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REPORT
117–48

PUERTO RICO RECOVERY ACCURACY IN DISCLOSURES ACT OF 2021 (PRRADA)

DECEMBER 13, 2021.—Ordered to be printed

Mr. MANCHIN, from the Committee on Energy and Natural Resources, submitted the following

R E P O R T

together with

ADDITIONAL VIEWS

[To accompany H.R. 1192]

The Committee on Energy and Natural Resources, to which was referred the bill (H.R. 1192) to impose requirements on the payment of compensation to professional persons employed in voluntary cases commenced under title III of the Puerto Rico Oversight Management and Economic Stability Act (commonly known as "PROMESA"), having considered the same, reports favorably thereon with an amendment (in the nature of a substitute) and recommends that the bill, as amended, do pass.

AMENDMENT

The amendment is as follows:

Strike all after the enacting clause and insert the following:

SECTION 1. SHORT TITLE.

This Act may be cited as the "Puerto Rico Recovery Accuracy in Disclosures Act of 2021" or "PRRADA".

SEC. 2. DISCLOSURE BY PROFESSIONAL PERSONS SEEKING APPROVAL OF COMPENSATION UNDER SECTION 316 OR 317 OF PROMESA.

(a) DEFINITIONS.—In this section:

(1) LIST OF MATERIAL INTERESTED PARTIES.—The term "List of Material Interested Parties" means the List of Material Interested Parties established under subsection (c)(1).

(2) OVERSIGHT BOARD.—The term "Oversight Board" has the meaning given the term in section 5 of PROMESA (48 U.S.C. 2104).

(b) REQUIRED DISCLOSURE.—

(1) IN GENERAL.—In a case commenced under section 304 of PROMESA (48 U.S.C. 2164), no attorney, accountant, appraiser, auctioneer, agent, or other professional person may be compensated under section 316 or 317 of that Act (48 U.S.C. 2176, 2177) unless prior to making a request for compensation, the professional person has filed with the court a verified statement conforming to the disclosure requirements of rule 2014(a) of the Federal Rules of Bankruptcy Procedure setting forth the connection of the professional person with any entity or person on the List of Material Interested Parties.

(2) SUPPLEMENT.—A professional person that submits a statement under paragraph (1) shall promptly supplement the statement with any additional relevant information that becomes known to the person.

(3) DISCLOSURE.—Subject to any other applicable law, rule, or regulation, a professional person that fails to file or update a statement required under paragraph (1) or files a statement that the court determines does not represent a good faith effort to comply with this section shall disclose such failure in any filing required to conform to the disclosure requirements under rule 2014(a) of the Federal Rules of Bankruptcy Procedure, for at least five years thereafter.

(c) LIST OF MATERIAL INTERESTED PARTIES.—

(1) PREPARATION.—Not later than 30 days after the date of enactment of this Act, the Oversight Board shall establish a List of Material Interested Parties subject to—

(A) the approval of the court; and

(B) the right of the United States trustee or any party in interest to be heard on the approval.

(2) INCLUSIONS.—Except as provided in paragraph (3), the List of Material Interested Parties shall include—

(A) the debtor;

(B) any creditor;

(C) any other party in interest;

(D) any attorney or accountant of—

(i) the debtor;

(ii) any creditor; or

(iii) any other party in interest;

(E) the United States trustee and any person employed in the office of the United States trustee; and

(F) the Oversight Board, including the members, the Executive Director, and the employees of the Oversight Board.

(3) EXCLUSIONS.—The List of Material Interested Parties may not include any person with a claim, the amount of which is below a threshold dollar amount established by the court that is consistent with the purpose of this Act.

(d) REVIEW.—

(1) IN GENERAL.—The United States trustee shall review each verified statement submitted pursuant to subsection (b) and may file with the court comments on such verified statements before the professionals filing such statements seek compensation under section 316 or 317 of PROMESA (48 U.S.C. 2176, 2177).

(2) OBJECTION.—The United States trustee may object to applications filed under section 316 or 317 of PROMESA (48 U.S.C. 2176, 2177) that fail to satisfy the requirements of subsection (b).

(e) LIMITATION ON COMPENSATION.—In a case commenced under section 304 of PROMESA (48 U.S.C. 2164), in connection with the review and approval of professional compensation under section 316 or 317 of PROMESA (48 U.S.C. 2176, 2177) filed after the date of enactment of this Act, the court may deny allowance of compensation or reimbursement of expenses if—

(1) the professional person has failed to file the verified disclosure statements required under subsection (b)(1) or has filed inadequate disclosure statements under that subsection; or

(2) during the professional person's employment in connection with the case, the professional person—

(A) is not a disinterested person (as defined in section 101 of title 11, United States Code) relative to any entity or person on the List of Material Interested Parties; or

(B) represents or holds an adverse interest in connection with the case.

PURPOSE

The purpose of H.R. 1192 is to impose on any attorney, accountant, appraiser, auctioneer, agent, or other professional person compensated under section 316 or 317 of the Puerto Rico Oversight

Management and Economic Stability Act (commonly known as "PROMESA") the same disclosure requirements imposed by rule 2014(a) of the Federal Rules of Bankruptcy Procedure on professional persons retained in bankruptcy cases pursuant to section 327 of title 11, United States Code.

