

REMARKS OF
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AT THE

AMERICAN BANKRUPTCY INSTITUTE
ONE YEAR ANNIVERSARY PROGRAM ON
THE BANKRUPTCY ABUSE PREVENTION AND
CONSUMER PROTECTION ACT OF 2005

GEORGETOWN UNIVERSITY LAW CENTER

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MAKING BANKRUPTCY REFORM WORK

Let me thank the American Bankruptcy Institute for the opportunity to participate at today's important program. ABI plays a critical role in improving bankruptcy practice through its many seminars and publications. By providing a forum to review the changing landscape of the bankruptcy system one year after the general effective date of the BAPCPA, ABI is making another significant contribution to the community of bankruptcy professionals and policymakers that it serves.

I will discuss with you this morning the progress made by the United States Trustee Program (USTP or Program) of the Department of Justice in doing our part to make bankruptcy reform work for all stakeholders in the system -- including debtors, creditors, and the general public. I will focus my oral presentation on the Program's enforcement and implementation of the consumer provisions of the BAPCPA in which the USTP plays a critical role.

Let me begin by saying that my general conclusions are that the consumer provisions of the reform law are workable and the initial results show promise for making long-lasting improvements in the system. These accomplishments are due to the good faith and incredibly hard work of the dedicated professionals in the United States Trustee Program and in the larger bankruptcy community. I believe we can make faster progress in the future, however, if the tenor of debate can be elevated and if bankruptcy professionals make a greater effort to breed respect for the rule of law.

CHANGING BANKRUPTCY TERRAIN

In the wake of the most comprehensive bankruptcy legislation passed in a generation, we have seen a roller coaster in bankruptcy filings. More than 600,000 petitions were filed during the two weeks prior to the October 17, 2005, general effective date of the new law. In the 11 months following October 17th, there were fewer than 500,000 filings. Filings now are trending upward and recently reached about 40 percent of pre-BAPCPA filing rates.

Another important change in filing trends has been the mix of chapter 7, chapter 11, and chapter 13 cases. Whereas fewer than 30 percent of all cases were filed under chapter 13 before reform, they now account for about 40 percent of all filings. The number of chapter 11 cases has dipped by more than 20 percent.

These and other data will provide for much academic and practical discussion in the months to come. The United States Trustee Program and others will continue to review data in the search for information that will help us do a better job of meeting our obligations under bankruptcy reform.

MEANS TESTING

Let me start my discussion of the substantive provisions of the law with means testing because it is the cornerstone of the BAPCPA. Under the new section 707(b), the former subjective "substantial abuse" standard is replaced by a more objective means test formula to

determine whether a case is “presumed abusive.” It is still too early to determine the long-term impact of means testing on the bankruptcy system, but let me suggest two preliminary conclusions.

First, means testing is workable. There is a system in place by which debtors can obtain the necessary IRS and Census Bureau information and make required calculations. This success is due in no small part to those in the United States Trustee Program and on the Judicial Conference’s Advisory Committee on Bankruptcy Rules who developed the new Official Forms that must be filed in most individual bankruptcy cases.

I should add some important caveats to this optimistic assessment, though. For example, many debtors and their lawyers still do not fill out the means test forms properly. This puts a significant burden on the United States Trustees, the private trustees, and the courts. Anecdotal evidence I hear from the field suggests that the quality of the filed forms is improving, but debtors’ counsel still need to do a better job.

Another important reason we should not draw any firm conclusions at this point is that the number of filings has been extremely low since the October 17, 2005, general effective date of the law. Therefore, we cannot be certain that we will be able to process a larger number of cases with the same efficiency in the future as we have over these past 11 months. My concern about our long-term ability to efficiently process the forms arises largely out of the fact that the courts have not yet mandated “smart forms” with “data tags” that could allow us to automate most of our procedures for the benefit of the United States Trustees, chapter 7 trustees, and others involved in the process. We are hopeful that in 2007 the Judicial Conference will adopt, with limited exceptions, data tag technology as a mandatory technical standard for petitions and schedules filed electronically.

