

REMARKS OF  
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Thank you so much for allowing me again this year to intrude on your business meeting to talk a bit about issues of mutual interest to the United States Trustee Program and the chapter 7 trustees. I am dividing my time between this important NABT conference and the Judicial Conference's Advisory Committee on Bankruptcy Rules which is meeting here in Seattle today and tomorrow. Three other senior United States Trustee Program officials are also attending the Rules Committee meeting, and I am very pleased that several United States Trustees are here with you for the entire NABT Conference.

It has been a pleasure over this past year working with your President David Birdsell and I look forward to working with Gene Crane over the next 12 months as well. As you may know, the Program meets with your leadership on a regular basis. After Clarkson McDow ended his detail at the Executive Office and returned to his full time duties as the United States Trustee in Region 4, we were fortunate to recruit Jake Miller from our Spokane office for a rotational assignment as head of the Office of Review and Oversight. Clarkson and Jake are wonderful representatives of the United States Trustee Program, and I consider them valued friends whom I rely on for their expertise and sound judgment.

In addition to the Liaison Committee meetings that Clarkson and Jake have coordinated over the past year, we have twice invited the NABT to participate in the periodic meetings I hold with all United States Trustees. So, there has been a lot of talking going on. And that is a good thing, because we have a lot to talk about.

As we cope with the enormous new responsibilities imposed upon us by the bankruptcy reform law, we in the Program rely on each other to function as a cohesive team, speaking with one voice, and dedicated to achieving our mission. We recognize our team works best when we are in partnership with you – the chapter 7 trustees. Without your good work, the bankruptcy system cannot operate effectively. So, let me express to you my fervent hope that the United States Trustee Program team will continue to strengthen its partnership with the NABT so that we can accomplish our important goal to enhance the integrity and efficiency of the bankruptcy system.

I would like to discuss a few items with you this afternoon. First and foremost, I want to report to you on the Program's progress in making bankruptcy reform work for all stakeholders in the system – debtors, creditors, and the general public. Second, I would like to touch upon some legal and litigation issues of mutual interest. Finally, I would like to suggest some agenda items that might guide the USTP/NABT Liaison Committee during the coming 12 months.

### **Bankruptcy Reform**

Let me start with bankruptcy reform. Means testing is the cornerstone of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. Under the new section 707(b) and other provisions, the former subjective "substantial abuse" standard is replaced by a more objective means test formula to determine whether a case is "presumed abusive."

It is still too early to determine the long-term impact of means testing on the bankruptcy system, but let me suggest a few preliminary conclusions. First, means testing is workable. There is a system in place by which debtors can obtain the necessary IRS and Census Bureau information and make required calculations. This success is due in no small part to those in the U.S. Trustee Program and on the Advisory Committee on Bankruptcy Rules who developed the new Official Forms that must be filed in most individual bankruptcy cases.

I should add some important caveats to my optimistic assessment. For example, many debtors and their lawyers still do not fill out the means test forms properly. This puts a significant burden on the United States Trustees, the private trustees, and the courts. Anecdotal evidence I hear from the field suggests that the quality of the filed forms is improving, but debtor's counsel still needs to do a better job.

Another important reason we should not draw any firm conclusions at this point is that the number of filings has been extremely low since the October 17, 2005, general effective date of the reform law. About three quarters of a million cases were filed during the four weeks leading up to October 17<sup>th</sup>; since then, only about 375,000 cases have been filed. Therefore, we cannot be certain that we will be able to process a larger number of cases with the same efficiency in the future as we have over these past 11 months. My concern about our long-term ability to efficiently process the forms arises largely out of the fact that the courts have not mandated "smart forms" with "data tags" that could allow us to automate most of our procedures for the benefit of the United States Trustees, chapter 7 trustees, and others involved in the process.

