REMARKS BY

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I. INTRODUCTION

Thank you so much for the opportunity to participate in the annual ABI Bankruptcy Battleground West. Every ABI conference is chock full of interesting panels and one cannot leave without picking up worthwhile information on multiple topics of interest to insolvency professionals. But what I appreciate most at these conferences is the opportunity to talk informally with a cross-section of the profession and even, occasionally, to engage in a candid clash of views.

The United States Trustee Program (USTP or Program) is often a part of that clash of views. Institutionally, our job is to advocate for the most faithful reading of the Bankruptcy Code to ensure that policy preferences embodied in the statute are respected. Not surprisingly, and quite properly, private lawyers make arguments to advance the economic interests of their clients. In contrast, the USTP's role is fulfilled every time we stand up for the integrity of the Code and ensure that issues are properly teed up for court resolution.

As more reflective debate outside the courtroom at professional conferences and meetings sometimes suggests, what is good for the largest creditors in a case is not always good for bankruptcy practice or policy. More than anything, I was struck by that honest debate during the meetings of the ABI Commission to Study the Reform of Chapter 11. I participated as an *ex officio*, non-voting member of the Commission which was ably led by co-chairs Bob Keach and Al Togut. Although I do not necessarily share all of the views expressed in the Commission Report, it stands as a work of scholarship and provides vital reference material that I consult from time to time as we develop legal policy within the USTP.

Like many of you here today, the USTP is engaged in both consumer and chapter 11 practice. In fact, consumer matters – from appointing and overseeing private trustees to administering the means test to enforcing the law against debtors and creditors alike – take up the majority of time in almost all of our 93 field offices. Today, I will use my time to discuss not only some of our consumer activities, but also to describe our views on some emerging issues in chapter 11 practice.

II. USTP CONSUMER PRIORITIES

Aside from the mandatory statutory duties we carry out, enforcement against creditor violations has been the hallmark of our consumer practice for the past ten years. I think we have shown conclusively that the USTP understands all the words of the title of the 2005 reform law – the Bankruptcy Abuse Prevention *and Consumer Protection* Act of 2005.

A. Creditor Abuse Enforcement

In that vein, just last month, we announced the Program's 12th national settlement, which was the ninth one involving a major financial institution or creditor. These settlements have covered a range of violations, from the collection of discharged debt to improper disclosure of privacy protected information to misconduct by mortgage servicers. The settlements reflect a

litigation strategy to combat national systemic violations of the Bankruptcy Code and Rules with national solutions that hold creditors accountable and protect consumers.

That 12th settlement was between DOJ and its federal and state partners with HSBC Bank to resolve a panoply of mortgage loan origination and servicing claims. The USTP is a signatory to the $470 million agreement which also addressed violations of bankruptcy law that deprived distressed homeowners of some of their rights as they sought to save their homes in chapter 13. As I said in the Department's news release, even as the mortgage crisis recedes, the USTP will continue to combat mortgage servicer abuse of federal bankruptcy laws.

The HSBC settlement was just the latest in a series of settlements that we and our federal and state partners have reached with financial institutions since the historic $25 billion National Mortgage Settlement with the nation's five largest mortgage servicing institutions reached in 2012. Our review of the wide swath of bankruptcy cases has allowed the USTP to compile evidence that has been instrumental in forging these settlements.

Importantly, though, we also enter into national agreements that are confined solely to bankruptcy-specific violations and do not involve federal or state partners. For example, recently, we identified cases involving major national banks that, years after entering into the National Mortgage Settlement, were still failing to comply with bankruptcy law. In particular, some banks systematically failed to timely and accurately notify bankruptcy customers about changes in mortgage payments and to provide timely and accurate escrow analyses.

In March 2015, we announced a $50 million settlement with Chase and then, in November 2015, an $81.6 million settlement with Wells Fargo. The violations committed by these banks affected well over 100,000 customers seeking to save their homes through chapter 13 bankruptcy. In the case of Chase, the bank engaged in the robo-signing of tens of thousands of court documents. That conduct was especially egregious because it occurred several years after the scandal of robo-signing mortgage documents first broke onto the front pages of newspapers.