BACKGROUND AND NEED

Disclosure under rule 2014(a)

The Bankruptcy Code, title 11 of the United States Code, imposes strict conflict-of-interest restrictions on professionals hired to assist in bankruptcy cases.[1] Section 327 of the Bankruptcy Code requires bankruptcy trustees to obtain court approval before they can hire professionals to assist in a bankruptcy case. It permits the court to approve the employment of a professional only if the court first finds that the professional does not hold or represent an adverse interest and is "disinterested." The purpose of these requirements is to ensure that professionals employed in bankruptcy cases have no conflicting interests.[2] They "serve the important policy of ensuring that all professionals appointed pursuant to section 327(a) tender undivided loyalty and provide untainted advice and assistance in furtherance of their fiduciary responsibilities."[3] They are necessary "to preserve the integrity of the bankruptcy system."[4]

Rule 2014 of the Federal Rules of Bankruptcy Procedure is the mechanism by which bankruptcy courts police the conflict-of-interest standards of section 327. Rule 2014 requires professionals to file with the bankruptcy court, before they are hired, "a verified statement . . . setting forth the [professional's] connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee." The purpose of rule 2014 is to provide the bankruptcy court with the information it needs to determine whether the professional is disinterested or holds or represents an adverse interest.[5] The rule places the obligation to disclose on the professional, since the courts do not have the resources to seek out conflicts of interest that are not disclosed.[6] "Disclosure 'goes to the heart of the integrity of the bankruptcy system.' . . . [T]he duty to disclose under Bankruptcy Rule 2014 is considered sacrosanct because the complete and candid disclosure by [a professional] seeking employment is indispensable to the court's discharge of its duty" to ensure that the professional meets the requirements of section 327.[7] "To the extent . . . conflicts are not disclosed, the court is prevented from exercising its statutory obligation to rule on the propriety of the [professional's] employment."[8]

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[1] *Rome v. Braunstein,* 19 F.3d 54, 57 (1st Cir. 1994).
[2] *In re Tinley Plaza Associates, L.P.,* 142 B.R. 272, 277 (Bankr. N.D. Ill. 1992).
[3] *Rome v. Braunstein,* 19 F.3d at 57.
[4] *In re Tinley Plaza Associates, L.P.,* 142 B.R. at 280.
[5] *In re Worldcom, Inc.,* 311 B.R. 151, 164 (Bankr. S.D. N.Y. 2004), citing *In re Leslie Fay Cos., Inc.* 175 B.R. 525, 533 (Bankr. S.D. N.Y. 1994).
[6] *In re EWC, Inc.,* 138 B.R. 276, (Bankr. W.D. Okla 1992).
[7] *In re eToys, Inc.,* 331 B.R. 176, 189 (Bankr. D. Del. 2005).
[8] *In re Roberts,* 75 B.R. 402, 411 (D. Utah 1987).

"Both [section] 327 and Bankruptcy Rule 2014(a) require strict enforcement to preserve the integrity of the bankruptcy system."[9] The conflict of interest requirements of section 327(a) are enforced through section 328(c) of the Bankruptcy Code which provides that a bankruptcy court may deny compensation to a professional if, at any time during the professional's employment under section 327, the professional is not disinterested or holds or represents an adverse interest. Similarly, "failure to disclose relevant connections [under rule 2014] is an independent basis for the bankruptcy court to disallow fees or to disqualify the professional from the case."[10] Indeed, "[v]iolation of the disclosure rules alone is enough to disqualify a professional and deny compensation, regardless of whether the undisclosed connections" rose to the level of a conflict of interest.[11]

Municipal bankruptcies

Important as the requirements of section 327(a) and rule 2014(a) are in private bankruptcy cases, they do not apply in municipal bankruptcy cases.[12] That is because a municipality is a political subdivision or public agency or instrumentality of a State, and section 904 of the Bankruptcy Code, 11 U.S.C. § 904, forbids bankruptcy courts from interfering with the political or governmental powers of a municipal debtor, including the ability to hire professionals.[13]

As a result, the bankruptcy court's ability to police conflicts of interest in a municipal bankruptcy case is more limited than in a corporate bankruptcy. The court's power to police conflicts rests mainly on its power to confirm the municipality's debt adjustment plan. Under section 1129(b)(1) of the Bankruptcy Code (which is made applicable to municipal bankruptcy cases by section 901 of the Code), the court must find that a municipality's plan is "fair and equitable." Under section 943(b)(3) of the Code, the bankruptcy court must also determine that all amounts paid by a municipal debtor to its professionals "have been fully disclosed and are reasonable."

