

**Department of Justice
Executive Office for United States Trustees**

**Final Agency Action
Case No: 2010-02**

**Review of the Decision of the
United States Trustee for Region []
Regarding []**

[] Esq., a chapter 7 panel trustee (“trustee” or “[]”) for the District of [] seeks review of a decision by the Acting United States Trustee for Region [] (the United States Trustee)^{1/} to suspend the assignment of new cases to the trustee. Based up the record before me, I affirm the United States Trustee’s decision to suspend and partially modify the conditions of the trustee’s reappointment.

I. Course of this Proceeding

Since June 23, 2009, the trustee has served on the panel of chapter 7 trustees for the District of []. By Notice of Suspension dated August 9, 2010 (“Notice of Suspension”), the United States Trustee suspended him from active chapter 7 rotation in the District of [] based upon allegations of fraudulent conduct against him in a federal court lawsuit and because of negative comments by his former employers in a background investigation conducted at the United States Trustee’s request. Notice of Suspension at 1.

On August 26, 2010, the trustee requested that I review the United States Trustee’s decision to suspend (the “Request for Review”). On September 10, 2010, the United States Trustee submitted a response to the trustee’s Request for Review (the “Response”). On September 20, 2010, the trustee submitted a reply to the United States Trustee’s Response (the “Reply”). Subsequently, from September 15 to October 25, 2010, pursuant to 28 C.F.R. § 58.6(h), the United States Trustee and the trustee submitted supplemental information for consideration in connection with this review.

Accordingly, the administrative record in this matter consists of: (1) the Notice of Suspension and Appendix; (2) the Request for Review and supporting exhibits; (3) the Response and supporting exhibits; (4) the Reply; (5) the United States Trustee’s September 15, 2010 Email to the Executive Office for United States Trustees (“EOUST”); (6) the United States Trustee’s September 24, 2010 Email to EOUST; and (7) the United States Trustee’s and the trustee’s October 25, 2010 Emails to EOUST.

^{1/} United States Trustees are officials of the Department of Justice who are appointed by the Attorney General. 28 U.S.C. § 581(a), (c). The Director of the Executive Office for United States Trustees (“EOUST”) is a Department of Justice official who acts under authority delegated by the Attorney General.

II. Standard of Review

In conducting this review, I must consider two factors:

1. Was the United States Trustee's decision to suspend supported by the record?
2. Did the United States Trustee's decision constitute an appropriate exercise of discretion?

See 28 C.F.R. § 58.6 (i) (specifying the scope of the Director's review). I may "adopt, modify or reject the United States Trustee's decision to suspend or terminate the assignment of future cases to the trustee." Id.

III. Analysis

A. Duties of the United States Trustee and Panel Trustee

United States Trustees work to effectuate the goals of the United States Trustee Program, which are to protect the public interest by ensuring efficiency in the administration of cases and to protect the integrity of the bankruptcy system.^{2/} United States Trustees supervise chapter 7 panel trustees, 28 U.S.C. § 586(a)(1), and appoint them to specific chapter 7 cases. 11 U.S.C. § 701. United States Trustees "carefully monitor the performance of panel members . . . to determine whether they should be continued in or removed from panel membership." H.R. Rep. No. 95-595, at 102 (1977). "The United States Trustee is permitted to conduct his own investigation . . . to exercise effective supervision and make effective evaluation of the performance of the private trustees on the panel." Id. at 110.

Chapter 7 panel trustees are fiduciaries with wide-ranging responsibilities to implement the goals of chapter 7 of the Bankruptcy Code. As fiduciaries, trustees are held to high standards of conduct. See generally Mosser v. Darrow, 341 U.S. 267 (1951); Woods v. City National Bank & Trust Co., 312 U.S. 262, 278 (1941). See also Meinhard v. Salmon, 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928) (Cardozo, C.J.). Because debtors and creditors cannot choose their trustee, and because the trustee is a fiduciary charged with protecting the interests of all estate beneficiaries, a trustee must be a person of integrity and good moral character.

