

STATEMENT OF  
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UNITED STATES DEPARTMENT OF JUSTICE

BEFORE THE

SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW  
COMMITTEE ON THE JUDICIARY  
UNITED STATES HOUSE OF REPRESENTATIVES

July 26, 2005

Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to appear before you to discuss the United States Trustee Program's plans for implementing the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. In describing the changes that are underway, it is important to provide an update on the ongoing work of the Program, including information on our fiscal year 2006 budget request and the resources needed to carry out our new responsibilities.

The United States Trustee Program is the component of the Department of Justice whose mission it is to promote the integrity and efficiency of the bankruptcy system by enforcing bankruptcy laws, providing oversight of private trustees, and maintaining operational excellence. Not only do we carry out numerous administrative, regulatory, and litigation responsibilities under title 11 of the United States Code (the Bankruptcy Code) and title 28 of the United States Code, but in the past four years, we have launched significant enforcement efforts to combat fraud and abuse in the system. Using a balanced approach, we have addressed debtor wrongdoing and sought protections for consumer debtors victimized by attorneys or others in a bankruptcy case. We have made great progress in accomplishing our goals, and our efforts provide a helpful springboard as we launch new initiatives to implement and enforce bankruptcy reform.

**Implementing and Enforcing Bankruptcy Reform**

The successful implementation and enforcement of bankruptcy reform is the most pressing responsibility now facing the United States Trustee Program. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 provides the Program with new tools to enhance the integrity and efficiency of the bankruptcy system for the benefit of all parties and in the public interest. In cooperation with other governmental bodies with responsibilities under the new law, especially the federal court system, we will achieve the policy objectives of the new statute.

All Program personnel are currently engaged in a sprint culminating on October 17, 2005, when most provisions of the reform law become effective. A major effort is underway to develop the policies, protocols, associated technology systems or data systems/processes, and staffing patterns that will allow us to carry out our new responsibilities. Building upon work performed four years ago when reform seemed on the verge of passage, the past few months have been spent in a multi-faceted campaign to prepare for implementation. We have met with staff at all levels,

and we can report a high level of energy, professionalism, and commitment to getting the job done. We are in the midst of an unprecedented training effort that will reach nearly 800 employees and provide them with the necessary information and systems to effectively carry out and enforce our new responsibilities.

There are five major areas of bankruptcy reform in which the U.S. Trustee Program will play a key role. Program staff from both headquarters and the field are preparing our policies, procedures, and processes to implement the Act. A brief description of these areas follows.

- *Means Testing:* Congress prescribed new objective criteria for determining an individual debtor's eligibility for bankruptcy relief. Under the new statute, the United States Trustee Program must review petitions of debtors seeking chapter 7 relief to ensure they satisfy a means test and must file motions against those who have the ability to repay all or part of their debt. The new law sets forth a means test formula and specific requirements for the United States Trustee. The Program has worked closely with the Advisory Committee on Bankruptcy Rules of the Judicial Conference to develop model forms, which may be adopted by the courts in August, for use by debtors that will provide financial information required to determine their eligibility for chapter 7 relief.
  
- *Credit Counseling and Debtor Education:* The new law seeks to ensure that debtors are made aware of their options prior to filing bankruptcy and are equipped with more knowledge to avoid future financial difficulties before they exit bankruptcy. As a condition of eligibility to file a bankruptcy petition, debtors must file a certificate from an approved credit counselor demonstrating that they received credit counseling. As a condition of receiving a discharge, debtors must complete an approved personal financial management course. Under the law, the United States Trustee must approve eligible credit counseling agencies and debtor education courses. The Program must also develop procedures to ensure compliance by debtors. These provisions hold much promise for ensuring that debtors are well informed about their decision to file bankruptcy and better equipped to avoid future financial difficulties. The agency approval process, however, will present many technical, administrative, and legal challenges for the Program. As recently reported by a Congressional Committee, and evidenced by enforcement actions taken by the Internal Revenue Service and Federal Trade Commission, some agencies within the credit counseling industry have engaged in abusive practices and other wrongful behavior. To the maximum extent possible, the Program must screen out unscrupulous counselors who would defraud individuals to the detriment of debtors and creditors. It will be a major challenge for the Program to review the large volume of applications it expects to receive and to approve only those who conscientiously and competently provide financial management advice and assistance to vulnerable debtors. The application forms for approval as a credit counselor or a debtor educator are posted on the Program's Internet site, and applications are being accepted.

