Department of Justice

STATEMENT OF

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BEFORE THE

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

FOR A HEARING CONCERNING

OVERSIGHT OF THE UNITED STATES TRUSTEE PROGRAM

PRESENTED

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Statement of Director Clifford J. White III
Executive Office for United States Trustees
U.S. Department of Justice
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Commercial and Antitrust Law
Committee on the Judiciary
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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 historic 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 statutorily allowed 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 2013, the Program took more than 44,000 civil enforcement actions and inquiries with a potential monetary impact of $1.66 billion in debts not discharged, fines, penalties, and other relief. Since we began tracking our results in 2003, we have taken more than 619,000 actions and inquiries, with a potential monetary impact in excess of $14 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 2013, approximately 12 percent of chapter 7 debtors had income above their state median. Of the 83,000 cases filed by above median income debtors, about 4,900 (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 3,100 (63 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 analysis.[3] For example, the case of a debtor who retains luxury items, incurs debt on the eve of

[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.

[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.

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 2013, United States Trustees initiated more than 8,500 civil enforcement actions and inquiries against creditors, lawyers, and other parties who acted improperly towards debtors.[4] More than 3,700 of these related to abusive conduct by creditors, including about 62 percent of which involved mortgage fraud and abuse.

In recent years, the USTP has addressed multi-jurisdictional violations with a coordinated enforcement approach. As a result, the Program has entered into nine nationwide settlements, including five settlements to protect consumer debtors against national creditors. These national settlements provide relief for victimized debtors, require systemic corrective actions so such violations do not recur, and uphold the integrity of the bankruptcy system. In several of these settlements, the Program insisted upon an independent review to verify compliance.[5]

For example, on June 5, 2013, the Program announced the successful conclusion of its 2008 settlement with Capital One Bank (USA) N.A. resolving allegations that the bank improperly filed claims in bankruptcy cases for previously discharged debts. Under the settlement, Capital One agreed to an audit overseen by an independent auditor. The audit revealed that the bank had filed more than 15,500 erroneous claims with a total face value of approximately $25 million–seven times more than initially alleged. The auditor's final report illustrates how important it is for the USTP to address systemic, wrongful conduct with enforcement actions that ensure independent verification and monitoring.

As another example, in July 2013, the Program announced the unsealing of a settlement with Citigroup Inc. (Citi) involving the protection of the personal information of nearly 150,000 consumers in 85 jurisdictions. Citi agreed to redact proofs of claim filed in bankruptcy cases nationwide in which the personal information, including Social Security numbers and birthdates,

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

[5] One of the national settlements involved a major law firm that the USTP alleged violated disclosure rules pertaining to conflicts of interest. The settlement provides for, among other things, an independent expert to review and approve the firm's relevant internal policies and practices.

of consumer debtors and third parties had not been properly redacted as required by the Bankruptcy Rules. Citi also agreed to notify all affected consumers and offer them one year of free credit monitoring. The settlement, which was originally approved by the court in March 2012, had been sealed to prevent potential wrongdoers from learning of the breach and seeking to victimize the affected consumers. 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 instances of disclosure were corrected. An independent auditor appointed under the settlement is reviewing Citi's redaction and replacement process and is expected to issue a certification of that process shortly.

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 bankruptcy requirements of 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 many cases, mortgage servicers file 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 was successful in obtaining court decisions against mortgage servicers, their attorneys, and their agents. Initially, the USTP had been satisfied when servicers corrected their mistakes in the case at bar; however, the mistakes continued and they were not confined by geographic district or by servicer. It was clear that there was a protracted, widespread, and national problem, so the USTP changed its strategy and took a broader approach.

Our earliest major achievement was obtaining nationwide relief against Countrywide Home Loans, Inc. and its servicing affiliate. After investigating Countrywide's improper default servicing practices and taking numerous actions, in 2010, the Program helped obtain a settlement that resolved a Federal Trade Commission complaint and the USTP's litigation in bankruptcy courts across the country. Through that settlement, Countrywide paid $108 million to compensate affected homeowners, including a large number of chapter 13 debtors.

