

**IN THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF PUERTO RICO**

LEX CLAIMS, LLC, et al.,

Plaintiffs,

v.

ALEJANDRO GARCÍA PADILLA, et al.,

Defendants.

Case No. 3:16-cv-02374 (FAB)

**COFINA SENIOR BONDHOLDERS' MOTION FOR LEAVE TO INTERVENE**

Proposed intervenors Jose F. Rodriguez and certain institutional holders who together hold in excess of \$2 billion of senior secured bonds issued by the Puerto Rico Sales Tax Financing Corporation (“COFINA”),<sup>1</sup> move to intervene pursuant to Rule 24 of the Federal Rules of Civil Procedure (“FRCP”) in this action (the “GO Action”) commenced by certain holders (the “Plaintiffs”) of general obligation bonds (the “GO Bonds”) issued by the Commonwealth of Puerto Rico (the “Commonwealth”).<sup>2</sup> In accordance with Rule 24(c), attached as Exhibit A is a proposed answer setting forth the relief for which intervention is sought.

### **PRELIMINARY STATEMENT**

Plaintiffs commenced the GO Action on July 20, 2016, shortly after the Puerto Rico Oversight, Management, and Economic Stability Act (“PROMESA”) was enacted. The first two versions of the Complaint asserted a single cause of action in which the Plaintiffs challenged the legality of Executive Order 2016-30, issued by the (former) Governor on June 30, 2016 (the “Executive Order”) compelling the Commonwealth Treasury to halt payments to GO bondholders. Plaintiffs contend that the Executive Order violates PROMESA and is preempted by the newly

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<sup>1</sup> Mr. Rodriguez and the institutional holders of the COFINA senior bonds are referred to herein as the “COFINA Senior Bondholders.” In addition to Mr. Rodriguez, the COFINA Senior Bondholders are the following entities, either as beneficial holders or on behalf of managed funds and accounts: Cyrus Capital Partners, L.P.; Decagon Holdings 1, L.L.C.; Decagon Holdings 2, L.L.C.; Decagon Holdings 3, L.L.C.; Decagon Holdings 4, L.L.C.; Decagon Holdings 5, L.L.C.; Decagon Holdings 6, L.L.C.; Decagon Holdings 7, L.L.C.; Decagon Holdings 8, L.L.C.; Decagon Holdings 9, L.L.C.; Decagon Holdings 10, L.L.C.; GoldenTree Asset Management LP; Merced Capital, L.P.; Old Bellows Partners LP; Scoggin Management LP; Taconic Master Fund 1.5 L.P.; Taconic Opportunity Master Fund L.P.; Tilden Park Capital Management LP; Värde Credit Partners Master, L.P.; Värde Investment Partners, L.P.; Värde Investment Partners (Offshore) Master, L.P.; The Värde Skyway Master Fund, L.P.; and Whitebox Advisors LLC.

<sup>2</sup> On February 17, 2017, this Court entered an Opinion and Order, at Docket Number 184 (the “Stay Order”), denying the COFINA Senior Bondholders’ prior motion to intervene because the underlying basis for the motion—enforcing the PROMESA stay—was rendered moot by the Court’s decision on the stay. By this motion, the COFINA Senior Bondholders timely seek to intervene on the merits.

enacted federal law. On November 4, 2016, Plaintiffs filed a Second Amended Complaint which added 12 new causes of action, including causes of action relating to COFINA. In these Counts, Plaintiffs seek to interrupt the statutory transfer of sales and use tax from the point of collection to COFINA (the “Dedicated Sales Tax”)<sup>3</sup> by: (a) prohibiting COFINA from receiving the Dedicated Sales Tax; (b) requiring COFINA to transfer the Dedicated Sales Tax it does hold to the Commonwealth; and (c) obligating the Commonwealth to preserve and segregate funds transferred from COFINA. Dkt. No. 78 at ¶¶ 133-34, 138-99; pp. 66-70. It is undisputed that if this relief is granted, COFINA will be unable to service its debt obligations to all COFINA Bondholders. In such event, the governing Bond Resolution requires that COFINA Senior Bondholders be paid in full prior to any COFINA Subordinate Bondholder receiving payment.<sup>4</sup>

The COFINA Senior Bondholders formed their coalition in the Spring of 2015 to provide a forum for holders of COFINA Senior Bonds without significant exposure to other Puerto Rico investments to have an organized approach to protect and defend their legal rights. The COFINA Senior Bondholders have participated in good faith in all phases of the Commonwealth’s restructuring efforts, including negotiations with the former Governor’s working group, the current Governor’s administration, the Oversight Board, the self-styled Major COFINA Bondholders (the majority of such institutions’ exposure being COFINA Subordinate Bonds), and others.

