

Department of Justice
Executive Office for United States Trustees

Final Agency Action
Case No. 97-A-2

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

[REDACTED] seeks review by the Director of the Executive Office for United States Trustees of a decision by [REDACTED], United States Trustee for Region [REDACTED], to suspend the assignment of future cases to [REDACTED] and not reappoint him to the panel of chapter 7 trustees for the United States Bankruptcy Court for the Northern District of [REDACTED] when his current appointment expires.¹

Based upon the record before me,² I affirm the United States Trustee's suspension of case assignments to [REDACTED], but having studied and reviewed that record, I also modify the United States Trustee's decision not to reappoint [REDACTED] to the panel of chapter 7 trustees by substituting a two-year suspension and a requirement that [REDACTED] improve and install internal controls in the manner set forth in this decision.

I. Factual Background

[REDACTED] has been a trustee for 23 years, and a member of the chapter 7 panel of

¹ United States Trustees are Justice Department officials appointed by, and who serve at the pleasure of, the Attorney General. 28 U.S.C. 581(a) and (c). The Director of the Executive Office for United States Trustees is a Justice Department official who acts under authority delegated by the Attorney General. Panel trustees, such as [REDACTED], serve under appointments that have a term not to exceed one year.

² The record in this matter includes the United States Trustee's decision; [REDACTED]'s request for review; the United States Trustee's response; correspondence submitted by [REDACTED] to the Director; records that the parties produced at the request of the Director; documents that accompanied those various submissions; and [REDACTED]'s Application and Renewal Appointment — which were obtained from the Office of Review and Oversight.

trustees for the United States Bankruptcy Court for the Northern District of [REDACTED], [REDACTED] Division since its formation by the United States Trustee in 1987. On July 8, 1997, [REDACTED], United States Trustee for Region [REDACTED], suspended the assignment of future cases to [REDACTED] and informed him that he would not be reappointed to the panel of chapter 7 trustees when his current appointment expires. 28 U.S.C. 586(a)(1). [REDACTED] sought administrative review of those decisions by the Director of the Executive Office for United States Trustees in a letter that was undated, but received by the Executive Office for United States Trustees on July 21, 1997.

On September 9, 1997, the United States Trustee for Region [REDACTED] responded to [REDACTED]'s request for review in a letter addressed to the Director. The region's letter incorporated by reference its July 8th letter to [REDACTED] and was accompanied by a group of documents that included a number of [REDACTED]'s evaluations and Office of Inspector General ("OIG") audits. The September 9th letter reiterated the July 8th letter's finding that [REDACTED] had been suspended and his appointment to the panel of trustees would not be renewed because he had signed, presented, and cashed checks made out, and belonging to two creditors, the [REDACTED] Department of Revenue and the Internal Revenue Service, for the benefit of a debtor in a bankruptcy case he administered — In re [REDACTED] Lee, [REDACTED], and because the report he submitted to the bankruptcy court in that case inaccurately reported that the creditors had received those payments. The two checks aggregated approximately \$1,900. The two tax creditors were the only claimants in the A. Paris Lee case due to receive payment on their claims.

The September 9th letter justified suspension and non-renewal as sanctions for failing to safeguard the Lee accounts, failing to administer the Lee estate satisfactorily (because the two creditors were not paid due to [REDACTED]'s signing their checks), and failing to file an accurate final account (by inaccurately reflecting that the two creditors had been paid in a report filed with the bankruptcy court). There is no allegation in the record that [REDACTED] sought to steal this money or that he knowingly or intentionally took the funds. There is no indication in the record before me that [REDACTED]'s conduct in the Lee case replicates prior problems or is symptomatic of an inability to perform any of his trustee duties adequately. There is also no indication that [REDACTED] cannot or will not perform his trustee duties or that the United States Trustee has lost confidence in [REDACTED]'s ability or motivation to act as a competent trustee.

[REDACTED] acknowledges he negotiated the two creditors' checks but says he did so by mistake. He says his final accounting to the court incorrectly reflected that the creditors had been paid because the canceled checks were returned to his office, which caused he and his staff to presume incorrectly that the creditors had received and signed them.