Thus, even though the conflict of interest provisions of section 327 and 328(c) of the Bankruptcy Code do not apply in municipal bankruptcy cases, the Supreme Court has made it clear that bankruptcy courts have the power to remedy conflicts of interest. That power "is not dependent on express statutory provisions. It inheres in the jurisdiction of a court of bankruptcy," and is based on the court's responsibility to ensure that a municipality's debt adjustment plan "embodies a fair and equitable bargain openly arrived at and devoid of overreaching, however subtle,"[14] and that all professional compensation is "fully disclosed and reasonable." The term "reasonable compensation," the Court has said "necessarily implies loyal and disinterested service," free from conflicts of inter-

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[9] *In re Tinley Plaza Associates, L.P.,* 142 B.R. at 280.

[10] *Banner v. Cohen, Estis & Associates, LLP. (In re Balco Equities Ltd.),* 345 B.R. 87, 112 (Bankr. S.D. N.Y. 2006), quoting *Exco Resources, Inc. v. Milbank, Tweed, Hadley & McCloy LLP (In re Enron Corp.),* 2003 U.S. Dist. LEXIS 1442 at 14 (S.D. N.Y. 2003).

[11] *In re EWC, Inc.,* 138 B.R. 276, 280 (Bankr. W.D. Okla. 1992).

[12] *See In re East Shoshone Hospital District,* 226 B.R. 430 (Bankr. D. Ida. 1998).

[13] *See In re Pauls Valley Hospital Authority,* 2013 Bankr. LEXIS 5510 at 6–12 (Bankr. W.D. Okla. 2013).

[14] *American United Mutual Life Insurance Co., v. City of Avon Park,* 311 U.S. 138, 145–146 (1940). *See also In re City of Detroit,* 524 B.R. 147, 210 (Bankr. E.D. Mich. 2014).

est.[15] But without the disclosures required by rule 2014 in private sector bankruptcy cases, the court's ability to police conflicts of interest is more limited in municipal bankruptcy cases.

PROMESA

The Bankruptcy Code only affords "municipalities" protection under chapter 9.[16] Neither the Commonwealth of Puerto Rico nor its instrumentalities qualify as "municipalities" for purposes of chapter 9 because Puerto Rico is not a "State."[17] As a result, Puerto Rico could not obtain protection under the Bankruptcy Code when it was no longer able to service its debts.[18]

Congress responded to Puerto Rico's financial crisis in June 2016 by enacting the Puerto Rico Oversight, Management, and Economic Stability Act, commonly known as PROMESA.[19] Title I of PROMESA establishes a federally appointed Financial Oversight and Management Board as an entity within Puerto Rico's territorial government. Title II gives the Oversight Board broad powers to help restore Puerto Rico to financial health. Title III establishes a unique form of bankruptcy protection for the Commonwealth and its instrumentalities and authorized the Oversight Board to file cases under title III before a federal judge selected by the Chief Justice of the United States.

Title III of PROMESA is largely modeled on the municipal bankruptcy provisions codified in chapter 9 of the Bankruptcy Code.[20] Like section 904 of the Bankruptcy Code, section 305 of PROMESA prohibits the bankruptcy court from interfering with the governmental powers of the Commonwealth or its instrumentalities. Like section 901 of the Bankruptcy Code, section 301 of PROMESA incorporates by references many of the provisions of the Bankruptcy Code governing private bankruptcy cases, but not section 327, governing the employment of professionals. Although section 310 of PROMESA applies the Federal Rules of Bankruptcy Procedure to cases under title III, the disclosure requirements of 2014 do not apply to professionals hired by the Commonwealth, its instrumentalities, or the Oversight Board because those requirements are tied to section 327, which does not apply.

But while PROMESA does not give the court the power to screen professionals for conflicts of interest before they are hired,[21] sections 316 and 317 of PROMESA do give the court responsibility for approving their compensation and the reimbursement of their expenses. Sections 316 and 317 of PROMESA are largely modeled on sections 330 and 331 of the Bankruptcy Code, which give bankruptcy court control over compensation of professionals in private sector bankruptcies. Section 316 (and by extension, section 317) requires that compensation must be "reasonable," and it authorizes

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[15] *Woods v. City National Bank & Trust Co.,* 312 U.S. 262, 268 (1941), citing *Avon Park,* 311 U.S. at 147.

[16] 11 U.S.C. 109(c).

[17] 11 U.S.C. 101(40) (defining "municipality" as an "instrumentality of a State") and 101(52) (defining a "State" to exclude Puerto Rico "for the purpose of defining who maybe a debtor under chapter 9").

[18] *Puerto Rico v. Franklin California Tax-Free Trust,* 597 U.S. 115 (2016).

[19] Public Law 114–187, 130 Stat. 549, codified at 40 U.S.C. 2101 *et seq.*

[20] *Colon-Torres v. Negron-Fernandez*, 997 F.3d 63, 69 (1st Cir. 2021) ("PROMESA creates a . . . bankruptcy process for the Commonwealth and its instrumentalities modeled on the reorganization process for municipalities, codified in Chapter 9 of the Bankruptcy Code").

[21] Section 316 gives the Commonwealth, its instrumentalities, and the Oversight Board the "sole discretion" to employ professionals.

the court, "on its own motion or on the motion of the United States Trustee or any other party in interest," to award less than the amount of compensation requested, if the amount requested is unreasonable.

