REMARKS OF

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Introduction

Thank you for the invitation to speak with you this morning about the major priorities of the United States Trustee Program ("USTP" or "Program"). In particular, let me thank Jamie Sprayregen for asking me to participate in this important conference. I greatly admire Jamie for his leadership in the insolvency and bankruptcy field in the United States, and it is my honor to serve with him and other distinguished insolvency professionals on the American Bankruptcy Institute's Commission to Study the Reform of Chapter 11.

Let me also acknowledge this morning the important work that INSOL and the Group of Thirty-Six perform for the benefit of consumers and businesses worldwide. Not only are you the leading professionals who make the insolvency and bankruptcy system work, but your important projects and research inform government policymakers and practitioners. A vibrant economy that advances the interests of shareholders, creditors, employees, and other investors depends on entrepreneurship and a legal framework within which troubled commercial enterprises can obtain a breathing spell and recover profitability. Each of you plays a critical role in guiding commercial enterprises back to job producing financial health.

Mission, Structure, and Functions of the USTP

As many of you know, the USTP was established in the Bankruptcy Reform Act of 1978, better known as the Bankruptcy Code. In creating the USTP, Congress called us the "watchdog" of the bankruptcy system. Our mission of protecting the efficiency and integrity of the system for the benefit of all stakeholders – debtors, creditors, and the American public – is vital for allowing corporations either to successfully reorganize or to sell their assets to enterprises that can more effectively deploy them.

To fulfill our mission, the Congress gave the Program broad authority to carry out our administrative, regulatory, and enforcement responsibilities. Under the Bankruptcy Code, we have the right to appear and be heard on almost every issue in almost every bankruptcy case. We have responsibilities in cases ranging from individual consumer cases to the largest corporate reorganizations. Our role, however, in chapter 15 cross-border insolvency cases is somewhat limited, although we do play a larger role in concurrently filed cases.

Organizationally, Congress placed the USTP within the Department of Justice. This separated the judicial and executive functions that formerly were merged within the bankruptcy court system. Among other things, this allows bankruptcy judges to focus on the adjudication of disputes and promotes fairness because courts do not appoint the trustees who bring those disputes before them.

The USTP is structured at three levels, with a Director in the Executive Office headquarters in Washington, DC, who leads the Program. There are United States Trustees (USTs) with line supervision over 21 regions. Within those regions are a total of 95 field offices, headed by Assistant United States Trustees, and staffed with more than 1,200 trial attorneys, financial analysts, paraprofessionals, and support staff.

Our major activities fall into three areas – administration, regulation, and enforcement. First, we carry out core administrative tasks such as appointing and overseeing private trustees in chapters 7, 12, and 13. These private trustees distribute almost $8 billion annually in well over one million cases each year. We appoint official committees of unsecured creditors in chapter 11. And among our other administrative tasks, we approve credit counselors and financial educators who are authorized to provide statutorily mandated pre-filing and post-filing credit counseling and financial education to consumer debtors.

On the regulatory front, we prescribe financial reporting by trustees and chapter 11 debtors, issue regulations governing credit counselor and financial educator conduct, and promulgate rules on a variety of matters.

In recent years, our emphasis has been on enforcement. Although most of our work is in the area of civil enforcement, we maintain a robust criminal enforcement practice by making referrals to the United States Attorneys, the FBI, and other law enforcement agencies. In addition, about 25 of our attorneys are cross-designated to prosecute bankruptcy crimes. We participate in more than 90 federal law enforcement task forces or working groups, including the President's Financial Fraud Enforcement Task Force which is headed by the Attorney General.

In the area of civil enforcement, we take more than 50,000 actions each year, including informal investigations that do not ripen into litigation, with a potential monetary impact of about $2.5 billion in debts not discharged, disgorgements, and other relief. A majority of these actions are taken to curb abuse of the system by debtors – such as seeking dismissal of a chapter 7 case when the debtor has disposable income to fund a chapter 13 repayment plan or seeking denial of discharge where the debtor concealed assets. However, in the past four years, we have more then doubled the number of actions taken to protect consumer debtors.

