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**Before the**

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**National Association of Bankruptcy Trustees (NABT)**

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## **Introduction**

Thank you for inviting me to speak with you this afternoon about the United States Trustee Program (USTP or Program). I enjoy this annual opportunity to get together with you to highlight some of the work we have been doing and to talk with you about the challenges facing all of us in the bankruptcy system.

Once again this year, I am joined by several United States Trustees and senior staff from our headquarters who will be speaking with you as part of the conference sessions. Of course, the real value of our attendance comes from the chance to spend some time with you informally. I hope that you will take the opportunity to share with us your thoughts on any bankruptcy issues of concern to you.

Among those you can talk with is our newest United States Trustee in Region 8, Sam Crocker. Sam needs no introduction to this crowd. He served for 27 years as a chapter 7 trustee and for many years in the leadership of the NABT, including a term as President. Sam brings to us a wealth of practical knowledge about case administration, as well as a solid understanding of the law. He will be an increasingly vital source of advice and assistance to me as the United States Trustee Program moves into the future.

Let me begin by thanking Lynn Schoenmann for her leadership over the past year. Lynn has been a strong advocate for chapter 7 trustees -- not only with the USTP, but also with other bankruptcy policy-makers. She is a real problem solver and I have greatly appreciated that skill during the past year. So, from one public servant to another, well done and thank you. I also would like to extend congratulations and best wishes to Neil Gordon as he takes over as the NABT's newest President. Neil, you are following some impressive former Presidents, and I look forward to working with you during the coming year.

One of the notable things about your annual conference is that you have participation from a broad swath of the bankruptcy community. I think this is indicative of how well you work with others within the bankruptcy system. I certainly know that is true with respect to the USTP. Not only do we receive outstanding support from chapter 7 trustees at the local level, but nationally as well. I would like to take this opportunity to extend a special thanks to Kelly Hagen, Lynn Riley, Rick Nelson, Jenice Golson-Dunlap, and Jim Boyd for all their hard work on various USTP/NABT working groups throughout the year.

## **Challenging Environment**

It seems like ever since I became Director about five years ago I have been saying to groups of trustees and USTP staff how important it is that they meet the unprecedented challenges facing the bankruptcy system.

### **Increase in Filings**

Most recently, you faced an incredible surge in filings which are now back to about the pre-2005 amendment level. Nationwide, in USTP districts, total filings have nearly doubled over the past three calendar years – up by 90 percent. In chapter 7, the increase has been even greater at 121 percent. Although there is a significant variation in chapter 7 case filings around the nation – ranging from a high of an increase of 326 percent in the Central District of California to a low of only six percent in the Western District of New York – caseload increases have presented challenges almost everywhere.

Last fiscal year, filings began leveling off and we are now seeing a decrease in FY 2011. The bottom line, though, is that total filings are at about pre-2005 reform law levels. Moreover, the rapid rate of increase in chapter 7 cases in the past three years means that the ratio of chapter 7 to chapter 13 cases also is returning to pre-2005 levels – with about 70 percent of all case filings now made in chapter 7.

### **Trustee Compensation**

Following the 2005 amendments, chapter 7 trustees most certainly have been asked to do more work and in more cases. Yet, the gap in time between the filing of cases and the administration and receipt of payments has meant that overall national trustee compensation has gone down. In fact, nationwide, total chapter 7 trustee compensation from all sources – including the no asset fee, the commission on distributions, and fees to the trustee as professional in a case – has declined about 10 percent over the last three calendar years. Again, there is a wide variation among trustees, but we fully understand that any decline in compensation is not easy to handle.

We do see that this situation is beginning to change. The increased number of cases filed and closed recently is likely to lead to an increase in total chapter 7 trustee compensation in 2011 and over the next few years. So, again, thank you for your perseverance, patience, and professionalism.

## **Overall USTP Activity**

Let me now turn to a report on significant activities of the USTP. Like all of you, we too have had to cope with increased demands and escalating caseloads. I am grateful to my colleagues throughout the country for the extraordinary example of public service that they set every day. Our overall productivity in advancing the integrity and the efficiency of the bankruptcy system is extremely high.

