BANKRUPTCY - PUERTO RICO

In re Financial Oversight and Management Board for Puerto Rico

United States Court of Appeals, First Circuit - November 23, 2022 - F.4th - 2022 WL 17175263

State-chartered credit unions that were part of a financial cooperative system that provided banking and financial services to communities in the Commonwealth of Puerto Rico filed second amended adversary complaint against the Commonwealth, the Financial Oversight and Management Board for Puerto Rico (FOMB) and its individual members, and other governmental entities, asserting claims under, inter alia, Puerto Rico contract and tort law, Puerto Rico's Act Against Organized Crime and Money Laundering (PR-RICO), and provisions of the Commonwealth and United States constitutions, alleging that defendants engaged in a fraudulent scheme to coerce plaintiffs into buying government bonds knowing that the bonds were unsustainable and would diminish in value.

Plaintiffs also sought an order excepting their claims from discharge in certain defendants' debt adjustment proceedings under Title III of the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) as well as additional declaratory relief, injunctive relief, and compensatory damages.

Defendants moved to dismiss for lack of subject matter jurisdiction and failure to state a claim. The United States District Court granted the motions and dismissed the claims. Credit unions appealed.

The Court of Appeals held that:

- Credit unions failed to allege fraud with the requisite particularity;
- Under Puerto Rico law, the statute of limitations for credit unions' negligence-based claims was not equitably tolled; and
- Credit unions failed to plausibly plead coercion as the manner in which the government and related entities deprived them of any property interest in the bonds, as required to establish their takings claims under the Commonwealth's and United States' Constitutions.

State-chartered credit unions failed to meet heightened pleading standard for claims of fraud against Commonwealth of Puerto Rico, Corporación Pública para la Supervisión y Seguro de Cooperativas de Puerto Rico (COSSEC), and Government Development Bank (GDB), arising from defendants' alleged participation in fraudulent scheme to coerce credit unions into buying government bonds while knowing that bonds were unsustainable and would diminish in value; while providing some factual allegations beyond "based-on-information-and-belief" assertions, credit unions did not plausibly plead even the first element of fraud, false representations by defendants, with complaint failing to provide requisite level of particularity and instead outlining a broad and vague scheme involving COSSEC's issuance of circular letters, purported threats, and unspecified meetings between individuals over four-year period, and mere speculation about defendants' knowledge of falsity of any allegedly false statements.

Under Puerto Rico law, the statute of limitations for credit unions' negligence-based claims against the Commonwealth of Puerto Rico, the Financial Oversight and Management Board for Puerto Rico (FOMB) and its individual members, and other governmental entities arising from credit unions' purchase of government bonds was not equitably tolled; even taking as true credit unions' allegations of actual loss on the bonds at specified time and of their efforts to work with the government at that time to mitigate that loss, the one-year statute of limitations for their negligence-based claims expired prior to Hurricane Maria's passage through Puerto Rico.

State-chartered credit unions that were part of financial cooperative system failed to allege facts showing that regulatory actions of Commonwealth of Puerto Rico and related governmental entities coerced them to purchase allegedly unsustainable government bonds, as required to support their takings claims under the Commonwealth's and United States' Constitutions; although government-issued "circular letters" authorized and enticed credit unions to purchase bonds in an amount representing up to 30% of their liquid assets, letters' use of permissive language belied claim that credit unions had no choice but to purchase the bonds offered, and allegations about so-called mandatory nature of circular letters in general and the general authority of the Corporación Pública para la Supervisión y Seguro de Cooperativas de Puerto Rico (COSSEC) to force compliance with regulations did not lead to the inference that defendants actually forced or compelled credit unions to purchase the bonds.