No. 22-367

IN THE

Supreme Court of the United States

FINANCIAL OVERSIGHT AND MANAGEMENT BOARD FOR PUERTO RICO,

Petitioner,

v.

COOPERATIVE DE AHORRO Y CREDITO ABRAHAM ROSA, *et al.*,

Respondents.

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

REPLY BRIEF FOR PETITIONER

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INTRODUCTION

Respondents do not dispute that the decision below is unprecedented: It is the first time that a Circuit court has held that a class of unsecured claims arising before bankruptcy is constitutionally ineligible for discharge. Respondents also do not effectively dispute that the decision below creates a split with the Ninth Circuit. Two Respondents try to dismiss as "dicta" the Ninth Circuit's ruling in *Stockton* that just-compensation claims can be discharged, but the First Circuit expressly sided with *Stockton*'s dissent and acknowledged the split. The United States correctly concedes that *Stockton*'s ruling was a holding. And that holding is directly at odds with the decision below that just-compensation claims *cannot* be discharged. This Court's review is necessary to ensure uniformity in this important area of law.

The Question Presented is exceptionally important to Puerto Rico and its instrumentalities, which have over $300 million riding on the answer. It is also important to municipal entities in general, many of which have eminent-domain powers. Indeed, the discharge question has arisen in the three largest municipal bankruptcies of the past decade as well as in other Chapter 9 cases. Contrary to an assertion by the United States, the Title III setting is not "idiosyncratic." Title III expressly incorporates the Bankruptcy Code's discharge provisions, so the holding below has significant implications for all municipal bankruptcy cases and for takings claims in any bankruptcy case.

Given the clear circuit split, the undoubted importance of the Question Presented, and the lack of any vehicle issues, the Petition should be granted. The decision below was incorrectly decided and should not be permitted to stand.

ARGUMENT

I. THERE IS A GENUINE, DEEP CIRCUIT SPLIT ON THE QUESTION PRESENTED.

There is no serious dispute that the circuits are split over the dischargeability of just-compensation claims. Two Respondents try to dismiss the Ninth Circuit's conflicting holding in *Cobb v. City of Stockton (In re City of Stockton)*, 909 F.3d 1256 (9th Cir. 2018), as dicta, but that is plainly wrong. *Contra* Mandry-Mercado Br. 13–17; Suiza Br. 12–13. The First Circuit acknowledged that it was creating a conflict and embraced *Stockton*'s dissent. Pet. App. 30a. And the United States concedes that the Ninth Circuit's ruling is an alternative holding, not dicta. *See* U.S. Br. 16. Alternative holdings are binding precedent in the Ninth Circuit. *See United States v. Brown*, 996 F.3d 998, 1011 (9th Cir. 2021) (citing *Woods v. Interstate Realty Co.*, 337 U.S. 535, 537 (1949)). Accordingly, as the law currently stands, unsecured claims for just compensation are dischargeable within the Ninth Circuit, but not within the First Circuit. That is as glaring an inconsistency as can be.

The United States tries to minimize the conflict by arguing that the *Stockton* claimant engaged in "dilatory conduct," unlike here. U.S. Br. 16. But any de-

lay in *Stockton* was relevant only to the Ninth Circuit's alternative holding about equitable mootness, *not* the holding concerning discharge, which was decided as a matter of law. *See* 909 F.3d at 1266. With respect to discharge, *Stockton* discussed the procedural history merely to show that the claimant "did not possess a right to the property protected by the Fifth Amendment" but instead held only "a claim for greater compensation, which is an unsecured monetary debt claim." *Id.* at 1267. The same facts are present here: Like the claimant in *Stockton*, the claimants below did not hold property interests during the bankruptcy case, but rather held unsecured claims for just compensation arising from pre-petition takings. The two cases are materially indistinguishable.[1]

The United States' other efforts to tame *Stockton* fare no better. The idea that the Ninth Circuit "might well revisit" *Stockton* in light of the decision below is fanciful. U.S. Br. 17. The First Circuit followed the dissent in *Stockton*, whose positions the Ninth Circuit majority had already rejected. The related contention that *Stockton* was overruled by *Knick v. Township of Scott*, 139 S. Ct. 2162 (2019), because the latter clarified that "just compensation" means "full compensation," is simply not true. U.S. Br. 17. The ruling in *Stockton* did not turn on whether just compensation requires full compensation, which was scarcely men-

[1] It is incorrect that the *Stockton* claimant "did not seek exemption from discharge" at the bankruptcy court (U.S. Br. 16). *See* Case No. 12-32118, ECF 1481 at 11:2–23 (Bankr. E.D. Cal. May 7, 2014). It is also irrelevant because the Ninth Circuit's holding did not turn on questions of preservation or forfeiture.

tioned in the fifteen-paragraph analysis of the discharge question. *See* 909 F.3d at 1266–69. Moreover, *Stockton*'s discussion of "full compensation" is consistent with *Knick* for the reasons discussed below. *See* Point IV.B, *infra*.

