



Department of Justice

STATEMENT

OF

CLIFFORD J. WHITE III
DIRECTOR
EXECUTIVE OFFICE FOR UNITED STATES TRUSTEES
U.S. DEPARTMENT OF JUSTICE

COMMITTEE ON THE JUDICIARY
SUBCOMMITTEE ON ADMINISTRATIVE OVERSIGHT
AND THE COURTS
UNITED STATES SENATE

CONCERNING

“OVERSIGHT OF THE IMPLEMENTATION OF THE
BANKRUPTCY ABUSE PREVENTION
AND CONSUMER PROTECTION ACT”

PRESENTED ON

DECEMBER 6, 2006

Statement of

Clifford J. White III

Director

Executive Office for United States Trustees

**“Oversight of the Implementation of the Bankruptcy Abuse Prevention
and Consumer Protection Act”**

Committee on the Judiciary

Subcommittee on Administrative Oversight and the Courts

United States Senate

December 6, 2006

Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to appear before you today to discuss the progress made by the United States Trustee Program to enforce and implement the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA). The United States Trustee Program (USTP or Program) is the component of the Department of Justice with a mission to enhance the integrity and the efficiency of the bankruptcy system. The BAPCPA imposed significant new responsibilities on the Program, and each of our 95 field offices plays a major role in carrying out the law.¹

I am pleased to report that the USTP has made significant progress in achieving its goal of making bankruptcy reform work for all stakeholders in the system – debtors, creditors, and the general public. Although it is far too early to determine the long-term impact of the new

¹ The USTP has jurisdiction in all judicial districts, except those in Alabama and North Carolina.

bankruptcy law, the reforms have been workable and show promising signs for positive results in the future.

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 12 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 change we have seen has been in the mix of chapter 7, chapter 11, and chapter 13 filings. 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 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.

Civil and Criminal Enforcement

The BAPCPA provides new tools for the Program to combat bankruptcy fraud and abuse. One of the reasons we have been able to meet the extraordinary challenges and new responsibilities presented to us by the reform law is that we are building on five years of steady progress realized through our civil and criminal enforcement initiatives. These enforcement efforts reflect a balanced approach to address debtor wrong-doing, as well as to protect consumer debtors who are victimized by attorneys, petition preparers, and others.

In Fiscal Year 2006, we estimate that we took more than 58,000 civil enforcement and related actions, including actions not requiring court resolution, with a monetary impact of more than \$878 million in debts not discharged, fines, penalties, and other relief. Since we began tracking our results in 2003, we have taken more than 220,000 actions with a monetary impact in excess of \$2.6 billion. Enforcement actions include such wide-ranging litigation as denials of discharge against debtors who conceal assets and monetary sanctions against attorneys who fail to fulfill their obligations to their debtor clients.

On the criminal enforcement side, we also made much progress in Fiscal Year 2006. Our Criminal Enforcement Unit, which was established within the Executive Office three years ago to assist our field operations in enhancing their criminal referral and law enforcement assistance activities, trained more than 1,500 federal prosecutors and law enforcement personnel, USTP staff, private trustees, and others. The Program increased its number of bankruptcy-related

criminal referrals by more than 20 percent, and 25 of the Program's attorneys are now cross-designated as Special Assistant United States Attorneys.

The Department's efforts on the criminal enforcement front were illustrated just a few weeks ago when Deputy Attorney General Paul McNulty announced the conclusion of "Operation Truth or Consequences," a nationwide bankruptcy fraud sweep. In this Operation, United States Attorneys filed criminal charges against 78 defendants in 69 separate prosecutions in 36 judicial districts within the previous two months. Nine lawyers, including bankruptcy lawyers, were among those charged. Eighteen of the charges were filed the day before the announcement.

The charges included concealment of assets ranging from luxury vehicles to a chateau in France; fraud committed against consumer debtors, including mortgage fraud scams that victimized those facing foreclosure on their homes; identity theft; and federal benefits fraud, including a health care fraud case in which Medicaid reimbursements were taken for services never rendered and the proceeds used to purchase a Porsche and other assets that were concealed in the defendant's bankruptcy case.

At the news conference concluding Operation Truth or Consequences, the Department also announced the launch of a new Bankruptcy Fraud Internet Hotline. This Hotline provides a more central mechanism for the public to report instances of bankruptcy fraud. We believe it will be helpful in our efforts to police the integrity of the system.

Bankruptcy Reform

Bankruptcy reform has presented many significant enforcement and implementation challenges. In carrying out our new duties, we reached out to other federal agencies, the private trustees, and creditor and debtor representatives to gain the benefit of their valuable information and insights pertaining to our new tasks. The Program is extremely grateful for the cooperation, advice, and assistance we received.

Under the BAPCPA, the USTP has taken on major new responsibilities in five general areas, which are described below.

Means Testing

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.” In many ways, means testing is the cornerstone of the new bankruptcy reform law.

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. There is also a system in place for United States Trustee staff to process that information, make a determination of “presumed abuse,” and decide whether to bring a motion to dismiss. 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.

We cannot draw any firm conclusions about the long-term effectiveness of the means test because the number of filings has been extremely low since the October 17, 2005, general effective date of the reform law. Among other things, 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 12 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, the chapter 7 trustees, and others involved in the process. We are hopeful that in 2007 the Judicial Conference will adopt data tag technology as a mandatory technical standard (with limited exceptions) 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 17, 2005, through the end of September, 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 with reference to the statutory formula.