Second, preliminary data suggest that means testing provides a promising approach to identifying abuse. Of the individual debtors who filed from October 17<sup>th</sup> through the end of June, 95 percent were below the median income. Of those above the median, the United States Trustees determined that slightly less than 10 percent were "presumed abusive." Of the presumed abuse cases that did not voluntarily dismiss or convert, United States Trustees filed motions to dismiss in about three-quarters of the cases and declined to file in about one-quarter of the cases. These data suggest that the means test is a useful screening device to identify abusive cases. They also suggest that the statute provides the United States Trustees with sufficient discretion so that decisions on filing motions to dismiss can be made on a case-by-case basis and not solely based upon the statutory formula.

Another major aspect of bankruptcy reform is financial education. As you know, individual debtors must receive credit counseling prior to filing and receive debtor education prior to discharge. These are potentially the most far-reaching consumer protection provisions of the Bankruptcy Code. These requirements are designed to ensure that debtors enter bankruptcy knowing what their options are and exit bankruptcy with the tools to avoid future financial catastrophe.

The job of the United States Trustee is to approve providers who meet statutory qualifications to offer credit counseling and debtor education services to debtors. This function is

entirely new to the Program and has required enormous effort on our part to carry it out effectively.

As with means testing, there are positive signs that the credit counseling and debtor education provisions are workable. The credit counseling industry has been a troubled one. So, our first priority was to screen out those who might seek to defraud debtors. Importantly, it appears that we have been successful thus far. We developed our approval and monitoring criteria with enormous assistance from the Internal Revenue Service and the Federal Trade Commission. Our procedures have been praised by those agencies, and also by representatives of creditor and consumer groups, such as the Consumer Federation of America and the National Association of Consumer Bankruptcy Attorneys. It is almost inevitable that eventually a bad actor will get through the “net,” but we are much relieved that our screening procedures seem to be quite effective. In September, we will commence post-approval, on-site reviews where we can better verify an applicant’s qualifications.

Another important, positive sign is that there is adequate capacity to serve the debtor population. Again, the true test will come when filings reach more expected and higher levels. As of the end of August, we had received over 1,000 applications and re-applications from credit counselors and debtor educators. About two-thirds of the applications were approved; about one-third of the applications were denied, voluntarily withdrawn, or were still under review. There are currently 153 approved credit counseling agencies and 275 approved debtor education providers.

In addition to approving applications by providers, the United States Trustee is also the major enforcer of the requirement that debtors receive credit counseling. In some districts, I understand that trustees are also providing assistance by verifying that debtors have filed proof of credit counseling. Verification should become much easier in the near future because of a new Official Form that may be approved by the Judicial Conference in September to become effective on October 1<sup>st</sup>. The Official Form was proposed by the U.S. Trustee Program and designed primarily by Bankruptcy Judge Wedoff to provide clear notice to all debtors, especially pro se debtors. The form should decrease the number of enforcement actions required by the United States Trustees or other parties.

The new form must be filed with the petition. On it, the debtor must check one of five boxes. Box #1 says that a credit counseling certificate is attached. Box # 2 says that counseling was received, but a certificate will be filed within 15 days. Box #3 says that there are “exigent circumstances” and the debtor will file a motion for an extension. Box #4 says that the debtor will file a motion for permanent waiver, such as for a disability. Finally, Box #5 says that the United States Trustee has waived the requirement for the entire district.

In addition to these actions, we have issued interim regulations governing applicant qualifications and will issue more extensive rules within the next few months. In the upcoming Notice of Proposed Rulemaking, we may address a number of issues not squarely covered by the

statute, such as criteria for granting a waiver of the fee charged by providers and restrictions to address perceived abuses of the system by debtor's counsel and others.

The USTP is learning more and more every day. We will continue to do an increasingly better job as we gain experience and expertise in carrying out our new duties to enforce and implement the credit counseling and debtor education provisions of the law.

