

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

THE GOVERNMENT DEVELOPMENT
BANK FOR PUERTO RICO,

Applicant

PROMESA

Title VI

CASE NO. 18-1561

**GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO AND PUERTO RICO FISCAL
AGENCY AND FINANCIAL ADVISORY AUTHORITY'S REPLY TO FIDELITY AND
DEPOSIT COMPANY OF MARYLAND'S AND ZURICH AMERICAN INSURANCE
COMPANY'S SUPPLEMENTAL AND SUPERSEDING OBJECTION TO QUALIFYING
MODIFICATION (DOCKET NO. 203)**

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COME NOW, Applicant Government Development Bank for Puerto Rico (“GDB”) and the Puerto Rico Fiscal Agency and Financial Advisory Authority (“AAFAF”) and hereby respond to Fidelity and Deposit Company of Maryland’s and Zurich American Insurance Company’s (“F&D/Zurich”) *Supplemental and Superseding Objection to Qualifying Modification* (“Objection”) (Docket No. 203).

PRELIMINARY STATEMENT

Through its October 23, 2018 Objection, F&D/Zurich seek to prevent approval of the Qualifying Modification under Title VI of PROMESA, 48 U.S.C. §§ 2231-2232, based on their alleged subrogated rights as sureties to claim the amounts owed to a GDB vendor, L.P.C.D., Inc., (“LPCD”), a contractor that worked on the Comunidad Río Bayamón Norte-Urban Infrastructure Project (“CRB Project”) owned by GDB. Ultimately, as F&D/Zurich recognize, they do not have a Bond Claim, but rather, a subrogated claim to at least some of the amounts that LPCD alleges GDB owes it in unpaid contract funds (retainage), and which are currently disputed by GDB in light of the contractor’s non-compliance with the construction contract. Because such disputes—the main dispute as to entitlement by LPCD to any unpaid contract funds and the ancillary dispute as to whether F&D/Zurich have subrogated rights to any part of what may eventually be paid out to LPCD, if anything—are not Bond Claims, they do not belong in this Title VI proceeding. Put another way, whatever the merits of F&D/Zurich’s claims, they are unaffected by the Title VI proceeding and should not be litigated here.¹

¹ GDB has not, contrary to what F&D/Zurich misleadingly assert at Docket No. 203, conceded F&D/Zurich’s entitlement to any rights or moneys from GDB. Indeed, F&D/Zurich’s Objection is full of impertinent and unfounded allegations regarding GDB’s negotiations with F&D/Zurich and other parties that have made claims to the retainage funds for the CRB Project. While those claims are ultimately meritless in this proceeding, because they are *not* Bond Claims, whether they be asserted by LPCD, F&D/Zurich, or any other party, it bears noting that F&D/Zurich have improperly made representations and misrepresentations in the Objection based on settlement discussions that GDB held with F&D/Zurich and other parties claiming a right to the same funds, including representations concerning a settlement offer made by GDB that would have comprised the deposit of certain funds by way of interpleader. Because

Ultimately, F&D/Zurich are aware of the fact that their claims do not belong in this proceeding. Their corporate representative acknowledged as much in his deposition, as discussed below, and in any event they explicitly note at Docket No. 204 that they are “trade vendors”. (Docket No. 204, p. 45.) The fact that, as admitted by F&D/Zurich, F&D/Zurich do not have a Bond Claim is dispositive of their Objection.

FACTUAL BACKGROUND

The key facts for purposes of analyzing F&D/Zurich’s Objection are few and straightforward. First, GDB and LPCD executed a contract for the construction and development of the common urban infrastructure facilities for the Río Bayamón Community, that is, the CRB Project. *See Exhibit A*, J. Santiago Statement Under Penalty of Perjury. Second, GDB and LPCD have made claims against each other in connection with the performance of such contract; LPCD claiming to be entitled to the 10% retainage and other amounts withheld, and GDB asserting that LPCD breached its obligations by, among other things, delay in the completion and failure to timely submit Substantial Completion and Final Completion Certificates. Id. Those claims are disputed and are slated to be arbitrated by the parties. Id. Third, F&D/Zurich have claimed to have rights to any unpaid contract funds due to LPCD pursuant to alleged subrogation rights and/or assignment by LPCD. Id. As F&D/Zurich describe it, their claim is premised on their alleged right to “step into LPCD’s shoes”. *See* Docket 204 (Deposition transcript of Mr. Paul Eaves, corporate representative for F&D/Zurich; “P. Eaves Deposition”), p. 45, line 19.