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<sup>3</sup> In the Stay Order, the Court accepted at the pleading stage the Plaintiffs’ characterization of injunctive relief as seeking to prohibit the “diversion of IVU [Dedicated Sales Tax] revenues to COFINA.” Stay Order at 11 n.7. The COFINA Senior Bondholders will demonstrate that compliance with COFINA’s enabling statute does not “divert” revenues belonging to the Commonwealth under Puerto Rico law, which of course is the issue at the heart of this dispute.

<sup>4</sup> See Puerto Rico Sales Tax Financing Corporation, Amended and Restated Sales Tax Revenue Bond Resolution, adopted on July 13, 2007, as amended on June 10, 2009 (the “Bond Resolution”), at 5 (defining “Class Priority”), available at [http://www.gdb-pur.com/investors\\_resources/documents/COFINA-AMENDEDANDRESTATEDBONDRESOLUTION.PDF](http://www.gdb-pur.com/investors_resources/documents/COFINA-AMENDEDANDRESTATEDBONDRESOLUTION.PDF).

On October 24, 2016, the COFINA Senior Bondholders moved to intervene in the GO Action for the limited purpose of seeking enforcement of the PROMESA stay. Dkt. 50. Last week, the Court held that the PROMESA stay did not preclude Counts 2 and 12 of the GO Action from proceeding and, accordingly, denied the COFINA Senior Bondholders' requested intervention as moot. Stay Order at 37.

Because the relief sought by the Plaintiffs would, if granted, directly impair the COFINA Senior Bondholders' property interests as owners of senior secured bonds backed by a statutory lien,<sup>5</sup> and because the parties to the litigation cannot adequately represent their interests, the COFINA Senior Bondholders are entitled to intervene in this action under FRCP 24.

### **ARGUMENT**

#### **I. THE COFINA SENIOR BONDHOLDERS CAN INTERVENE AS A MATTER OF RIGHT**

Rule 24(a) of the FRCP grants anyone the right to intervene when the party seeking intervention "claims an interest relating to the property or transaction that is the subject of the action, and is so situated that disposing of the action may as a practical matter impair or impede the movant's ability to protect its interest, unless existing parties adequately represent that interest." FRCP 24(a)(2). A court is required to grant this request if the party meets four conditions: "(1) its motion is timely; (2) it has an interest relating to the property or transaction that forms the foundation of the ongoing action; (3) the disposition of the action threatens to impair or impede its ability to protect this interest; and (4) no existing party adequately represents its interest." Stay Order at 28 (quoting *Ungar v. Arafat*, 634 F.3d 46, 50 (1st Cir. 2011)). The COFINA Senior Bondholders satisfy all four conditions.

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<sup>5</sup> See Stay Order at 38 n.15 (recognizing that ownership of COFINA Bonds "represent[s] a legitimate interest related to the subject matter of this case").

**A. The COFINA Senior Bondholders’ Motion to Intervene Is Timely**

This motion is timely because the litigation is still in its initial stages. *Id.* at 30 n.11. The Court decided the parties’ various stay motions less than a week ago, on February 17, 2017, and outside of the applicability of the stay, there have been no substantive rulings on Plaintiffs’ Second Amended Complaint and no discovery has taken place. As such, “the balance of prejudices . . . weigh heavily in favor of the [proposed intervenor].” *Id.* (quoting *P.R. Tel. Co. v. Sistema de Retiro de los Empleados del Gobierno y la Judicatura*, 637 F.3d 10, 16 (1st Cir. 2011) (alterations in original)); *see also Geiger v. Foley Hoag LLP Ret. Plan*, 521 F.3d 60, 64-65 (1st Cir. 2008).

