



Department of Justice

STATEMENT OF
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DIRECTOR
EXECUTIVE OFFICE FOR UNITED STATES TRUSTEES
U.S. DEPARTMENT OF JUSTICE

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

FOR A HEARING CONCERNING
H.R. 3553,
THE “BANKRUPTCY ADMINISTRATION
IMPROVEMENT ACT OF 2017”

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Mr. Chairman, Ranking Member, and Members of the Subcommittee:

I appreciate the opportunity to appear before you today to discuss chapter 7 trustee compensation, including the proposal contained in H.R. 3553, the “Bankruptcy Administration Improvement Act of 2017.” The United States Trustee Program (USTP or Program) appoints and oversees approximately 1,100 chapter 7 trustees who serve as fiduciaries for bankruptcy estates in liquidation. These trustees handle the day-to-day activities of approximately 600,000 chapter 7 cases and distribute on average about \$3 billion annually from the assets of estates.

As the “watchdog” of the bankruptcy system, the USTP can attest to the crucial role of chapter 7 trustees in ensuring that bankruptcy estates are administered fairly and efficiently. They are on the frontline and, in most cases, are the only representative of the bankruptcy system with whom debtors and creditors have contact. It is a direct result of the chapter 7 trustees’ efforts that debtors are provided the “fresh start” they seek and creditors receive repayment to which they are entitled by law.

Over the past many years, the Congress has given chapter 7 trustees additional statutory responsibilities. Yet trustee compensation has not kept pace with these added duties or with inflation. Although there has been consensus on the need to provide trustees with additional compensation, there has not been consensus on the appropriate source(s) of that funding. We urge the Congress to break the logjam to ensure that the bankruptcy system can continue to benefit from a skilled and competent corps of chapter 7 trustees.

Chapter 7 Trustee Duties

The chapter 7 trustee serves as the representative of the bankruptcy estate and is a fiduciary charged with protecting the interests of all estate beneficiaries. Section 704 of the Bankruptcy Code enumerates 12 overarching duties of a chapter 7 trustee. Chief among those are to investigate the financial affairs of the debtor, collect and reduce to money property of the estate as expeditiously as is compatible with the best interests of parties in interest, and provide a full and complete accounting of the administration of a case. The list also includes changes made by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), including new responsibilities relating to domestic support obligations, health care bankruptcies, and the administration of employee benefit plans.

Notably, chapter 7 trustees also support the USTP in both its civil and criminal enforcement responsibilities. On the civil side, this includes referring cases to the United States Trustees that may warrant enforcement action, such as cases in which a debtor causes unreasonable delay, conceals or destroys property, or otherwise fails to comply with bankruptcy requirements. On the criminal side, trustees refer suspected bankruptcy or bankruptcy-related fraud to the USTP, and offer important assistance to the Program and law enforcement, including reporting on their review of the debtor's financial information and testifying at trial.

One recent example of the USTP partnership with private trustees in ferreting out fraud involves a case in the Southern District of New York. The chapter 7 trustee successfully pursued a now former bankruptcy lawyer who embezzled funds from a chapter 11 estate. After the USTP's Manhattan office investigated the lawyer for a lack of proper accounting of sales proceeds, it obtained a court order converting the case to chapter 7 and appointed the trustee. In coordination with the USTP, the chapter 7 trustee immediately commenced discovery and obtained court orders holding the attorney in contempt and issuing a bench warrant for his failure to turn over documents and funds paid without court approval. Meanwhile, the USTP continued to investigate the conduct of the attorney in the converted case, as well as his representation of clients in other bankruptcy cases. The investigation revealed many financial irregularities, such that the USTP referred the lawyer's conduct to its federal and state law enforcement partners. In March 2018, the lawyer pled guilty in federal district court to one count of embezzlement from a bankruptcy estate and, in May 2018, pled guilty to two state charges relating to his embezzlement of funds from his attorney escrow account. Sentencing is scheduled for October in both the federal and state criminal proceedings.

Though more than 90 percent of chapter 7 cases are no-asset cases – meaning that the debtor does not own any non-exempt assets that can be liquidated for the benefit of creditors – trustees must still devote significant time to review the financial information filed in the case, question the debtor under oath about assets and liabilities, and perform other statutory duties. Trustees must undertake these responsibilities even in no-asset cases in which the debtor qualifies for a waiver of the filing fee, and the trustee receives no fee. In fact, it is often only by performing these time-consuming activities that trustees can identify additional assets to bring into the estate for the benefit of creditors, as well as verify the debtor's and other parties' compliance with bankruptcy law.

Chapter 7 Trustee Compensation History

For carrying out these important case administration responsibilities, chapter 7 trustees receive compensation from two sources. First, trustees are paid \$60 per case from the fees paid by the debtor upon the filing of a bankruptcy petition. This is sometimes referred to as the “no-asset” fee. In addition, in those cases in which assets are available for distribution to creditors, pursuant to section 326 of the Bankruptcy Code, chapter 7 trustees also receive a percentage of those distributions based on a sliding scale. This “percentage fee” also is referred to as the “trustee commission.” Currently, the percentage fee ranges from 25 percent on the first \$5,000 of distributions to three percent on amounts above \$1 million.