My second preliminary conclusion is that early data suggest that means testing provides a promising approach to identifying abuse. Of the individual debtors who filed from October 17th through the end of June, 94 percent were below the median income. Of those above the median, the United States Trustees determined that slightly less than 10 percent were “presumed abusive.” Of the presumed abuse cases that did not voluntarily dismiss or convert, United States Trustees filed motions to dismiss in about three-quarters of the cases and declined to file in about one-quarter of the cases.

These data suggest that the means test is a useful screening device to identify abusive cases. They also suggest that the statute provides the United States Trustees with sufficient discretion so that decisions on filing motions to dismiss can be made on a case-by-case basis and not solely upon the statutory formula.

CREDIT COUNSELING AND DEBTOR EDUCATION

Another major aspect of bankruptcy reform is financial education. As you know, individual debtors must receive credit counseling prior to filing and receive debtor education prior to discharge. These are potentially the most far-reaching consumer protection provisions of the Bankruptcy Code. These requirements are designed to ensure that debtors enter bankruptcy knowing what their options are and exit bankruptcy with the tools to avoid future financial catastrophe.

The job of the United States Trustee is to approve providers who meet statutory qualifications to offer credit counseling and debtor education services to debtors. This function was entirely new to the Program and has required enormous effort on our part to carry it out effectively.

As with means testing, there are positive signs that the credit counseling and debtor education provisions are workable. The credit counseling industry has been a troubled one, so our first priority was to screen out those who might seek to defraud debtors. Importantly, it appears that we have been successful thus far. We developed our approval and monitoring criteria with enormous assistance from the Internal Revenue Service and the Federal Trade Commission. Our procedures have been praised by those agencies and also by representatives of creditor and consumer groups. It is almost inevitable that eventually a bad actor will get through the “net,” but we are much relieved that our screening procedures seem to be effective. In September, to further strengthen our efforts, we commenced post-approval, on-site reviews where we can better verify an applicant’s qualifications.

Another important, positive sign is that there is adequate capacity to serve the debtor population. Again, the true test will come when filings reach more expected and higher levels. As of the end of August, we had received nearly 700 initial applications from credit counselors and debtor educators. About 64 percent of those applications were approved, 32 percent were either denied or voluntarily withdrawn, and 4 percent were still under review. Moreover, nearly all of the credit counselors and debtor educator who had received probationary approval reapplied for a twelve month approval. There are currently 153 approved credit counseling agencies and 275 approved debtor education providers.

In addition to approving applications by providers, the United States Trustee is also the major enforcer of the requirement that debtors receive credit counseling. We expect that verification will become much easier because of a new Official Form that was approved by the Judicial Conference and became effective on October 1st. The Official Form, which is Exhibit D to the petition, was proposed by the United States Trustee Program and designed primarily by Bankruptcy Judge Wedoff, who you will hear from later, to provide clear notice to all debtors, especially pro se debtors, of the requirement to obtain credit counseling. The form should decrease the number of enforcement actions required by the United States Trustees or other parties.

Finally, we have issued interim regulations governing applicant qualifications and will publish more extensive rules within the next few months. In the upcoming Notice of Proposed Rulemaking, we may address a number of issues not squarely covered by the statute, such as criteria for granting a waiver of the fee charged by providers and restrictions to address perceived abuses of the system by debtor's counsel and others.

The USTP is learning more and more every day. We will continue to do an increasingly better job as we gain experience and expertise in carrying out our new duties to enforce and implement the credit counseling and debtor education provisions of the law.

DEBTOR AUDITS

The final bankruptcy reform area I would like to highlight is the new system for debtor audits. This is sort of a preview of coming attractions since implementation of the new debtor audit provisions does not become effective until this Friday, October 20th. By law, the United States Trustee Program must commence a series of debtor audits designed to verify the accuracy of schedules filed by individual chapters 7 and 13 debtors. This regimen of audits will help us to identify cases of fraud and abuse, enhance deterrence, and may provide baseline data to gauge the magnitude of fraud, abuse, and errors in the bankruptcy system.