**B. The COFINA Senior Bondholders Have an Interest in the Continued Validity of the COFINA Structure and the Dedicated Sales Tax**

To satisfy the second condition for intervention, a proposed intervenor must have a “direct and substantial interest in the subject matter of the action.” *Cabot LNG Corp. v. P.R. Elec. Power Auth.*, 162 F.R.D. 427, 429 (D.P.R. 1995). While “there is no precise and authoritative definition of the interests required to intervene,” “the intervenor’s claim must bear a sufficiently close relationship to the dispute between the original litigants.” *Id.* (internal quotation marks omitted). This requirement is broadly interpreted. *Daggett v. Comm’n on Gov’t Ethics & Election Practices*, 172 F.3d 104, 110 (1st Cir. 1999).

Here, Plaintiffs are seeking to abrogate the COFINA structure and divert the Dedicated Sales Tax statutorily pledged to secure COFINA bonds away from COFINA in order to pay debt service on Plaintiffs’ GO Bonds. *See, e.g.*, Second Amended Complaint at pp. 67-68. Indeed, the ownership of the Dedicated Sales Tax—COFINA’s constitutionally protected property and the collateral backing the COFINA Senior Bondholders’ securities—is the crux of the Plaintiffs’ claims related to COFINA, and if the Plaintiffs are successful, COFINA will be deprived of the means to timely repay its debts owed to the COFINA Senior Bondholders. Plaintiffs’ asserted

claim to COFINA's property unquestionably satisfies the requirement of FRCP 24 that the COFINA Senior Bondholders "claim[] an interest relating to the property or transaction that is the subject of the action."<sup>6</sup>

**C. Disposition of this Action Would Impair and Impede the COFINA Senior Bondholders' Ability to Protect Their Property Interests in the Dedicated Sales Tax**

The disposition of this action would impair and impede the ability of the COFINA Senior Bondholders to protect their property interests in the Dedicated Sales Tax. The "impair and impede" standard is effectively a "'practical' test of adverse effect." *Daggett*, 172 F.3d at 110. This test is satisfied because, if Plaintiffs are successful, COFINA would be deprived of the Dedicated Sales Tax securing the COFINA Bonds which would cause a payment default under the Bond Resolution by which COFINA issued bonds, and COFINA would be unable to timely satisfy its obligations to the COFINA Senior Bondholders. This would not only impact the COFINA Senior Bondholders' ability to receive payment on their bonds, but would also impact the value of those bonds. There is little question that either outcome would have an "adverse effect" on the COFINA Senior Bondholders.

**D. No Party Can Adequately Represent the COFINA Senior Bondholders' Interests**

Finally, no party to the GO Action can adequately represent the COFINA Senior Bondholders' interests. As this Court noted, an intervenor has only a "modest burden of showing that there is a possibility" that no named party may adequately represent its interests. Stay Order at 39; *see also Conservation Law Found. of New Eng., Inc. v. Mosbacher*, 966 F.2d 39, 44 (1st

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<sup>6</sup> As this Court noted with regards to intervenors the Puerto Rico Funds and the Major COFINA Bondholders, it is readily "apparent" that ownership of COFINA bonds "represent[s] a legitimate interest related to the subject matter of this case." Stay Order at 38 n.15.

Cir. 1992) (“An intervenor need only show that representation may be inadequate, not that it is inadequate.”); *W Holding Co. v. Chartis Ins. Co.-P.R.*, 845 F. Supp. 2d 422, 428 (D.P.R. 2012) (“[A]n intervenor need only make a ‘minimal’ showing that the representation afforded by a named party would prove inadequate.” (internal quotation marks omitted)). The COFINA Senior Bondholders easily meet this “modest” burden.

1. The Named Parties Cannot Adequately Represent the Interests of the COFINA Senior Bondholders

As the Court explained in the Stay Order, none of the named Defendants<sup>7</sup> “would suffer direct economic harm if the GO Bondholders are ultimately successful in this case.” Stay Order at 36 n.14. That reason alone is sufficient to make a showing of inadequate representation. *See id.* (“[T]he potential for . . . litigation to have a greater adverse impact on [the potential intervenor] is sufficient to establish that a named party is an inadequate representative.”) (quoting *B. Fernandez & Hnos., Inc. v. Kellogg USA, Inc.*, 440 F.3d 541, 547 (1st. Cir. 2006)).<sup>8</sup> Thus, no named party can adequately represent the interests of the COFINA Senior Bondholders in the GO Action.

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<sup>7</sup> The named Defendants are the Commonwealth of Puerto Rico, the Governor of the Commonwealth, the Secretary of Treasury of the Commonwealth, the Director of the Office of Management and Budget of the Commonwealth, COFINA, the Executive Director of COFINA, and the Bank of New York Mellon Corp., as indenture trustee (“BNYM Trustee”).

