Department of Justice

STATEMENT OF

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BEFORE THE

COMMITTEE ON THE JUDICIARY
SUBCOMMITTEE ON REGULATORY REFORM,
COMMERCIAL AND ANTITRUST LAW
U.S. HOUSE OF REPRESENTATIVES

AT A HEARING ENTITLED

"ONGOING OVERSIGHT: MONITORING THE ACTIVITIES OF THE U.S. TRUSTEE PROGRAM"

PRESENTED
MAY 19, 2015

Clifford J. White III
Director
Executive Office for United States Trustees
Before the Subcommittee on Regulatory Reform,
Commercial and Antitrust Law
Washington, D.C.
May 19, 2015

Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to appear before you to discuss the activities of the United States Trustee Program (USTP or Program). We are the component of the United States Department of Justice whose mission is to enhance the integrity and efficiency of the bankruptcy system for the benefit of all stakeholders – debtors, creditors, and the general public.[1]

The Program employs more than 1,100 attorneys, financial analysts, and support staff in 93 locations across the country, as well as in the Executive Office in Washington, DC. We cover more than 300 court sites where bankruptcy judges conduct hearings and more than 400 sites where administrative proceedings are held.

The Program has steadfastly carried out its core statutory responsibilities of policing debtor abuse and ensuring that private trustees effectively administer estate assets. We also have demonstrated great agility and responsiveness in protecting consumer debtors from fraud and abuse, and enhancing the accountability of management and professionals in chapter 11 business cases. Among our accomplishments in these areas have been settlements with mortgage servicers who violate bankruptcy law and harm distressed homeowners, and the promulgation of new guidelines for attorneys' fees in large chapter 11 cases to ensure that bankruptcy lawyers do not charge above market rates.

The Program's success in fulfilling its mission of addressing threats to the integrity and efficiency of the bankruptcy system is a testament to the highly professionalized corps of dedicated professionals in our offices throughout the country who have exhibited extraordinary diligence and commitment to public service.

[1] The USTP has jurisdiction in all judicial districts except those in Alabama and North Carolina. In addition to specific statutory duties and responsibilities, United States Trustees "may raise and may appear and be heard on any issue in any case or proceeding under this title but may not file a plan pursuant to section 1121(c) of this title." 11 U.S.C. § 307.

Civil Enforcement and Means Testing

A core function of the USTP is to combat bankruptcy fraud and abuse. We combat fraud and abuse committed by debtors by seeking denial of discharge for the concealment of assets and other violations, by seeking case conversion or dismissal if a debtor has an ability to repay debts, and by taking other enforcement actions. Similarly, we combat fraud and abuse committed by attorneys, bankruptcy petition preparers, creditors, and others against consumer debtors by pursuing a variety of remedies, including disgorgement of fees, fines, and injunctive relief.

In fiscal year 2014, the Program took more than 35,000 civil enforcement actions and inquiries with a potential monetary impact of $1.07 billion in debts not discharged, fines, penalties, and other relief. Since we began tracking our results in 2003, we have taken more than 654,000 actions and inquiries, with a potential monetary impact in excess of $15.1 billion.

Means Testing

One of the major responsibilities of the United States Trustees is to administer and enforce the "means test." Under the means test, all individual debtors with income above their state median are subject to a statutorily prescribed formula to determine disposable income.[2] The formula is based partially on allowable expense standards issued by the Internal Revenue Service for its use in tax collection. The primary purpose of the means test is to help determine eligibility for chapter 7 bankruptcy relief.

In fiscal year 2014, approximately 12 percent of chapter 7 debtors had income above their state median. Of the 68,000 cases filed by above median income debtors, about 3,900 (6 percent) were "presumed abusive" under the means test. Of those presumed abusive cases that did not voluntarily convert to chapter 11 or 13 or dismiss, we exercised our statutory discretion to decline to file a motion to dismiss in about 68 percent of the cases after consideration of the debtor's special circumstances, such as recent job loss, that justified an adjustment to the current monthly income calculation.

It is important to note that even if a case is not presumed to be abusive under the means test, the law permits the USTP to take action under a bad faith or a totality of the circumstances

[2] By statute, disabled veterans whose debts were incurred primarily while on active duty or while performing a homeland defense activity are excepted from the means test. In addition, the National Guard and Reservists Debt Relief Extension Act of 2011 exempts from the means test qualifying reservists and National Guard debtors called to active duty or to perform a homeland defense activity for not less than 90 days, although this exemption is set to expire on December 19, 2015.

analysis.[3] For example, the case of a debtor who retains luxury items, incurs debt on the eve of bankruptcy, or fails to disclose fully the information required by the Bankruptcy Code and Rules might be subject to dismissal.

Due to the USTP's judicious use of its statutory discretion, Congress' purpose of establishing an objective basis for allowing chapter 7 relief without creating unfair results for those with special circumstances has been largely achieved.