Credit Counseling and Debtor Education

Another major aspect of bankruptcy reform is financial education. Individual debtors must receive credit counseling prior to filing and 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 Trustees 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 to carry 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. 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. 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,² although again, the true test will come when filings reach higher levels, as expected. 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 educators who received probationary approval reapplied for a 12-month approval. There are currently 155 approved credit counseling agencies and 285 approved debtor education providers.

In addition to approving the applications of providers, United States Trustees also enforce the requirement that debtors receive credit counseling. Verification should 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 provides clear notice to individual debtors that they are required to receive pre-petition counseling, unless they qualify for one of the enumerated exceptions.

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 these new duties to enforce and implement the credit counseling and debtor education provisions of the law.

² Pursuant to 11 U.S.C. §§ 109(h)(2)(A) and 727(a)(11), the United States Trustee exempted debtors in the districts most heavily affected by Hurricane Katrina from the credit counseling and debtor education requirements. The exempted districts are the Southern District of Mississippi and the three judicial districts in Louisiana.

Debtor Audits

The BAPCPA also mandated a new regimen for debtor audits beginning with cases filed on October 20, 2006. The 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 of cases filed by individual debtors. 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. Our ability to select appropriate cases for non-random audits will be enhanced significantly if the courts agree to adopt data tags for electronic filers.

The procedure for debtor audits 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, since 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.

Business Reorganizations

The new law made many changes in chapter 11 practice for both small businesses and large corporations. Since October 17th, approximately 950 chapter 11 debtors have indicated they were a small business on their petitions. In the area of small business case administration, we have a mandate to conduct initial debtor interviews soon after a business files a petition; we help enforce the tighter deadlines for filing a disclosure statement and plan of reorganization; and we review a debtor's self-designation as a "small business." Further, we developed a prototype financial reporting instrument which the Bankruptcy Rules Committee has made available for public comment.

While many of the new tools and requirements reflect "best practices" that were followed by USTP offices prior to the BAPCPA, the new provisions provide promising enforcement mechanisms. Among these are the financial reporting requirements of section 1116 and the new deadlines by which businesses must confirm plans of reorganization

The United States Trustees also carry out important new duties in cases involving businesses other than small businesses. In approaching our new responsibilities, we are mindful of the purpose of these provisions. In many respects, the business bankruptcy reforms enhance management accountability and provide greater protections to creditors, shareholders, and the public. The corporate debtor has fiduciary obligations and the right to remain in possession is not unchecked.

Among other things, the law now requires that the United States Trustee seek 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 addition, debtors are under stricter time deadlines to confirm a plan of reorganization. They also are restricted in their ability to pay corporate executives large bonuses while lower level employees, shareholders, and creditors face unemployment, devalued pensions, or other economic loss. Moreover, section 1112(b) was amended to lessen the court’s discretion in ordering conversion to chapter 7 if the debtor is not expeditiously reorganizing in accordance with the commands of chapter 11.

While, to date, the United States Trustees have been prudent in enforcing the new provisions, we have invoked the “reasonable grounds to suspect” criterion of section 1104(e) in moving for the appointment of a chapter 11 trustee in about 10 cases since enactment of the BAPCPA. We have been successful in about half of them. We also have enforced the executive compensation restrictions contained in the new section 503(c), and have opposed debtors’ proposed key employee retention plans in approximately 15 cases.

Studies

The USTP also is required by statute to conduct three studies; these are ongoing. In one study, we have developed and will evaluate a model debtor education curriculum. The model curriculum is currently being tested in six districts, and a report will be issued in September 2007. In another, we will study the utilization of Internal Revenue Service expense standards for

determining current monthly expenses under the means test. That report will consider the impact of using the IRS standards and identify issues that have arisen during the first year of implementation. The report will be issued in April 2007. The final required study will examine the impact of the new household goods definition in the Bankruptcy Code, and may help identify changes in the number of lien avoidance actions taken. The report is due in April 2007. Both the means testing and household goods studies are hampered, to an extent, by the lack of data tagging or equivalent software that would make it easier for researchers to identify cases and aggregate information contained on filed financial statements.

In addition to the required studies, the Program also is exploring special issues associated with credit counseling delivered via the Internet. We have contracted with a research firm to report back to us on their conclusions within the next few months.

Other New Duties

Beyond these five major areas, the United States Trustee Program has also carried out many other important new duties, such as appointing privacy and patient care ombudsmen and litigating many issues of first impression. For example, we have assisted the Civil Division in its defense of the debt relief agency provisions of the reform law, we have filed numerous briefs in defense of the right of chapter 13 debtors to make continued charitable contributions, and we have vigorously asserted our position on many disputed matters pertaining to the application of the means test in both chapter 7 and chapter 13 cases. We also continue to collaborate very closely with the Judicial Conference's Advisory Committee on Bankruptcy Rules.

Conclusion

The new bankruptcy reform law has presented many challenges to the United States Trustee Program. I am extremely proud of the diligence and professionalism which Program officials in headquarters and in the field have shown since passage of the new law. Their extraordinary efforts, extremely hard work, and fidelity to the law have allowed us to make substantial progress. We look forward to continuing our efforts in the future to make bankruptcy reform work for debtors, creditors, and the general public.

#