But for the actions of the United States Trustee, the two creditors and the debtor almost certainly would have suffered losses. [REDACTED] failed to detect the misdirection of funds even when the canceled creditors' checks bearing his signature were returned to, received and

reviewed by his office. [REDACTED] did repay the money when Region [REDACTED] told him about the loss and he cooperated with Region [REDACTED]'s investigation. To our knowledge, to date, the Region's subsequent investigation has not uncovered any other instances of lost or misappropriated funds or creditors who failed to receive monies owing to them.

The facts regarding [REDACTED]'s negotiation of the creditors' checks are not in dispute — at least neither the region nor the trustee profess to disagree with the other party's factual statements. Based upon the uncontroverted evidence in the record, it appears that [REDACTED] received a stack of eight to ten checks from his secretary. Most were made payable to him for work he or his law firm had performed. Included in the stack were two checks made payable to creditors. [REDACTED] presumed all the checks were made payable to him.

At approximately the same time, [REDACTED] decided to purchase a mattress from a certain Brookstone store in [REDACTED]. He called Brookstone and obtained the precise cost, then took two checks from the stack, one of which was made payable to a creditor and the other to [REDACTED], stuck them in his shirt pocket and took them to the local bank. He handed them to the teller and asked for a cashier's check. The teller asked him to sign the back of the checks. He did so. Assertively, neither he nor the teller noted that one of the checks was payable to a creditor rather than to [REDACTED]. The bank gave [REDACTED] a cashiers check, which he used to purchase the mattress. The bank did not detect the discrepancy, presumably because [REDACTED]'s handwriting is a "scribble." Nor did [REDACTED] or his staff detect his personal endorsement when the canceled check was returned to his office. [REDACTED] maintains that he obtained and used a cashiers check because he was uncertain whether Brookstone, which was located in Atlanta, would accept his out of town check.

A short time later, [REDACTED] took other checks from the pile to deposit in his bank account. His wife filled out a deposit slip and gave him checks to sign. Again, he did not note that one was made out to a creditor. The bank also failed to detect the discrepancy as did [REDACTED] and his staff when the check was returned.

At the time the United States Trustee discovered the losses in the Lee case, the United States Trustee had sound reasons for believing that [REDACTED]'s misdirection of funds may have constituted theft. The transfers bear classic indicia of fraud. In particular, the use of one check to purchase a cashier's check rather than depositing it into [REDACTED]'s personal or office account should have and did cause the United States Trustee's office serious concern. The fact that [REDACTED] and his staff failed to identify his own signature after the checks bearing his endorsement were returned to his office and reviewed by them also constituted good reason to wonder whether [REDACTED] was engaging in intentional misconduct.

Indeed, [REDACTED]'s explanation that he failed to inspect two separate checks, but determined their amount, and endorsed and negotiated them in two separate instances without ever noticing that he was not the payee, is troubling. Clearly, there were many points at which [REDACTED] had the opportunity to discover these mistakes.

In order to determine whether [REDACTED] was acting intentionally, and in order to identify any other creditors who might have been injured by [REDACTED], the United States Trustee investigated this matter with the trustee's cooperation. The record discloses that the United States Trustee did not uncover any other misdirected funds or any other suspicious conduct. To the contrary, the record before me reflects these misappropriations appear to be isolated and seemingly innocent incidents. Accordingly, the United States Trustee does not base suspension or non-renewal of [REDACTED] upon theft or intentional diversion of funds. Instead, the United States Trustee's submissions conclude that suspension and non-renewal are justified because [REDACTED] inadvertently signed these checks and thereafter submitted a proposed final report that erroneously presumed the checks had been negotiated by the creditors.

II. Standard of Review

The United States Trustee took two actions in response to [REDACTED]'s negotiation of these checks. First, he suspended [REDACTED] from the panel of chapter 7 trustees for the United States Bankruptcy Court for the Northern District of [REDACTED] and, second, he informed [REDACTED] that he would not renew [REDACTED]'s appointment to that panel when his appointment expired.

In reviewing each of these actions, the Director will consider two factors:

1. Did the United States Trustee's decision constitute an appropriate exercise of discretion; and,
2. Was the United States Trustee's decision supported by the record.