- *Debtor Audits:* It is estimated that as a result of the Act, the United States Trustees will audit approximately 7,500 chapters 7 and 13 cases in the first year after the debtor audit provisions become effective. One of every 250 cases will be selected for random audit. In addition, the Program will target a sample of cases for audit based upon criteria prescribed in the law. This requirement is not effective until 18 months after enactment, but the data collection, procurement of contract auditors, and other preparatory work has commenced. The United States Trustee is currently reviewing the coverage of the audits to establish the necessary scope of the work.
- *Small Business Chapter 11 Cases:* The new law will subject businesses with debts of not more than \$2 million to new requirements designed to expedite their progress through bankruptcy, and to dismiss or convert unsuccessful cases more quickly before assets are dissipated. Many of the duties imposed on the United States Trustee (e.g., initial debtor interviews and appropriate site visits) codify existing best practices. Nonetheless, the Program will need to devote additional attention to this area under the reform law.
- *Reports, Data, and Automation:* The United States Trustee Program is required to perform important studies on the effectiveness of the new law, such as reviewing the applicability of Internal Revenue Service expense standards in the conduct of means testing and studying the effectiveness of new financial education training programs. Moreover, the Program will need to develop new databases and collect additional types of data to perform these studies and to carry out statutory requirements. The standardization and automation of forms is critical to effective implementation, and accurate and timely case processing will benefit debtors and creditors alike. If "smart" forms (i.e., data-enabled forms) are fully implemented by the courts and the Program before the October 17, 2005, effective date, this innovation will expedite case analysis for means testing and will dramatically improve data collection by the Program and the courts. The United States Trustee Program is working closely with the court system to develop new forms and "smart" forms which may be issued by the Judicial Conference.

In addition to these major areas of activity, there are a number of other discrete provisions of the amended Bankruptcy Code requiring action by the United States Trustee Program, such as the appointment of health care and privacy ombudsmen and the standardization of forms. The Executive Office will issue policy and guidance wherever possible to ensure consistency in practice so that the new law is enforced uniformly and fairly in all districts where we have jurisdiction.

I believe that the United States Trustee Program, through its work over the past few years, has laid a solid foundation on which to successfully implement bankruptcy reform. As the discussion below will demonstrate, the significant progress we have made in several key areas will be further enhanced by the reform law, and has positioned the Program to assume our new responsibilities and satisfy our mandate.

## Update on Major Activities of the United States Trustee Program

### Civil Enforcement

Combating fraud and abuse in the bankruptcy system has been and continues to be a key priority of the United States Trustee Program. The cornerstone of this effort has been the National Civil Enforcement Initiative which was designed: (1) to root out and remedy debtor fraud and abuse by taking such actions as seeking dismissal for “substantial abuse” under § 707(b) and denial of discharge for the concealment of assets under § 727; and (2) to provide consumer protection by seeking the disgorgement of fees, fines, or other remedies against attorneys, bankruptcy petition preparers, and others who prey upon those in financial distress.

Although the ultimate goal of enhancing the integrity of the bankruptcy system does not easily lend itself to a quantitative measure, we have instituted and refined new systems to monitor the results of our work. In fiscal year 2004, the Program took over 52,400 civil enforcement and other actions that yielded more than \$520 million in debts not discharged, penalties, and other monetary remedies. The number of actions and their dollar outcomes have grown impressively since we began tracking our efforts, and I believe our work in many jurisdictions has markedly improved compliance with the law. Through training and more refined guidance, we have focused on producing work products of the highest quality and have encouraged the strategic selection of cases to achieve the maximum deterrent effect. As a result of the diligence and expertise of Program attorneys, financial analysts, and other staff, we are filing more complex adversary actions that tend to produce the greatest financial benefit to the system.