Moreover, we have adopted a litigation strategy of reaching nationwide settlements to resolve litigation or investigations that are on-going in multiple USTP districts. In the past few years, we have reached four nationwide settlements with creditors, beginning in 2008 with a settlement with Capital One in connection with its collection of debts that had been discharged in bankruptcy.

National Mortgage Settlement

Our signature achievement was the recently concluded National Mortgage Settlement. The Department of Justice, including the USTP, the Department of Housing and Urban Development, other federal agencies, and 49 state Attorneys General obtained a Consent Order involving the five largest mortgage servicers in the United States.

Our participation in the Settlement resulted from more than five years of investigation and litigation against the mortgage industry for violations of the Bankruptcy Code. Even before the mortgage meltdown, we uncovered protracted and systematic violations, such as the filing of inflated claims, the filing of motions seeking relief from the automatic stay (that is, court permission to foreclose) based on the creditor's faulty accounting, and the charging of fees that were presented to homeowners only after they emerged from bankruptcy court protection. These violations caused real harm to homeowners in financial distress, including the potential loss of their homes.

Leading up to the Settlement, we stepped up our investigations and coordinated with other agencies. As Attorney General Holder cited at the news conference announcing the Settlement, in an eight month period, the USTP reviewed more than 37,000 documents and conducted discovery in more than 175 cases. The major mortgage servicers responded by consistently opposing our investigations, including by filing about 300 motions to quash discovery.

The National Mortgage Settlement is reported to be the second largest civil settlement of all time, exceeded only by the tobacco settlement. Under the terms of the agreement, the servicers will pay $25 billion, with most of that amount credited against loan modifications and principal write-downs. The settling banks also are obligated to follow detailed mortgage servicing standards that are prescribed in the agreement and now backed by a federal court order. The Settlement will be monitored by an independent third party who will issue public reports on servicer compliance for 3-1/2 years.

Our mortgage industry enforcement efforts did not end with the Settlement. We continue to review the conduct of the settling servicers, and also are reviewing claims filed by other servicers who are not currently parties to the agreement.

Chapter 11 Priorities

Let me now turn to chapter 11 matters. Although most of our work is in the consumer area, we also have important statutory obligations in business reorganization cases. In recent years, we have made special efforts to ensure consistency among our offices in both legal policy and practice. With some allowance for variation in prevailing case law in our federal system, generally you should see USTP field offices taking similar actions and making similar legal arguments in cases with similar facts, regardless of whether the case is pending in, say, Portland, Maine, or Portland, Oregon.

In the interests of time, I would like to highlight four priorities in the chapter 11 arena that have received a fair amount of public attention.

Chapter 11 Trustees, Examiners, and Chief Restructuring Officers

I will start with our actions relating to chapter 11 trustees, examiners, and chief restructuring officers.

The 2005 amendments to the Code placed new responsibilities on the Program to promote accountability by management of companies in chapter 11. The Code requires that a UST seek the appointment of a chapter 11 trustee if the UST has reasonable grounds to suspect that the debtor or its management engaged in financial fraud. Our efforts in this area have been hampered by case law requiring that grounds for the appointment of a trustee be established by clear and convincing evidence. We find no basis in law for that elevated standard. In fact, in *Grogan v. Garner*, the Supreme Court concluded in a section 523 exception to discharge case that a burden of proof stronger than "preponderance of the evidence" may not be applied in the absence of clear statutory language. Despite that holding, bankruptcy courts remain split. I am pleased we have had some recent litigation success on this issue, including with the 8th Circuit Bankruptcy Appellate Panel.