The need for legislation

The court's ability to police conflicts of interest among professionals under PROMESA is implicit, at best. It rests upon the court's authority to award "reasonable compensation" under section 316 and 317 of PROMESA, to confirm plans only if "fair and equitable" under section 1129(b)(1) of the Bankruptcy Code, and on the court's equitable authority to issue necessary or appropriate orders under section 105 of the Bankruptcy Code (both of which Code sections are made applicable to PROMESA cases by section 301(a) of PROMESA). PROMESA leaves it to the diligence of the court, the United States Trustee, or a party in interest to ferret out any conflicts of interest. Nothing in PROMESA requires the professionals themselves to disclose their connections to interested parties that may give rise to a conflict of interest or create the appearance of a conflict of interest.

Legislation is therefore needed to extend the disclosure requirements of rule 2014 to professionals employed in PROMESA cases.

LEGISLATIVE HISTORY

H.R. 1192 was introduced in the House of Representatives by Representative Velázquez (D–N.Y.) on February 22, 2021. It passed the House on February 24, 2021, by a vote of 429 to 0.

Similar legislation was introduced in the Senate by Senator Menendez on February 23, 2021. The Committee on Energy and Natural Resources held a hearing on both H.R. 1192 and S. 375 on July 29, 2021.

Similar legislation was also introduced in both the House and Senate during the 116th Congress. Rep. Velázquez introduced H.R. 683 on January 17, 2019, and Senator Menendez introduced S. 1675 on May 23, 2019. The Subcommittee on Antitrust, Commercial, and Administrative Law of the House Committee on the Judiciary heard testimony on H.R. 683 on June 25, 2019, and the House Committee on the Judiciary ordered the bill favorably reported on September 9, 2020. The House passed H.R. 683 by voice vote on December 8, 2020.

Similar legislation was also included during the 116th Congress in H.R. 6975, which was introduced by Rep. Grijalva (D–AZ) on May 22, 2020. The House Committee on Natural Resources heard testimony on a draft of H.R. 6975 on October 22 and 30, 2019, and received additional testimony on the bill at an oversight hearing on June 11, 2020.

COMMITTEE RECOMMENDATION

The Senate Committee on Energy and Natural Resources, in open business session on November 18, 2021, by a majority voice vote of a quorum present, recommends that the Senate pass H.R. 1192, if amended as described herein.

COMMITTEE AMENDMENT

The Committee adopted an amendment in the nature of a substitute during its consideration of H.R. 1192. The amendment addresses concerns with the bill as passed by the House. Concerns were raised during hearings on the bill in both the House and the Senate that strict implementation of the bill would not be feasible because of the extraordinarily large number of creditors in the PROMESA cases.

Natalie Jaresko, the Executive Director of the Oversight Board, testified before the House Committee on Natural Resources that the bill, as introduced, was "overly expansive" because it would require professionals to disclose their connections with over 165,000 creditors that had filed claims against the government of Puerto Rico. While "very supportive" of greater disclosure, Ms. Jaresko warned that disclosure on the scale required by the bill "would be an impossible exercise," and said that the bill would need to be interpreted or amended to allow for "its practical implementation."[22]

Similarly, Judge Arthur Gonzales, a former bankruptcy judge and a member of the Oversight Board, testified before the Committee on Energy and Natural Resources that requiring every professional in the PROMESA cases to disclose their connections with each of the more than 165,000 creditors "would cause extraordinary delays and drive expenses up considerably," and that it "would be virtually impossible to complete in any relevant timeframe and [would] be extraordinarily costly." Like Ms. Jaresko, Judge Gonzales testified in support of the bill, but urged that it "be clarified or modified . . . to ensure its purpose [can] be accomplished."[23]

The Committee amendment addresses this concern by narrowing the disclosure requirement to a professional's connection with persons or entities on a "List of Material Interested Parties," drawn up by the Oversight Board and approved by the bankruptcy court. Rather than requiring disclosure of a professional's connection with every retiree eligible to receive a government pension, for example, use of the material interested parties list will enable the court to focus its attention on connections that pose a more substantial risk of compromising a professional's impartiality, based upon a dollar threshold or other criteria established by the court.

In addition, the Committee amendment omits several provisions of the House-passed bill. It omits section 2(b)(3) of the House-passed bill because parties in interest already have the right to be heard under section 1109 of the Bankruptcy Code (which is made applicable to PROMESA cases by section 301(a) of PROMESA). It omits section 2(c) of the House-passed bill because section 306 of PROMESA already confers jurisdiction of all cases under title III of PROMESA in the district courts (and section 307 establishes venue in the District of Puerto Rico). It omits section 2(e)(2) of the House-passed bill so as not to limit the discretion afforded to bankruptcy courts to decide whether to deny payment of professional compensation. It omits section 2(e)(3) because attorneys and ac-

[22] PROMESA Implementation During the Coronavirus Pandemic: Oversight Hearing Before the House Committee on Natural Resources, 116th Cong., at 29 and 90 (June 11, 2020).