settlement discussions are not evidence, nor may they be used as such, see Fed. R. Evid. 408, F&D/Zurich’s allegations and misrepresentations concerning settlement discussions with GDB and other parties should be disregarded.

Nothing contained in this Reply is an admission of the validity of any claim against GDB, or a waiver of GDB’s, AAFAF’s, or any other party’s rights to dispute any claim on the merits.

ARGUMENT

F&D/Zurich Claim Is Not Redressable in the Title VI Proceeding

Although F&D/Zurich claim to be entitled to the unpaid contract funds for the CRB Project that would (if undisputed) otherwise be payable to LPCD, such a claim cannot be redressed through this proceeding. Simply put, this proceeding is directed at Participating Bond Claims, not at alleged liabilities of GDB that fall outside the purview of Participating Bond Claims, as is the case with F&D/Zurich's claim. And, because F&D/Zurich's claim is outside the scope of this proceeding, the results thereof will not affect it or its claim.

As stated in the *Application of the Government Development Bank for Puerto Rico and the Puerto Rico Fiscal Agency and Financial Advisory Authority, Pursuant to Section 601(m)(1)(D) of the Puerto Rico Oversight, Management, and Economic Stability Act, for the Approval of the Modification for GDB* (the "Application"), GDB seeks to modify approximately \$4.5 billion in **Bond Claims** through Title VI of PROMESA (Docket No. 1, ¶ 18). The Bond Claims subject to the Qualifying Modification (*i.e.*, the Participating Bond Claims) include claims based on (i) GDB's outstanding public bonds; (ii) certain deposits held at GDB by municipalities and non-public entities; and (iii) certain contingent and unliquidated claims. (Docket No. 1, ¶ 18).

Although PROMESA broadly defines "Bonds" to determine eligibility for a Qualifying Modification under Title VI, *not all debts are considered Bond Claims*. Indeed, a Bond is defined under PROMESA as:

a **bond, loan**, letter of credit, other borrowing title, obligation of insurance, or other financial indebtedness for **borrowed money**, including rights, entitlements, or obligations whether such rights, entitlements, or obligations arise from contract, statute, or any other source of law, in any case, related to such a bond, loan, letter of credit, other borrowing title, obligation of insurance, or other financial indebtedness in physical or dematerialized form of which the issuer, obligor, or guarantor is the territorial government.

PROMESA § 5(2); 48 U.S.C. § 2104(2)(emphasis added). In turn, PROMESA section 5(3) defines “Bond Claims” to mean, as it relates to a **Bond**, the:

(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or

(B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

PROMESA § 5(3); 48 U.S.C. § 2104(3).

The amounts being sought by F&D/Zurich are not in connection with a Bond as defined under Section 5(2) of PROMESA, 48 U.S.C. § 2104 (2), and therefore, their claim is not a Bond Claim under Section 5(3), 48 U.S.C. §2104(3). The nature of GDB’s purported debt to LPCD, and, therefore, to F&D/Zurich to the extent they “step into LPCD’s shoes,” *does not arise from its role as a bank or an issuer. Rather, it arises out of its role as the owner of the parcel of land being developed through LPCD as contractor.* In other words, whatever amounts, if any, are owed by GDB to LPCD do not arise from a bond, loan, letter of credit, borrowing title or other financial indebtedness for borrowed money.