The final bankruptcy reform area I would like to highlight is the new system for debtor audits. This is sort of a preview of coming attractions since implementation of the new debtor audit provisions isn't until October 20<sup>th</sup>. By law, the United States Trustee Program must commence a series of debtor audits designed to verify the accuracy of schedules filed by individual chapters 7 and 13 debtors. This regimen of audits will help us to identify cases of fraud and abuse, enhance deterrence, and provide baseline data to gauge the magnitude of fraud, abuse, and errors in the bankruptcy system.

In FY 2007, we will use contractors to conduct approximately 7,000 audits. Of that number, up to 6,000 will be random audits, and 1,000 will be targeted audits of cases in which debtors have unusually high income or expenses. The procedure will work as follows. Shortly after a case is filed, selected debtors or their counsel will receive a notification of audit and request for documents. We hope that most audits can be completed within 70 days after a debtor's schedules are filed. Reports will be filed with the court by the auditors. We will not seek an extension of time to object to discharge, except in unusual circumstances. The statute provides that a discharge may be revoked if the auditor finds a material misstatement not adequately explained or if the debtor does not adequately explain a failure to provide information to the auditor.

My overall assessment of the consumer features of bankruptcy reform is positive. The new systems are working because of your good work, our good work, and the good work of other players in the bankruptcy system. I again want to commend the Judicial Conference's Advisory Committee on Bankruptcy Rules – and especially its Chairman, District Court Judge Thomas Zilly – for the extremely thorough and efficient manner in which it has adopted Interim Rules. I consider the United States Trustee Program's very active participation on the Advisory Committee to be among the most productive actions we have taken to make bankruptcy reform work as intended by the Congress.

In August, the Interim Rules and Official Forms were published for public comment. Early comments will be considered at the Rules Committee meeting this week, and we will make final recommendations on any changes to the Rules and Official Forms at the March 2007 meeting.

## **Emerging Legal Issues**

In addition to those critical features of consumer bankruptcy reform, both chapter 7 trustees and United States Trustees are addressing numerous other important and emerging legal issues. Let me touch on just a few of them.

The Department of Justice is considering participating in the case of Marrama v. Citizens National Bank of Massachusetts and the Chapter 7 Trustee, which is pending in the United States Supreme Court. As all of you should be aware, this case arises out of Massachusetts where the bankruptcy court, the Bankruptcy Appellate Panel, and the First Circuit denied the debtor's request for conversion from chapter 7 to chapter 13. In Marrama, the Supreme Court will decide whether a debtor has an absolute right to convert even when the chapter 7 trustee proves the debtor has acted in bad faith.

There are also several other important cases now in litigation. For example, since the enactment of the BAPCPA, approximately 18 challenges to the constitutionality of section 526 have been filed. There are additional non-constitutional challenges as well. We are working closely with the Civil Division of the Justice Department in defending this provision of law which is designed to ensure that consumer debtors are protected against unscrupulous or inadequate lawyers and non-attorney petition preparers. Section 526 ensures that proper disclosures are made to debtors and that improper advice is not given.

To date, the constitutionality of the statute has been upheld in all but two cases. The United States District Courts in the Northern District of Texas and the District of Oregon struck down as unconstitutional that portion of section 526 prohibiting debt relief agencies from advising clients to incur debt in contemplation of filing bankruptcy. The Justice Department is seeking to overturn those two court decisions.

Last year, I came before you and announced our policy on trustee compensation. I told you that new section 330(a)(6) of the Bankruptcy Code would be given its full meaning by the United States Trustees. I said that "absent extraordinary factors, trustees should be compensated in the full amounts allowed based upon the percentage calculation provided in section 326." I went on to say that "although it may be prudent for trustees to maintain records of time spent on a case, and some local bankruptcy courts may require it, United States Trustees will not independently require trustees to maintain time records."

As might have been expected, some bankruptcy courts have taken a different approach. Recently, the bankruptcy court in the District of Utah denied a chapter 7 trustee's request and held that various pre-BAPCPA standards governing trustee compensation still applied. We disagree and believe the trustee is entitled to his full compensation up to the limits allowed under section 326. Accordingly, we will file papers in bankruptcy court in support of the chapter 7 trustee's maximum compensation in that case.