We also view the appointment of examiners as valuable in appropriate cases. Unlike a trustee, an examiner does not displace the debtor-in-possession. An examiner is, first and foremost, an investigator. The examiner investigates the financial affairs of the debtor and files a report of the investigation with the court. If the UST or other party-in-interest requests the appointment of an examiner in a case where the debtor has more than $5 million in specified types of debt, the appointment is mandatory. We do not automatically seek an examiner appointment in such cases. If, on the other hand, we believe that an examination will uncover valuable information that will aid in the administration of the estate or that will assist parties in evaluating plan proposals or in making other decisions, we do not hesitate to seek the appointment of an examiner.

Once the court directs the appointment of a trustee or examiner, the duty to make the appointment rests on the UST. The UST is required to consult with parties before making an appointment, which must be approved by the court. We take the consultation duty seriously, and we consider candidates suggested by the parties. We also ask parties what skills they believe the trustee or examiner should have, and we factor that into our decision. But, the appointment decision is ultimately the UST's and our principal critera at all times are the independence and integrity of the appointee. It is not rare for us to consider highly qualified candidates who were not recommended by any party during the consultation process.

Our strong emphasis on the independence of fiduciaries in bankruptcy cases leads me to another observation: there appears to be an increasing use of Chief Restructuring Officers (CROs). Although we recognize that a CRO often plays a critical role in successfully rehabilitating a financially ailing company, a CRO is not a legally permissible substitute for a chapter 11 trustee. For example, unlike a trustee, prevailing corporate governance law precludes a CRO from operating free from the control of the debtor's management or board of directors. In many cases, installation of a CRO is a perfectly appropriate action. But, in some cases, it is not.

We are aware that CROs are often forced upon debtors by their major secured lenders. By contrast, Congress conferred upon the USTP the power to appoint trustees, in part, so that the interests of all stakeholders are protected. A decision by the debtor and its largest institutional lender to install a CRO who operates outside of ordinary principles of corporate governance is contrary to the Code and will be opposed by the United States Trustee.

With increasing frequency, CROs have been used by small to medium chapter 11 debtors as a trustee avoidance mechanism. CROs sometimes are installed after the UST files, or even discusses with the debtor the necessity of filing, a motion for the appointment of a trustee. Among other scenarios, in cases in which allegations of fraud or other improper conduct are alleged, pre-petition management will be jettisoned and replaced by a CRO. The debtor often will ask the court to order that the CRO be authorized to exercise all of the powers of the debtor-in-possession and may be removed only by order of the court. We strongly believe that this management scheme is completely contrary to the Bankruptcy Code and we will continue to object to such CRO motions.

Again, the installation of a CRO, prior to or even after a bankruptcy filing, may be perfectly appropriate if the CRO operates in accordance with the norms of corporate governance. But the hiring of a CRO should not defeat the appointment of a trustee or examiner if such an appointment otherwise is justified under the Bankruptcy Code.

Official Committees of Unsecured Creditors

Let me move to another priority of increased importance to the bankruptcy community – the appointment of official committees of unsecured creditors. It is a bedrock duty of the United States Trustee to appoint a committee that is representative of the entire class of creditors. Committee members act as fiduciaries for the entire constituency. The committee is authorized, among other things, to hire counsel and professionals to assist them in investigations and negotiations with the debtor.

The Program takes very seriously the need to appoint a committee promptly so that creditors may be organized and participate in the earliest hearings in a case. Our USTs and their staffs must learn as much as they can, as quickly as they can, about debtors and their debt structures. The lightning speed with which some of these cases proceed requires extraordinary efforts on the part of Program personnel. In a case of significant size, we generally hold an organizational meeting where we collect written information from prospective committee members and interview candidates privately to gather additional information. For example, in the Lehman and GM cases, the committees were appointed just two days after filing.

In recent years, financial markets have grown increasingly complex and so have creditor interests in cases. It is not unusual for significant creditors to hold multiple interests in a case as both a secured and unsecured lender. Moreover, creditors holding apparently similar claims may have divergent interests in the outcome of the case as a result of how and when they acquired their claims. The UST will consider these complexities in seeking to form a representative committee. Furthermore, the UST will seek periodic updates from committee members to assure that their status as claimholders has not changed.