I apply these factors because they are identical to those the Director must consider pursuant to a final Rule the Department of Justice recently promulgated to formalize the procedures to be used by the Director in reviewing decisions by United States Trustees to cease assigning future cases to panel and standing trustees. *Procedures for Suspension and Removal of Panel Trustees and Standing Trustees*, 62 Fed. Reg. 51740 (Oct. 2, 1997). The final Rule, which is codified at 28 C.F.R. 58.6, is not effective for suspension and non-renewal decisions, like [REDACTED]'s, that were made prior to November 3, 1997. 62 Fed. Reg. at 51740. Nevertheless, I apply the Rule's factors, which are set out in subsection 58.6(i), because they constitute a rational basis upon which to review the United States Trustee's decisions in this case.

III. Legal Analysis

A. The Suspension Decision

The record fully supports the United States Trustee's decision to suspend [REDACTED] upon discovery of the misdirected checks. That decision was an entirely appropriate exercise of the United States Trustee's discretion.

First, the circumstances underlying [REDACTED]'s misapplication of funds raised legitimate concerns that [REDACTED] might have been engaging in fraud or intentional misconduct. [REDACTED] took two checks, which were obviously drafted in the names of two creditors, and cashed them for his personal use. In one instance, a check was used to purchase a cashiers check rather than deposited into [REDACTED]'s account, which the United States Trustee reasonably could have concluded might have been done in an attempt to prevent detection of the misallocation or even realization of personal income. Thereafter, the canceled checks were returned to and received by [REDACTED]'s office. Even though they bore his endorsement rather than the endorsement of the legitimate creditors, both [REDACTED] and his staff purported to overlook that fact. Thereafter, [REDACTED] inaccurately represented to the bankruptcy court in his final report that he had paid these creditors when he had not.

Suspending [REDACTED] enabled the United States Trustee to prevent the risk of injury to other innocent creditors while the United States Trustee investigated the circumstances underlying [REDACTED]'s misapplication of funds. In this case, the record does not reflect that the United States Trustee determined that [REDACTED] had committed fraud. The United States Trustee's submissions to me do not contest [REDACTED]'s contention that the misdirections were mistakes. [REDACTED] provided an explanation to the United States Trustee for the mistakes.

Although the United States Trustee does not contend that the available evidence establishes fraud, this does not change the fact that the United States Trustee acted appropriately in suspending [REDACTED] while investigating [REDACTED]'s misallocation. Given that the initial evidence revealed obvious misallocation of funds by [REDACTED] for personal use, it was only prudent to suspend [REDACTED] pending a thorough investigation of [REDACTED]'s administration of the bankruptcy estates under his charge. A failure to suspend [REDACTED] could have proven disastrous. [REDACTED] held large amounts of money belonging to debtors and creditors. The United States Trustee, who acts as the administrator of the bankruptcy system and the protector of debtors and creditors, cannot allow a trustee who may have stolen money to continue receiving new case assignments. Suspension in such a circumstance is fully justified because it ensures that no further misallocations will occur, and no other debtors and creditors will be harmed, pending a thorough review of the trustee's conduct.

A suspension also was appropriate because [REDACTED]'s conduct constituted a negligent performance of his trustee duties. Trustees are fiduciaries, whom the law holds to very high standards of honesty and loyalty. See generally Woods v. City National Bank & Trust Co., 312 U.S. 262, 278 (1941); Mosser v. Darrow, 341 U.S. 26 (1951). See also Meinhard v. Salmon, 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928) (Cardozo, C.J.). Among a panel trustee's statutory duties are being accountable for all property received, 11 U.S.C. 704(2), and making a final report and filing a final account of the administration of the estate to the court, 11 U.S.C. 704(9). That the final report is to be accurate is without question. The trustee is the person who ensures that it is accurate.

The record clearly establishes that [REDACTED] negligently failed to fulfill those duties in his administration of the Lee estate. [REDACTED] violated his duty under section 704(2) of the Bankruptcy Code by failing to account for property received from the Lee estate because he appropriated for himself funds owed to two legitimate creditors, the Internal Revenue Service and the [REDACTED] Department of Revenue. [REDACTED] also violated his duty under section 704(9) because the final report he submitted to the court in the Lee case incorrectly stated these creditors had received payment when they had not.