[23] Hearing on S. 375 and H.R. 1192 Before the Senate Committee on Energy and Natural Resources, 117th Cong. (July 29, 2021), Written Testimony of Arthur Gonzales at 4 and Transcript at 19.

countants of creditors' committees are already subject to the disclosure requirements of rule 2014 since section 301(a) incorporates section 1103 (unlike section 327) of the Bankruptcy Code into PROMESA.[24]

The Committee amendment also eliminates references to "the estate," since there is no "estate" in cases under title III of PROMESA,[25] and it otherwise conforms the terms used in the bill to the terminology of PROMESA and the Bankruptcy Code.

SECTION-BY-SECTION ANALYSIS

Section 1 provides a short title for the Act, the "Puerto Rico Accuracy in Disclosure Act of 2021" or "PRRADA."

Section 2 contains the Act's substantive provisions.

Subsection (a) defines the terms "List of Material Interested Parties" and "Oversight Board" used in the Act.

Subsection (b) establishes disclosure requirements for professionals employed in cases under title III of PROMESA that conform to the disclosure requirements of rule 2014 of the Federal Rules of Bankruptcy Procedure for professionals employed pursuant to section 327 of the Bankruptcy Code.

Paragraph (1) applies to attorneys, accountants, appraisers, auctioneers, agents, and other professionals (mirroring the list of professionals in rule 2014(a)) that are employed in a case under section 304 of PROMESA. It provides that no such professional may be compensated under the compensation provisions of sections 316 and 317 of PROMESA unless the professional has filed with the court a "verified statement" (the term used in rule 2014(a)) that conforms to the disclosure requirements of rule 2014(a) and sets forth the connection of the professional person with any entity or person on the List of Material Interested Parties under section 2(c).

Paragraph (2) requires professionals to file supplemental disclosure statements as additional connections become known. Although rule 2014(a) does not expressly require supplemental disclosure, the courts have interpreted the duty of disclosure under rule 2014 as an ongoing one.[26] "Continuing disclosure is necessary to preserve the integrity of the bankruptcy system by ensuring that . . . professionals remain conflict free."[27] Thus, consistent with the practice under rule 2014, paragraph (2) requires professionals employed in PROMESA cases to promptly disclose to the court any previously undisclosed connection with a party on the List of Material Interested Parties that may arise after the professional has filed the disclosure statement required under paragraph (1).

Paragraph (3) requires professionals to disclose any previous failure to disclose connections in subsequent disclosure statements. It makes it clear that the burden is on the professional "to come for-

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[24] Professionals employed by creditors' committees, unlike those employed by the Oversight Board or the Commonwealth and its instrumentalities, are subject to rule 2014 because they are appointed pursuant to section 1103 of the Bankruptcy Code, which is made applicable to PROMERSA cases by section 301(a) of PROMESA.

[25] *Gracia-Gracia v. Financial Oversight & Management Board for Puerto Rico (In re Financial Oversight & Management Board for Puerto Rico),* 939 F.3d 340, 349 (1st Cir. 2019).

[26] *In re Granite Partners*, 219 B.R. 22, 35 (Bankr. S.D. N.Y. 1998) ("Rule 2014(a) does not expressly require supplemental or continuing disclosure . . . Nevertheless, section 327(a) implies a duty of continuing disclosure, and requires professionals to reveal connections that arise after their retention."); *Rome v. Braunstein*, 19 F.3d 5457–58 (1st Cir. 1994) ("the need for professional [disclosure] and avoidance of conflicts of interest does not end upon appointment").

[27] *In re Granite Partners*, 219 B.R. at 35.

ward and make full, candid, and complete disclosure" to the court if the professional has failed to file a disclosure statement required by paragraph (1), failed to file a supplemental statement required by paragraph (2), or filed a statement pursuant to paragraph (1) or (2) that failed to disclose connections that should have been disclosed. In other words, if a professional neglects to disclose a connection when first required, the professional has a duty to disclose the omission promptly once it is discovered. As is the case under rule 2014, negligence does not excuse the failure to disclose connections that should be disclosed.[28]

Subsection (c) provides for the creation of the List of Material Interested Parties referred to in subsection (b)(1), which requires professionals to disclose their connection with any person or entity listed on the List of Material Interested Parties.

Paragraph (1) directs the Oversight Board to prepare the list, subject to the approval of the court and the right of the United States trustee and any party in interest to be heard on the approval of the list.

Except as provided in paragraph (3), paragraph (2) requires the List of Material Interested Parties to include the same types of persons or entities listed in rule 2014. Rule 2014 lists "the debtor,[29] creditors, any other party in interest,[30] their respective attorneys and accountants,[31] [and] the United States trustee, or and any person employed in the office of the United States trustee."[32] Paragraph (2) adds the Oversight Board, including its members, Executive Director, and employees.

Paragraph (3) authorizes the bankruptcy court to establish a threshold dollar amount, consistent with the purpose of the Act, for Material Interested Parties. Persons with claims below the threshold amount need not be included on the List of Material Interested Parties.