The amount of the no-asset fee has not been adjusted over the past 24 years. Accordingly, if Congress was correct in its assessment in 1994 that the no-asset fee should be set

at \$60, then that amount should be \$100 today to account for inflation alone, and probably higher if the increased demands on trustees resulting from BAPCPA are considered.

Beyond the fixed no-asset fee that has lagged far behind inflation, the statutory formula for calculating the percentage fee on distributions in asset cases also has not changed since 1994. But in the 2005 BAPCPA amendments, Congress added a provision to ensure that courts would award these fees “as a commission.” The USTP adopted the legal position that a trustee was entitled to the maximum percentage fee absent “extraordinary circumstances,” such as substandard performance, a wholly disproportionate discrepancy between the trustee’s effort in achieving the distribution as compared with the fee calculation under the statutory formula, or other factors that apply only in rare instances.

The USTP’s position on the percentage fee has been adopted by the United States Courts of Appeals for the Fourth and Fifth Circuits. But some courts still employ methodologies that yield lower compensation, perhaps appreciably so in some cases. We respectfully disagree with those courts and believe that those courts are unnecessarily depressing trustee compensation and failing to give full meaning to the text of the statute.

In contrast to the lack of a compensation increase for chapter 7 trustees, one academic study showed that, in the years immediately after BAPCPA, debtor attorneys’ fees rose by about 45 percent. Lois R. Lupica, *The Consumer Bankruptcy Fee Study: Final Report*, 20 Am. Bankr. L. Rev. 17 (2012). Although attorneys’ fees vary significantly among local markets, customary fees nationally exceed \$1,000 and may be significantly higher. In most jurisdictions, chapter 7 trustees may employ themselves as an attorney paid by the estate for performing non-trustee legal work in a case, such as litigation. Even when court-approved attorneys’ fees paid to the trustee are added to the no-asset fee and trustee commissions, total compensation paid to chapter 7 trustees has decreased in six of the last ten fiscal years. In most of those years, the increases and decreases were modest; but, in FY 2017, trustee compensation plummeted by 18 percent.

The compensation decreases may help explain two other statistical changes that have occurred in the chapter 7 system. First, the number of chapter 7 trustees has decreased by about 20 percent over the past decade. The decrease in the number of trustees is due, in large part, to prudent decisions by United States Trustees not to fill vacancies due to lower filing rates. Nevertheless, limited recruitment data show that the number of applicants for chapter 7 trustee vacancies has decreased significantly, from an average of 58 candidates in 2010 to 20 candidates last year.

Although it is difficult to measure the precise impact of diminished compensation, it stands to reason that continual decreases in compensation may threaten the financial viability of some trustee operations and impede the recruitment of the best qualified candidates. These possible adverse impacts are of particular concern in light of recent filing trends that suggest that previous reductions in filing levels have stabilized and filings may start to increase. It is critical to the bankruptcy system that we are able to retain and recruit the highest caliber of trustees to serve as estate fiduciaries.

Funding an Increase in Chapter 7 Trustee Compensation

Under H.R. 3553, the fee for filing a chapter 7 case would increase by \$60 to fully fund a proposed increase in the no-asset fee to \$120 per case. In addition, the Bill would index the no-asset fee and make a technical clarification to 11 U.S.C. § 330(a)(7) governing the chapter 7 trustee percentage fee. The annual aggregate cost of increasing the no-asset fee to \$120 would be about \$27 million based on current filing rates.

Raising the chapter 7 filing fee to increase the no-asset fee paid to trustees is reasonable because more than 90 percent of chapter 7 cases are no-asset cases that require the expenditure of substantial trustee time and resources. The impact of such an increase, however, would be borne by debtors who may already be in dire financial straits.

Other options also have been identified in the past. For instance, the formula in section 326 for awarding trustees a percentage fee on distributions to creditors could be altered to allow for a higher percentage fee on larger estates. Those costs would be borne by creditors. Such an increase may not be the entire solution, however, because the benefits and costs would not be borne evenly across all cases or jurisdictions. That is because state laws generally determine the value of assets that debtors may exempt from bankruptcy estates, and those laws vary greatly. Therefore, not all trustees would benefit similarly from the statutory change because trustees in states with more debtor-friendly exemption laws typically administer fewer asset cases. Congress could, however, designate any increase in the percentage fee to fund the no-asset fee increase.

In addition, a variety of other fees that are imposed by the courts on litigants (*e.g.*, fees for filing motions in a case) could be raised and allocated to chapter 7 trustees. These fees are paid by stakeholders who are the most fully engaged in bankruptcy cases through litigation or otherwise.

The source of additional trustee compensation may well involve a combination of the above and other possible sources.

Conclusion

Chapter 7 trustees do an outstanding job administering bankruptcy cases fairly and efficiently. Much of the work they perform is in no-asset cases in which the fee, even with a reasonable increase, is below the cost of providing the service. Accordingly, chapter 7 trustees deserve an increase in compensation levels that have not changed over the past 24 years.

I appreciate the Subcommittee's attention and would be happy to answer any questions.