Obviously, I will not promise that we will litigate every case in which a bankruptcy court rules contrary to our interpretation of section 330. But we will do our best to vindicate our interpretation of the statute by litigating in favor of the chapter 7 trustee's full compensation in appropriate cases. Congress has acted in favor of treating chapter 7 trustee compensation "as a commission." The United States Trustee Program will litigate to uphold that act of Congress.

The NABT leadership has done a wonderful job over the past year telling the Program about percolating issues and matters that should be addressed. For example, we have discussed the importance of the Program's consistent application of policies and practices in helping to ensure the efficiency, effectiveness, and elemental fairness of the bankruptcy system. In fact, I believe that a hallmark achievement of the Program over the past five years has been greater uniformity in policies and practices carried out by our 95 field offices. Clearly, differences do and should persist in some areas in light of differences in case law and other local factors. But, we operate now more than ever as a unified team with one voice.

The NABT is a valuable partner with us when they point out matters on which the USTP is not operating as consistently as it should. Recently, your leadership alerted us at a United States Trustee meeting that our position was not clear on the calculation of trustee compensation in cases. I want to inform you that we have reviewed our actions around the country, and have reiterated our policy that trustee compensation under section 326 will be calculated on all distributions, excluding those to debtors, but including those to administrative claimants. This view is not universal in case law. In districts where bankruptcy courts are enforcing a different standard, we encourage you to alert us to the issue and we will seek to change the case law.

### **Future Agenda**

Finally, let me turn to future agenda items that might guide liaison meetings between the NABT and the USTP. Building on what we already have achieved together, let me suggest two areas to consider for future action.

First, I would suggest that we evaluate the success of the United States Trustee Program's streamlined oversight of chapter 7 trustees. A few years ago, the Program changed its regimen of trustee reporting and auditing requirements. The reforms were designed to reduce paperwork and focus attention on the most significant indicators of trustee performance. I think it is now time to evaluate whether that streamlining initiative has worked. We should explore such issues as whether the timeliness, accuracy of financial reporting, and distributions to creditors have increased. We also should explore whether the new system allowed us to identify poorly performing trustees and to take remedial actions sooner. In this regard, we would welcome the NABT's observations on the best indicators of trustee success, on how each of us can enhance our training for chapter 7 trustees, and on possible ways the trustees could engage in self-policing and peer-to-peer assistance.

Let me also tell you that we are open to your thoughts on the trustee evaluation instrument. I read in a recent issue of NABTalk that there remains residual concern among some

trustees about the fact that the highest trustee rating is termed “acceptable.” We are happy to work with you on nomenclature or other improvements.

I want to ask for your assistance in elevating the public discourse about bankruptcy reform. A primary duty of each of us is to promote respect for the law. Statements in and out of court that disparage the law undermine public confidence in our legal system. This point has been made eloquently by Bankruptcy Judge Eugene Wedoff who has expressed his concern over some strident rhetoric that he continues to hear from bankruptcy professionals.

Without respect for the law, it is more difficult for the United States Trustee to enforce the law, it is more difficult for debtor lawyers to obtain their clients’ compliance with the law, and it is less likely that decisions of the court will receive the respect that is essential to our system of government. Chapter 7 trustees have an especially important stake in breeding respect for the law. You depend on financial information produced in a largely self-reporting system. If debtors are told that certain disclosure or other requirements are without merit, then it is less likely that they will diligently and conscientiously satisfy their obligations under the Code.

I would like for us to join together to look for ways that we can elevate the discourse about bankruptcy law and administration. Through our conferences, publications, and almost constant interactions with other constituents in the system, we can promote respect for the law, demonstrate our fidelity to the law, and thereby help advance the efficiency and integrity of the bankruptcy system.

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I am grateful for your hospitality this afternoon. I wish you a successful conference this week, and look forward to working with the NABT leadership in the future.

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