Subsection (d) directs the United States trustee to review disclosure statements filed with the court pursuant to subsection (b) and confirms the United States trustee's authority to contest the award of compensation to professionals under sections 316 and 317 of PROMESA.[33]

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[28] *In re B.E.S. Concrete Products, Inc.,* 93 B.R. 228, 237 (Bankr. E.D. Cal. 1988) ("The burden is on the . . . [professional] to come forward and make full, candid, and complete disclosure . . . Negligent omissions do not vitiate the failure to disclose.").

[29] Section 301(c)(2) of PROMESA defines the "debtor" to mean the Commonwealth of Puerto Rico or an instrumentality of the Commonwealth.

[30] A "party in interest" is someone "who has a 'legally protected interest that could be affected by a bankruptcy proceeding.'" *In re Tower Park Properties, LLC*, 803 F.3d 450, 457 (9th Cir. 2015), quoting *In re Thorpe Insulation Co.,* 677 F.3d 869, 884 (9th Cir. 2012), quoting *In re James Wilson Associates,* 965 F.2d 1034, 1042 (3d Cir. 1985).

[31] As passed by the House, H.R. 1192 only covers attorneys and accountants of "any . . . party in interest" other than the debtor or a creditor. Consistent with rule 2014, the Committee amendment covers attorneys and accountants of the debtor, any creditor, or any other party in interest.

[32] Rule 2014 includes the United States trustee and persons employed by the office of the United States trustee in the list of connections that professionals must disclose. The House-passed bill excludes them. The Committee amendment restores them in view of the significant additional duties that H.R. 1192 imposes upon the United States trustee in PROMESA cases.

[33] The United States trustees and Assistant United States trustees are Justice Department employees who are appointed and supervised by the Attorney General. 28 U.S.C. 581, 582. They oversee the administration of bankruptcy cases by, among other things, monitoring applications to employ professionals, 28 U.S. 586 (a)(3)(I), and reviewing applications for professional compensation in private sector bankruptcy cases. 28 U.S.C. 586(a)(3)(A). PROMESA gives the United States trustee the opportunity to review and contest applications for compensation, though not for employment. 48 U.S.C. 2176.

Paragraph (1) directs the United States trustee to review each verified statement filed with the court pursuant to subsection (b), and authorizes the United States trustee to file comments on such statements with the court. This authority is consistent with the United States trustee's role in reviewing professional employment applications under section 327.

Paragraph (2) authorizes the United States trustee to object to applications for professional compensation filed under sections 316 and 317 of PROMESA that fail to satisfy the disclosure requirements of subsection (b) of H.R. 1192. This authority is consistent with the United States trustee's existing authority to contest professional compensation under sections 316 and 317.

Subsection (e) authorizes the court to deny payment of compensation for services or reimbursement of expenses under section 316 or 317 of PROMESA if the professional fails to meet either the disclosure requirements in paragraph (1) or the conflict-of-interest requirements in paragraph (2).

Paragraph (1) is a disclosure requirement. It provides that the court may deny compensation to a professional who fails to file a disclosure statement required under subsection (b)(1) or files an inadequate disclosure statement under that subsection. It reflects the large body of bankruptcy case law that holds that the duty of disclosure is so important "that the failure to disclose relevant connections is an independent basis for the bankruptcy court to disallow fees or to disqualify the professional from the case,"[34] even if the undisclosed connection does not pose an actual conflict of interest.[35]

Paragraph (2) is a conflict-of-interest requirement. It provides that the court may deny compensation to a professional who is not disinterested or who represents or holds an adverse interest. It contains the same "disinterested" and "adverse interest" standards as section 327 of the Bankruptcy Code and provides the same sanction—denial of compensation—as section 328(c) of the Code, for violated those standards.[36]

The terms "disinterested" and "interest adverse" used in paragraph (2) have well-established meanings in bankruptcy law. The term "disinterested person" is defined in section 101(14) of the

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[34] *Banner v. Cohen, Estis & Associates, LLP (In re Balco Equities Ltd.)*, 345 B.R. 87, 112 (Bankr. S.D.N.Y. 2006), quoting *Exco Resources, Inc. v. Milbank, Tweed, Hadley & McCloy LLP (In re Enron Corp.)*, 2003 U.S. Dist. LEXIS 1442 at 14 (S.D.N.Y. 2003), citing *In re Leslie Fay Cos.*, 175 B.R. 525, 533 (Bankr. S.D.N.Y. 1994). "It is well settled that the Court may deny compensation to a professional when the professional fails to comply with the disclosure requirements of" rule 2014. *In re Etheridge*, 2019 Bankr. LEXIS 3786 (Bankr. M.D. N.C. 2019), citing *In re Crivello*, 134 F.3d 831, 836 (7th Cir. 1998) ("failure to disclose is sufficient grounds to revoke . . . employment . . . and deny compensation"). "Authority to disqualify a professional is not explicitly set forth in the Bankruptcy Code. However, that authority arises out of the court's equity powers." *In re Rusty Jones, Inc.,* 134 B.R. 321, 341 (Bankr. N.D. Ill. 1991).