[REDACTED]'s administration of the Lee estate reveals slovenly practices and a lack of adequate internal controls. By his own admission, [REDACTED]'s office commingled creditor and trustee checks in a stack on his desk. [REDACTED] freely admits he endorsed and negotiated checks without ascertaining whether they were drawn on his behalf. Moreover, it appears that his office did not have a log to reflect that a creditor check actually was sent to that creditor; if it did, [REDACTED] failed to use the log in these two instances. In addition, [REDACTED] admits he failed to adequately review the endorsement signatures on the two returned checks to verify that the payees received the checks. His staff also failed to review the checks adequately. Finally, [REDACTED] acknowledges that he certified to the bankruptcy court and the Lee creditors that the Internal Revenue Service and the [REDACTED] Department of Revenue had been paid when they had not.

Given these facts, I conclude that the United States Trustee's decision to suspend [REDACTED] constituted an appropriate exercise of discretion and is supported by the record. [REDACTED]'s lax performance of his duties reveals both a negligent attention to detail and a lack of adequate internal controls in the Lee case and in his office procedures. The United States Trustee acted appropriately in suspending [REDACTED] from the management of debtors' estates unless and until [REDACTED] rectified these inadequacies. The record supports the conclusion that [REDACTED] should not be allowed to act as a trustee, in pending or in future cases, without first rectifying these inadequacies.

B. The Non-renewal Decision

Chapter 7 panel trustees typically serve under one year appointments, which are subject to renewal. In this instance, the United States Trustee concluded that [REDACTED]'s two improper negotiations of creditor checks justified non-renewal. The United States Trustee does not contend these negotiations were intentional, does not contend other instances of similar conduct have occurred, and does not contend that [REDACTED] has a history of weak, poor, or inadequate performance of his trustee duties. The United States Trustee also does not contend that [REDACTED] lacks the ability to perform his trustee duties adequately or that the United States Trustee has lost faith in [REDACTED]'s ability to function as an effective trustee.

The record reveals that [REDACTED] had a clean record prior to this incident. His annual evaluations and OIG audits were positive.

Both his evaluations and his audits reported that [REDACTED] protects estate funds and handles them appropriately. Both concluded he adequately safeguards estate funds and his internal controls have been adequate.³ Neither disclosed any problems similar to the mistakes he made with the two checks in the Lee case.

The United States Trustee's evaluations of [REDACTED] regularly noted that [REDACTED] is a courteous and helpful trustee, respected by debtors, creditors, and the bar. The region repeatedly praised his interpersonal skills. One recent evaluation stressed that [REDACTED] is the only person in the district who had been able to interact successfully with a particularly difficult debtor.

His evaluations also found that [REDACTED] acts aggressively to recover assets for estates and he seeks to dismiss improperly filed cases. On the other hand, the earliest evaluation in the record noted that [REDACTED]'s knowledge of the Bankruptcy Code was merely adequate. It appears that [REDACTED] rectified this weakness because the region's subsequent reviews found that he is conversant with the Code.

The evaluations and audits do not reveal any pattern of weak or unsatisfactory performance. Both [REDACTED]'s evaluations and his audits identified areas of potential concern but none could be characterized as serious. The record reveals that [REDACTED] provided prompt written responses to the region in which he addressed those areas of concern. The record reveals that many of the potential problems ultimately were determined to be misunderstandings rather than problems. In others, [REDACTED] agreed to change his conduct or procedures. In those instances, Region [REDACTED] agreed in writing that [REDACTED]'s responses rectified the problems and "closed" the areas of concern.

Thus, the question in this case becomes whether it is an appropriate exercise of discretion to terminate [REDACTED], a trustee with many years of service, for a negligent administration of an estate when the record reflects an absence of any conclusion by the United States Trustee about the implications of [REDACTED]'s mismanagement of that single estate, or any other instances of inattentive or careless work, inadequate controls, inadequate performance, inaccurate final reports, or any other significant problems. Under those circumstances, I conclude that an appropriate exercise of discretion calls for:

1. A 24 month suspension effective from July 8, 1997, which would reinstate [REDACTED] to the panel of chapter 7 trustees on July 7, 1999; and,
2. A requirement that before that date [REDACTED]:

³ The OIG audits did question whether review solely by [REDACTED] and a secretary was adequate. Region [REDACTED] rejected this concern. It determined, several times, that such a level of review was entirely appropriate for a small trusteeship like [REDACTED]'s.