Some recent examples of successful civil enforcement actions brought by U.S. Trustee offices that cover a variety of misconduct include the following.

*Substantial Abuse:* In the District of Utah, the chapter 7 discharge of \$606,756 in unsecured debt was prevented when a real estate agent agreed to dismissal of his case on the eve of a hearing on a substantial abuse motion filed by the U.S. Trustee. The debtor, who had an \$800,000 home and gross annual income ranging from \$130,000 to \$300,000, wanted to retain a Hummer vehicle with a \$900 monthly payment. He had paid no withholding tax for four years. The U.S. Trustee’s review of his personal and business accounts did not support his claimed business budget and revealed wasteful extravagance.

*False Statements and Concealment of Assets:* In the District of South Carolina, the Bankruptcy Court entered a judgment to prevent the chapter 7 discharge of almost \$500,000 in unsecured debt, about half of which was credit card debt. The debtor had failed to disclose that, four months before filing bankruptcy, he pre-paid nearly \$20,000 on a two-year lease of a 2004 Chrysler vehicle. He also failed to disclose transfers of a condominium in New York, a 2001 Chrysler, and two personal water craft, all of which were sold within five months of filing for a net profit of over \$50,000. The debtor also gave false testimony at his section 341 meeting and failed to make numerous other material disclosures in his schedules and statements.

*Bankruptcy Petition Preparers:* In the District of Arizona, on motion of the United States Trustee, the bankruptcy court fined father and son bankruptcy petition preparers more than \$2.1 million for 3,657 violations of § 110 and civil contempt. The preparers' violations included abandoning their clients; collecting filing fees from clients and then forging their signatures on applications to pay filing fees in installments; causing the dismissal of clients' cases through failure to timely prepare documents; and filing documents without client review. In addition to the civil penalties, a grand jury in Maricopa County, Arizona, indicted the preparers on 20 felony counts of theft and one count of fraudulent schemes and artifices. The father ultimately pleaded guilty to theft and was sentenced to three and a half years in state prison; the son pleaded guilty to attempted illegal enterprise and was sentenced to six months in jail and three years probation, and ordered to pay restitution. The U.S. Trustee referred the criminal matter to the county attorney and provided information leading to the arrest of the preparers.

*Creditor Misconduct:* The Program's National Civil Enforcement Coordinator issued a letter demanding that a law firm cease filing claims on behalf of a creditor based upon documentation that, on its face, evidenced no relationship to the individual(s) in whose case it was filed. United States Trustees from three regions had reported the pattern of abuse. The law firm responded by acknowledging that claims were filed in error in numerous cases, which they purported to be as a result of a data migration issue; that they were withdrawing the claims; and that the creditor had modified its business practices to require a manual review of each proof of claim prior to filing.

*Attorney Misconduct:* In the Central District of California, a lawyer who had filed over 1,200 bankruptcy petitions for clients in one year agreed to, among other things, a voluntary suspension from practicing bankruptcy law for 30 months. The bankruptcy court had previously found that the lawyer's non-attorney husband had provided legal advice to a debtor, and concluded that the lawyer had aided in the unauthorized practice of law by failing to adequately supervise the work of non-attorneys. The court also found that the lawyer and other attorneys in her office had failed to provide legal services to a debtor or meet with the debtor before filing a petition. The court referred the lawyer to the Discipline Panel for the Bankruptcy Court for the Central District of California, which approved the agreement. The U.S. Trustee's Los Angeles office assisted in the investigation of the matter.

As an enhancement to the Program's civil enforcement efforts, a bankruptcy prevention component has been added. We have partnered with the Credit Abuse Resistance Education (CARE) program developed by Chief Bankruptcy Judge John C. Ninfo II of the Western District of New York, as well as other financial literacy projects, to deliver educational programs to high schools and community groups across the country. We also developed and have distributed more than 20,000 brochures that provide information on a variety of financial literacy resources. Finally, the United States Trustee Program has encouraged chapter 13 trustees to provide financial management instruction to their debtors, and there are a number of trustees across the country who offer programs to debtors in their districts.