Even as we continue to investigate mortgage violations, we have launched investigations of the conduct of creditors who engage in the buying and selling of unsecured consumer claims. There may be more to report on this initiative at a later time.

Although we cannot begin to compete with the resources of the armies of legal professionals engaged by major creditors, we can leverage the resources of our 93 field offices to engage in discovery and other litigation around the country. We can amass representative evidence, detect patterns of violations, and then seek global agreements. Generally, these global resolutions are court-ordered and include monetary payments and other relief to borrowers, changes to internal practices, and long-term compliance monitoring by an independent party acceptable to the USTP and paid for by the creditor. All agreements can have variations, but we have developed what we consider to be an effective investigative strategy and formula for resolving broader systemic misconduct.

Our success as an enforcement agency is demonstrated not only by the settlements achieved to date, but by the reaction we receive from the creditor and financial communities which now seem more willing to accept the important role of the USTP as a regulator and enforcer in the consumer arena. We are pleased that some financial institutions have begun to come forward to admit to us operational flaws detected in their own internal compliance reviews. While we are prepared to litigate, this trend is a welcome outgrowth of the success of our enforcement efforts and may augur well for future consensual and efficient resolution of violations.

B. Poorly Performing Consumer Attorney Enforcement

Let me also give you a preview of a coming attraction on the consumer side of our practice. We are deeply concerned about the increase in poorly performing debtors' lawyers, especially those who are marketed as national law firms or who recruit clients via the Internet. Consumers in financial distress are at one of the most vulnerable times in their lives. Fortunately, the USTP has a lot of experience in dealing with those who seek to prey on that vulnerability – from our long-standing practice of seeking the disgorgement of fees from attorneys who fail their consumer clients to sanctions against non-attorney bankruptcy petition preparers who violate the law.

Perhaps as a result of the recent decline in filings, many good consumer lawyers may be leaving the practice and some unscrupulous attorneys may be attempting to take their place. We are reviewing our statutory options to deal with this problem on a more national basis. You will hear more about this initiative in the coming months.

III. CHAPTER 11 REORGANIZATION PRIORITIES

Allow me to shift gears just a bit and devote the rest of my time today to addressing three brewing issues in chapter 11 bankruptcy practice: professional compensation; corporate governance; and the need for predictability and transparency in bankruptcy proceedings.

A. Professional Compensation

1. USTP Fee Guidelines

On the professional compensation front, last year the Government Accountability Office (GAO) studied the USTP's Guidelines for Attorney Compensation in Large Chapter 11 Cases. Notably, in its final report, the GAO made no recommendations for changes in the content or implementation of the Guidelines.

I had a chance last fall to discuss our experience under the Guidelines as part of an ABI panel held in conjunction with the annual meeting of the National Conference of Bankruptcy Judges. The session turned into somewhat of a debate between Jamie Sprayregen and me. But, one thing I found particularly interesting was that all of the panelists agreed that professional firms had made efforts to comply with the Guidelines rather than provoke litigation. Our goal has been to encourage compliance over conflict.

The Guidelines have caused some disclosures that showed non-compliance with section 330. To date, those matters have been resolved by modification of the retention or fee application. For example, some firms that provided pre-petition fee discounts to their client had to amend their retention applications to provide the same discounts after the client filed for chapter 11 protection.

As we continue to review compliance, the USTP will increasingly expect firms to provide more complete and responsive information, especially regarding comparable billing data. As law firms put compliance systems into effect, USTP offices should more closely scrutinize, for example, explanations for charging higher hourly rates for bankruptcy engagements than non-bankruptcy work. We intentionally have avoided litigation, and hope to continue to do so. But, to avoid future objections to their fee applications, law firms will be expected to provide more substantive explanations of apparent rate disparities.

2. ***Asarco*** **and Its Progeny**

The major development on the professional compensation front this past year was the Supreme Court's decision in *Asarco v. Baker Botts*. In its decision, the Court took a stricter position than what the government urged and held that law firms cannot recover fees for defending objections to their fee applications in bankruptcy court. The high Court found that the American Rule governs. Each side pays its own legal fees absent express statutory or contractual exception.