### **Mortgage Servicer Violations**

Although we cope daily with a large caseload, we have intensified our efforts to police mortgage servicer violations of the Bankruptcy Code. This is a topic of even greater interest to our chapter 13 trustee colleagues. But I know many chapter 7 trustees have helped us identify egregious actions by mortgage servicers that harm homeowners.

We began investigating mortgage servicer violations of the Bankruptcy Code as far back as 2006. We have realized many successes during this time, including last year's settlement reached by the USTP and the Federal Trade Commission (FTC) with Countrywide Home Loans. As a result of that settlement, the FTC recently paid \$108 million to victimized homeowners, including many chapter 13 debtors.

### **Concentrated Enforcement Effort**

Currently, we are engaged in a special initiative to review mortgage servicer violations. This initiative, which we launched last November in select offices, has been widely reported in the major media. As part of the President's Financial Fraud Enforcement Task Force, we have coordinated with other agencies in reviewing mortgage servicer practices. Among other things, we provided technical assistance to the prudential banking regulators during their recent review of servicing practices.

Although all offices have a mandate to take action against mortgage servicer violations, under the initiative, the finding of a "facial deficiency" in a proof of claim or motion for relief from stay will trigger a filing of a motion for a Rule 2004 examination or other discovery. We have uncovered a bevy of "facial discrepancies" that suggest nationwide and industrywide problems.

Some examples of problems we have uncovered include –

- one case in which a \$52,000 deficiency claim ultimately was reduced to \$3,000;
- escrow double-dips in which the lender seeks to get paid "double" by claiming a pre-petition arrearage on the claim, while also increasing the monthly mortgage payment; and
- inaccurate claims of arrearages when the debtor was actually up to date because

the homeowner was paying a reduced amount under an approved mortgage modification plan.

These cases can have real consequences. In some cases, the lender attempts to foreclose without adequate justification and based on the lender's own misaccounting.

The response of the mortgage servicers has been a consistent opposition to providing discovery. We are currently litigating more than 280 motions to quash. We have obtained 80 favorable rulings thus far. But, as we win in bankruptcy court, we are then facing motions for reconsideration and appeals. Moreover, we have had to file motions to compel the servicers to obey court orders in at least six cases.

Although the servicers have demonstrated a willingness to give us information on a case-by-case basis, they have resisted giving us national policies and procedures that would shed light on systemic problems. Furthermore, they challenge the right of the United States Trustee even to investigate creditor violations. In effect, they maintain that the "watchdog" of the bankruptcy system has a mandate to protect creditors from debtors, but not to police creditor conduct.

Fortunately, in a number of districts, United States Attorneys have provided assistance to us in carrying out our investigations and litigation, and we are beginning to obtain needed witness testimony and document production. The servicers can delay our investigations, but they cannot thwart our investigations. Through August 30<sup>th</sup>, we have conducted 50 examinations involving 13 witnesses in 134 cases. We also have reviewed thousands of pages of documents. We have now obtained discovery in about 35 cases involving a servicer's national policies and procedures, and are evaluating the evidence obtained to date.

I have no doubt that we will continue to prevail in discovery litigation. The servicers' dilatory tactics have delayed justice, but they have not defeated justice. Nor will such tactics be productive in the future.

#### Recent Court Decisions and Significant Developments

Not surprisingly, as we move forward on litigation to hold mortgage servicers accountable for their actions, courts are considering the scope of the bankruptcy's court authority to provide relief. The USTP recently participated in two appeals decided this summer that illustrate the kinds of issues that we are asking courts to resolve:

- In Wells Fargo v. Stewart, the United States Court of Appeals for the Fifth Circuit struck down injunctive relief imposed against Wells Fargo on the ground that, among other things, the debtor in that case had settled her dispute with Wells Fargo.
- In contrast, in In re Taylor, the United States Court of Appeals for the Third Circuit upheld sanctions against HSBC and its law firm by noting that the bankruptcy court properly considered the effect sanctions may have on future

conduct. The Taylor decision contains some important language regarding the duty of a creditor's lawyer to make reasonable inquiry before representing facts to the bankruptcy court.