Consumer Protection

The United States Trustees are active in the Department's efforts to protect Americans from financial fraud and abuse. In fiscal year 2014, United States Trustees initiated more than 6,800 civil enforcement actions and inquiries against creditors, lawyers, bankruptcy petition preparers, and other parties who acted improperly towards debtors. Nearly 2,100 of these related to abusive conduct by creditors, including about 72 percent of which involved mortgage fraud and abuse.[4] Enforcement efforts have focused on the improper exposure of the personal information of debtors, attempts to collect on previously discharged debt, and other failures to comply with bankruptcy law.

In recent years, the USTP has addressed multi-jurisdictional violations with a coordinated enforcement approach. As a result, the Program has entered into ten nationwide settlements, including six settlements that protect consumer debtors against national creditors. These national settlements provide relief for victimized debtors, require systemic corrective actions so violations do not recur, and uphold the integrity of the bankruptcy system. In several of these settlements, the Program insisted upon an independent reviewer to verify compliance. One example of the success of this approach is the settlement reached with Citigroup Inc. (Citi), which concluded in December 2014 with the certification by the independent auditor appointed under the settlement that Citi had completed the required actions. The settlement involved the protection of the personal information of nearly 150,000 consumers in 85 jurisdictions that had not been properly redacted as required by the Bankruptcy Rules, including approximately 50,000 filings that were uncovered as a result of the verification process mandated by the settlement. In the nearly one year that it took to effectuate the appropriate redactions, the USTP worked with courts across the country and with Citi to ensure the improper disclosures were corrected.

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[3] 11 U.S.C. § 707(b)(2) provides for dismissal under the means test. 11 U.S.C. § 707(b)(3) provides for dismissal under a "bad faith" or "totality of the circumstances" test.

[4] United States Trustees are frequently successful in reaching resolution of their creditor abuse inquiries without the need to take formal action in court.

Mortgage Servicer Violations

A centerpiece of the USTP's consumer protection efforts has been vigorous enforcement of the Bankruptcy Code and Rules against mortgage servicers who inflate their claims or otherwise fail to comply with requirements for accuracy, disclosure, and notice to their customers in bankruptcy. The Program holds mortgage servicers to the same standard of completeness and accuracy in their filings that we do the debtors who owe them money. In far too many cases, mortgage servicers have filed inflated proofs of claim or motions for relief from stay that are predicated upon faulty accounting. The consequences of their improper filings can be catastrophic to debtors who may lose their homes and unfair to other creditors who may receive a smaller distribution because of the mortgage company's unjustified claim.

Beginning in late 2006, the USTP launched its initial review of the mortgage industry's practices in bankruptcy. The fruits of that resource-intensive project grew over time, and the USTP moved from simply requiring servicers to correct their mistakes in a case at bar to seeking nationwide settlements to address systemic misconduct by mortgage servicers, their attorneys, and their agents. Noteworthy among these efforts are the $100 million nationwide settlement with Countrywide Home Loans that the USTP negotiated in conjunction with the Federal Trade Commission in 2010, as well as the integral role the Program played in reaching the historic $25 billion National Mortgage Settlement (NMS) involving numerous federal agencies and 49 state Attorneys General against the five largest mortgage servicers in the country. Importantly, beyond providing monetary compensation, both of these settlements put in place stringent mortgage servicing standards, including special rules for servicing loans in bankruptcy.

The USTP remains actively engaged in the mortgage servicing area and employs a multi-pronged enforcement strategy. First, we continue close oversight of the servicers who are signatories to the NMS. The Program serves as the federal co-chair of the NMS Monitoring Committee and, in that capacity, works with federal and state agencies to ensure that the banks satisfy their obligations under the settlement. The Committee also oversees the independent Monitor established by the NMS who verifies compliance by the settling servicers.

Second, we address the conduct of banks that are not a party to the NMS. For example, the USTP assisted the Consumer Financial Protection Bureau and other federal and state partners in negotiating a settlement with Ocwen that was announced in December 2013. The agreement included monetary relief to homeowners and imposition of servicing standards similar to those in the NMS. In addition, the USTP was a critical player in the federal-state agreement announced by the Attorney General in June 2014 with SunTrust bank to settle allegations of wrongdoing by SunTrust in its mortgage securitization and servicing practices. Under the agreement, SunTrust will pay nearly $1 billion and adopt the servicing standards imposed under the NMS. The USTP amassed evidence of SunTrust's practices, assisted in the negotiations on servicing, developed an

additional metric to protect customers' privacy protected information from disclosure in bankruptcy filings, and will ensure that SunTrust implements the bankruptcy specific servicing standards.

The third prong of our enforcement strategy is to focus additional attention on the newer entrants into the mortgage servicing industry. In recent years, specialty servicers have created or greatly expanded their operations by purchasing the servicing rights to billions of dollars of mortgages, including those of distressed homeowners in and outside of bankruptcy. Our investigations and enforcement actions strongly suggest that at least some of these servicers exhibit the same kinds of flawed servicing systems that we uncovered within the largest banks. To this end, we have established special litigation teams within the USTP to handle litigation against these servicers. This will ensure a coordinated approach and will allow us to more effectively identify patterns of noncompliance. It also provides our field offices with the expertise required to investigate and litigate as needed against this growing segment of the mortgage servicing industry.