An alleged debt that GDB may have with a contractor, such as LPCD (or, assuming for the purposes of this motion only, to F&D/Zurich pursuant to their alleged subrogation rights), is not a Bond under Section 5(2) of PROMESA, 48 U.S.C. § 2104(2). **In fact, F&D/Zurich’s own witness, Mr. Paul W. Eaves, characterized F&D/Zurich as a vendor – as stepping into the shoes of LPCD to recover some alleged payable contract funds – .** See Docket No. 204, Paul W. Eaves Deposition, p. 45, lines 14-22. The exchange below during F&D/Zurich’s deposition is illustrative:

Q: [...] And in your claim to the court, this Title VI proceeding, you've asserted that you have a private bond claim against GDB. So, I ask you if you can tell me what the basis of your claim of being a private bond claimant of GDB is, if you know.

A: Okay. Well, I believe I understand your question.

We know that this project was completed by Las Piedras, and we also have been made aware that the final payment under the contract has not been paid to Las Piedras. I learned that, once the payment bond claim started coming, I discovered that this project was still open. And in light of that, that is when we decided that we were going to file our indemnity agreement, to notify GDB that we have an assignment of those funds.

It is Zurich's position that we have a valid assignment of any remaining contract funds related to the Río Bayamón infrastructure project. And that [has] been the premise of what we've been trying to accomplish with respect to GDB is to ascertain the quantity of funds that are being held, and to ensure that at least we get an opportunity to be heard about our assignment, as well as our equitable subrogation rights to those funds.

Q: Okay. But, is it your position that you have a bond claim against GDB?

A. As to my understanding, Zurich is characterized as a vendor. Again, I've used the term earlier in my deposition where I sued the term, "We step into the shoes of L.P.C.D. So, since we have suffered a loss, and since LP.C.D. is in default, my position is we have stepped into their shoes."

So, to the extent GDB has any remaining contract funds that would otherwise be payable to Las Piedras, Zurich is saying, "No, I have an assignment of those funds. They're mine." And that is one avenue of our claim.

And the other is what we were discussing early on, our equitable subrogation rights, were I've actually paid losses related to that project.

See Docket 204, P. Eaves Deposition, p. 44, line 13, through p. 46, line 5.

Consistent with the foregoing, F&D/Zurich opened their brief stating that "GDB conceded that F&D Zurich are trade vendors of GDB and are entitled to have their claims allowed and paid in full, inasmuch as they subrogated as co-sureties of a general contractor who ... is a vendor/contractor of the Petitioners. The co-sureties agree with that assessment". Docket No. 203, p. 1-2. While the first sentence of that statement is incorrect, as GDB has not "conceded"

that F&D/Zurich are themselves (as opposed to LPCD) trade vendors, much less that they are entitled to have their alleged claims paid in full, the key to that statement is that F&D/Zurich view themselves as trade vendors, not holders of Bond Claims.

F&D/Zurich's subrogated claims as sureties to the unpaid contract funds do not assert a Bond Claim under Section 5 of PROMESA, 48 U.S.C. § 2104. And, such a claim against the GDB is not a component of the Qualifying Modification and no relief with respect to such claims is being sought by the Application. Because F&D/Zurich's claim is not a Bond Claim, and therefore unaffected by the Qualifying Modification, its objection to the Qualifying Modification sought by GDB lacks merits.

Furthermore, the Court in this Title VI process is not called upon to provide any redress to entities, like F&D/Zurich, alleging to have a claim for unpaid retainages. As stated in the Application, the Title VI Court is called upon to engage in a "limited supervisory role." (Docket No. 1, ¶ 1). Specifically, the Court must determine whether Section 601 requirements are lawfully met, in particular as they relate to vote pooling and claim classification, vote solicitation and tabulation. See 48 U.S.C. §§ 2231(m)(1)(D); 2231(n). The scope of this analysis does not include assessing claims by non-bondholders like F&D/Zurich.

Precisely because F&D/Zurich do not have a Bond Claim pursuant to Title VI and the Qualifying Modification does not affect their claims or alleged right to redress, F&D/Zurich's takings argument is meritless. F&D has no property rights to the disputed retainage funds, but even if it did, the Qualifying Modification simply would not affect such alleged right.