As part of its due diligence prior to making appointments, the USTP carefully looks for conflicts of interest and ulterior motives in forming committees. The *Universal Building Products* case in the district of Delaware focused attention on the use of proxies by candidates seeking membership. In that case, the person holding the proxies for the members had agreed to support the retention of two law firms competing for retention by the committee. The bankruptcy court denied the firm's retention, finding that it had violated ethical strictures by soliciting business from non-clients. We have issued detailed guidance to our offices on all aspects of committee formation which includes a questionnaire that seeks information on any contacts candidates might have had with professionals about the case.

Executive Bonuses

The third chapter 11 priority I would like to discuss has been the subject of a number of major articles in the *Wall Street Journal* and other publications in recent weeks. The 2005 amendments to the Bankruptcy Code impose strict limitations on the payment by chapter 11 debtors of bonuses for the purpose of retaining key employees. These Key Employee Retention Plans often are referred to as KERPs. If the key employee is an insider, the debtor-company may not pay a retention bonus unless the employee has a bona fide job offer and, even then, the amount of the bonus is strictly limited.

On the other hand, insiders may be paid incentive bonuses based upon future performance. These Key Employee Incentive Program bonuses, or KEIPS, as well as bonuses paid to non-insiders, may be justified in light of the facts and circumstances of the case. Under prevailing case law, the debtor must justify the KEIP under the “business judgment” standard. This is a much easier test than the statutory test for retention bonuses to insiders.

Not surprisingly, debtor companies rarely request permission to pay a KERP. Instead, they seek to justify the bonus as a bona fide incentive payment. Frequently, we conclude that the incentive plans are merely disguised KERPs. Among the touchstones we look for in distinguishing a prohibited retention plan from a permissible incentive program are measurable milestones that are difficult to achieve, such as consummating a sale of assets for a price above an existing bid, confirming a plan of reorganization within a tight time frame that results in a benefit to the estate, or meeting certain financial performance standards. For instance, a bonus could be payable upon the achievement of specified levels of EBITDA.

We seek to vigorously enforce the statutory limitations on KERPs and KEIPs. Although all parties in interest in a chapter 11 case have standing to object to KERPs and KEIPs, the UST often is the only party doing so. Several weeks ago, page one of the *Wall Street Journal* featured a story about several well known and generous management bonus programs approved by the court over the United States Trustee’s objection. The good news was that we were recognized for having been vigilant. The bad news was that we lost in a number of the reported cases.

The *Wall Street Journal* story got the facts essentially correct. Data suggest that our KERP success rate is lower than our success rate for any other litigation. I should hasten to add that we recognize that most KERP and KEIP disputes tend to be fact sensitive and often are resolved either by the debtor seeking to compromise with the UST to avoid adjudication of an objection, or by the court ordering modification of the plan.

Professional Fees in Large Reorganization Cases

The final priority I will address is our proposed revised fee guidelines for attorneys in large chapter 11 cases. I suspect that those of you from major American law firms are at least minimally aware of these. While I will not go into great detail, some background is in order.

In the Bankruptcy Reform Act of 1994, Congress imposed a mandate on the USTP to establish uniform guidelines for reviewing applications for professional compensation in bankruptcy cases. Insofar as bankruptcy judges award professional fees under statutory standards, the guidelines were not to change substantive law for awarding such fees. Rather, they were intended to provide uniformity in the fee application preparation and review process. In early 1996, the Program published fee guidelines that, while not mandatory by law, have been adopted in whole or in part in many jurisdictions and are followed with various degrees of rigor in districts throughout the country. Among the original guidelines were threshold disclosure requirements, task-based billing requirements, and standards for reimbursement for certain expenses.