<sup>8</sup> As the Court noted in the Stay Order, BNYM Trustee “has moved to dismiss the second amended complaint on grounds that could result in BNYM Trustee being dismissed as a defendant,” and if successful, would not be able to represent COFINA bondholders. Stay Order at 39-40. This is sufficient to render the BNYM Trustee inadequate to represent the interests of the COFINA Senior Bondholders. *Id.* With respect to COFINA and its officers, courts within this district have stated that government agencies “cannot adequately represent private interests in litigation.” *Cabot LNG Corp.*, 162 F.R.D. at 431.

2. No Other Intervenor Can Adequately Represent the Interests of the COFINA Senior Bondholders

None of the three creditor parties whose intervention was granted by the Court in the Stay Order (the “Intervenors”) can adequately represent the interests of the COFINA Senior Bondholders. Each of the three Intervenors—Ambac, the Major COFINA Bondholders, and the Puerto Rico Funds—is situated differently from the COFINA Senior Bondholders with respect to their exposure to Puerto Rico bonds. First, unlike the COFINA Senior Bondholders, each of these Intervenors has substantial exposure to a variety of Puerto Rico-based bonds other than COFINA, including GO Bonds—the very type of bonds that would benefit from a ruling in favor of the Plaintiffs. Because the bond holdings of each Intervenor differs radically from the COFINA Senior Bondholders, the outcome of this litigation may “have a greater adverse impact” on the COFINA Senior Bondholders than on the Intervenors, rendering them unable to adequately represent the COFINA Senior Bondholders. *See Kellogg USA, Inc.*, 440 F.3d at 547. Further, the Intervenors themselves have already pointed to the potential for conflict even within the COFINA structure, which is composed of two tranches of bonds—senior and subordinate. *See* Section I.D.2.(a), *infra*. Finally, setting aside the different economic exposures of each Intervenor, as discussed in more detail below, unique facts and potential legal exposures also prevent the Intervenors from adequately representing the COFINA Senior Bondholders in this litigation.

(a) **The Major COFINA Bondholders Cannot Represent the COFINA Senior Bondholders in this Litigation**

Intervenors who have called themselves the Major COFINA Bondholders acknowledge that their interests and the interests of the COFINA Senior Bondholders diverge. *See* Dkt. 113 at 7-8. Those statements alone should be sufficient to establish that the Major COFINA Bondholders will not adequately represent the interests of the COFINA Senior Bondholders. In any event, the Major COFINA Bondholders—mutual funds managed by OppenheimerFunds, Franklin Advisors,



and Santander Asset Management—are heavily exposed to Puerto Rico debt other than COFINA bonds, including GO Bonds like those held by Plaintiffs who bring this very litigation. In fact, according to public disclosures of OppenheimerFunds, Franklin Advisors and Santander Asset Management, it appears that COFINA bonds account for less than one third of these funds’ Puerto Rico holdings. Moreover, the Major COFINA Bondholders acknowledge that the bulk of their COFINA holdings—nearly 80%—are COFINA Subordinate Bonds.<sup>9</sup> *Id.* at 1. As such, the Major COFINA Bondholders suffer from the same conflict of interest as BNYM Trustee. According to the Major COFINA Bondholders, “the Trustee . . . faces a conflict of interest among the holders of the Senior Bonds and the Subordinate Bonds which may hamstring the Trustee’s ability to efficiently and effectively defend the interests of both.” *Id.* at 7. Due to that inherent conflict, bondholders with substantial COFINA Subordinate Bond holdings cannot represent the interests of holders of COFINA Senior Bonds.

**(b) The Puerto Rico Funds Cannot Represent the COFINA Senior Bondholders in this Litigation**

Intervenors Puerto Rico Funds are unable to represent the interests of the COFINA Senior Bondholders for reasons similar to the Major COFINA Bondholders—the funds, and other funds managed by the same investment advisors, have exposure to bonds other than COFINA, and even within COFINA itself, own both Senior and Subordinate Bonds. *See* Dkt. 95 at 8. These latent conflicts prevent the Puerto Rico Funds from adequately representing the COFINA Senior Bondholders. Moreover, all of the Puerto Rico Funds are mutual funds affiliated with UBS, which was heavily involved in the issuance, underwriting, and sale of Puerto Rico bonds for many years. *See id.* at 2 n.1 (listing names of individual Puerto Rico Funds). In fact, UBS was lead or joint