Building on our success in Countrywide, the USTP undertook a concentrated effort that included the review of tens of thousands of claims, motions, and case files involving the nation's five largest mortgage servicers (i.e., Bank of America, Chase, Citigroup, Wells Fargo, and the former GMAC). The information gleaned from that effort allowed the Program to document systemic mortgage servicer misconduct, which proved to be a critical element in reaching the historic National Mortgage Settlement (NMS) announced by the Attorney General in early 2012. That landmark federal/state settlement with the five largest mortgage servicers required payment of $25 billion in assistance to homeowners and penalties, and adherence to a uniform and comprehensive set of mortgage servicing standards that address every type of servicer misconduct identified by the USTP in bankruptcy cases.

Importantly, the USTP remains actively engaged in the mortgage servicing area and has employed 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.

Although the banks have satisfied all of their financial obligations under the NMS, progress in complying with the new servicing standards has not been as complete. Those standards provide for, among other things, accuracy in billing, disclosure and reasonableness of default servicing fees, and prompt response to homeowners who seek loan modifications. In May 2014, the Monitor reported that the settling banks, collectively, had cured nine of ten previously reported failures under metrics that test their compliance with the mortgage servicing standards. The Monitor also reported, however, that one servicer had eight new metrics failures, including all of the bankruptcy specific metrics. In addition, the USTP has separately identified additional violations of bankruptcy standards that are not tested by the Monitor. The USTP and the Monitor have scheduled individual meetings with each settling servicer to request corrective action plans to cure these violations.

In addition to helping lead the NMS enforcement process, the USTP has taken a number of independent actions in cases around the country where the settling servicers violated their bankruptcy obligations under the Bankruptcy Code and Rules. Among the instances of non-compliance we have pursued are problems with improper signatures on payment notices filed in bankruptcy court under penalty of perjury attesting to the personal review of information contained in the notices. Insofar as robo-signing ignited a public furor over bank practices several years ago, it is difficult to fathom that any vestige of this problem still persists.

The second prong of our mortgage servicer enforcement efforts is aimed at addressing the conduct of banks that are not a party to the NMS. Recently, the USTP assisted in the settlement between Ocwen and the Consumer Financial Protection Bureau, state Attorneys General, and state banking regulators to address systemic misconduct by Ocwen with respect to their mortgage servicing practices. Under the settlement, Ocwen must pay $125 million to borrowers who lost their homes to foreclosure and provide $2 billion in first lien principal reductions. In addition, Ocwen must implement new servicing standards similar to those required under the NMS, with compliance overseen by the NMS Monitor. Although the Program was not a signatory to the settlement, we developed servicing standards to address bankruptcy specific issues that were incorporated into the settlement.

Further, in June, the Attorney General announced a federal-state agreement with SunTrust bank to settle allegations of wrong-doing in 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 was a critical player in the SunTrust investigation and negotiations on servicing. We amassed evidence of SunTrust practices, helped develop an additional metric to ensure customers' privacy protected information was not disclosed in bankruptcy filings, and will ensure that SunTrust implements all of 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 prior to the NMS. We are communicating with many of these entities not only about case-specific violations that must be remedied, but also systemic reforms of their internal operations. 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.

<u>Unsecured Creditor Violations</u>

In addition to our mortgage servicer enforcement efforts, the USTP also has undertaken a review of claims filed by unsecured creditors in bankruptcy. New Bankruptcy Rules that went into effect on December 1, 2012, set forth required disclosures in proofs of claim filed by credit card and other unsecured revolving debt holders. 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.

The USTP is taking a closer look at the conduct of high volume claims filers, including those who purchase credit card and other unsecured revolving debt. We have found that many creditors are complying with the Rules, but significant improvement is still required. We have successfully worked with one large debt buyer to conform its practices, are focusing on several high volume claims filers that are not complying with the Rules, and have produced a presentation for trustees and counsel that suggests effective means of evaluating claims for compliance and possible objection. This project already has led to significant improvements.