[35] "The scope of disclosure [required under rule 2014] much broader than the question of disqualification [under section 327 of the Bankruptcy Code]." *In re Granite Partners, L.P.*, 219 B.R. 22, 35 (S.D. N.Y. 1998). A "court may find a disclosure violation even if the undisclosed connection does not amount to a conflict." Id., citing *In re Olsen Industries, Inc.*, 22 B.R. 49, 60 (Bankr. D. Del. 1997). The disclosure requirements of rule 2014 "are more encompassing than those governing the disinterestedness inquiry under section 327. For while retention under section 327 is only limited by interests that are 'materially adverse,' under Rule 2014, 'all connections' that are not so remote as to be *de minimus* must be disclosed." *In re Leslie Fay Cos.,* 175 B.R. 525, 536 (Bankr. S.D. N..Y. 1994).

[36] Section 328(c) provides that "the court may deny allowance of compensation for services and reimbursement of expenses of a professional person . . ., if, at any time during such professional person's employment . . ., such professional person is not a disinterested person, or represents or holds an interest adverse . . . with respect to the matter on which such professional person is employed."

Bankruptcy Code, and generally means someone "who does not have an interest materially adverse to the interest of the estate . . . for any . . . reason." An "adverse interest" is not defined by the Bankruptcy Code, but generally means a conflicting economic interest or a bias against the estate.[37] The "disinterested" and "adverse interest" tests "overlap and form a single test to judge conflicts of interest."[38]

The courts have held that both the disclosure requirements of rule 2014 and the conflict of interest requirements of section 327 of the Bankruptcy Code "require strict enforcement to preserve the integrity of the bankruptcy system."[39] But, as important as strict enforcement of the disclosure requirements is, "the bankruptcy judge [is] not bound by a completely inflexible rule mandating denial of all fees in all cases."[40]

"Section 328(c) declares that . . . the court 'may' deny compensation. . . . [T]he plain language of the statute is permissive. . . . The permissive 'may deny' language does not require the court to deny . . . fees or disgorge previous[ly] paid fees in all cases."[41] Subsection (e) uses the same "may deny" language as section 328(c).

COST AND BUDGETARY CONSIDERATIONS

The Congressional Budget Office has not estimated the costs of H.R. 1192 as passed by the House (or of H.R. 698 during the 116th Congress). The Committee has requested, but has not yet received, the Congressional Budget Office's estimate of the cost of H.R. 1192 as ordered reported. When the Congressional Budget Office completes its cost estimate, it will be posted on the Internet at www.cbo.gov.

REGULATORY IMPACT EVALUATION

In compliance with paragraph 11(b) of rule XXVI of the Standing Rules of the Senate, the Committee makes the following evaluation of the regulatory impact which would be incurred in carrying out H.R. 1192.

As passed by the House, section 2(a) of H.R. 1192 would require all professionals compensated under section 316 or 317 of PROMESA to file a verified statement disclosing any connection they may have with over 165,000 creditors in cases filed under section 304 of PROMESA with the court prior to seeking compensation, supplemental statements disclosing additional information, and annual statements confirming the accuracy of prior statements. In addition, section 2(d) of the House-passed bill would require any professional compensated prior to the enactment of H.R.

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[37] *In re Granite Partners, L.P.*, 219 B.R. 22, 32–33 (Bankr. S.D. N.Y. 1998).

[38] *Id.* at 33.

[39] *In re Tinley Plaza Associates, L.P.*, 142 B.R. 272, 280 (Bankr. N.D. Ill. 1992).

[40] *In re Watson Seafood & Poultry Co., Inc.*, 40 B.R. 436, 440 (Bankr. E.D. N.C. 1984). "There is considerable precedent establishing that nondisclosure of potential conflicts alone justifies the bankruptcy court's exercise of discretion to deny all fees," but "[t]he law . . . does not require such a result." *In re Roberts*, 75 B.R. 402, 412 (D. Utah 1987). "The general rule should be that all fees are denied when a conflict is present, but the court should have the ability to deviate from that rule in those cases where the need for . . . discipline is outweighed by the equities of the case. This flexibility is supported by [section] 328(c) [of the Bankruptcy Code], which says that the court 'may' (rather than 'shall') deny compensation when [a professional holds or] represents an interest adverse to the estate." *In re Watson Seafood & Poultry Co., Inc.*, 40 B.R. at 440.

[41] *Gray* v. *English*, 30 F.3d 1319, 1323 (10th Cir. 1994).

1192 to file a disclosure statement. A witness testified that compliance with these requirements would be "extraordinarily costly" and may prove too burdensome for smaller professional firms.

The Committee amendment to the bill attempts to reduce the cost and burden of the bill by narrowing the required disclosures to a List of Material Interested Parties. Creditors with claims under a threshold dollar amount established by the court would be excluded from the List. The Committee believes that the amendment will significantly reduce the cost and burden of compliance.

