No. 20-126

IN THE
# Supreme Court of the United States

ANDALUSIAN GLOBAL DESIGNATED ACTIVITY COMPANY, ET AL.,

*Petitioners*,

v.

THE 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 FOR PETITIONERS


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## CORPORATE DISCLOSURE STATEMENT

The Rule 29.6 corporate disclosure statement included in the petition for a writ of certiorari remains accurate.

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## REPLY BRIEF FOR PETITIONERS

The First Circuit grafted onto an important federal bankruptcy statute atextual requirements that four other circuits have rejected. Respondents' opposition boils down to the assertion that the First Circuit did not even decide a federal question. That is demonstrably incorrect. As its opinion shows, the court of appeals construed the statute as a matter of federal law—engaging in a freestanding analysis of 11 U.S.C. § 552(b)(1), without relying on Puerto Rico law, to find that the provision protects only security interests that are fixed and calculable prepetition. Once respondents' key premise denying the existence of a federal issue is exposed as false, their remaining arguments collapse, and it is clear certiorari is needed.

First, respondents insist the First Circuit "did not construe § 552(b)," Board Br. 3, and merely decided a question of "local Puerto Rico law," Comm. Br. 11. But that is not how the case was postured—or resolved—below. The Board expressly asked the First Circuit to hold that "§ 552(b) *by its plain terms* does not apply to post-petition contributions . . . generated by labor performed by employees after the Petition Date," Board C.A. Br. 19 (emphasis added); and the Committee's brief never mentioned Puerto Rico property law, *see* Comm. C.A. Br. 8–9, 18–30.

Unsurprisingly, the First Circuit proceeded to construe Section 552(b)(1) and created its "fixed" and "calculable" requirements based on the text of *that* provision, not Puerto Rico property statutes or cases. Pet. App. 20a–24a & n.9. Although the phrase "under Puerto Rico law" is used twenty-three times in respondents' characterization of the First Circuit's holding, *see* Board Br. i, 1, 2, 3, 10, 15, 19; Comm. Br. 2, 3,

11, 12, 17, 20, 30, it appears not once in the court's own description of the holding. What respondents *wish* the court had done is not what it *actually* did.

Second, repeating this same error, respondents assert there is no circuit split because the First Circuit applied Puerto Rico law, whereas the four other circuits did not. *See* Board Br. 25–27; Comm. Br. 16–19. In fact, while the First Circuit held as a matter of federal law that Section 552(b)(1) does not protect security interests that are not fixed and calculable prepetition, Pet. App. 20a, four circuits have held it protects precisely such interests, Pet. 13–16. Respondents try to distinguish this case based on "legislative contingencies," *e.g.*, Comm. Br. 15—but those are not unique to this litigation, and the "contingency" of diminished appropriations had *no* effect on contributions made directly by employers including public corporations and municipalities, *see* Pet. App. 71a–72a.

There is no meaningful dispute that the decision below, properly understood, creates significant uncertainty for the vitally important secured-lending and municipal bond markets. Pet. 27–33. Contrary to respondents' suggestions, *see* Board Br. 30; Comm. Br. 25, the decision has already had adverse consequences, with more to come when other insolvencies occur and bondholders seek to collect in bankruptcy proceedings. Finally, this case neither requires this Court to decide anything about the Bankruptcy Uniformity Clause nor presents any other vehicle issue. The petition should be granted.

## I. THE FIRST CIRCUIT DECIDED A FEDERAL QUESTION AND DID SO IN CONFLICT WITH THIS COURT'S TEACHINGS ABOUT THE SCOPE OF FEDERAL BANKRUPTCY LAWS.

Respondents assume the First Circuit merely found no "property" interest under Puerto Rico law. Board Br. 12–24; Comm. Br. 12–22. But as the First Circuit explained, "the § 552 [i]ssue" turned on the scope of Section 552(b)(1), not Puerto Rico law. Pet. App. 28a. That is unsurprising, as it is precisely how respondents pitched the case below. The First Circuit's federal-law gloss on Section 552(b)(1), however, conflicts with this Court's precedents construing the term "property" in other federal bankruptcy laws.

**A.** The First Circuit was crystal clear that it was presented with a federal question: whether petitioners' "liens survive because of the exception in § 552(b)(1)." Pet. App. 10a.

As the parties generally agree, while state law determines which sticks are in a person's bundle, federal law determines whether those sticks constitute "property" within the meaning of federal bankruptcy laws. *See Local Loan Co.* v. *Hunt*, 292 U.S. 234, 243, 245 (1934) (not following "Illinois decisions" in determining, under federal law, whether the assignment of future wages in Illinois is a "lien" under the Bankruptcy Act); *In re Miranda Soto*, 667 F.2d 235, 237 (1st Cir. 1981) (same for future wages in Puerto Rico); *see also United States* v. *Craft*, 535 U.S. 274, 278 (2002); Pet. 22; Board Br. 16–17; Comm. Br. 5–6. After all, determining whether "some federal interest requires a different result" from state law is an inherently federal question. *Butner* v. *United States*, 440 U.S. 48, 55 (1979).