Soon after the decision, we posted on our public Web site a series of questions and answers on this matter so that firms could proceed with full knowledge of our likely response. Among other things, we made it clear that we will not object to fees for reasonable time spent negotiating fee issues – so long as those negotiations occur before an objection is filed with the court.

The most significant issue that arose after *Asarco* was whether professional firms could enter into an agreement with the debtor or committee under section 328 for the payment of fees on fees. We made clear in our Q&A that we viewed such agreements as contrary to the Supreme Court ruling. The lead case to test that position was *Boomerang Tube* in the district of Delaware. About 25 other cases raising the same issue quickly piled up, nearly two-thirds of which are in Delaware. In February, Bankruptcy Judge Walrath ended the suspense. In an opinion largely tracking the analysis in our briefs, the court found that section 328 is not an exception to the American Rule that governs in section 330. In *Asarco*, the Supreme Court declared that fees on fees are not allowed. Therefore, the court may not approve section 328 agreements that violate that Rule.

Recently, Professor Stephen Lubben wrote a piece in *The New York Times* on the *Boomerang* decision. He suggested several possible effects of the decision, including that the decision may cause professionals to file more cases in the Southern District of New York in search of a more fee-friendly venue. He also said that professionals may simply raise their rates to make up for the prohibition on fees on fees. He speculated that there will be less transparency

in the fee award process because professionals will simply hide their compensation. Professor Lubben concludes that "the United States Trustee has won the battle, but the result may be that professional fees become even less transparent than they were before. . . ."

I am struck by how cynical Professor Lubben is about bankruptcy lawyers and the system. He appears to agree with the 18 out of 25 judges interviewed by the GAO in its study who believe that professional fees are a factor influencing venue selection. Professor Lubben incorrectly suggests that firms may raise their bankruptcy rates in response to *Asarco* regardless of their customary rates for non-bankruptcy engagements. This would violate the "comparability" standard in section 330, which Professor Lubben does not even mention. And, most alarmingly, he says that bankruptcy professionals will intentionally hide their real billing rates.

Let us hope Professor Lubben is wrong on all counts. Even though I do not acknowledge the validity of Professor Lubben's cynicism about the bankruptcy system, the USTP will be on the alert and we will object to any further attempts to eviscerate the Supreme Court's decision.

B. **Corporate Governance**

When I began my remarks, I noted the contributions of the ABI Commission on studying corporate governance under chapter 11. Among other recommendations, the Commission favored a statutory amendment to clarify that the burden of proof for ordering the appointment of a trustee under section 1104 is "preponderance of the evidence." The ABI Commission's position is consistent with the USTP's view that "preponderance" is the correct standard under current law. However, courts in many districts, including Delaware and the Southern District of New York, apply the higher "clear and convincing" standard.

The fact is that it is extraordinarily difficult to oust management in some districts. At one ABI event a few years ago, the late Harvey Miller acknowledged that more trustees should be appointed. I have discussed this problem before on innumerable panels and in articles. Without a viable option to replace management with an independent fiduciary, entrenched management or the most powerful lenders can control a case to the detriment of other stakeholders and interests.

We face many common arguments against the appointment of a trustee. Often, the debtor-in-possession (DIP) says it dismissed bad management right before or after the bankruptcy filing, so all is well. That argument has prevailed even in cases in which senior officers hand-picked by the discredited prior management are placed in control of the company. In other cases, the DIP asserts that a sale or other pivotal transaction is imminent. And in many cases, the DIP negotiates dubious loan covenants that imperil the financial condition of the company if entrenched management is replaced.

There are multiple examples I could provide. Here are just a few:

- In one case several years ago, a chief executive remained on the board for months after he was arrested for financial crimes and defrauding the company's creditors.

- In another case, a top corporate officer pled the Fifth Amendment in declining to respond to questions about the debtor's financial transactions, and still our trustee motion was denied because a CRO had just been hired and the debtor made the predictable assertion that a sale was imminent.

- And, a company whose chief executive was arrested, dismissed from the company, and then pled the Fifth Amendment defeated a motion for a trustee. In that case, a board member who was selected during the tenure of the chief executive was joined by two new directors, but only after the chapter 11 filing. Once again, the assertion that the debtor's fragile business would be imperiled if new management was installed prevailed over corporate governance arguments.