The split between the First and Ninth Circuits is exacerbated by the Eighth Circuit's decision in *Poinsett Lumber & Manufacturing Co. v. Drainage District No. 7 of Poinsett County*, 119 F.2d 270 (8th Cir. 1941). *See* Pet. 11. The United States mischaracterizes *Poinsett* when it argues that the Eighth Circuit did not "determine whether the bankruptcy court had authority to discharge any prepetition takings claims over the objection of the holders of such claims." U.S. Br. 18. In fact, that is exactly what *Poinsett* determined. Like the creditors below, the creditor in *Poinsett* argued that his claim for just compensation "is not subject to be adjusted" because it is "invested with a constitutional sanctity beyond other forms of liability." 119 F.2d at 272. The Eighth Circuit rejected that argument (*id.* at 273), whereas the First Circuit below sustained a nearly identical contention (Pet. App. 22a–33a). The two decisions cannot be reconciled.

Although *Poinsett* involved a different type of bankruptcy case—a composition, *see* U.S. Br. 17—that is a distinction without a difference. The First Circuit held that the Fifth Amendment *never* permits the discharge of a just-compensation claim over the objection of a creditor. Pet. App. 33a. That holding controls regardless of the type of debtor or bankruptcy case. The Eighth Circuit, by contrast, held that the Fifth Amendment does *not* prohibit the discharge of a just-

compensation claim. *Poinsett*, 119 F.2d at 272–73 (citing *Luehrmann v. Drainage Dist. No. 7 of Poinsett Cnty.*, 104 F.2d 696 (8th Cir. 1939)). That is a full-on conflict.

II. THE QUESTION PRESENTED IS EXCEPTIONALLY IMPORTANT.

Respondents attempt to downplay the split among the First, Eighth, and Ninth Circuits by arguing that the Question Presented is somehow unimportant. That is not plausible. This Court's resolution of the question would have tremendous implications for Puerto Rico and for municipal bankruptcies generally. *See* Pet. 22–24.

The United States observes that Puerto Rico's plan of adjustment would be feasible even if the Court denies certiorari. U.S. Br. 19–20. That is beside the point. It is undisputed that more than $300 million turns on the question presented here. That money would have a material impact on the lives of the people of Puerto Rico, whose government before PROMESA was "unable to provide its citizens with effective services." 48 U.S.C. § 2194(m)(2). Any attempt to belittle a sum of that size is not credible.

A decision on whether just-compensation claims can be discharged has implications beyond Puerto Rico, too. Although Respondents contend that the question does not arise frequently (*e.g.*, U.S. Br. 19), in just the past decade it has been hotly contested in the three most significant municipal restructurings: Puerto Rico, Detroit, and Stockton. And contrary to what some Respondents argue (*e.g.*, Suiza Br. 24), the

issue has arisen in other municipal bankruptcies also. *See, e.g.*, *In re Jefferson Cnty.*, No. 11-bk-05736, ECF 2182 (Bankr. N.D. Ala. 2013) (plan of adjustment with an unimpaired class of "eminent domain claims").

The contention that "[f]ew governmental entities with eminent-domain authority file for bankruptcy" (U.S. Br. 19) is also incorrect. In reality, all kinds of municipal debtors with eminent-domain power regularly seek bankruptcy protection—not just cities, but also housing, transportation, and urban-renewal authorities, school districts, and utilities. *See* U.S. Gov't Accountability Off., Eminent Domain: Information about Its Uses and Effect on Property Owners and Communities Is Limited 6–7 (2006) (listing examples of municipal entities with eminent-domain power); *see also Jefferson Cnty.*, 11-bk-05736, ECF No. 2182 (discharge question arising in case involving debtor county); *Poinsett*, 119 F.2d at 271 (drainage district). Within these very Title III cases, creditors have disputed whether just-compensation claims against the Puerto Rico Highways and Transportation Authority (HTA) and the Puerto Rico Electric Power Authority (PREPA) can be discharged. HTA and PREPA are municipal entities with eminent-domain power that are not cities. *See, e.g.*, *In re Fin. Oversight & Mgmt. Bd. for P.R.*, No. 17-bk-03283, ECF Nos. 23094 at 33, 22581 at 46–47 (D.P.R.).