In our view, the bankruptcy court has broad authority to remedy creditor abuse of the bankruptcy process. There is not a great deal of case law on this issue, but I suspect we will see more decisions in the future because of the Program's policing of mortgage servicer conduct.

Under the leadership of the Associate Attorney General, the United States Trustee Program is part of a broader inter-agency process of seeking a nationwide settlement of mortgage servicer issues in and outside of the bankruptcy arena. The best result will be a global settlement that resolves the violations that we, other federal agencies, and the state Attorneys General believe have been committed. But, absent a global settlement, the USTP is committed to seeing our litigation through to a successful conclusion that protects the integrity of the bankruptcy system and assists homeowners in financial distress.

#### Legislation Introduced in Senate

Of additional interest on the mortgage servicer litigation front, Senate Judiciary Chairman Patrick Leahy has introduced legislation titled "Fighting Fraud in Bankruptcy Act of 2011." The bill addresses the major obstacles we have faced in our mortgage servicer litigation. Among other things, the bill clarifies USTP authority to bring actions to remedy creditor abuse and it gives bankruptcy courts express authorities to impose fines and enter nationwide injunctive relief. In addition, the bill gives the USTP authority to conduct audits of creditor proofs of claim in a manner similar to current statutory provisions governing audits of debtor schedules and statements of financial affairs. We will continue to monitor the progress of this legislation.

#### **Chapter 7 Trustee Banking**

Now, let me turn to an important administrative matter that has been occupying a lot of the United States Trustees' time lately – and probably a lot of your time too. I am speaking of service fees for trustee banking and software.

Over many years, chapter 7 trustees, bankruptcy courts, and the USTP have realized many benefits from the development of specialized computer applications that allow approved depositories to automate much of a chapter 7 trustee's operation. And you have realized remarkable efficiencies in preparing financial reports and filing documents with the United States Trustees and courts as a result of vendor software.

From the outset, the costs of the software and the other additional costs of servicing bankruptcy accounts were absorbed through an interest rate differential. Thus, trustees were paid a smaller return on estate funds as compared to other commercial clients.

Several months ago, we were made aware of major changes in the economics of the trustee software vendors. The low interest rate environment, combined with other adverse

economic conditions besetting the country as a whole, made bankruptcy deposits less desirable. Furthermore, the cost of the banking software could no longer be absorbed in the interest rate differential.

After careful review of the matter, and after consultation with the NABT and outreach to many others in the bankruptcy community, we decided to lift – temporarily – the USTP-imposed prohibition on account fees charged to bankruptcy estates by approved financial depositories. This decision was not made lightly or precipitously. We notified vendors of the likely change in April so they would have plenty of time to notify their trustee customers. We emphatically did not approve any specific fee amount or methodology. Let me emphasize that point again. The United States Trustee Program is not in the business of encouraging the imposition of fees or the setting of fees.

Although our decision to allow fees on deposits was a decision borne of economic necessity, the decision has produced two benefits for the system. First, the costs associated with banking and software applications suddenly became transparent. The costs are no longer hidden within an interest rate spread. And the costs are openly stated and subject to scrutiny by all parties. Second, by making the costs transparent, trustees can comparison shop vendors and banks based on price and quality of services. In effect, there now may be a better opportunity for competition for the trustees' business.

Now, I know I do not need to tell you that this change comes with certain complications. For example, local court practices governing the approval of expenses vary from district to district. And material provisions of vendor contracts differ, including provisions governing the amount charged and trustee obligations under the contract.

Trustees have a responsibility to shop carefully for financial vendor software. They have to make a reasoned judgment and be able to defend their decision. For the part of United States Trustees, we do not substitute our judgment for yours in making business decisions, and we will not substitute our judgment for yours on the choice of software providers and banks. We understand that trustees must weigh the value of services against monetary costs. You are in the best position to do that. Furthermore, in the near term, in considering whether a change is appropriate, you have to weigh the costs of any disruption there might be in switching vendors. Your judgment is entitled to significant deference and you will receive that deference from the United States Trustees. We will revisit our suspension of the prohibition against banking fees no later than December 31, 2012. In the meantime, I hope we may be so fortunate as to see more competition for estate accounts.

