution obligations that did not yet legally exist.

Moreover, if Petitioners' overly broad interpretation of § 552(b)(1) were correct, it would render other provisions of the Bankruptcy Code as surplusage. Congress was well aware that the background rule of § 552(a) cut off the ability of creditors to claim a right to post-petition revenues in the vast majority of cases, including municipal bankruptcies, even with the narrow exceptions set forth in § 552(b). In the decade following the most recent major overhaul of the Bankruptcy Code, Congress considered, and rejected, a proposed blanket exemption of municipal bonds from § 552(a). Proponents of this rejected legislation advanced the same argument that Petitioners raise here: that applying § 552(a) to future municipal revenues would make lenders unwilling to provide financing to municipalities. *See Legislation to Amend Chapter 9 of the Bankruptcy Code: Hearing on H.R. 3845 Before the Subcomm. on Monopolies and Commercial Law of the H. Comm. on the Judiciary*, 100th Cong. 26-27 (1988). But as critics of the proposed legislation argued at the time, "[t]he only asset that a municipality has to offer its creditors in a municipal reorganization is its future revenues," and if those are tied up by past creditors, "reorganization would be next to impossible." *The American Bankruptcy Institute Survey: Hearing on S.*

1626, S. 1358, S. 1863, and S. 2279 Before the Subcomm. on Courts and Administrative Practice of the S. Comm. on the Judiciary, 100th Cong. 535, 536-542 (1988) (report of the National Bankruptcy Conference on Proposed Municipal Bankruptcy Amendments).

Congress instead enacted the 1988 special revenue amendments, which provided that a municipality may not pledge its revenues in perpetuity except to secure a narrowly defined class of special revenue bonds. Act of Nov. 3, 1988, Pub. L. No. 100-597, § 8 102 Stat. 3028, 3029. Thus, 11 U.S.C. § 928 enables creditors to maintain a pre-petition lien only on "special revenues acquired" post-petition, including various taxes and receipts from future revenue streams of discrete projects, "[n]otwithstanding section 552(a)." 11 U.S.C. §§ 928, 902(2). If the § 552(b)(1) exception were broad and general enough to encompass expectancies in not-yet-existent municipal revenues and not-yet-binding obligations, there would have been no need for Congress to have enacted § 928 at all.

Indeed, it is Petitioners' position that could have sweeping effects on bankruptcy law. Granting Petitioners a lien on post-petition proceeds would severely upset the balance that the Bankruptcy Code attempts to strike between a particular creditors' fair expectation of returns on investment and a debtors' need to rehabilitate. *See In re Premier Golf Props.*, 477 B.R. at 772. If Petitioners could acquire a lien on new employer contributions despite the restrictions and contingencies set forth in for these particular bonds, that would effectively eliminate the System's ability to generate unencumbered revenue and, therefore, to

engage in new financing arrangements. "[T]his would run counter to the 'fresh start' philosophy of the [bankruptcy] code." *In re Miranda Soto*, 667 F.2d at 237.

Petitioners are sophisticated investors. They entered the security agreement to purchase bonds from the System with full knowledge that any interest they held in future employer contributions was not yet fixed or enforceable—unlike cases such as *Slab Fork Coal* involving an existing property right in a private contract, not a statute, and not subject to unilateral modification by any party. From both existing Puerto Rico law and the plain language of the Bond Resolution, Petitioners were well aware that their expectation of returns could be affected or even eliminated by the Commonwealth in the event of new legislation, a fiscal crisis, appropriations failures, or various other contingencies and they received an above-market interest rate to compensate them for this risk. Pet. App. 12a n.2. Section 552(b) protects "a secured creditor's rights to maintain a *bargained-for* interest in certain items of collateral," but is not designed to grant a windfall beyond Petitioners' fair expectations. *Bering Trader*, 944 F.2d at 502 (emphasis added). The First Circuit's denial of Petitioners' request for a "floating lien" on post-petition employer contributions is therefore well within the risk they assumed when investing in the bonds.

Allowing creditors in Petitioners' position to lay claim to post-petition contributions would also deprive a bankruptcy estate of its core revenue necessary for equitable distribution to other creditors. *See Fin. Sec.*

Assurance, Inc. v. Days Cal. Riverside (In re Days of Cal. Riverside Ltd.), 27 F.3d at 374, 375 (9th Cir. 1994) ("[T]he purpose of § 552 is to permit a debtor 'to gather into the estate as much money as possible to satisfy the claims of all creditors.'" (quoting *Bering Trader*, 944 F.2d at 502)). Thus, in seeking to circumvent § 552(a) and the contingencies that Petitioners were well aware of (and compensated for, Pet. App. 12a n.2) when assessing the risks and benefits of their bond investment, Petitioners would have this Court undermine this additional purpose of the Bankruptcy Code.

But even if even if this Court were to conclude that the prerequisites of the § 552(b)(1) exception are met in this case—and they are not—that does not end the inquiry. In accordance with Congress's purpose of "balance[ing] the Code's interest in freeing the debtor of pre-petition obligations with a secured creditor's right to maintain a bargained-for interest in certain items of collateral," *In re Premier Golf Properties*, 477 B.R. at 772, as well as the interests of other creditors in recovering from the estate, *Bering Trader*, 944 F.2d at 502, the statute expressly empowers the district court to deny the § 551(b)(1) exception "based on the equities of the case." *In re Days of Cal. Riverside*, 27 F.3d at 375 (quoting § 552(b)). This is true even if the requirements for the exception are otherwise met, providing an additional reason why the specific facts of this case make it an inappropriate vehicle for the question presented, and a strong basis for this Court to deny review.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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