## Criminal Enforcement

Criminal enforcement continues to be a key component of the Program's strategy to combat bankruptcy fraud and abuse. By statute, a United States Trustee must refer suspected criminal activity to the United States Attorney for prosecution. Program staff identify instances of suspected criminal behavior and assist United States Attorneys in the prosecution of such cases. To focus our efforts, two years ago, the Program established a Criminal Enforcement Unit headed by a veteran prosecutor working out of headquarters in Washington, DC. The Unit is assisted by a career Assistant U.S. Trustee who has been involved with the Program's criminal enforcement efforts for many years, three career Federal prosecutors in the field, and another headquarters-based attorney.

The Criminal Enforcement Unit has significantly strengthened our ability to detect, refer, and assist in the prosecution of criminal violations. The Unit has provided extensive training to Program staff, private trustees, and federal and local law enforcement personnel in courses at the National Advocacy Center, the Federal Law Enforcement Training Center, the Inspectors General Criminal Academy, and scores of district offices. In the past 12 months, staff of the Unit have participated in over 50 programs, including training for special agents of the FBI and Internal Revenue Service; Inspectors General at the Department of Housing and Urban Development, Social Security Administration, and Environmental Protection Agency; the United States Postal Inspection Service; and Immigration and Customs Enforcement.

On October 28, 2004, the Program announced the filing of 17 criminal cases against 21 defendants in 11 districts. Dubbed "Operation Silver Screen," the prosecutions demonstrated the breadth of bankruptcy crime enforcement actions taken by the Justice Department. The cases collectively involved the concealment of more than \$7 million in assets. The alleged violations were committed by a variety of debtors, including an attorney, a certified public accountant, and a police officer. The criminal conduct charged included the use of false social security numbers, identity theft, the submission of forged court documents, false statements, and other fraudulent acts.

The following are examples of the Program's work in the criminal area.

- A former trading and investment firm executive was indicted in the Northern District of Illinois on multiple counts of bankruptcy fraud, wire fraud, and money laundering, and one count of using a fire to commit a felony. The indictment alleged that, in 2002, the defendant intentionally set fire to his residence to obtain insurance money and made it appear as if the fire was set by his elderly mother, who died in the fire. The indictment also alleged that the defendant concealed significant assets, including an off-shore account containing more than \$300,000, when he filed bankruptcy in 2003. The Program's Regional Criminal Coordinator in Chicago is the lead prosecutor on this case.
- A husband and wife who operated a credit card bust-out scheme that resulted in \$11 million in losses were sentenced in the Central District of California. A credit card bust-out is a criminal scheme used by individuals to fraudulently obtain

numerous credit cards in their own names or in the names of businesses that they control, incur a large amount of debt over a short period of time with no intention of paying it back, use the credit cards to obtain cash advances and a variety of goods, and then file bankruptcy to receive a discharge of the debt incurred as a result of the scheme. The husband was sentenced to 41 months in prison and ordered to pay \$4.9 million in restitution; the wife was sentenced to 12 months in prison and ordered to pay nearly \$500,000 in restitution. The couple provided false information when they sought millions of dollars in credit for their business from credit card companies, banks, and high-end national retail stores. Once they obtained credit, the couple accumulated large balances with no intent to repay. They spent more than \$350,000 of the fraud proceeds on luxury items such as watches, diamonds, and designer clothing. When the bust-out was complete, the couple filed bankruptcy for themselves and the company to avoid paying the debts. Related to this case, two other individuals pleaded guilty to conspiracy charges for participating in the bust-out scheme, as well as the schemes of three other companies that declared bankruptcy after millions of dollars worth of merchandise was purchased on credit. The Regional Criminal Coordinator in Los Angeles assisted on the case.