Settlement with JPMorgan Chase Bank, N.A.

The most recent illustration of the USTP's continued focus on compliance by mortgage servicers is a nationwide settlement reached by the USTP with JPMorgan Chase Bank, N.A. (Chase) that was approved by the bankruptcy court on March 9, 2015. The settlement addressed issues uncovered by the USTP involving the robo-signing of payment change notices filed in bankruptcy court, as well as Chase's failure to timely and accurately provide payment change notices and escrow statements to their customers in bankruptcy. Under the agreement, Chase agreed to pay more than $50 million, primarily through cash payments and credits to homeowners in bankruptcy; to change internal procedures and systems to prevent a recurrence of the violations; and to submit to independent monitoring to ensure compliance with the settlement for a minimum of 18 months. This is the single largest settlement negotiated solely by the USTP in our history.

The bad conduct exhibited by Chase was uncovered by the United States Trustee's office in Detroit and similar conduct was identified by other USTP offices. In the Detroit case, Chase filed a payment change notice that more than tripled the debtors' monthly mortgage payment (from about $500 to nearly $1,700), without explanation. When the debtors inquired with Chase about the increase, Chase could provide no justification for the increase and would not allow the debtors to speak with the person whose name appeared on the payment change notice filed with the court. Upon investigation by the United States Trustee's office, it was discovered that Chase had affixed the signature of a former employee who did not review or sign the document that was filed with the bankruptcy court under penalty of perjury.

Ultimately, as a result of the United States Trustee's investigation, Chase acknowledged that it had robo-signed more than 50,000 payment change notices filed in bankruptcy courts across the country from December 2011 to November 2013. These notices–which are signed under penalty of perjury–were signed by former employees, current employees, and employees of contractors who had nothing to do with reviewing the accuracy of the debtor's account. Chase further acknowledged that it had failed to provide timely or accurate payment change notices and escrow statements as required under the Bankruptcy Rules to more than 25,000 homeowners. The notice requirement, which went into effect on December 1, 2011, was imposed in the aftermath of revelations that mortgage companies were failing to properly account for payments and impermissibly imposing fees on homeowners during their bankruptcy cases.

Unsecured Creditor Violations

In addition to our mortgage servicer enforcement efforts, the USTP also has undertaken a review of claims filed by unsecured creditors to collect consumer debt in bankruptcy. Bankruptcy Rules that went into effect on December 1, 2012, set forth required disclosures in proofs of claim filed by holders of unsecured credit card and other revolving consumer debt. The Rules are designed to assist debtors and their case trustees in associating a claim with a known account and to provide a basis for assessing the accuracy of a claim. Thus, debtors and trustees are better able to determine if claims objections are warranted.

Among the matters currently under investigation by the USTP are practices related to claims trading in consumer debt. The USTP is seeking discovery related to two key areas. First, we are reviewing bank practices in selling debt. The investigation is partially in response to debtor allegations that some banks fail to provide information to credit reporting agencies to show that the debts were discharged in bankruptcy, thereby indirectly encouraging the violation of the bankruptcy injunction against the collection of these debts. Second, the Program is reviewing the practices of some claims buyers to determine if they routinely robo-sign proofs of claim that are filed in bankruptcy court under penalty of perjury and with an attestation as to the accuracy of the claim. The USTP has documented in court filings evidence of an enormous volume of claims signed by a single individual at two major consumer claims buying companies.

As we continue to review the compliance and practices of unsecured claimants, we are mindful that, as the only national enforcer of the Bankruptcy Rules, we have a unique perspective to identify and address systemic abuse, and our interpretations of the requirements and our actions should be consistent and predictable throughout the country. Consistent government enforcement can be a major benefit to any business, including to creditors of debtors in bankruptcy.

Criminal Enforcement

Criminal enforcement is another key component of the Program's efforts to uphold the integrity of the bankruptcy system. In fiscal year 2014, the Program made 2,080 bankruptcy and bankruptcy-related criminal referrals. The Program is an active member of the President's Financial Fraud Enforcement Task Force and two national workings groups sponsored by the Department of Justice's Criminal Division. In addition, our offices participate in more than 80 local bankruptcy fraud working groups, mortgage fraud working groups, and other specialized task forces throughout the country. We conduct extensive training for federal prosecutors and law enforcement personnel, USTP staff, private trustees, and others; and we publish internal resource documents and training videos. In addition, Program staff–including attorneys, bankruptcy analysts, and paralegals–are frequently called upon to assist with investigations and to provide expert or fact testimony at criminal trials.