As we continue to review compliance by unsecured claimants, we are mindful that, as the only national enforcer of the Bankruptcy Rules, 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 2013, the Program made 2,074 bankruptcy and bankruptcy-related criminal referrals. While this represented a decline of 2.2 percent over fiscal year 2012, prior to that, the Program had experienced growth in the number of its referrals for seven consecutive years. The slight decline in fiscal year 2013 may be attributable to several factors, including fewer staff on board and reduced bankruptcy filings. Notwithstanding these factors, fiscal year 2013 referrals still exceeded the number of referrals made in fiscal year 2011.

The Program is an active member of the President's Financial Fraud Enforcement Task Force, and our offices participate in more than 90 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 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 examples demonstrate the wide array of prosecutions that result from USTP referrals, as well as the Program's commitment to addressing both debtor fraud and criminal violations by those who seek to exploit debtors.

- On March 4, 2014, in the District of New Jersey, a husband and wife each pleaded guilty to bankruptcy fraud by concealment of assets, bankruptcy fraud by false oaths, bankruptcy fraud by false declarations, and conspiracy to commit mail and wire fraud. The husband also 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 debtors are awaiting sentencing. As part of the plea agreement, the wife is required to pay $200,000 to the government at the time of sentencing. 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.

- After a seven-day trial, on April 17, 2013, a jury in the Northern District of Illinois found a defendant guilty on all counts for operating two rescue fraud schemes. He was sentenced on September 30, 2013, to 78 months incarceration and was ordered to pay restitution of more than $1.5 million. The defendant first operated a scheme that persuaded financially distressed homeowners to sell their homes to investors. He arranged for the purchase of the houses by the investors through fraudulent loan applications and filed false mortgages in his company's name to skim all the equity created during these sales. In a second scheme, the defendant promised distressed homeowners he could delay and stop foreclosures by filing bankruptcy cases in their names. He failed to reveal his role as a petition preparer on the bankruptcy petitions, used forged credit counseling certificates in filing the cases, and on at least one occasion forged the debtor's signature on the petition. The U.S. Trustee's Chicago office referred the case to law enforcement, a Regional Coordinator from the USTP's Office of Criminal Enforcement investigated and charged the case as a Special Assistant U.S. Attorney, and a Trial Attorney testified at trial.

- On February 25, 2014, in the Eastern District of Michigan, a bankruptcy petition preparer was sentenced to 46 months in prison on five counts of criminal contempt and fined $25,000. The preparer had been convicted after a jury trial on September 19, 2013. The evidence presented at trial showed that the preparer knowingly disobeyed five bankruptcy court orders permanently enjoining his activities, that he continued to act as a petition preparer, and that he manipulated some debtors into signing false documents and lying under oath about his involvement in their cases. Many of the defendant's victims either did not receive a bankruptcy discharge or had their cases dismissed as a result of the preparer's actions. A Trial Attorney from the Detroit office prosecuted the case as a Special Assistant U.S. Attorney, and another Trial Attorney and a Paralegal from the office testified at 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 role as a watchdog of the bankruptcy system 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 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 further 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 clearly demonstrates 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. 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 for certain expenses.

The USTP recently concluded the first phase of revisions to the fee guidelines. Beyond the goal of simply modernizing the guidelines, the Program undertook its review guided by a number of objectives, including to: (1) ensure that fee review is subject to client-driven market forces, accountability, and scrutiny; (2) enhance meaningful disclosure and transparency in billing practices; (3) decrease the administrative burden of review; (4) maintain the burden of proof on the fee proponent; and (5) increase public confidence in the integrity and soundness of the bankruptcy compensation process.

We started with revisions to the guidelines for attorneys in cases with assets and liabilities each of $50 million or more. We conducted extensive outreach to the bench and bar, twice published proposed guidelines for public comment, and conducted a public hearing. The final guidelines were promulgated in the Federal Register with an effective date of November 1, 2013. Generally, the final guidelines provide for a showing that rates charged reflect market rates outside of bankruptcy; the use of budgets and staffing plans; the disclosure of rate increases that occur during the representation; the submission of billing records in an open, searchable electronic format; and the use of fee examiners and “efficiency” counsel.