In early 2004, the Program developed and piloted a completely revamped automated data collection system to track the Program's criminal enforcement work. Implemented nationwide on October 1, 2004, the Criminal Enforcement Tracking System allows the Program to track the number of criminal referrals and analyze the types of referred violations. Over time, this will provide a more accurate measure of criminal enforcement actions, assist in trend identification, and permit management improvements through focused resource allocation.

#### Chapter 11 Practice and Other Litigation

Last year, the Program participated in more than 10,000 chapter 11 reorganization cases, ranging from small, single proprietorship cases to giant, multinational conglomerates. Without substituting our business judgment for that of parties with a monetary stake in a case, the Program focuses its attention to such areas as the appointment of official committees of creditors and equity holders; the retention of professionals under § 327; professional fee approvals under §§ 326, 330 and 331; and the adequacy of disclosure statements, especially in smaller cases. Issues regarding the retention and compensation of professionals are litigated not only in chapter 11, but in chapter 7 and chapter 13 cases as well. The following discussion addresses some examples of our work in these areas.

- Joining the Second, Seventh and Ninth Circuits, the United States Court of Appeals for the Sixth Circuit agreed with the United States Trustee Program that a debtor's attorney is not entitled to collect on unpaid pre-petition attorney fees because such fees are discharged under section 727(b) of the Bankruptcy Code. At the time of the filing of the bankruptcy case, the debtor owed her attorney unpaid fees for pre-petition work. Debtor's counsel argued he was entitled to collect on this debt based on 11 U.S.C. § 329. The United States Trustee opposed debtor's counsel on the grounds that section 329 constitutes a disclosure provision

that requires all attorneys for debtors to disclose the fees they have charged and will charge their clients and does not give the attorneys any rights to fees beyond the express provisions of the Bankruptcy Code.

- Issues pertaining to the retention of professionals in chapter 11 cases under section 327 continue to receive the attention of the Program. In *New Weathervane Retail Corporation*, a case pending in the District of Delaware, counsel for the debtor agreed to withdraw from its representation after the United States Trustee filed an objection challenging its retention for lack of disinterestedness and actual conflicts of interest. The firm also agreed not to seek approximately \$160,000 in the value of services provided to the debtor or to seek reimbursement of its out-of-pocket expenses. The law firm regularly represented the largest shareholder, which held 62 percent of the debtor's equity securities and became a secured creditor within two months preceding the filing of the bankruptcy petition. In addition, the law firm simultaneously represented multiple parties, including the largest shareholder and the debtor's CEO, in a proposed merger transaction that terminated on the eve of bankruptcy. The firm failed to disclose much of this information in its application for retention, but other parties in the case brought some of this information to the attention of the United States Trustee.
- The Program also continues to monitor professional fees sought under sections 330 and 331 in large chapter 11 cases. One example involves a case where a financial advisor agreed to an \$800,000 reduction of fees requested in its final compensation application after objections were filed by the U.S. Trustee, the unsecured creditors' committee, and an individual creditor. The financial advisor had been retained by the chapter 11 debtors, *Homeland Holding Corporation* and *Homeland Stores*. The U.S. Trustee argued that a requested "sale fee" was not earned and the requested compensation exceeded a reasonable amount compared to the benefit received by the estates from the financial advisor's services.

### Trustee Oversight

United States Trustees are responsible for appointing and supervising about 1,400 private trustees who administer bankruptcy estates and distribute dividends to creditors. The Program trains trustees and evaluates their overall performance, reviews their financial operations, ensures the effective administration of estate assets, and intervenes to investigate and recover the loss of estate assets when embezzlement, mismanagement, or other improper activity is suspected or alleged.

The Program works closely with the various bankruptcy trustee associations to improve case administration and to address other matters of mutual concern and interest. These efforts have resulted in a marked improvement in the degree of cooperation and collegiality between the Program and the private bankruptcy trustees. Progress on this front is evident in a number of initiatives over the past few years, as exemplified by the following examples.