The following case illustrates the important work of the USTP in combatting fraud and ensuring the integrity of the bankruptcy system. In October 2014, in the District of New Jersey, a husband and wife were sentenced to 41 months and 15 months in prison, respectively, along with forfeiture and fines. The couple earlier had pleaded guilty to bankruptcy fraud by concealment of assets, bankruptcy fraud by false oaths, bankruptcy fraud by false declaration, and conspiracy to commit mail and wire fraud. The husband also had pleaded guilty to failure to file a tax return. From September 2001 through September 2008, the couple submitted fraudulent applications and supporting documents to lenders to obtain mortgages and other loans, falsely representing that they were employed and/or receiving substantial salaries. In their 2009 chapter 7 bankruptcy case, the debtors intentionally concealed and made false oaths and declarations about businesses they owned; income they received from a rental property; and the wife's true income from a television show, Web site sales, and personal and magazine appearances. The husband also admitted that for tax years 2004 through 2008, he failed to report nearly $1 million in individual income. The United States Trustee's Newark office referred the matter to the United States Attorney and assisted in the investigation. The office also filed a civil enforcement action seeking to prevent the couple from discharging debts exceeding $7.1 million; the couple agreed to waive their bankruptcy discharge prior to the civil trial.

Chapter 11 Issues

The Program carries out significant responsibilities in business reorganization cases. These responsibilities include such matters as appointing official committees of creditors and equity security holders, objecting to the retention and compensation of professionals, reviewing and objecting to disclosure statements to ensure adequate information is provided to stakeholders, appointing trustees and examiners when warranted, enforcing the statutory limitation on insider and executive compensation, and moving to dismiss or convert about two-

thirds of chapter 11 cases each year because they are not progressing towards financial rehabilitation.

Business reorganization cases often raise highly complex questions of law and require sophisticated financial analysis. As a result, they can be extremely time intensive for Program staff. Two of our main objectives in chapter 11 have been to restore balance to the fee review process and to ensure accountability by the management of debtor corporations.

As the USTP has stepped up its enforcement in the chapter 11 arena, it has become increasingly clear that our role as watchdog is essential to vindicate congressional mandates in the Bankruptcy Code. Even when debtor companies and some of their major creditors agree on a course of action, the interests of other stakeholders often are implicated. The USTP's watchdog role allows it to present issues for judicial decision even where parties either will not, or lack the financial wherewithal to, litigate. Although the USTP should never substitute its business judgment for that of economic stakeholders, it is our job to ensure that the Bankruptcy Code and Rules are followed by all participants in the bankruptcy system. This view of our role has led us to oppose both debtors and creditors on issues such as payment of attorney fees, executive bonuses, and other matters of corporate governance.

Review of Professional Fees

United States Trustees have an express statutory responsibility to review applications for professional compensation in bankruptcy cases. Congress amended that obligation in the Bankruptcy Reform Act of 1994 by imposing a mandate on the Program to establish uniform guidelines for reviewing fee and expense applications. The guidelines were intended to foster uniformity in the fee application preparation and review process.

The role of the USTP in policing professional fees is a perfect example of how the Program frequently must act alone to vindicate the strictures of the Bankruptcy Code. It is generally recognized that private parties and their counsel are reluctant to challenge each other's fees. As a result, the USTP often is the only party in a case to raise objections to the reasonableness of fees charged by professionals.

In 1996, the Program published its initial Guidelines for Reviewing Applications for Compensation and Reimbursement of Expenses Filed Under 11 U.S.C. § 330. Though not mandatory by statute, they were adopted in whole or in part by bankruptcy courts in many jurisdictions and are followed with various degrees of rigor in districts throughout the country. Among the reforms achieved through these guidelines were threshold disclosure requirements, task-based billing, and standards for reimbursement of certain expenses.

In November 2013, the USTP promulgated new guidelines for attorneys in large cases with assets and liabilities each of $50 million or more. The guidelines were designed to reflect significant changes in the legal industry and the complexity of business bankruptcy reorganization cases since the guidelines were first published, as well as to enhance transparency and public confidence in the integrity and soundness of the bankruptcy compensation process. Generally, the new guidelines provide that attorney applicants should demonstrate that rates charged in bankruptcy reflect market rates outside of bankruptcy; develop budgets and staffing plans; use "efficiency counsel" for routine tasks that can be performed less expensively by other firms; and submit billing records in an open, searchable electronic format.

Given the recent decrease in filings, only about 100 cases have been filed since the new guidelines became effective, and fee applications trail the date of an appointment by at least four months, although frequently longer. Even though there is a paucity of hard data with which to analyze the impact of the guidelines, certain anecdotal evidence is mounting. By and large, counsel have agreed to abide by the guidelines; large firms have improved internal billing practices and processes; and firms are providing greater discounts and taking cost-cutting measures that heretofore were rarely provided in bankruptcy cases.

Management Accountability and Corporate Governance

The Program has focused significant efforts on the appointment of trustees and examiners in cases in which management may have engaged in wrong-doing, and we have objected to management bonuses that exceed the bounds set forth in the statute.