^{2/} The United States Trustee Program's detailed Mission Statement provides as follows:

The United States Trustee Program acts in the public interest to promote the efficiency and to protect and preserve the integrity of the bankruptcy system. It works to secure the just, speedy, and economical resolution of bankruptcy cases; monitors the conduct of parties and takes action to ensure compliance with applicable laws and procedures; identifies and investigates bankruptcy fraud and abuse; and oversees administrative functions in bankruptcy cases.

Indeed, integrity and moral character are attributes so essential to a fiduciary that the Department of Justice promulgated a formal rule conditioning a trustee's appointment and continued eligibility upon the trustee's possession of "integrity and good moral character." See 28 C.F.R. § 58.3(b)(1). A United States Trustee may suspend a chapter 7 trustee if the trustee fails to meet that requirement. See 28 C.F.R. § 58.6(a)(9). Moreover, a United States Trustee may suspend a trustee when an "[a]ction by or pending before a court . . . calls the trustee's competence, financial responsibility or trustworthiness into question." 28 C.F.R. § 58.6(a)(11).

B. Grounds for the United States Trustee's Decision to Suspend the Trustee

The Notice of Suspension cites two reasons for the trustee's suspension. First, the trustee was named as a third-party defendant in a lawsuit now pending in the Federal District Court for the District of [REDACTED], alleging that the trustee engaged in fraudulent conduct relating to the financial records and bankruptcy filings of a former employer. [REDACTED]

Second, a background investigation conducted at the United States Trustee's request as part of the trustee appointment process contained allegations that [REDACTED] "moonlighted" at his former employment, failed to complete work duties, and complained about his pay scale. Notice of Suspension at 1. The background investigation also contained allegations that [REDACTED] work performance was unsatisfactory, that his personnel files were missing after his departure, and that he downloaded company files to his laptop computer for personal use. Notice of Suspension at 1.

The United States Trustee determined that the issues raised by the lawsuit and the background investigation presented "serious ethical concerns" challenging the trustee's "integrity in the discharge of professional duties," and therefore warranted the trustee's suspension until favorable resolution of the issues raised by the lawsuit and the background investigation. Id.

The Notice of Suspension conditioned the trustee's receipt of new case assignments upon the conclusion of the third-party litigation and evidence to the satisfaction of the United States trustee that issues in the litigation were resolved in favor of the trustee; satisfactory resolution of the background investigation issues; and reinstatement approval by the Deputy Director for Field Operations of the Executive Office for United States Trustees. Notice of Suspension at 2.

C. The Record Supports the United States Trustee's Decision to Suspend the Trustee and the Decision Was an Appropriate Exercise of Discretion

As set forth more fully below, I conclude that the record supports the United States Trustee's decision to exercise his discretion to suspend the trustee pending the favorable resolution of the issues raised in the third-party lawsuit, and partially modify the conditions of the trustee's reappointment.

a. The Trustee's Involvement in Federal Court Litigation

The record shows that on January 28, 2010, third-party plaintiffs [redacted] (“Mr. [redacted]”), [redacted], and [redacted] filed a third-party complaint against the trustee in the United States District Court for the District of [redacted] alleging claims of negligent misrepresentation, indemnification, and breach of fiduciary duty. Request for Review, Ex. B. The third-party complaint, styled [redacted] [redacted] seeks to hold the [redacted] liable as a third-party defendant for any damages awarded against [redacted] [redacted] and [redacted] as a result of claims made against them by [redacted], a lender to and secured creditor of [redacted] [redacted], Case No. [redacted] [redacted]

The [redacted] Litigation

[redacted] seeks compensatory and punitive damages against [redacted] [redacted] and [redacted] for claims of fraudulent misrepresentation, negligent misrepresentation, and fraudulent concealment arising out of the alleged actions of [redacted] [redacted] and others with respect to a water maintenance agreement between [redacted] and [redacted] and with respect to [redacted] 2004 and 2005 federal court bankruptcy filings. See [redacted] Compl. According to the [redacted] complaint, [redacted] owns and controls both [redacted] and [redacted] [redacted] Compl. at ¶¶ 6, 10-11. According to the [redacted] third-party complaint, [redacted] was chief financial officer of [redacted] [redacted] Compl. at ¶ 4.