- Program staff and private trustees continue to work together successfully to develop critical management reports and financial reporting and record keeping procedures that reduce the administrative burden on the trustees while providing the Program the information it needs to fulfill its oversight duties. New annual reports, monthly reports, and budget forms have been adopted for standing trustees which have incorporated automation improvements to save time, reduce duplication of effort, and increase the usefulness of the reports.
- A new information technology security initiative has been developed for chapter 13 trustees, and other measures have been taken to assist trustees in adapting to the electronic case filing environment and to otherwise take advantage of technology.
- The Program developed policy to assist the trustees in adapting to the requirements of Check 21, the federal law enabling banks to process checks electronically.

### Performance-Based Management

In addition to the substantive areas of activity addressed above, the United States Trustee Program has also made progress in programmatic and management areas. In fiscal year 2004, 615 participants attended 13 training courses sponsored by the Program's National Bankruptcy Training Institute (NBTI) of the Justice Department's National Advocacy Center in South Carolina. Over the past four years, the NBTI has hosted over 2,400 participants from within and outside the Program at 55 training courses ranging from one day to one week.

Moreover, the Program issued its new Strategic Plan for 2005 to 2010. The Strategic Plan links with the Department of Justice's Strategic Plan, incorporates elements of the President's Management Agenda and the Attorney General's Management Initiatives, and reinforces the statutory Government Performance and Results Act strategic planning and results measurement requirements.

### **Fiscal Year 2006 Budget Request**

Last year, the Program oversaw 1.5 million bankruptcy cases filed in 88 judicial districts in 48 states, the U.S. Virgin Islands, the Territory of Guam, and the Commonwealths of Puerto Rico and the Northern Mariana Islands. (The Program does not have jurisdiction in Alabama and North Carolina.) To handle its work, the Program is structured with an Executive Office in Washington, DC; United States Trustees in 21 regions whose geographic jurisdiction is set in statute; and 95 field offices that cover 150 court sites and about 280 administrative meeting locations. The Program employs approximately 1,100 staff comprised of attorneys, financial analysts, and support staff, and more than 92 percent of its employees are located in the field.

The USTP is entirely self-funded through user fees paid by bankruptcy debtors. All revenues are deposited into the United States Trustee System Fund. The Program may expend funds as appropriated by Congress. Historically, 60 percent of the Program's funding is derived from quarterly fees paid in chapter 11 reorganization cases. The balance of the funds comes from

filing fees paid in chapters 7, 11, 12, and 13 cases, as well as interest earnings and other miscellaneous revenue. With the changes to the filing fees enacted by the Bankruptcy Abuse Prevention and Consumer Protection Act, as amended by the FY 2005 Emergency Supplemental Appropriations Act, the historic balance of revenue from quarterly fees and filing fees will change somewhat.

For fiscal year 2006, the President's budget requests \$222,577,000 for the Program to cover 1,519 permanent positions (388 attorneys) and 1,351 work years. The request reflects the budget amendment transmitted to the Congress by the Office of Management and Budget on June 13, 2005, and includes \$11.8 million in adjustments for rent, pay, and other mandatory increases necessary to maintain a current services base level, as well as \$37,175,000, 321 positions (123 attorneys), and 161 work years to implement the Bankruptcy Abuse Prevention and Consumer Protection Act. The Act contemplated growth by the Program to implement bankruptcy reform, raising filing fees and allocating \$241 million over five years to the United States Trustee Program. We appreciate your consideration of the FY 2006 budget request to ensure adequate funding for the Program.

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Over the past year, the United States Trustee Program has made substantial contributions to the efficiency and effectiveness of the bankruptcy system. Among other things, we have strengthened and expanded our civil and criminal enforcement efforts, as well as devoted attention to bankruptcy prevention. With adequate resources as contemplated by the new bankruptcy reform statute, the Program looks forward to successfully implementing the new law. We are in the midst of a six month effort to develop implementation systems and enforcement strategies, and we are confident that we will get the job done.

Thank you for the opportunity to testify on the recent major activities of the United States Trustee Program. I am pleased to answer any questions from the Subcommittee.