The First Circuit was equally clear that the answer to the federal question presented turned on Section 552(b)(1), not Puerto Rico law. In setting forth the "relevant statutes," the court identified "PROMESA and the Bankruptcy Code," but no Puerto Rico provisions. Pet. App. 9a–10a. And in explaining *why* it thought ERS' pledged right to future payments was not "property," the court relied on Section 552(b)(1)'s text, authorities applying non-Puerto Rico law, and even the Bond Resolution and ERS' enabling statute—but no Puerto Rico property statute or case. *See* Pet. App. 17a–22a. And in distinguishing other federal cases, the court did not dismiss them out of hand as not involving Puerto Rico law, as one would expect if this case turned on local law, but instead analyzed how each construed Section 552(b)(1). *See* Pet. App. 22a–24a & n.9 (discussing *In re Tracy Broad. Corp.*, 696 F.3d 1051, 1058–59 (10th Cir. 2012); *Cadle Co.* v. *Schlichtmann*, 267 F.3d 14, 16–21 (1st Cir. 2001); *United Va. Bank* v. *Slab Fork Coal Co.*, 784 F.2d 1188, 1191 (4th Cir. 1986)).

The First Circuit mentioned Puerto Rico property law only once—in a footnote, and then only to support the "generally accepted" principle that an "expectancy" "is not itself a property interest." Pet. App. 21a n.7. Even that footnote relied on two *federal* due-process cases, *Redondo-Borges* v. *HUD*, 421 F.3d 1, 9 (1st Cir. 2005); *Carrasquillo* v. *Aponte Roque*, 682 F. Supp. 137, 141 (D.P.R. 1988), not any Puerto Rico cases, and nowhere stated that Puerto Rico law, rather than Section 552(b)(1), controlled this case.

The First Circuit similarly framed its holding about Section 552(b)(1)'s scope as a conclusion of federal law. In ruling that petitioners "lacked any se-

cured interest in property that could produce postpetition 'proceeds' to which they could be entitled," the court cited only Section 552(b)(1) and a case construing the meaning of "'[§] 552(b).'" Pet. App. 20a (brackets in original) (quoting *In re Cross Baking Co.*, 818 F.2d 1027, 1032 n.6 (1st Cir. 1987)); *see also id.* at 17a (concluding "Section 552 Prevents the Bondholders' Security Interest from Attaching to Postpetition Employers' Contributions"); *id.* at 34a (referencing "our reading of § 552"). And in announcing that Section 552(b)(1) applies only to "property" and "proceeds" that are fixed and calculable prepetition, the court did not cite any Puerto Rico law. *See* Pet. App. 23a–24a.

Contrary to respondents' insistence, and regardless of the correct approach, the First Circuit simply did not decide this case under Puerto Rico property law; it construed the scope of Section 552(b)(1) as a matter of federal law.

**B.** The First Circuit took this approach because that is exactly what the district court did and what respondents asked both lower courts to do.

Before the district court, neither respondent referenced Puerto Rico property law. Indeed, the Board urged that "*Section 552(b) [be] interpreted narrowly* . . . to apply" only if "the collateral generating the proceeds . . . exist[ed]" prepetition. Board Opp'n to Mot. for Summ. J. at 23 (emphasis added). The district court likewise never invoked Puerto Rico property law, but instead held that "Section 552(b)(1) protects post-petition . . . proceeds of collateral that was fixed in form or quantity and owned by the pledgor pre-petition." Pet. App. 77a. That holding was based on "lower court decisions" construing Section 552(b)(1), not Puerto Rico law. Pet. App. 71a–74a (citing *In re HRC Joint Venture*, 175 B.R. 948 (Bankr.

S.D. Ohio 1994); *In re Tex. Tri-Collar, Inc.*, 29 B.R. 724 (Bankr. W.D. La. 1983)).

On appeal, the Board again argued, "§ 552(b) *by its plain terms* does not apply to post-petition contributions that were not owed to ERS on the Petition Date." Board C.A. Br. 19 (emphasis added). The Board briefly discussed Puerto Rico property law only after canvassing other jurisdictions. *See id.* at 24–28. The Committee, for its part, never mentioned Puerto Rico property law, relying instead on Section 552's congressional intent and purpose. *See* Comm. C.A. Br. 8–9, 18–30. Having successfully *asked* the First Circuit to construe Section 552(b)(1) as a matter of federal law, respondents cannot credibly contend the court did something else.