As this process moves forward, I ask that you perform your due diligence, make reasoned judgments about software and banking, and be prepared to articulate the reasons for your decisions. This is a time for calm deliberation, for clear analysis, and for thoughtful decisions. In other words, I ask chapter 7 trustees to do what they do every day so very, very well.

## **Chapter 7 Trustee Oversight**

Before I conclude, let me move to a couple of chapter 7 trustee oversight matters of some interest to both of us. I should note that there are several important issues that will be discussed during the United States Trustee panel on Saturday, including efforts we have made to streamline the trustee evaluation system and a new vendor release provision to ensure better access to financial information. Therefore, I will focus my remarks on just two trustee oversight matters.

### **Application Process**

First, let me address the trustee application process. I reported to you last year that the USTP would – in consultation with the NABT – review our various methods of trustee oversight. In part, our review was prompted by the defalcation committed by chapter 7 trustee Marika Tolz in the Southern District of Florida. Trustee Tolz’s defalcation was uncovered by the United States Trustee through a routine review of the trustee’s bank records. Trustee Tolz pled guilty to one count of conspiracy to commit wire fraud and was sentenced to 81 months imprisonment, to be followed by 18 months of home confinement.

In considering all of the facts of this major trustee defalcation, we decided it would be relevant for the United States Trustee to know more about a trustee’s other business interests – both prior to appointment and after appointment. In the example of Ms. Tolz, she served not only as a chapter 7 trustee, but also as a fiduciary to the United States Marshals Service, as a state court receiver, and as a real estate broker.

Consequently, we now have an “Update to the Application of Individual for Appointment” form, which will be used to capture information about a trustee’s outside business interests. All trustees will be required to submit the new form annually with their Trustee Interim Report. This form will help to identify any potential areas of concern where appropriate safeguards to ensure against co-mingling of funds or other improper practices may need to be implemented. In addition, in recognition of the reality that more and more trustees maintain their case files electronically, we have developed a “Computer and Software Vendor Release” form that will permit the Program to obtain electronic copies of a trustee’s bankruptcy case-related records.

In mentioning the Tolz matter, I also wanted to take this opportunity to commend all the panel members who took the reassignment of cases after the Tolz defalcation. I especially want to recognize Robert Furr and Joel Tabas who took on a lion’s share. Among other things, Robert and Joel assisted the United States Attorney’s office in its investigation and prosecution of the case, and ensured that the bonding company reimbursed each of the estates where funds were stolen. Their service is yet another example of the ways in which chapter 7 trustees protect the integrity of the bankruptcy system, often with little or no additional compensation.



## Trustee Appointments

Finally, I want to let you know about a decision I just made concerning the chapter 7 trustee re-appointment process. Nationally, beginning in 1992, we began to issue annual appointments to chapter 7 panel trustees. Subsequent to that, we promulgated trustee removal and suspension regulations whereby chapter 7 trustees had appeal rights to the Director to challenge a United States Trustee's actions.

As part of ongoing efforts to ensure we are both efficient and effective in our oversight of trustees, we recently reconsidered the trustee appointment process. We have effective oversight mechanisms in place – including interim reporting, final case distribution reporting, and biennial evaluations of trustees for both financial accountability and case administration.

Upon review and reflection, we decided that the combination of these oversight mechanisms with the “due process” regulations that apply to decisions to suspend or terminate the assignment of cases render the re-appointment document somewhat superfluous. Accordingly, I will soon be signing a new directive to the United States Trustees eliminating the trustee re-appointment process.

After a trustee is appointed to the panel, the trustee will serve subject to the United States Trustee's favorable reviews of the trustee's conduct and performance. If that conduct and performance are determined to be inadequate, then the trustee can be suspended or removed from the panel. And that decision by the United States Trustee can continue to be appealed under the regulation.

I hope you agree with me that the formal trustee re-appointment is a step that we can do without. Oversight is not affected, trustee rights are not affected, and all of us save a little more time by dealing with one less piece of paper each year.

## Conclusion

Thanks for letting me take time out of your busy agenda. I appreciate your commitment to the integrity and efficiency of the bankruptcy system. If there is time for questions, I am happy to entertain them.

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