WRITTEN TESTIMONY OF

Arthur J. Gonzalez

before the

Senate Committee on Energy and Natural Resources

Hearing on S. 375 and H. R. 1192, the Puerto Rico Recovery Accuracy in Disclosures Act of 2021

July 29, 2021

Chairman Manchin, Ranking Member Barrasso, and Members of the Committee, my name is Arthur J. Gonzalez. I am a member of the Puerto Rico Financial Oversight and Management Board (the "Board") [1] and a Senior Fellow at New York University School of Law - teaching courses in bankruptcy law. I became a Senior Fellow in March 2012 upon my retirement as Chief Judge of the United States Bankruptcy Court for the Southern District of New York. Prior to becoming a Bankruptcy Judge in 1995, I was the United States Trustee ("UST") for Region 2 that includes the states of New York, Vermont and Connecticut. During my early legal career as an attorney, I was a District Counsel attorney at the Office of Chief Counsel of the Internal Revenue Service

Prior to graduating from law school and entering the practice of law, I spent 12 years as a teacher in New York City Public Schools.

Thank you for inviting me to testify today before the Committee regarding the Puerto Rico Recovery Accuracy in Disclosure Act of 2021. ("PRRADA" or the "Bill")

My testimony regarding the Bill will primarily draw from my experience with the interpretation and application of Bankruptcy Rule ("Rule") 2014 and the determination of "disinterestedness" under Section 101(14) of the Bankruptcy Code ("Code") and their potential application and impact on the PROMESA Title III cases pending in the United States District Court in Puerto Rico. Section 2(a) of the Bill before this Committee is premised in large part upon the disclosure requirements of Rule 2014.

As a Bankruptcy Judge and UST, I gained a great deal of experience regarding issues of "disclosures" under Rule 2014 in the context of large complex bankruptcy cases - often referred

[1] I was appointed to the Board in August 2016 by President Obama in accordance with Section 101(e)(1)(A)(vi) for a three-year term. Following the expiration of that term, I remained on the Board in "holdover" status until the appointment of Justin M. Peterson by President Trump to the Board in October 2020. Thereafter, I was reappointed to the Board in January 2021 by President Trump from a list of candidates submitted by Speaker Pelosi in accordance with Section 101(e)(1)(A)(i) for a three-year term and continue to serve in that capacity.

to as "Mega" cases. During my career as a bankruptcy judge, I presided over a number of "Mega" cases, including Enron, WorldCom, Chrysler and Sunbeam. Further, during my tenure, I have reviewed, either directly or indirectly, well over a thousand professional persons' retention applications. Such review included submissions of verified statements under Rule 2014 dealing with disclosures related to the retention process.

Comments and Observations regarding PRRADA

The following are my comments and observations regarding PRRADA that I believe may aid in its implementation and furtherance of its goals.

As an initial matter, I would like to state that as a Board member, I fully support the Bill's purpose to extend the disclosure requirements of the Federal Rules of Bankruptcy Procedure to professional persons seeking compensation under PROMESA Sections 316 and 317. This will help to avoid conflicts of interest and provide greater transparency through enhanced disclosure. I believe the Bill should be administered consistent with the disclosure requirements upon which it is based, under the Bankruptcy Code and Rules, to ensure a reliable and predicable application and the interpretation of the terms of the Bankruptcy Code and Rules contained in the Bill.

There are currently over 165,000 proofs of claim filed in the Title III cases. Unless and until a claim is disallowed, the holder of such claim is considered a "creditor." A technical application of term "creditor" would render compliance with the statute practically impossible and extraordinarily costly to the Title III cases. Such compliance effort would require a "connection" analysis with every single one of the more than 165,000 creditors regardless of amount. More importantly, such analysis likely would not necessarily provide any more meaningful additional relevant information or transparency, as opposed to a more focused approach, described below.

At the outset of a typical bankruptcy case, an "interested parties list" is created by the debtor for purposes of the Rule 2014 analysis. That list is generally comprised of parties related to the debtor, parties to litigations with the debtor, a list of creditors[2] of the debtor known to the debtor at the time of filing, parties that have entered an appearance in the case, etc. The "interested parties list" is routinely updated to reflect additional parties based upon the categories referenced above. It is, however, not updated with the names of proof of claim filers. The "interested parties list" approach to the connection analysis of the term "creditor" as implemented in cases under the Code would provide relevant and meaningful disclosures and fulfill the purpose of the Bill. An application of the term creditor for those purposes that would include all those who filed a proof of claim would impede the goals and effectiveness of the Bill.

[2] Often the list of creditors may be limited in a large case to a threshold dollar amount.