Once promulgated, the USTP worked diligently to ensure that practitioners were aware of and understood the expected disclosures and other provisions of the guidelines. To date, 61 cases have been filed to which the guidelines apply, and we are monitoring them closely. By and large, counsel in these cases has agreed to abide by the guidelines. In fact, it appears that at least some of the nation’s largest law firms have changed internal billing practices and processes to satisfy requirements of the guidelines. It is still too early, however, to judge the ultimate impact of the guidelines on bankruptcy practice in larger chapter 11 cases.

By law, the guidelines are a statement of the USTP’s enforcement policy and failure to comply will result in objections to fees or other court actions. The USTP will be prudent in applying the guidelines in a consistent manner throughout the country. Although our emphasis will be to promote compliance with the law and avoid unnecessary litigation, we will take enforcement actions where necessary, including appeals of adverse court decisions. The USTP believes strongly that the new guidelines can make the fee review process more efficient for the courts, United States Trustees, and interested parties. If everyone works together to implement the guidelines in a reasonable and consistent manner, public confidence in the integrity of the bankruptcy compensation process can be restored.

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 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 wrong-doing 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.[6] 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 wrong-doing. 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."[7] 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 often is more expensive discovery and litigation.

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[6] 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.

[7] *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).

When the court grants a motion to appoint a trustee or examiner, the USTP appoints one 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 high 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.[8]

One recent case of significance where the USTP's motion to appoint a trustee was granted and where we believe the appointment will be critical to advancing the case is that of *New England Compounding Pharmacy, Inc.*, No. 12-19882 (Bankr. D. Mass.) ("NECC"). In that case, the United States Trustee filed a motion to appoint a chapter 11 trustee based on gross mismanagement of the debtor leading to, among other things, the suspension of the debtor's license, the recall of all of its products, the closing of its facility, and the death of at least 39 people as well as the infection of more than 600 individuals with fungal meningitis from its tainted products. The motion also noted the pre-petition conduct of at least one member of the Board of Directors subject to potential criminal liability, as evidenced by his refusal to answer questions posed by a Congressional Committee. Although NECC tried to defeat the motion by hiring a CRO, following a hearing, the court agreed with the USTP and granted the motion to appoint a trustee. The trustee recently entered into a settlement with the owners of NECC and certain insurers to ensure a fund of $100 million will be available for the payment of claims of persons injured or killed by the company's tainted products.

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 in contravention of section 503(c), often disguising these retention awards as "performance bonuses" that are allowed under a more flexible standard.

[8] 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 . . .".)

In fiscal year 2013, the USTP formally challenged more than 40 proposed KERPS in court. Many USTP objections, however, 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 (*In re AMR Corp.*, 497 B.R. 690 (Bankr. S.D.N.Y. 2013)) perhaps provides our most noteworthy success in enforcing executive compensation restrictions. 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 its plan of reorganization, which had been approved by a vote of creditors. 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.

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 simply 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 years. Many of the appeals we participate in arise from enforcement actions in which we are a named party, 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 recently 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). 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. Simply put, the Bankruptcy Code establishes rules and standards that may not be ignored or re-written just because the debtor and its creditors agree to a different plan.

In another case, *Hills v. McDermott (In re Wicker)*, 702 F.3d 553 (6th Cir. 2012), the United States Court of Appeals for the Sixth Circuit affirmed a bankruptcy court order imposing civil penalties under 11 U.S.C. §§ 110(i), 110(l), and 526(c)(5)(B) against a non-lawyer who assisted a debtor in filing for bankruptcy. Mr. Hills had been permanently enjoined from providing any bankruptcy services because of prior misconduct. When, two years later, he unlawfully advised a debtor about her rights under the Bankruptcy Code and instructed her to lie under oath on numerous occasions in order to obfuscate his role in the case, the bankruptcy court sanctioned Mr. Hills. The circuit court agreed that the bankruptcy court correctly calculated the $6,500 penalty under section 110 and, in the first decision from a court of appeals on section 526(c)(5)(B), held that the $5,000 penalty under that section was an "appropriate civil penalty."