The [redacted] complaint alleges that in July 2001, [redacted] loaned [redacted] \$11.5 million, secured by two deeds of trust. [redacted] Compl. at ¶¶ 12-13. [redacted] subsequently defaulted on the loan, and [redacted] sought to foreclose on the properties subject to its deeds of trust. *Id.* at ¶¶ 16-19. Before it could do so, on July 14, 2004, [redacted] filed a voluntary petition for bankruptcy relief pursuant to chapter 11 of the United States Bankruptcy Code. *Id.* at ¶ 19. According to the complaint, shortly before filing the petition, [redacted] “took advantage of his control over the financial books and records to materially alter [redacted]’s financial books and records for the purpose of hiding a \$4 million asset.” *Id.* at ¶ 20.

[redacted] alleges that, pursuant to Mr. [redacted] instructions, [redacted] “made backdated entries in the [redacted] general ledger - specifically in the intercompany account with [redacted] - for each month going back to July 2001.” [redacted] Compl. at ¶ 22. According to the complaint, the “cumulative impact” of those backdated entries was to reduce [redacted] \$4 million debt to [redacted] under a water maintenance agreement between them thereby permitting [redacted] to be listed on [redacted]’s bankruptcy schedules as an unsecured creditor for \$200 rather than \$4 million. *Id.*

In December 2004, [redacted] voluntarily dismissed its bankruptcy case over [redacted]'s objection. Id. at ¶ 24. Subsequently, [redacted] filed an involuntary petition for relief against [redacted] under chapter 7 of the United States Bankruptcy Code. Id. at ¶ 25. The [redacted] complaint alleges that the 2005 bankruptcy schedules “falsely represent[ed]” that [redacted] owed [redacted] approximately \$1.5 million under the water maintenance agreement. Id. at ¶ 26.

Thereafter, in July 2005, “in reliance on defendants’ materially false representations and omissions concerning [redacted]’s financial condition,” as set forth in [redacted] 2004 and 2005 bankruptcy schedules, [redacted] entered into a settlement agreement with [redacted] modifying the amount owed under its loan from \$14 million to \$11 million. Id. at ¶ 27. According to the complaint, after discovering in 2007 that [redacted] and others had “cooked the books” and made false statements in the bankruptcy schedules, [redacted] filed its complaint against them. Id. at ¶ 28.

The Third-Party Complaint

In response to the [redacted] complaint, [redacted] [redacted] and [redacted] filed the third-party complaint against Mr. [redacted] and others. The third-party complaint alleges that [redacted] drafted the water maintenance agreement between [redacted] and [redacted]. Id. Compl. ¶ 11. It further alleges that he prepared [redacted]’s bankruptcy schedules in 2004 and 2005, id. at ¶ 8, yet never informed [redacted]’s bankruptcy counsel of any “improprieties or issues” relating to the water maintenance agreement and the [redacted] debt. Id. at ¶ 12. The third-party complaint further alleges that “well after being advised” of facts that should have put him on notice of improprieties relating to the agreement, [redacted] “continued to present and represent to third parties [that] the financials of [redacted] accurately reflected charges owed to [redacted] under the agreement. Id. at ¶ 13.

Under a theory of derivative liability, third-party plaintiffs assert that if they are held liable for fraud, because [redacted] “perpetrated the fraud and advanced it, at the time of the creation of the [agreement] and when the representations to the Bankruptcy Court were made regarding the [agreement] itself,” he should be held liable for their damages. Id. ¶ at 14; and see [redacted] Compl. at Counts I and II (alleging claims of negligent misrepresentation and indemnification). In addition, under Count III of the complaint, third-party plaintiffs bring an independent, non-derivative cause of action for breach of fiduciary duty against [redacted]. Count III alleges that he “acted in the role of agent[], financial advisor[], and chief financial officer[] of [redacted].” Id. at ¶ 24, and see ¶ 4. According to the complaint, Mr. [redacted]’s role placed fiduciary duties upon him, which the complaint alleges he breached by placing his interest ahead of the interests of [redacted], [redacted] and [redacted], and that [redacted] has either “gained personally from the transactions . . . [or has] failed to regard” their interests as superior. Id. at ¶¶ 25, 26. Count III seeks punitive damages for his alleged “fraudulent, oppressive or malicious intentional acts.” Id. at ¶ 28.