The Restructuring Support Agreement ("RSA") provides that *only* the holders of Participating Bond Claims –those described on Schedule 1 to the RSA, which do not include the claims for contract funds by LPCD or any assignee or entity subrogated in LPCD's rights— will

be subject to the Qualifying Modification. *See* Docket 5-7, Exhibit G, p.10-11 (Ex. A to Docket No. 5-7). As if that were not clear enough, the RSA explicitly provides that “the liabilities of GDB that are not Participating Bond Claims will not be subject of the Qualifying Modification....” *Id.*

Moreover, the RSA sets forth that GDB will maintain a Vendor Claim Reserve, a separate account with “cash equal to the aggregate amount of claims asserted against GDB by parties that provided goods and services to GDB in the ordinary course of business [...], which claims are disputed by GDB on the Closing Date or for which payment has not yet become due. *See* Docket No. 5-7, Exhibit G, p. 17.² The Vendor Claim Reserve is one of the specified cash assets that is an “excluded asset”, therefore, not affected by the Qualifying Modification.³ *Id.* at p. 16-17, 25. LPCD’s disputed claims for payment of contract funds is subject to payment under the Vendor Claim Reserve (assuming LPCD establishes a right to payment, given the disputed nature of the claim). Whatever subrogation rights F&D/Zurich may have, those rights do not extend beyond

² While the Issuer has a security interest over the Vendor Claim Reserve Residual, that does not affect LPCD’s disputed vendor claim, much less F&D/Zurich’s alleged subrogated rights. What will be transferred to the Issuer as Recovery Authority Assets are the cash or equivalents “remaining in the account in respect of the Vendor Claim Reserve after the payment of all Open or Disputed Vendor Claims.” *See* Docket No. 5-7, Exhibit G, p. 17.

³ *See* Docket No. 5-7, Exhibit G, at p. 16-17, 25, for the following definitions:

- **Vendor Claim Reserve:** The amount of cash equal to the aggregate amount of claims asserted against GDB by parties that provided goods and services to GDB in the ordinary course of business (such amount at any time, the “Vendor Claim Reserve”), which claims are disputed by GDB on the Closing Date or for which payment has not yet become due (“Open or Disputed Vendor Claims”), shall remain at GDB in a separate account subject to a perfected security interest in favor of the Issuer securing the obligation to transfer to the Issuer the Vendor Claim Reserve Residual [...].
- The “**Specified Cash Assets**” shall equal the sum of (a) the Vendor Claim Reserve (as defined below) [...], (b) restricted cash held by GDB, and (c) \$28.9 million or such other amount for operating cash requirements of GDB as may be acceptable to the RSA Requisite Bondholders [...].
- “**Excluded Assets**” means [...] (vi) the Specified Cash Assets, to be retained by GDB.

Besides, Applicant’s proposed *Findings of Fact, Conclusions of Law, and Order Approving Qualifying Modification for the Government Development Bank for Puerto Rico Pursuant to Section 601(M)(1)(D) of the Puerto Rico Oversight, Management, and Economic Stability Act* does not even consider a vendor claim. (Docket No. 158, Exhibit A).

what LPCD may recover, if anything, from the Vendor Claim Reserve. The Vendor Claim Reserve holds approximately \$15 million to pay Open or Disputed Vendor Claims (see Docket 5-15, Exhibit O, p. 30). The amount of the retainage claim related to the CRB Project allocated to the Vendor Claim Reserve is approximately \$9 million, which exceeds F&D/Zurich's alleged claim of approximately \$7.7 million (Docket 203, p. 4, ¶ 12 & Docket 204, p. 37, lines 3-8). There is thus no question that F&D/Zurich's alleged subrogation rights will not be impaired by the Qualifying Modification, which excludes disposition of the Vendor Claim Reserve. Simple math shows that the Vendor Claim Reserve holds enough funds to pay the LPCD claim to which F&D/Zurich asserts subrogation rights.