In addition, the Committee eliminates the requirement for annual statements under section 2(a)(2)(B) and for statements from former professionals under section 2(d) of the House-passed bill, further reducing the amount of paperwork required by the House-passed bill.

Since H.R. 1192 mandates the filing of disclosure statements, the cost of preparing them is likely to be compensable as part of the "actual, necessary services rendered by the professional person" under section 316 of PROMESA.[42] But section 316 limits compensation for professional services to "reasonable" amounts, as determined by the court, taking into account the considerations listed in section 316(c).

No personal information would be collected under the bill. Therefore, there would be no impact on personal privacy.

CONGRESSIONALLY DIRECTED SPENDING

H.R. 1192, as ordered reported, does not contain any congressionally directed spending items, limited tax benefits, or limited tariff benefits as defined in rule XLIV of the Standing Rules of the Senate.

EXECUTIVE COMMUNICATIONS

The Committee did not request Executive Agency views on H.R. 1192.

[42] *See Baker Botts L.L.P.* v. *ASARCO LLC*, 576 U.S. 121, 132 (2015) (finding time spent preparing a fee application compensable under section 330 of the Bankruptcy Code).

ADDITIONAL VIEW OF SENATOR MANCHIN

I strongly support enactment of H.R. 1192 as proposed to be amended by the Committee amendment. I append my additional views to explain why.

Disclosure of potential conflicts in a bankruptcy case is needed not only to guard against conflicts of interest but to assure the parties to the bankruptcy case and the public that the end result is fair. As Judge Henry Friendly said, "the conduct of bankruptcy proceedings not only should be right but must seem right."[43] This is as true in PROMESA cases as in any other bankruptcy case. Extending the disclosure requirements of rule 2014 to cases under PROMESA will not only protect the integrity of the cases, but will assure the people of Puerto Rico of their integrity.

Extending the disclosure requirements to pending cases, however, poses two challenges. The first challenge is that rule 2014 was designed to apply prospectively, to the hiring of professionals and not, as here, retrospectively, as many as five years after they were hired. The second challenge stems from the sheer number of creditors in the pending cases, which threatens to make strict compliance with the disclosure requirements costly, burdensome, and even infeasible.

Applied literally and inflexibly, the House-passed bill could unfairly result in the disqualification of, and denial of payment to, innocent professionals whose "connections" pose no serious threat to the integrity of the cases. Worse, it could disrupt or delay the progress being made to restore Puerto Rico to financial stability.[44]

I believe that the Committee amendment fairly addresses both of these challenges by preserving Judge Swain's equitable discretion to apply the disclosure requirements in a manner that is both just and practicable.

Like all bankruptcy judges, Judge Swain, the District Court Judge who Chief Justice Roberts entrusted with the herculean task of presiding over the PROMESA cases, sits as a court equity, imbued with broad equitable powers to achieve a justice and fair-

[43] *In re Ira Haupt Co.*, 361 F.2d 164, 168 (2d Cir. 1966).

[44] Robert J. Keach, a past President of the American Bankruptcy Institute, testified to this effect before the House Judiciary Committee in June 2019. "[B]ecause the PROMESA proceedings have been in place for some time, and the disinterestedness and other standards of the Bankruptcy Code were not requirements for retention of professionals at the outset of any of the Title III cases," Mr. Keach testified, "the remedy provisions of [H.R. 1192] will have to be carefully considered, and likely amended, to prevent the inadvertent disqualification or necessary resignation of professional firms, including many local firms, that fairly and properly met the standards of retention when the Title III cases commenced. Such an event could be highly disruptive of the current proceedings and the considerable progress made in those cases. Calibration of the application of the Bankruptcy Code standards going forward, when such standards did not previously govern, is essential to avoid interfering with that progress."

ness.[45] Justice and fairness are essential in all bankruptcy cases, but they are especially important in the case of a government debtor, where the goal is not just a fair division of assets among creditors, but the maintenance of public services.[46] The Committee amendment preserves Judge Swain's discretion to apply the disclosure requirements in a manner that is both fair and feasible, consistent with longstanding practice under rule 2014 and the equities of the PROMESA cases.

JOE MANCHIN, III.

CHANGES IN EXISTING LAW

In compliance with paragraph 12 of rule XXVI of the Standing Rules of the Senate, the Committee notes that no changes in existing law are made by the bill as ordered reported.

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[45] *Pepper* v. *Litton*, 308 U.S. 295, 304 (1939); *Miller* v. *Generale Bank Nederland, N.V. (In re Interpictures, Inc.)*, 2000 U.S. App. LEXIS 1848 at 5 (2d Cir 2000), citing *In re Momentum Manufacturing Corp.*, 25 F.3d 1132, 1136 (2d Cir. 1994).

[46] *In re Financial Oversight & Management Board for Puerto Rico*, 432 F. Supp. 3d 25, 30 (1st Cir. 2020). *See also Puerto Rico* v. *Franklin California Tax-Free Trust*, 136 S. Ct. 1938, 1950 (J. Sotomayor, dissenting) ("governments cannot shut down power plants, water, hospitals, sewers, and trains and leave citizens to fend for themselves").