- (a) Put adequate internal controls in place to ensure that problems as have occurred do not occur in the future;
- (b) Obtain an opinion from a recognized accountant, who is approved by the United States Trustee and who has not provided services to [REDACTED] or his trusteeship, that those controls are adequate and manifest no material weaknesses; and,
- (c) Provide a written certification to the United States Trustee that [REDACTED] will follow those new procedures in every case he administers.

Among other controls, [REDACTED] must establish that he has created and will use a registry or log to keep track of all checks mailed by his trustee operation.

Non-renewal would have been an appropriate exercise of discretion if the record had revealed that [REDACTED] had any history of weak or inadequate or problematic performance of any of his trustee duties. Such a history would indicate that [REDACTED]'s negligent administration of the Lee case was symptomatic of broader problems. Similarly, termination could have been an appropriate remedy if the United States Trustee had determined that [REDACTED] could not adequately perform his trustee duties or [REDACTED]'s mismanagement of the Lee estate replicated prior problems or constituted evidence of an inability to function as an effective trustee.

Permanent cessation of new case assignments is not an appropriate remedy, however, for what the record reveals to be isolated negligent acts in the administration of one estate by a trustee who has served the debtors and creditors of the [REDACTED] division with no evidence of meaningful weaknesses or problems in performance of those duties. Given the absence in the record of any history of any sort of trustee problems and the absence of a specific determination by Region [REDACTED] that [REDACTED] cannot perform his duties adequately or that the United States Trustee has lost faith in his capacity to act as a trustee, it is appropriate to substitute suspension and implementation of internal controls in the place of non-renewal.

A two-year suspension serves two salutary purposes. It gives [REDACTED] sufficient opportunity to identify and implement adequate controls in a thoughtful and deliberate manner. It also should motivate [REDACTED] not to engage in such negligent conduct in the future because it provides an incentive to maintain and employ office procedures that are consistent with his position as a fiduciary.

The record justifies such a suspension. [REDACTED] admits he negligently administered the Lee estate. [REDACTED] negligently failed to segregate personal checks from creditor checks, he failed to maintain or use a disbursements registry, he failed to ascertain the payee on

two checks before endorsing them, he failed to adequately review canceled checks when they were returned to his office, he failed to ensure that the reports he submitted to the bankruptcy court were accurate, and he failed to discover and rectify his misfeasance in a timely fashion.

It must not be lost that [REDACTED]'s mismanagement of the Lee estate almost had significant consequences for debtor and creditor alike. But for the United States Trustee's thorough review of [REDACTED]'s operations, which promptly uncovered the improperly negotiated checks, [REDACTED]'s negligence would have resulted in two legitimate creditors failing to receive what was due under law. It also would have injured the debtor, Mr. Lee. Given that [REDACTED]'s report indicated that he had used Mr. Lee's funds to pay two of his creditors, Mr. Lee would have been justifiedly upset if the taxing authorities had subsequently come looking for payment, notwithstanding his apparent payment of those obligations. Thus, [REDACTED]'s negligence, although seemingly limited to his management of the Lee estate, was certainly serious and avoidable.

The bankruptcy system exists for the benefit of debtors and creditors. Trustees act within that system as service providers, who are to prudently and honestly divide debtors' limited assets among their legitimate creditors. The United States Trustee Program was created to ensure the effective administration of bankruptcy cases. The Program bears responsibility for protecting debtors and creditors from those trustees who fail to fulfill their obligations to the debtors and creditors whose interests they serve.

In this instance, [REDACTED] failed Mr. Lee. He failed the [REDACTED] Department of Revenue, and he failed the Internal Revenue Service. A two-year suspension provides a strong incentive for [REDACTED] not to similarly fail other debtors and creditors in other cases.

The record also justifies requiring [REDACTED] to implement adequate internal controls to ensure that such mistakes do not occur in the future. A thorough review by an independent accountant, and implementation of the accountant's recommendations for appropriate improvements, will minimize the risk that other creditors will encounter the problems that were experienced in [REDACTED]'s administration of the Lee estate.

The foregoing conclusions and decisions constitute final agency action in this matter.

Dated:

November 24, 1997

Joseph Patchan
Director
Executive Office for
United States Trustees