Finally, it bears noting that F&D/Zurich are estopped from objecting to the RSA. “[W]here a party assumes a certain position in a legal proceeding, and succeeds in maintaining that position, he may not thereafter, simply because his interests have changed, assume a contrary position, especially if it be to the prejudice of the party who has acquiesced in the position formerly taken by him.” *See New Hampshire v. Maine*, 532 U.S. 742, 749 (2001) *quoting Davis v. Wakelee*, 156 U.S. 680, 689 (1895). “This rule, known as judicial estoppel, ‘generally prevents a party from prevailing in one phase of a case on an argument and then relying on a contradictory argument to prevail in another phase.’” *See Id.*, *citing Pegram v. Herdrich*, 530 U.S. 211, 227, n. 8 (2000).

In this case, F&D/Zurich noted in the deposition of its corporate representative, they “step into the shoes” of their alleged debtor, LPCD. LPCD, however, is a signatory of the RSA, and therefore cannot lawfully object to the Qualifying Modification that the RSA contemplates and promotes. Accordingly, as an entity claiming to be subrogated in LPCD's rights and obligations, neither can F&D/Zurich.

CONCLUSION

For the reasons discussed herein this Court should conclude that F&D/Zurich's claims are outside of the purview of the Qualifying Modification, and thereby unaffected by it, and no relief with respect to such amounts can be sought through this Title VI proceeding. F&D/Zurich's *Supplemental and Superseding Objection to Qualifying Modification* should thus be denied as a matter of law.

Dated: October 31, 2018
San Juan, Puerto Rico

Respectfully submitted,

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JOSÉ SANTIAGO RAMOS UNSWORN STATEMENT UNDER PENALTY OF PERJURY

I, José Santiago Ramos, Chief Restructuring Officer of the Government Development Bank for Puerto Rico (GDB), married, and a resident of Guaynabo, Puerto Rico, declare under penalty of perjury that:

1. I have been an officer of GDB since February 2017, when I became the Chief Financial Officer of GDB. I was later appointed Chief Restructuring Officer of GDB.
2. I have reviewed GDB's records in connection with a certain claim made by L.P.C.D., Inc. for payment of retainage funds relating to Contract No. 2009-BGF0029, for the Río Bayamón Project, as well as a claim made by Fidelity and Deposit Company of Maryland's and Zurich American Insurance Company to entitlement of any such funds paid out to L.P.C.D., Inc.
3. In 2009, GDB and L.P.C.D. Inc. executed an agreement for L.P.C.D. Inc. to act as contractor in connection with the development and construction of the common urban infrastructure facilities for the Río Bayamón Community. That Contract is Contract No. 2009-BGF0029.
4. GDB made payments to L.P.C.D., Inc. for certifications submitted and approved during the contract period, but retaining 10% of the payment of the certification until final completion of the project was certified and approved, an event which has not yet happened.
5. GDB and L.P.C.D., Inc. have made claims against each other concerning the referenced Contract and L.P.C.D. Inc.'s work pursuant to such Contract. Without limiting the scope of the claims, L.P.C.D., Inc. has claimed that GDB owes it the 10% retainage and GDB has claimed that L.P.C.D. Inc. did not timely complete work nor submit the necessary Certificates of Substantial and Final Completion.
6. The unpaid contract funds allegedly due to L.P.C.D., Inc, principally for retainage, equal \$9,045,000.00.
7. GDB's claims encompass, among other things, the right to penalties and damages in an amount of no less than \$15,000.00 daily for L.P.C.D. Inc.'s delays in submitting the Final and Substantial Completion Certifications.
8. L.P.C.D., Inc. and GDB are slated to take their dispute to arbitration.
9. GDB has received requests from Fidelity and Deposit Company of Maryland's and Zurich American Insurance Company, sureties having issued certain bonds in connection with the Río Bayamón Project, for payment directly to such companies of any amounts to be paid out to L.P.C.D. Inc. Fidelity and Deposit Company of Maryland's and Zurich American Insurance Company have claimed that they are subrogated in L.P.C.D. Inc.'s rights.

10. GDB has also notice of other L.P.C.D. Inc. creditors claiming rights to the amounts allegedly due to L.P.C.D., Inc.

I declare under penalty of perjury that, to the best of my knowledge and recollection, the foregoing is true and correct.

Executed in San Juan, Puerto Rico, on this 31st day of October, 2018.



José Santiago Ramos