III. THERE ARE NO VEHICLE ISSUES.

The Question Presented is a pure question of law squarely presented. It does not turn on any factual findings, and it does not require the Court to wade

into the procedural history of this case. The question is raised here as cleanly as it will ever be.

Two Respondents effectively concede the point by failing to raise any vehicle challenges. The United States raises one such challenge: In its view, this case is "idiosyncratic" because it arises under Title III of PROMESA rather than Chapter 9 of the Bankruptcy Code. U.S. Br. 20–21. But there is no substantive difference between the two types of bankruptcy cases because PROMESA incorporates the relevant Bankruptcy Code provisions into a Title III case. *Compare* 11 U.S.C. § 901 (incorporating various Bankruptcy Code provisions into a Chapter 9 case), *with* 48 U.S.C. § 2161(a) (incorporating the nearly identical provisions as well as most of Chapter 9 itself into a Title III case).[2] In fact, the exact same discharge provision (11 U.S.C. § 944) governs in both settings. *See* 48 U.S.C. § 2161(a) (incorporating § 944). Whether the discharge of just-compensation claims pursuant to 11 U.S.C. § 944 violates the Fifth Amendment must be answered the same way in both types of cases.

IV. THE DECISION BELOW WAS WRONGLY DECIDED.

Respondents do not dispute that the decision below is the first in history by a Circuit court to hold that

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[2] The few substantive differences between Title III and Chapter 9 are irrelevant to the question here. For example, Chapter 9 contains provisions addressing federalism concerns applicable only to States, not Puerto Rico. *See* 11 U.S.C. §§ 903–904. And in Chapter 9, the debtor files the plan of adjustment, whereas the Board files a plan in Title III. *Compare* 11 U.S.C. § 941, *with* 48 U.S.C. § 2172.

a class of pre-bankruptcy claims is ineligible for discharge in bankruptcy. Pet. 16–20. They nevertheless contend that the Petition should be denied because the decision below is correct. Their arguments fundamentally misapprehend how the Takings Clause and the bankruptcy power operate.

A. Respondents Misapply this Court's Bankruptcy Jurisprudence.

Respondents argue that the outcome of this case is dictated by precedent holding that "the bankruptcy power . . . is subject to the Fifth Amendment." U.S. Br. 10–11; Mandry-Mercado Br. 11–13; Suiza Br. 20 (quoting *United States v. Sec. Indus. Bank*, 459 U.S. 70, 75 (1982); *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 588 (1935)). But *Security Industrial Bank* and *Radford* involved a direct conflict between the Fifth Amendment and the bankruptcy power because the bankruptcy statutes at issue eliminated *secured interests* in specific property during the bankruptcy cases. *See* Pet. 16–20. Here, there is no conflict because the just-compensation claims are *unsecured claims* for payment arising before the bankruptcy case and untethered to any existing property interest. *Id.*

The United States acknowledges this fundamental distinction but gives a surprising response. U.S. Br. 12. It thinks the secured/unsecured dichotomy is irrelevant because the just-compensation claims here are "secured by the text of the Fifth Amendment itself." *Id.* That is a novel and unprecedented theory of security for which the United States supplies no authority. The Fifth Amendment's protections—in

bankruptcy and elsewhere—are limited to interests in specific *property*. *E. Enters. v. Apfel*, 524 U.S. 498, 541–42 (1998) (Kennedy, J., concurring). Constitutional text is not property. The Fifth Amendment is therefore not implicated in this case.

Moreover, this Court has acknowledged that inherent bankruptcy operations such as taking money validly paid within ninety days before bankruptcy to creditors to redistribute it among other creditors are not conditioned on just-compensation payments. *See Wright v. Union Cent. Life Ins. Co.*, 304 U.S. 502, 517 (1938). If the decision below were correct, the quintessential bankruptcy power to discharge prepetition claims to carry out the fresh-start and equitable-distribution policies, *see Cent. Va. Cmty. Coll. v. Katz*, 546 U.S. 356, 364 (2006), would be thwarted by the Fifth Amendment whenever the bankruptcy power is used to take property. That would have enormous implications in virtually all bankruptcy cases.

B. Respondents Misapprehend this Court's Takings Jurisprudence.

Respondents also contend that just-compensation claims are uniquely non-dischargeable because (i) the Takings Clause expressly prescribes the precise quantum of compensation for a violation, and (ii) no governmental action (such as bankruptcy cases) can eliminate the duty to provide that compensation. U.S. Br. 12; Mandry-Mercado Br. 21; Suiza Br. 18–19. They mainly rely on *Knick* for both propositions.