Not surprisingly, in many of these cases, the sale never materializes and there is further diminution of the estate. Incumbent management and their professionals stay in power longer and get paid handsomely for their services while creditors often suffer.

Despite the obstacles placed in our way, we will continue to move for the appointment of chapter 11 trustees where incumbent management committed or is tainted by egregious prior acts or misconduct.

C. **<u>Predictability and Transparency in Bankruptcy Proceedings</u>**

Finally, let me suggest to you that the understandable urgency of bankruptcy cases sometimes leads to processes that are inconsistent with the fundamental legal principles of predictability and transparency. The academic literature contains some thoughtful commentary about this issue that I believe deserves the attention of all of us who care about the overall health of the bankruptcy system.

Everyone agrees that transparency and predictability are the linchpins of the bankruptcy system. All legal systems require those attributes, but bankruptcy especially does because it is not a two-party litigation system. A bankruptcy case involves a multiplicity of interests. The Code carefully balances the rights of all parties and guarantees openness in court procedures.

A major reason for the creation of the USTP was to provide a neutral party without a financial interest in the outcome of a case to ensure consistent application of the law. Often, we are the only party to ask the court to "turn on the lights" so all stakeholders, including the public, can see what is transpiring and have access to critical information.

Some commentators have suggested that predictability and transparency in bankruptcy are yielding to other objectives such as putative efficiency and results-oriented procedures. In offering a few examples to consider, I am not suggesting that lawyers should be faulted for trying to gain an advantage for their clients or that courts do not have to take into account countervailing legal principles. I offer them merely to demonstrate that all bankruptcy professionals ought to be concerned whenever we compromise predictability and transparency.

1. Statutory Standards

When substantial rights and financial interests of creditors large and small are affected, then the clearer the standards and the law, the better for stakeholders –not only in the case at hand but in the larger marketplace as well. Predictability is good, both in law and in business.

The value of predictability and the need for flexibility are sometimes in conflict. Parties with an economic interest frequently call for more creative statutory construction to enhance their recoveries. It is not always easy for courts and parties to know precisely where the boundary lines are drawn. It is not always easy to determine when Congressional commands bump up against what appears to be the most economical result in the case at bar. And it is not always easy to know when efficiency of result in one case conflicts with fairness of result in future cases. The role of the USTP is to identify those possible conflicts, to advance the more faithful reading of the law, and to promote predictability.

There are many examples in which the USTP approach has met resistance. For example, in *Lehman Brothers*, we prevailed on appeal when creditors' committee members sought payment of their own legal fees even though Congress had amended the law specifically to clarify that they had no right to receive such fees for committee-related services. Similarly, in the *Boomerang* case, our reading of the Code prevailed over more creative interpretations of the law.

The Supreme Court is considering whether to review the Third Circuit's decision in *Jevic Holding Corporation*. In that case, the USTP lost on the issue of whether a settlement and structured dismissal may be used to distribute funds without following the Code's priority scheme. In *Jevic*, we sided with unpaid employees who held priority claims. I should note that the ABI Commission took a dim view of structured dismissals and suggested a statutory amendment to clarify the law.

There are, of course, many examples of cases without any USTP involvement in which statutory standards have been at issue. Many commentators point to a recent case involving the standard of "unfair discrimination" among classes of creditors. In that case, the bankruptcy court held that the statutory standard was met as long as the plan satisfied the judicial conscience. Regardless of whether it is right as a matter of law, such a test points out the tensions that may exist between the twin needs for flexibility in the case at bar and predictability of outcome in future cases.

2. Sealing and Other Practices

a. <u>Sealing Documents</u>

On the issue of transparency, anecdotal evidence from my colleagues in the USTP, as well as private practitioners, suggests that the number of motions to seal documents is increasing. The USTP interprets the sealing provisions of section 107 and Rule 9037 to set a very high bar for the court to deviate from the presumption in favor of open court records and proceedings.

For example, we often object to executive bonus motions that either do not provide or seek to seal information about the nature, amounts, and possible recipients of bonuses. While it might sometimes be appropriate to withhold the names of executives, it is not good practice to withhold other information that is needed to reasonably evaluate a bonus motion. Disclosure of the organizational level of an executive and the precise benchmarks that the executive must achieve to receive the bonus are essential for parties to make informed decisions on whether to object to the compensation.