In FY 2007, we will use contractors to conduct up to 7,000 audits. Random audits will be conducted in at least 1 out of every 250 individual chapter 7 and chapter 13 cases filed in a judicial district, and we anticipate between 1,000 and 2,000 audits of cases in which debtors' income or expenses vary greatly from the norm. The procedure will work as follows. Shortly after a case is filed, selected debtors or their counsel will receive a notification of audit and request for documents. We hope that most audits can be completed within 70 days after a debtor's schedules are filed. Reports of the audit results will be filed with the court by the auditors. We will not seek an extension of time to object to discharge based upon a pending audit, except in unusual circumstances, because the statute provides that a discharge may be revoked if the auditor finds a material misstatement not adequately explained or if the debtor does not adequately explain a failure to provide information to the auditor.

OTHER UNITED STATES TRUSTEE DUTIES

The United States Trustee Program also is responsible for enforcing and implementing a number of other provisions of the BAPCPA. We have carried out duties to expedite the administration of small business chapter 11 cases and taken actions to enhance management accountability in large corporate reorganizations. We have defended numerous legal challenges to the reform law and participated in other litigation presenting issues of first impression that must be sorted out through case law.

In addition, we are hard at work on producing required studies and reports, including a study of the effectiveness of debtor education, the application of the IRS standards to the means test, and the impact of the new definition of household goods.

Although the amount of new work and demands imposed on the USTP have been immense, the Program's staff have responded with extraordinary diligence and professionalism. We are getting the job done and are confident that our efforts will significantly improve the bankruptcy system.

ELEVATE PUBLIC DISCUSSION

The other matter I wanted to address with you today is what I believe to be an essential ingredient to making bankruptcy reform work effectively and fairly for all constituents served by the system. It is important that all professionals who are part of the system elevate the level of discussion about bankruptcy reform law and practice. We can no longer afford to indulge in strident rhetoric that tends to undermine the rule of law. Instead, we must show good faith and respect for the law.

The ABI has long been noted for the scholarship and professional quality of its programs. This organization advances the public discussion about bankruptcy law, policy, and practice. The ABI program today follows in that tradition. And we need ABI's leadership in enriching the discussion now more than ever.

If we are to make bankruptcy reform work, regardless of individual views on the wisdom of specific provisions of the law, then it is incumbent upon all bankruptcy professionals to promote respect for the rule of law. Public statements that are unconstructive and attack the integrity of the law undermine public confidence in our legal system. This point has been made by others who have expressed concern over the strident rhetoric that continues to emanate from a few in the bankruptcy community.

My colleagues and I in the United States Trustee Program, and I am sure many of you, have attended conferences where panelists expressed strong opinions on various provisions of the BAPCPA. That is entirely appropriate. But, we also have heard and read commentaries from esteemed bankruptcy professionals that mock or denigrate the law. I regularly hear and read ad hominem attacks on proponents of reform. Coarse references to the reform law have been repeated at several conferences. Such inappropriate behavior does not serve the cause of debtors, creditors, or the public.

I make this simple point: Without respect for the law, it is more difficult for the United States Trustee to enforce the law, it is more difficult for debtor lawyers to obtain their clients' compliance with the law, and it is less likely that decisions of the court will receive the respect that is essential to our system of government. Our appointed chapter 7 and chapter 13 trustees have an especially important stake in breeding respect for the law. They depend on financial information produced in a largely self-reporting system. If debtors are told that certain disclosure or other requirements are without merit, then it is less likely that they will diligently and conscientiously satisfy their obligations under the Code.

I hope that future conferences, seminars, and debates about bankruptcy reform will include less invective and more thoughtful analysis about how lawyers and policymakers can enhance the integrity, efficiency, and effectiveness of the bankruptcy system.

CONCLUSION

Thank you again for the opportunity to participate in this valuable one-year anniversary review of the BAPCPA. While it is premature to draw firm conclusions on the effectiveness of the new reform law, it is clear that the new requirements are proving workable and there is evidence of promising results that may benefit debtors, creditors, and the general public.

I look forward to your questions.

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