But *Knick* does not support either position. According to *Knick*, the failure to pay just compensation

is an *element* of a takings claim, not a constitutionally mandated *remedy* after a taking has already occurred. *See* Pet. 13 & n.3. Outside bankruptcy, a claimant is entitled to a remedy for a taking, and that remedy ordinarily will be the payment of just compensation. But in bankruptcy, a just-compensation claim is an unsecured claim for payment that can be discharged, the same as any other unsecured claim for payment arising under the United States Constitution. *See id.* at 14–15. The constitutional history cited in the Petition, showing that compensatory remedies were generally unavailable for a taking until the late 1800s, proves that there is no constitutional *guarantee* of compensation. *See* Pet. 14.[3]

On the second point, Respondents quote language from *Knick* to show that after a taking, nothing the government does can nullify the property owner's right to payment; the right is supposedly "irrevocable." U.S. Br. 9, 12 (citing *Knick*, 139 S. Ct. at 2171–72). But the Court was making a different point in the quoted passages. It was rejecting the view that after a constitutional taking violation occurred, a court-ordered remedy could undo the violation. To the contrary, the Court emphasized, the violation that triggered the remedy was "complete" as soon as the uncompensated taking took place. *Knick*, 139 S. Ct. at 2177. The fact that the taking *occurred* was "irrevocable" in the sense that no later event could erase it.

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[3] The United States ultimately concedes this point when it agrees that "as an original matter, the Fifth Amendment does not require . . . money damages" to remedy an uncompensated taking. U.S. Br. 12–13; *see also* Suiza Br. 19 (discussing non-monetary remedies). S*ee generally Knick*, 139 S. Ct. at 2175–77.

That does not mean the remedy for a taking can never be discharged.

C. The United States' Avoidance Argument Is Wrong and Beside the Point.

Strangely, the United States argues that the courts below should have avoided the constitutional question by exercising some kind of tacit statutory "discretion" to treat the just-compensation claims as non-dischargeable. U.S. Br. 8, 13–14 (citing 11 U.S.C. § 944(c)(1)). This point neither bears on certworthiness nor is persuasive.[4]

First, the avoidance argument is irrelevant because (as the United States concedes) the courts below did *not* avoid the constitutional issue. *See* Pet. App. 18a–21a. Instead, they squarely answered the Question Presented and held that the Fifth Amendment forbids the discharge of just-compensation claims. *See id*. at 22a–33a, 370a–81a. Since both courts rendered actual legal holdings about the dischargeability of just-compensation claims, it does not matter whether they *could have* avoided the question. They *didn't*. Their holdings are on the books and create a genuine circuit split.

Second, the United States' theory is wrong as a legal matter. As the First Circuit correctly recognized, § 944(c)(1) does not give courts "discretion" to

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[4] Moreover, as the court below explained, avoiding the question would effectively answer it because the only reason for exempting just-compensation claims from discharge would be that the Fifth Amendment mandates that result. Pet. App. 20a–21a.

except just-compensation claims from discharge. Pet. App. 21a. The Bankruptcy Code specifies which debts are non-dischargeable, *see* 11 U.S.C. § 523, and "courts are not authorized to create additional exceptions," *Law v. Siegel*, 571 U.S. 415, 424 (2014). Were it otherwise, a court would have the power to dictate the terms of a plan of adjustment, contrary to PROMESA's directive that only the Board can submit a plan. *See* 48 U.S.C. § 2172(a); *see also* 11 U.S.C. § 941 (only the debtor can file a plan in Chapter 9).

There is no authority for the United States' position. As a textual matter, § 944(c)(1) says nothing about authorizing courts to exempt claims from discharge. And the United States cannot cite a single case where a court has created an exception to discharge under § 944(c)(1). Instead, it cites *Artis v. District of Columbia*, 138 S. Ct. 594 (2018)—an employment-discrimination case—and *INS v. St. Cyr*, 533 U.S. 289 (2001)—an immigration case. U.S. Br. 14.

Nor does *In re City of Detroit*, 524 B.R. 147 (Bankr. E.D. Mich. 2014), help the United States. U.S. Br. 14. The *Detroit* court did not avoid the question—it expressly *answered* it. 524 B.R. at 270 (holding that a plan's impairment of just-compensation claims "violate[d] the Fifth Amendment"). The only example of constitutional avoidance in that decision involved a different question not raised here—namely, whether Chapter 9 is unconstitutional. *Id.*

CONCLUSION

The question whether pre-bankruptcy just-compensation claims can be discharged is squarely presented, is the subject of considered disagreement, and is extremely important to the parties here and to bankruptcy administration in general. The petition should be granted.

January 25, 2023 Respectfully submitted,

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