**C.** Respondents' merits arguments provide no basis for denying certiorari—and are wrong.

Respondents cannot reconcile the First Circuit's construction of Section 552(b)(1) with this Court's teachings. This Court has held (as a matter of federal law) that "contingen[t]" interests that "c[annot] be claimed" until postpetition constitute "property" under the bankruptcy laws, *Segal* v. *Rochelle*, 382 U.S. 375, 380 (1966), yet the decision below held that an interest contingent on events "occurring on and after the petition date" is not such "property," Pet. App. 20a. The Committee ignores *Segal*; and the Board mistakenly asserts (at 18 n.5) that *Segal* turned on "*Texas* law." In deciding whether certain claims were "property" under the Bankruptcy Act, *Segal* nowhere mentioned Texas law, holding instead that the "purposes" of the Act, not "a state taxing statute," "must ultimately govern." 382 U.S. at 379–81.

Respondents' analogy to accounts receivable is misplaced. *Cf.* Board Br. 15; Comm. Br. 29. Respondents' authorities all involved postpetition sales created "'solely as the fruit of the subsequent labor of *the bankrupt*,'" *Miranda Soto*, 667 F.2d at 237 (emphasis added) (citation omitted), or to which there was no prepetition entitlement, *see Cross*, 818 F.2d at 1030–31 (customers made "additional charges" postpetition); *In re Skagit Pac. Corp.*, 316 B.R. 330, 336 (B.A.P. 9th Cir. 2004) ("new accounts receivable were created"). In contrast, ERS did not create the employer contributions here, and its pledged "statutory right" to future contributions was an existing "legal asset." Pet. App. 106a. Section 552(b)(1), properly read, thus protects petitioners' lien.

## II. THE DECISION BELOW CONFLICTS WITH THE DECISIONS OF FOUR OTHER CIRCUITS.

The decision below held as a matter of federal law that Section 552(b)(1) does not protect rights to future payments that are "too indeterminate"—*i.e.*, not fixed and calculable as they are contingent on events "occurring on and after the petition date." Pet. App. 20a, 24a; *see id.* at 25a–26a (contributions were not "fixed prepetition" and "yet-to-be calculated"). Respondents cannot reconcile that holding with the decisions of the Fourth, Seventh, Eighth, and Tenth Circuits.

Those cases cannot be distinguished as applying local law from non-Puerto Rico jurisdictions, *cf.* Board Br. 25–27; Comm. Br. 16–19, as the First Circuit itself did not take that approach. Besides, the Fourth Circuit's decision in *Slab Fork* did not reference any state law. *See* 784 F.2d at 1189–91. And the other circuits considered whether state law created a property interest in future payments, but held—in conflict with the decision below—that Section 552(b)(1) *protected*

that interest even though the payments were contingent on future events. *See In re Fullop*, 6 F.3d 422, 424 (7th Cir. 1993); *In re Sunberg*, 729 F.2d 561, 562 (8th Cir. 1984); *Tracy*, 696 F.3d at 1056.

Nor are those cases factually distinguishable. The core difference, respondents contend, is that petitioners' right to payment was subject to "known legislative contingencies"—*i.e.*, that annual legislative appropriations on Puerto Rico's behalf might be reduced. *See* Board Br. 26–27; Comm. Br. 12–13, 15.[1] That difference is immaterial because, as the Board concedes (at 27 n.9), a legislature *always* can adversely affect existing property rights; that it then may need to provide just compensation does not change the nature of those rights. Regardless, any risk of diminished appropriations would *not affect* contributions made directly by employers or by public corporations or municipalities outside the appropriations process. *See* Pet. App. 71a–72a. And the First Circuit's holding that legislative contingencies render petitioners' interest a mere expectancy still squarely conflicts with *Tracy*, which similarly involved future proceeds contingent on government approval. *See* 696 F.3d at 1065 (FCC approval of license sale); Pet. 15.

Respondents' assertion that the other circuit decisions involved "fixed" prepetition entitlements ignores that—as here—each entitlement rested on speculative contingencies, including that payment might *never* be made. In *Slab Fork*, the "coal had to be supplied . . . before any right to payment arose," 784 F.2d

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[1] Respondents emphasize that ERS disclosed the risk that contribution levels may be reduced. But the legislature here *increased* contribution levels while funneling them away from ERS to avoid any liens.

at 1191; in *Fullop*, the working interest pertained to any oil "'that may'" or may not "'be produced'" in the future, 6 F.3d at 425 (citation omitted); in *Sunberg*, the agreement covered "any" future subsidies, the degree of which was not "foreseen," 729 F.2d at 562–63; and in *Tracy*, it was uncertain whether "an agreement to transfer the license" would ever occur, 696 F.3d at 1058. That the contract in *Sunberg* was subject to private enforcement, *cf.* Board Br. 26, is irrelevant because a statutory entitlement "has the qualities of a property right as to third parties" and hence was enforceable by petitioners here, *Freightliner Mkt. Dev. Corp.* v. *Silver Wheel Freightlines, Inc.*, 823 F.2d 362, 369 (9th Cir. 1987) (citing *Sunberg*).