These and other cases illustrate the importance of the USTP's participation in appeals to promote 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 2013, more than one million 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 $10.6 billion last fiscal year, the Program's effectiveness in this area is critical.

One of the key issues the Program has addressed in its oversight of trustees relates to chapter 7 trustee banking. In August 2012, the USTP amended its uniform depository agreement with financial institutions holding estate funds to delete a long-standing prohibition against the imposition of fees.[9] Rather than impose an approved fee structure, however, the USTP allowed banks to charge fees in accordance with market principles. That decision has benefitted the bankruptcy system in two important ways: (1) the costs associated with banking and software applications became transparent (costs are no longer recouped simply by the bank paying a lower interest rate on trustee accounts); and (2) trustees can comparison shop vendors based on the price and extent of services. It appears that the USTP's market-based approach is working. The USTP's new policy of allowing banks to charge fees in no way interferes with the authority of bankruptcy courts to approve or disapprove bank fees in specific cases. The policy also does not relieve bankruptcy trustees from the responsibility to comply with locally prevailing case law, rules, and practice. Since adoption of the USTP policy allowing bank fees, at least 25 new banks, including many smaller regionally-based banks, and one new software vendor have entered the market to compete for trustee business.

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 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*, No. 13-1270, 2014 WL 1663329 (4th Cir. Apr. 28, 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 1.3 percent in fiscal year 2013. This is the first decrease since fiscal

[9] Pursuant to 11 U.S.C. § 345, the United States Trustee Program ensures that chapter 7 funds are deposited or invested in accordance with statutory standards. Chapter 7 trustees are permitted to deposit estate funds in any financial institution that enters into a uniform depository agreement with the United States Trustee. This agreement contains provisions, *inter alia*, protecting estate funds in accordance with section 345, and providing the United States Trustee with access to estate account information and the right to freeze account activity upon suspicion of financial impropriety by a trustee.

year 2010. While there is a wide variation 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. In March 2013, the Program published in the Federal Register its Final Rules for the approval of credit counseling and debtor education providers. The Final Rules address a number of key issues, particularly with respect to credit counseling agencies, including providing greater specificity on fees and fee waiver policies, counselor qualifications, what constitutes an independent board and management, requirements for bonding and safeguarding of client funds, and prohibitions against providing legal advice.

There currently are 166 approved credit counseling agencies and 252 approved debtor education providers. In addition to the annual application screening process, the Program conducts Quality of Service Reviews of approved agencies. This mechanism for post-approval monitoring permits the Program to interview provider staff, review records, and observe counseling sessions. These reviews have helped to strengthen the Program's efforts to ensure that debtors receive quality services from approved 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, internal evaluation, and other research 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 "material misstatements" are then filed with the court.

In fiscal year 2013, 25 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 2014 Appropriation and FY 2015 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. Approximately 58 percent of the Program's revenue is derived from quarterly fees in chapter 11 reorganization cases; 41 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 2013, the USTP System Fund held a balance of $215 million. Monies from the Fund are not available without appropriations from Congress.

The USTP's budget for fiscal year 2014 consists of an appropriation of $224.4 million, which represents an increase of six percent over fiscal year 2013. The USTP also is authorized to use carryover funds from prior year appropriations. The President's budget request for the Program for fiscal year 2015 totals $225.9 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 welcome budget increase this year has 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 and achievement of mission, 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 allow us to achieve our mission during a period of severe budget stringency. Our primary focus always has been to preserve staff positions by reducing other costs. We have achieved considerable savings by streamlining operations, 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.

In addition, in keeping with the Executive Branch's efforts to reduce the federal "physical footprint," after conducting a cost study to determine if it would be efficient and effective to combine offices that were close in proximity to one another and that had leases coming due, we

[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. Filings in USTP districts in fiscal year 2013 were slightly more than one million cases. Although some commentators had predicted an increase in filings in 2014, filings in the first two quarters of fiscal year 2014 are below filings for the same period in fiscal year 2013.

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.

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.