I submit that the original guidelines have largely satisfied their objective. But, like most things, guidelines are not immutable and can become out-of-date. Although I think the guidelines have retained their essential validity, many of us concluded that changes in billing practices, law office technology, and other aspects of bankruptcy practice rendered the guidelines in need of updating and even a bit of re-thinking.

I assembled a group of colleagues from within the USTP to tackle the job of revising the professional fee guidelines. We sought and received input from many others throughout the Program. Based on the collective wisdom of the group, we identified several objectives:

(1) ensuring that fee review is subject to client-driven market forces, accountability, and scrutiny;
(2) enhancing meaningful disclosure and transparency in the billing practice;
(3) decreasing the administrative burden of review;
(4) maintaining the burden of proof on the fee proponent and not allowing the fee review process to shift that burden to the objecting party; and
(5) increasing public confidence in the integrity and soundness of the bankruptcy compensation process.

One of the most significant issues addressed in the proposed guidelines pertains to the attorney's burden to satisfy the statutory requirement that the fees charged in bankruptcy be comparable to the fees charged outside of bankruptcy. Prior to the 1978 rewrite of the bankruptcy laws, attorneys were paid in bankruptcy under an economy standard predicated upon the assumption that creditors were not paid in full, so neither should the professionals. Sensibly enough, the draftspeople of the modern Code concluded that the economy standard deprived bankruptcy practice of some of the best lawyers who would ply their trade in areas of the law where they could be paid their full worth.

The economy standard was replaced by a comparable services standard under the 1978 Code. Under the comparable services standard, a professional may be paid under section 330 based upon the "customary compensation charged by comparably skilled practitioners in cases" outside bankruptcy.

In recent years, private industry has imposed major cost controls on outside counsel. Budgets, discounts, and other cost saving measures are required under many retention agreements. But, in bankruptcy, budgets are rare and the bankruptcy bar considers compensation less than the full hourly rates to be unfair.

We are concerned that the economy standard that was changed by law to a comparable services standard has transformed into a bankruptcy premium standard, whereby bankruptcy professionals are allowed to charge rates above what they could charge non-bankruptcy clients. By seeking additional disclosures, the revised guidelines are designed to ensure adherence to the statutorily-based comparable services standard.

We prepared draft guidelines and disseminated them widely, posting them on the Internet on November 4 of last year. We solicited written comments, asking that they be provided to us on or before January 31. We received 23 comments and 4 supplemental comments, ranging from short email messages from individuals to lengthy expositions from professional and bar organizations and consortia of law firms. The comments reflected a divergent array of viewpoints. Some commenters suggested that the system for reviewing professional fees is in need of significant reform. Others, including more than 100 law firms who jointly signed one letter of comment, took the position that the fee review system is working just fine. And a third category of commenters agree that some revisions would be beneficial and have suggested ways in which our proposed guidelines could be improved.

Many of the commenters requested follow-up meetings. Because we wanted the guidelines to be developed in an open environment, we decided to hold a public meeting. That meeting is scheduled for June 4th at the Department of Justice in Washington, DC.

Our goal is to promulgate final guidelines that satisfy the objectives stated a moment ago. Those professionals who take the position that "the system ain't broke so don't fix it" undoubtedly will be disappointed by our final product. I am confident, however, that the final product will represent an improvement over the current guidelines and will help ensure that fees are awarded based upon a fuller record establishing that the Congressionally mandated fee award standards have been satisfied. In turn, that should increase public confidence and thereby benefit all stakeholders in the bankruptcy system.

Conclusion

I appreciate the opportunity to talk with you this morning. As the United States Trustee Program moves forward in its efforts to curb debtor and creditor violations of the Bankruptcy Code, and as we seek to hold management accountable in chapter 11 business cases, we are well aware of the expertise and professionalism that you and your colleagues bring to the insolvency and bankruptcy practice. I look forward to working with you as key stakeholders who appreciate that the integrity and fairness of the bankruptcy system is vital to debtors, creditors, and the general public.

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