We also disfavor sealing examiner reports. The exception here is a brief temporary seal so that parties, and the court if necessary, can resolve any objections to the public disclosure of privileged or otherwise protected information. In one well known case, though, the entire report was sealed for some period for the avowed purpose of incentivizing a settlement. My purpose here is not to question that court's determination, but to suggest that it raises broader policy issues for bankruptcy practice.

b. Sealing the Courtroom and Off-the-Record Chambers Conferences

Another example that illustrates the transparency issue is the sealing of courtrooms. Occasionally, courtrooms must be sealed. But it seems to the USTP that we have seen more of these requests recently than in the past. In numerous cases, chapter 11 debtors seek to discuss their financial condition in proceedings in which smaller creditors cannot participate. The USTP generally will oppose these requests.

In a few courts, parties seek off-the-record chambers conferences to discuss substantive matters. Traditionally, chambers conferences have been used to address administrative matters. In some cases, the conferences properly may be used for broader purposes. But USTP attorneys, and even practitioners, have complained to me that chambers conferences may involve more precise directions to parties, including the arguments and motions to be made, and are conducted without any transcription. I have been told that the overuse of chambers conferences has engendered confusion among litigants in certain cases. There may be reasons to keep certain discussions off the public record, but all of us ought to consider the appropriate circumstances justifying such conferences.

3. **Mediation**

Another practice we are seeing increasingly is mediation. Mediation is universally acclaimed as a means of reducing costs and producing speedier outcomes. Certainly, it can be a constructive tool in a judge's toolbox to bring about efficient resolution. And, encouraging the consensual resolution of issues is sound public policy. But mediation should not be used at the expense of due process, protecting the rights of all stakeholders, and ensuring public confidence in public proceedings.

Given the nature of our role as an administrator, regulator, and enforcement agency, the USTP is not frequently involved in mediation. So, we seldom opine in court on this issue. In an upcoming article in the *Yale Journal on Regulation*, Professor Melissa Jacoby raises the important question of whether mediation has been used to excess. If mediation does more than

facilitate negotiations, and if it is used to pressure parties to reach a settlement on terms favored by the mediators, then most would agree that it has gone too far and denies due process.

Perhaps we should consider whether mediation by a judge sitting in the same district where a case is being heard may, under certain circumstances, put undue pressure on professionals who may have to face the mediator-judge in other cases involving other clients. Perhaps too we should consider whether some uses of mediation may interfere with the mandate of access to court proceedings by all parties and the public. I am not taking an absolutist position on these questions, but raise them as worthy of debate and consideration within the bankruptcy community.

4. **Post-Confirmation Trusts**

Finally, the ABI Commission noted that transparency has been compromised by the increasing use of post-confirmation trusts to resolve core economic issues affecting both debtor and creditor rights. These post-confirmation trusts often are thinly described in the disclosure statement and plan of reorganization. The USTP should take an active role in objecting to disclosure statements that contain inadequate information about the corporate governance of trusts.

The Commission made several recommendations, including more detailed disclosure of the corporate governance of the trusts, standards for resolving claims and distributing proceeds, and mechanisms for creditors to object to trust administration and seek court relief. We believe these are valid recommendations and that such disclosures should be required under existing law.

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I could go on and on with examples of practices that may be reducing predictability and transparency. None of this, though, is to say that the courts do not have discretion, that chambers conferences are not a valuable vehicle for moving cases along, that sealing documents according to statutory criteria is not sometimes essential, that mediation is not immensely valuable and conserves resources, or that post-confirmation trusts are not often essential. My point is only that all professionals who are committed to advancing the ideals of the bankruptcy system should carefully consider whether we are losing predictability and transparency. There are always competing considerations, but we should be skeptical whenever the preeminent goals of predictability and transparency yield to other considerations.

IV. **CONCLUSION**

I appreciate your time today. I have tried to convey some major USTP priorities and to raise some issues about chapter 11 practice for future debate. I commend you for the important work you do for your clients and for the bankruptcy system. You are important participants who are essential for a well-functioning national economy. Thank you for your service and for your attention this afternoon.

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