Trustees and Examiners

Although the Bankruptcy Code generally allows company management to retain control during the chapter 11 process, that right is conditioned upon their faithful discharge of fiduciary responsibilities and compliance with various statutory requirements. Section 1104 of the Bankruptcy Code provides for the United States Trustee's appointment of a chapter 11 trustee to replace management that engaged in, among other things, gross mismanagement or wrongdoing specified in the statute. Section 1104(e) further provides that the United States Trustee must file a motion to oust management if there are "reasonable grounds to suspect" that current management participated in fraud, dishonesty, or other criminal acts in the debtor's management or public financial reporting.

In cases involving gross mismanagement or possible fraud, the USTP will file a motion to replace management in favor of an independent chapter 11 trustee to run the business or an examiner to conduct an independent investigation. These motions, however, generally face considerable resistance. In many cases, the board of directors of a failed company, either on its

own or at the behest of a large institutional creditor, will attempt to avoid a trustee or examiner by appointing a chief restructuring officer (CRO) as an alternative.[5] In addition, case law in certain districts impedes the Program's ability to successfully prosecute motions for the appointment of a trustee. For example, some courts hold that management is allowed to remain in control of the debtor corporation unless there is "clear and convincing evidence" of gross incompetence or wrongdoing. The USTP has consistently argued that this heightened burden of proof is incorrect as a matter of law, and the correct legal standard is "preponderance of the evidence."[6] Some courts also take a broad view of their discretion in adjudicating examiner motions and limit the scope of examinations in favor of allowing other constituents, often the unsecured creditors' committee, to conduct what we believe is, in many cases, more expensive discovery and litigation.

When the court grants a motion to appoint a trustee or examiner, the USTP appoints one disinterested individual subject to limited court review. In rare instances, creditors may choose to elect a trustee. Increasingly, the USTP has worked to expand the pool of candidates for these fiduciary appointments. Given the multiplicity of interests present in a bankruptcy case, it is important to appoint trustees and examiners who are not unduly influenced by either the debtor or a faction of creditors. The heightened burden of proof, frequent reluctance of bankruptcy professionals and insiders to accept an independent fiduciary, and other factors render trustee and examiner appointments somewhat infrequent.[7]

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[5] In many instances, the retention of CROs by distressed companies may increase the likelihood of a positive turnaround and financial rehabilitation. The USTP's objection pertains to the selection of a CRO by a tainted board of directors to avoid a trustee or to empower a CRO to act contrary to applicable standards of corporate governance.

[6] *Compare In re Keeley and Grabanski Land Partnership*, 455 B.R. 153 (B.A.P. 8th Cir. 2011) (preponderance of the evidence); *Tradex Corp. v. Morse*, 339 B.R. 823, 829 (D. Mass. 2006) (same), *with In re Adelphia Communications Corp.*, 336 B.R. 610 (Bankr. S.D.N.Y. 2006) (clear and convincing evidence); *Official Comm. of Asbestos Claimants v. G-I Holdings, Inc. (In re G-I Holdings, Inc.)*, 385 F.3d 313 (3rd Cir. 2004) (same). Note that the final report of the American Bankruptcy Institute Commission to Study the Reform of Chapter 11 recommended that the burden be preponderance of the evidence and that contrary authority be statutorily overturned. ABI Commission to Study the Reform of Chapter 11, *Final Report and Recommendations*, at 26 (Dec. 8, 2014), http://commission.abi.org.

[7] Examples of cases in which the USTP unsuccessfully sought a trustee include *In re Solyndra, LLC*, Case No. 11-12799, Dkt. 266 (Bankr. D. Del. Oct. 21, 2011) (court allowed the debtor to select its own CRO); *In re AgFeed USA, LLC*, Case No. 13-11761, Dkt. 409 (Bankr. D. Del. Oct. 4, 2013) (the court denied the USTP's motion, even though it stated that the "concerns raised by the Office of the United States Trustee . . . appear well-founded, legitimate and supported by, at least, the record thus developed that there was fraudulent conduct that needs to be investigated . . .").

Management Bonuses

In another important area of management accountability, the USTP is often the only party to enforce statutory restrictions on executive compensation. Section 503(c) of the Bankruptcy Code restricts a company's ability to pay bonuses to senior executives through Key Employee Retention Plans (KERPs). The intent of this section is to prevent the same management that brought the company into bankruptcy from paying itself large cash awards while shareholders and employees suffer financially. Regrettably, many corporate debtors continue to propose retention bonuses to insiders in contravention of section 503(c), often disguising these retention awards as "performance bonuses" that are allowed under a more flexible standard, or hiding them in other agreements, such as sales documents and employment contracts.

In fiscal year 2014, the USTP formally challenged 40 proposed KERPS in court. In addition, many USTP objections are resolved informally through voluntary modification of the debtor's initial bonus proposal. The kinds of changes sought by the USTP include eliminating top executives from the list of bonus recipients or imposing more stringent performance milestones that must be met prior to payment of the bonus.