Accordingly, the decision below creates a circuit conflict on the scope of Section 552(b)(1), and this Court's review is needed to ensure uniformity in federal bankruptcy law.

## III. THE DECISION BELOW HAS SIGNIFICANT CONSEQUENCES BEYOND THIS CASE.

Respondents' attempts to minimize the importance of the decision below do not withstand scrutiny. Because the First Circuit's construction of Section 552(b)(1) is not limited by Puerto Rico property law, its holding, too, is not limited to this case. *Cf.* Board Br. 29; Comm. Br. 22–24. It thus will be binding precedent throughout the First Circuit, and persuasive authority in other circuits. Indeed, the atextual criteria the court applied—the uncertainty of future payments and possible reduction of payments due to legislation—are not "sui generis," Comm. Br. 24, but frequently arise with a wide range of secured-lending agreements and municipal bond arrangements, Pet. 28–32 & n.4. That such security interests *can* attach to underlying assets such as patents, *see*

Board Br. 29, does not change that—as with "Bowie Bonds," mineral rights, and government refunds or benefits—many security interests *actually* are backed by rights to future revenues that are not fixed and calculable in advance, Pet. 28–30. If allowed to stand, the decision below imperils those security interests worth potentially billions of dollars.

Respondents do not dispute that normally the only property a municipality, public utility, or public university is free to pledge is a right to future revenues that are not fixed or calculable prepetition. *See* Pet. 30–31. It is no response that municipalities can theoretically rely on the "special revenues" exception in 11 U.S.C. § 928(a). *Cf.* Board Br. 30; Comm. Br. 25. That exception is limited, *see* 11 U.S.C. § 902(2), and was intended merely to "clarify long standing principles" and require "the same result" as other provisions, S. Rep. No. 100-506, at 14–15 (1988). Tellingly, respondents identify no municipal bond that would satisfy Section 928 if it fell outside Section 552(b)(1) under the decision below.

Contrary to respondents' assumption, this case has substantial stakes and has already had significant consequences. *Cf.* Board Br. 30; Comm. Br. 22, 25. A decision by this Court would both resolve petitioners' entitlement to "six weeks" of contributions (until July 2017), Comm. Br. 1, 3, 9—totaling tens of millions of dollars—and affect pending litigation on petitioners' entitlement to billions of dollars of contributions since July 2017, *see* Pet. App. 14a n.4. And as market participants factored in the decision below, the price of ERS' bonds dropped dramatically from around $40 to $20. *See* Elec. Mun. Mkt. Access, *Employees Retirement Sys Govt Comwlth Puerto Rico (PR): Trade Activity*, Mun. Sec. Rulemaking Bd.,

https://tinyurl.com/yxt3ex5l (December 2019 to February 2020).

Longer-term adverse consequences will become apparent when other municipalities begin to face bankruptcy and thus more "secured" interests are placed at risk of nullification. That no amici have weighed in to echo that self-evident point, *cf.* Comm. Br. 22, is no bar to certiorari.

## IV. THIS CASE PRESENTS AN IDEAL VEHICLE FOR DECIDING THE QUESTION PRESENTED.

Only the Committee disputes that this case is an ideal vehicle for certiorari, and its arguments are unpersuasive.

This case does *not* require the Court to decide whether the Bankruptcy Uniformity Clause applies to Puerto Rico. *Cf.* Comm. Br. 26–28. Petitioners do not argue that PROMESA's bankruptcy procedures violate that Clause. Rather, petitioners contend that because PROMESA's procedures expressly incorporate Section 552, *see* 48 U.S.C. § 2161(a), that general and uniform bankruptcy rule should be interpreted consistently. The decision below undermined this norm by departing from the courts of appeals' uniform construction of Section 552(b)(1).

The Committee also argues (at 3, 34) that, on remand, the district court might decline to apply Section 552(b)(1) based on the "equities of the case." But neither decision below even hinted that this exception could be outcome-determinative here. *See* Pet. App. 17a–29a, 68a–77a. The remote possibility that a lower court might someday rule in respondents' favor is no reason to tolerate an intractable circuit split on an important bankruptcy provision that needs uniform interpretation today.

## CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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