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<sup>9</sup> In fact, based on analysis of their public holdings reports, COFINA Senior Bonds appear to account for **less than 8%** of the Major COFINA Bondholders’ total Puerto Rico bond holdings.

underwriter of almost every Puerto Rico GO Bond offering since 2006, including the 2014 offering of GO Bonds apparently owned by the Plaintiffs in this litigation. The COFINA Senior Bondholders cannot be adequately represented by a party who not only has exposure to a wide variety of Puerto Rico bonds and owns both the senior and subordinate tranches of COFINA bonds, but also acted as underwriter for the bonds whose owners now seek to challenge the COFINA structure.

**(c) Ambac Cannot Represent the COFINA Senior Bondholders in this Litigation**

Ambac has publicly represented that it has insurance exposure to many Puerto Rico credits, including not only COFINA bonds, but GO Bonds, Puerto Rico Highways and Transportation Authority bonds, Puerto Rico Infrastructure Financing Authority bonds, and Puerto Rico Convention Center District Authority bonds.<sup>10</sup> Based on its public disclosures, COFINA bonds account for less than 40% of Ambac's exposure to Puerto Rico-based bonds. Further, all of the COFINA bonds that Ambac insures mature in 2047 or 2054, and this exclusively long-dated exposure may result in litigation interests that diverge from those of the COFINA Senior Bondholders, whose holdings are of varying maturities and are mostly uninsured. This divergence of interests and the potential impact of this litigation render Ambac unable adequately to represent the COFINA Senior Bondholders in this litigation for purposes of FRCP 24. *See Kellogg USA, Inc.*, 440 F.3d at 547.

**II. THE COURT SHOULD PERMIT THE COFINA SENIOR BONDHOLDERS TO INTERVENE**

Should the Court find that the COFINA Senior Bondholders do not satisfy the requirements of Rule 24(a) of the FRCP, the Court may still “permit anyone to intervene who . . . has a claim or

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<sup>10</sup> See Ambac, Puerto Rico Exposure, Third Quarter 2016 at 2, *available at* [http://www.ambac.com/pdfs/AMBC\\_Puerto\\_Rico\\_Exposure.pdf](http://www.ambac.com/pdfs/AMBC_Puerto_Rico_Exposure.pdf).

defense that shares with the main action a common question of law or fact[.]” so long as the motion is timely and there is no prejudice to the original parties. FRCP 24(b)(1)(B). The COFINA Senior Bondholders satisfy this standard. As discussed above, this motion is timely filed and there will be no prejudice to the parties by allowing the COFINA Senior Bondholders to intervene.

Moreover, the COFINA Senior Bondholders’ “interest in COFINA bonds implicates at least one legal question shared in common with this litigation, namely whether the use of [the Dedicated Sales Tax] to secure COFINA bonds” is constitutional. *See* Stay Order at 40 n.17 (noting that “[e]ven if the Puerto Rico Funds and the Major COFINA Bondholders were not entitled to intervene as a matter of right pursuant to Fed. R. Civ. P. 24(a)(2), the Court would nonetheless permit them to intervene pursuant to Fed. R. Civ. P. 24(b) because their interest in COFINA bonds implicates at least one legal question shared in common with this litigation, namely, whether the use of IVU [Dedicated Sales Tax] revenues to secure COFINA bonds is unlawful.”).

Finally, it should be noted that the COFINA Senior Bondholders are part of a group representing approximately 33% of all outstanding COFINA Senior Bonds. For that reason, no Qualifying Modification under Title VI of PROMESA can be approved without the consent of the COFINA Senior Bondholders, and including the COFINA Senior Bondholders in this litigation maximizes the prospect for any potential consensual resolution of COFINA under PROMESA.

Thus, in the alternative, the Court should grant the COFINA Senior Bondholders leave to intervene under Rule 24(b) of the FRCP.

### **CONCLUSION**

For the foregoing reasons, the COFINA Senior Bondholders’ Motion to Intervene should be granted.

DATED: February 22, 2017

Respectfully submitted,

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### **CERTIFICATE OF SERVICE**

I hereby certify that on February 22, 2017, I electronically filed the foregoing with the Clerk of the Court using the CM/ECF system which will send notification of such filing to counsel for the parties of record.

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