The highly publicized case of American Airlines perhaps provides our most noteworthy success in enforcing executive compensation restrictions.[8] In that case, the debtor and creditors' committee twice attempted to obtain bankruptcy court approval of a $20 million severance payment to the outgoing Chief Executive Officer (CEO). The court sustained our first objection in which the United States Trustee argued that the CEO bonus was impermissible under section 503(c)(2) of the Bankruptcy Code. The debtor and creditors' committee then sought approval of the bonus through the plan of reorganization. On September 12, 2013, the bankruptcy court again sustained the United States Trustee's objection and struck the CEO bonus from the plan as a violation of section 503(c). This ruling is particularly important because it has implications for policing other provisions of the Bankruptcy Code when companies attempt to circumvent the law through the plan confirmation process.

American Bankruptcy Institute (ABI) Commission to Study the Reform of Chapter 11

The ABI Commission to Study the Reform of Chapter 11 recently issued a report making far-reaching recommendations on chapter 11 practice. It is noteworthy that the recommendations include several provisions that would strengthen the role of the USTP in carrying out its duties and clarify the law to support long-standing legal positions the USTP has

[8] *In re AMR Corp.*, 497 B.R. 690 (Bankr. S.D.N.Y. 2013).

asserted in bankruptcy litigation on issues related to corporate governance and integrity of the bankruptcy system.[9] Among those proposals are:

(1) Make uniform the "preponderance of the evidence" standard for the burden of proof required for ordering the appointment of a chapter 11 trustee to replace incumbent management. The Second and Third Circuits currently follow a heightened "clear and convincing" standard that makes it more difficult to oust tainted management.

(2) Clarify the limited role of the courts in approving the USTP's appointment of trustees and examiners in chapter 11 cases. Under current law, the court may order that management be displaced in favor of a trustee, or order an independent investigation of the debtor by an examiner. Trustee and examiners, however, are selected and appointed by the USTP. The ABI recommendation endorses the USTP position that the judicial role in approving the selection is limited to a narrow review of such matters as disqualifying conflicts of interest, and that the court may not substitute its judgment for that of the USTP in choosing the most qualified candidate.

(3) Prohibit the practice of structured dismissals whereby debtors and controlling creditors may evade the chapter 11 process and protections at the expense of other stakeholders. The USTP has objected to structured dismissals that included distributions contrary to the priorities set forth in the Bankruptcy Code, payment of professional fees without court review, and impermissible releases from liability of insiders and professionals.

(4) Prohibit "gifting" where payments are made by the debtor, senior lender, or purchaser of estate assets to junior creditors ahead of other creditors who have priority under the Bankruptcy Code. This practice evades the priority scheme established in statute, promotes the buying of votes for a plan of reorganization, and inevitably decreases the value to distributions to other creditors because estate funds are directly transferred or the purchase price is decreased so that the payments can be made.

(5) Require that disclosure statements and plans of reorganization specify the terms of post-confirmation trusts, including governance matters such as how the trustee will be selected and compensated, as well as future operation of the business and how claims, recoveries, and distributions will be handled post-confirmation. This information is

[9] The Director of the USTP served as a non-voting member of the Commission. Other senior USTP officials served on ABI working groups addressing corporate governance and related topics. The USTP provided technical advice and perspectives on issues under discussion, but takes no position on the Report's legislative recommendations.

important to provide before confirmation to ensure all constituencies are afforded due process and other protections.

Appellate Practice

One of the most important roles the Program plays in the bankruptcy system is to identify and raise issues for review on appeal, thereby ensuring that the law is shaped, interpreted, and applied evenly in all judicial districts. Our view is that our mission often is achieved by obtaining a well-considered appellate decision that will advance consistency in bankruptcy law.

The Program has participated in more than 370 appeals to bankruptcy appellate panels, district courts, courts of appeals, and the Supreme Court in the past three fiscal years. Many of the appeals we participate in arise from enforcement actions we have prosecuted, but we also intervene as amicus in many other cases.

Importantly, many of our appeals address challenges to the integrity of the Bankruptcy Code. For example, the USTP won an appeal in the case of *U.S. Trustee v. Elliot Mgmt. Corp. (In re Lehman Brothers Holdings Inc.)*, No. 13-2211, slip op. (S.D.N.Y. Mar. 31, 2014). In that decision, the United States District Court for the Southern District of New York agreed with the Program's position and vacated a bankruptcy court order awarding $26 million to individual members of the unsecured creditors' committee for their personal attorneys' fees associated with their committee work. The district court reversed the bankruptcy court's order overruling our objection to a provision in the confirmed chapter 11 plan authorizing payment of those fees in contravention of section 503(b)(3)(F) and (4) of the Bankruptcy Code. The ruling is significant, particularly in the chapter 11 context, because it reaffirms–in the words of the district court–that "interested parties and bankruptcy courts" cannot "tweak the law to fit their preferences." In a very thoughtful opinion, the district court rejected the bankruptcy court's view and adopted our argument that parties' purported consent through a plan cannot circumvent the Bankruptcy Code. The implications of this decision go far beyond the issue of fees. The district court correctly observed that confirming a plan that contravenes the Code can lead to "serious mischief," and gave as an example plan terms providing for "gifting" to junior creditors in contravention of the order of payment priority established by Congress.