[redacted] does not deny that allegations of fraudulent conduct are pending against him in a federal court action. Nor does he argue that the claims in the [redacted] complaint and the [redacted] third party-complaint are unrelated to issues of ethics and integrity. Instead, [redacted] denies that he has engaged in fraudulent conduct, and contends that the third-party complaint is

[redacted]'s attempt to intimidate him. Request for Review at 6. He points out that he has denied the allegations against him and offers additional information and evidence to contradict them. Id.

In support of his arguments, [redacted] provides a copy of the third-party complaint, Request for Review at Ex. B, a declaration by [redacted] relating to alleged improprieties surrounding the agreement that the trustee drafted on behalf of his former employer, id. at Ex. C, a deposition excerpt from Mr. [redacted] purportedly demonstrating improper financial self-interest, id. at Ex. F, a copy of the trustee's own affidavit concerning the agreement in dispute in the third-party complaint, id. at Ex. D, affidavits from two attorneys who worked for [redacted] in which they state they are "not aware of" fraudulent activity perpetrated by the trustee, id. at Exs. E, G, and an affidavit from the former controller of his former employer, who was allegedly aware of [redacted]'s business dealings, id. at Ex. I. He also includes a copy of the findings of fact and conclusions of law in a separate lawsuit against [redacted]. Id. at Ex. H.

In response to these arguments, the United States Trustee acknowledges that the allegations against [redacted] are "both disputed and unresolved," but reiterates his conclusion that they challenge the trustee's "integrity in the discharge of professional duties" and "present serious ethical concerns." Response at 2. Because panel trustees maintain positions of trust, he reasons that such allegations should be resolved prior to the trustee receiving additional chapter 7 case assignments. Id. The United States Trustee also supplements the record with an affidavit and unsworn deposition testimony of [redacted] in a separate case against [redacted]. Response at Exs. 2 and 3, as well as the affidavit of [redacted] in the [redacted] bankruptcy case. Id. at Ex. 4. The trustee argues that "substantive evidence" in these supporting documents lends credence to allegations against the trustee in the federal court litigation. Id. at 2.

Having reviewed the arguments and the evidence of record, I agree with the United States Trustee that suspension is warranted. The existence of an "[a]ction by or pending before a court . . . which calls the trustee's competence, financial responsibility or trustworthiness into question" presents adequate grounds for suspension. 28 C.F.R. § 58.6 (a)(11). The allegations raised in the [redacted] complaint and the third-party complaint go directly to [redacted]'s "financial responsibility" and "trustworthiness." The pleadings explicitly allege improper conduct in a business and bankruptcy context at a time when [redacted] served as [redacted]'s chief financial officer, a high-level position laden with fiduciary obligations.

Mr. [redacted]'s denial of these allegations, and the range and type of exhibits provided in support of his denial, suggest that there also may be credible evidence to contradict these allegations. The trustee suggests that I should weigh the conflicting evidence with respect to these allegations and exonerate him from alleged improprieties. However, under 28 C.F.R. § 58.6 (i), I need not serve as finder of fact nor draw definitive conclusions concerning matters disputed in federal district court litigation. I need only determine whether the United States Trustee's decision to suspend the trustee from active case rotation is supported by the record and is an appropriate

exercise of discretion. Id. In light of the pending actions and the nature of the allegations against the trustee, I find that the record amply supports the suspension. The allegations in the [redacted] and [redacted] complaints raise ethical concerns about the trustee's ability to meet the high standards expected of members of the chapter 7 panel. Because a fiduciary is placed in a position of trust, even an appearance of impropriety may raise concerns, and under 28 C.F.R. § 58.6 (a)(11), it was well within the United States Trustee's discretion to suspend the trustee based upon the existence of the lawsuits.