As mentioned above, requiring every professional to run a "check" against each of the 165,000-plus creditors who filed a proof of claim in the Puerto Rico Title III cases would cause extraordinary delays and drive expenses up considerably. The burden of complying with such a requirement would most likely make it impossible for smaller professional firms that do not have the staff to undertake such a massive cross-checking effort to participate in the PROMESA case. The impact would be significant on all professional persons but would be most harshly felt by on-island firms. Limiting the cross-checking to creditors above a certain amount would greatly reduce the burden and be consistent with established practice in the disclosure process in bankruptcy cases of the size and breath of the Title III cases.

Section 2. Disclosure by Professionals Persons Seeking Approval of Compensation under Sections 316 and 317

Impact of PRRADA regarding "on island" professionals in the Title III cases

In my view, the term "any creditor" as used in PRRADA will likely result in virtually every "on island" professional person to be found to be "not disinterested."

I believe this because it is very likely that one or more partners in an on-island firm will own a bond issued by the Commonwealth or one of its instrumentalities, or be receiving a government pension due to previous government service. Under the attribution rules applied under Section 101(14) and Rule 2014, the status of one partner is attributed to the partnership. This would result in a determination that the firm is a "creditor." As a result, the partnership will be determined to be "not disinterested" as such term is applied under Section 2(e)(1)(B) of the Bill.

I mention this just to note that the unique nature and broad impact of the Title III cases and the likely "debtor/creditor" relationship between many of the residents of Puerto Rico and the government. This situation will result in a determination under Section (e)(1)((B) that could form the basis of an adjustment to relevant compensation being sought. I recognize that it is unlikely that an adjustment would be made based upon solely the type of "connection" described above. But that the determination of "not disinterested" would nonetheless be made.

Page 3, Section (2)(b) - Review

As written, the intended application of Section (2)(b) is unclear regarding the application of Subsection (b)(3). Under Subsection (b)(1) the UST "shall" review the verified statements filed under the Bill. Under Subsection (b)(2) the UST "may" file an objection" to compensation under Section (e). Under Subsection (b)(3), a party in interest under Section 1109 of the Code "… may appear and be heard on any issue in the case under this section." The lack of clarity is that if the UST does **not** file an objection, does Subsection (b)(3) apply? The question is whether there "an 'issue' in the case under this section has been raised, if the UST does not file an objection under Subsection (b)(2). In other words, if a Subsection (b)(2) objection has to be

made before Subsection (b)(3) applies, then the UST would be a "gatekeeper." In that, if the UST does not file an objection, then no one could be heard under Subsection(b)(3)

If, however, the UST is not a "gatekeeper" as described above, then Subsection (b)(3) applies independent of actions of the UST.

Page 4, Section (c) - Jurisdiction

Section (2)(c) states that the districts courts shall have jurisdiction of all cases under this section. I believe that this section is accurate that jurisdiction lies in the district court generally under the Bill in the Title III cases. Section 307 of PROMESA addresses the issue of venue of any Title III case, and section 308 provides for the selection of Presiding Judge of a Title IIII case. Currently all the Title III cases are pending in the United States District Court for the District of Puerto Rico. Under section 308 of PROMESA United States Laura Taylor Swain was selected as the "presiding judge" by Chief Justice John G. Roberts, Jr.

Compensation awarded in the Title III cases is under sections 316 and 317. Sections 316 and 317, use the term "the court" – meaning the court presiding over the Title III case or cases. This interpretation is consistent with the manner in which compensation issues under the Code sections 330 and 331 are decided.

My concern is that Section 2(c) referenced above in PRRADA, may be read to allow a party to bring an action regarding compensation sought by a professional person under sections 316 and 317 in a *district court* other than "the" court in which the Title III cases are currently pending. Such interpretation would lead to unnecessary use of court time, delay and additional expenses: the impacted professional person would have to remove any matter filed in another district court to the Title III Court. I believe that Section 2(c) should be clarified to provide that any issues arising under the application of the Bill be raised solely in the Title III Court.

Page 4, Section (d)(2) - No Delay

I do not understand the relevance or purpose of this subsection. It directs that the judge presiding over the Title III cases shall **not** delay any other proceeding in connection with the Title III case pending the filing of a verified statement under Section 2(a)(1). I do not understand how this would arise and under what basis a party required to file a verified statement under this section would cause or result in a request for a delay of other proceedings in the case.

That concludes my comments and observations.

I thank the Committee for the opportunity to be here today and hope that my statements and responses to any of the questions you may have will be helpful in your consideration of the Bill.