It is worth noting that the United States Supreme Court has heard five bankruptcy cases during its current term, including three in which the United States participated as *amicus*. The USTP provides assistance to the Solicitor General in analyzing bankruptcy cases before the high Court and was listed among the government's counsel in two of the briefs filed during this term. Among the issues to be decided are the constitutional authority of bankruptcy courts, *Wellness Int'l Network, Ltd. v. Sharif*, No. 13-935 (S. Ct.); standards for determining the finality of bankruptcy court orders, which might affect not only the denial of proposed consumer debt

repayment plans at issue in the case, but also many other matters (*e.g.*, USTP motions to disqualify counsel and objections to their fees), *Bullard v. Hyde Park Sav. Bank*, No. 14-116 (S. Ct.); and the right of attorneys to obtain additional fees for defending objections to their fee applications, *Baker Botts, L.L.P. v. ASARCO, L.L.C.*, No. 14-103 (S. Ct.).

These and other cases illustrate the importance of the USTP's participation in appeals to promote the coherent and consistent development of case law and ensure compliance with the commands of the Bankruptcy Code.

Private Trustee Oversight

One of the core functions of the United States Trustees is to appoint and supervise the private trustees who administer consumer bankruptcy estates and distribute dividends to creditors. The Program also trains trustees, evaluates their overall performance, reviews their financial accounting, and ensures their prompt administration of estate assets.

In fiscal year 2014, more than 900,000 consumer cases were filed under chapters 7, 12, and 13 of the Bankruptcy Code in the 88 judicial districts covered by the Program. The United States Trustees oversee the activities of approximately 1,300 private trustees appointed by them to handle the day-to-day activities in these cases. With distributions by these trustees of approximately $10.2 billion in fiscal year 2014, the Program's effectiveness in this area is critical.

We continually evaluate our trustee oversight activities and implement changes as appropriate. For instance, over the past few years, we have modified our chapter 7 trustee banking policy to improve transparency and move toward a more market-based approach to services; enhanced efficiency by automating trustee interim reports to streamline the review of chapter 7 trustee final and distribution reports; formalized procedures for reporting the loss or potential loss of consumers' personally identifiable information by private trustees; and revised our *Handbooks* for chapter 7 and for chapter 13 trustees to establish or clarify the USTP's position on trustee duties and responsibilities.

Chapter 7 Trustee Compensation

We are aware that the National Association of Chapter 7 Trustees (NABT) has requested that Congress amend title 11 to provide for an increase in chapter 7 trustee compensation. The USTP agrees, in principle, with such an increase. The basic compensation system for chapter 7 trustees has not changed since 1994. Chapter 7 trustees receive $60 for each case and an additional amount in cases with assets based upon a percentage of the distributions made to creditors. Despite an amendment to section 330 of the Bankruptcy Code made in 2005 providing

that chapter 7 trustee compensation should be paid "as a commission" calculated under section 326 of the Bankruptcy Code as a percentage of distributions, many courts still do not allow the percentage fee, but instead only allow a lower amount calculated by hourly rate. The USTP's position is that the commission should be awarded absent extraordinary circumstances. In the first appeal to a circuit court addressing this issue, the Fourth Circuit Court of Appeals on April 18, 2014, agreed with the USTP, acting as amicus, that the 2005 amendments to the Bankruptcy Code created a presumption that, absent extraordinary circumstances, chapter 7 trustees should receive the maximum fee under section 326. *In re Rowe*, 750 F.3d 391 (4th Cir. 2014).

Nationwide, total chapter 7 trustee compensation from all sources–including no-asset case fees, commissions on distributions in asset cases, and fees to the trustee as professional in a case–declined about 3.9 percent in fiscal year 2014 from fiscal year 2013. As a percentage of total receipts, trustee compensation remained about the same at 10 percent. While there is a wide variation in compensation among trustees, the 2005 amendments to the Bankruptcy Code required chapter 7 trustees to do more work in each case. Accordingly, we believe an increase is appropriate, but do not endorse any specific proposal for achieving this increase.

Credit Counseling and Debtor Education

Individual debtors must receive credit counseling before filing for bankruptcy relief and personal financial management instruction before receiving a discharge of debts. These requirements are intended to ensure individuals make informed financial decisions before entering bankruptcy and to provide debtors with the tools to avoid future financial catastrophe when they exit bankruptcy. United States Trustees are responsible for the approval of providers who meet statutory qualifications to offer credit counseling and debtor education services to debtors. There currently are about 140 approved credit counseling agencies and 220 approved debtor education providers.

Debtor Audits

To help ensure that the Program effectively carries out its statutory duties and achieves its mission, the USTP has substantially enhanced its data collection and internal evaluation activities. Among other projects, and as required by statute, the Program contracts with private auditors to verify the financial information provided by consumer debtors in their bankruptcy filings. Reports of any "material misstatements" are then filed with the court.