Moreover, it is indisputable that a trustee must "[p]ossess integrity and good moral character." 28 C.F.R. 58.3(b)(1). So long as the allegations against the trustee remain pending and unresolved, concerns about the trustee's integrity remain. Because of the important role of trustees as fiduciaries in the bankruptcy system, I conclude that the United States Trustee appropriately exercised his discretion to suspend the trustee pending resolution of issues in the litigation.

b. The Trustee's Background Investigation

The record shows that a background investigation was conducted as part of the trustee's appointment process as the federal court actions were proceeding.^{3/} Email of Sept. 15, 2010. A short excerpt from the investigation report, quoted in the Notice of Suspension, reveals that the trustee formerly worked for [redacted] ("[redacted]") and [redacted] [redacted] ("[redacted]"). Notice of Suspension at 1. It appears from the excerpt that unidentified representatives of [redacted] and [redacted] reported to an investigator that the trustee worked on outside projects during business hours, failed to complete work duties, and complained about his pay scale. Id. They also reported that in November 2006 the trustee was informed that his work performance was unsatisfactory and he should seek employment elsewhere, and that after the trustee left employment in April 2007 his personnel file was missing, and it appeared he had downloaded company files to his laptop computer for personal use. Id.

In a signed and notarized affidavit dated May 25, 2010, the trustee acknowledges he was employed by [redacted] and [redacted] but denies being notified of poor work performance. Request for Review at Ex. J. The trustee also acknowledges that, while employed by [redacted] and [redacted] he worked on various outside projects. Request for Review at 4 and Ex. J. The trustee contends that this did not hinder him from performing his designated work duties, noting that he did not receive compensation for some of those outside projects. Request for Review at 4-5 and Ex. J. The trustee denies that he was an unsatisfactory employee, contending that he received bonuses during his employment and was released only because his employer could no longer afford to pay his salary. Request for Review at 5 and Ex. J. He denies that he absconded with any personnel information post-employment and states that his employer provided him with the information. Id.

^{3/} A panel trustee must successfully undergo an initial and five-year background checks. See EOUST's Handbook for Chapter 7 Trustees (July 1, 2002) at p. 2-1. The trustee's appointment to the panel or the assignment of cases may be terminated based on unresolved problems discovered during background checks. Id.

The United States Trustee argues that, in conjunction with the allegations against the trustee in the federal court actions, the negative comments in the background investigation raise ethical concerns about the trustee. Notice of Suspension at 2. In response to the trustee's denial of some of the allegations of the report, the United States Trustee reiterates that argument. Response at 2.

I agree with the United States Trustee that, against the backdrop of the pending federal court actions, the negative comments raised in the background investigation do raise ethical concerns about the trustee, and that they warrant further inquiry. Because I have already concluded that suspension is warranted under 28 C.F.R. § 58.6(a)(11), I need not reach the question of whether these allegations, standing alone, would separately support the trustee's suspension.

Consequently, I affirm the suspension based upon the allegations against the trustee in the pending federal court actions and partially modify the conditions of reappointment set forth in the United States Trustee's Notice of Suspension, as follows: Effective upon the issuance of this decision, which marks the end of the review process available to the trustee under 28 C.F.R. § 58.6, the trustee will be ineligible to receive active case assignments under 28 C.F.R. § 58.3(b)(1). The trustee will remain a member of the chapter 7 panel, but will not receive new case assignments until the issues raised by the third-party litigation and the background investigation are resolved to the satisfaction of the United States Trustee. Nothing in this decision should be construed as limiting the United States Trustee's further inquiry into matters raised by the federal court litigation or the background investigation, and nothing in this decision shall limit the United States Trustee's ability to commence further action under 28 C.F.R. § 58.6 during the pendency of this suspension.

IV. Conclusion

Based upon my review of the record, for all of the foregoing reasons, I affirm the United States Trustee's decision to suspend the trustee from active case rotation status on the chapter 7 panel for the District of and partially modify the conditions of his reappointment, as explained above.

This decision constitutes final agency action in this matter.

Dated: _____

/s/ _____

Clifford J. White III
Director
Executive Office for United States Trustees