In fiscal year 2014, 23 percent of consumer debtor cases with completed audits contained material misstatements. The rate of material misstatements has not changed appreciably in the past six years. In cases selected for audit because a debtor's income or expenses vary from the

norm ("exception" audits), the rate of material misstatements is 10 to 15 percent higher than in random audits. Due to budgetary constraints, the number of audits conducted each year has varied and debtor audits have been suspended at various times over the past few years.

Fiscal Year 2015 Appropriation and Fiscal Year 2016 Appropriation Request

The USTP is self-funded through user fees paid by bankruptcy debtors. All revenues are deposited into the United States Trustee System Fund (the "Fund"). Approximately 61 percent of the Program's revenue is derived from quarterly fees in chapter 11 reorganization cases; 38 percent from filing fees paid in chapters 7, 11, 12, and 13; and one percent from interest earnings and miscellaneous revenues.[10] At the end of fiscal year 2014, the USTP System Fund held a balance of $172 million. Monies from the Fund are not available without appropriations from Congress.

The USTP was appropriated $225.9 million for fiscal year 2015, an increase of 0.7 percent over fiscal year 2014. The USTP also is authorized to use carryover funds from prior year appropriations. The President's budget request for the Program for fiscal year 2016 totals $228.1 million.

Over the past three years, the USTP has sustained a net loss of more than 100 employees or about 10 percent of total staff. The restoration of vital funding in the 2014 and 2015 appropriations allowed us to begin to backfill critical headquarters and field staff at all levels. In addition to our primary goal of hiring new staff, we also have looked to invest in areas that had been cut back, but which now require additional funding to ensure the efficient and effective continuation of Program operations, including information technology; oversight of trustees, credit counseling agencies, and debtor education providers; and staff training.

The Program has taken a number of important steps over the past few years to achieve our mission with fewer resources. We have achieved considerable savings by streamlining operations; utilizing an alternative case review system, thereby reducing the Program's costs for use of the Public Access to Court Electronic Records (PACER) system by more than 50 percent; returning underutilized space; and reducing space allocations as leases have expired. We also piloted and implemented nationwide a number of work process changes, including consolidating functions such as the financial review of trustees, with the goal of improving consistency and quality control and, over time, achieving economies of scale.

[10] Revenues fluctuate with the number of filings each year. Filings in USTP jurisdictions reached a peak of nearly 1.7 million cases in fiscal year 2005, plummeted for the next two years, and then rose precipitously for three years before beginning a four year decline. In fiscal year 2014, approximately 921,000 cases were filed in USTP districts. Although some commentators had predicted filing would rebound beginning in 2014, filings continued to decline. Filings in the first quarter of fiscal year 2015 remain below filings for the same period in fiscal year 2014.

In addition, in keeping with the Executive Branch's efforts to reduce the federal "physical footprint," after conducting a cost-effectiveness study on combining offices that were close in proximity to one another and that had leases coming due, we proceeded with plans for three office consolidations. After move-related costs, we estimate the three consolidations will save the Program about $1 million annually. In addition, the Executive Office for United States Trustees relocated in January 2013 from two commercial leases into one federal space, reducing its footprint by 21,000 square feet, for an estimated annual savings of $1.8 million.

Revenue Proposal

After a historic rise in the number of bankruptcy filings from fiscal year 2007 to fiscal year 2010, filing rates have declined for the past four years and have not followed traditional patterns. Based upon trend analysis, and without regard to changes in external economic conditions, the USTP projects continued filing decreases and a resultant decline in revenues from filing and quarterly fees. In the past, revenues have exceeded appropriations in most years. At the end of fiscal year 2014, the balance in the Fund was $172 million, but projected declines in filings and revenue could exhaust the Fund in fiscal year 2017.

To address the shortfall in the Fund, the USTP proposes to increase revenues by raising quarterly fees paid by the largest companies in chapter 11 for a period of three years. Consumer debtors and essentially all small businesses would be unaffected by the increase. Under the proposal, the USTP would be able to increase the quarterly fees for large chapter 11 cases with at least $1 million in quarterly disbursements. The new rate cannot exceed one percent of disbursements and likely would be set at 0.5 percent of disbursements, which still is less than the percentage currently paid by nearly all small business debtors. The fees would continue to constitute a very small portion of the administrative costs incurred by large companies that seek chapter 11 relief, including the fees of professionals. The proposed increase would expire after three years, but would allow the USTP to fund ongoing operations, rebuild the Fund, and assess filing trends to determine if a longer term increase would be necessary.

Conclusion

The United States Trustee Program has assembled a substantial record of accomplishment in carrying out its statutory duties, responding to emerging issues, and addressing threats to the integrity of the bankruptcy system. Employees at all levels throughout the Program–in headquarters and in offices throughout the country–have upheld the highest standards of the Department of Justice for professionalism and dedication to duty. Their team spirit and unwavering commitment to our mission of protecting the integrity and ensuring the efficiency of the bankruptcy system is unmatched. I am honored to work alongside them.