

Department of Justice
Executive Office for United States Trustees

Final Agency Action
Case No. 00-0004

[Decided September 29, 2000]

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

[Redacted] (“the trustee”), appointed by the United States Trustee to administer chapter 7 cases filed in the United States Bankruptcy Court for [redacted], seeks review under 28 C.F.R. § 58.6 of a decision by the United States Trustee to suspend his receipt of new case assignments for a period of 30 days. I affirm the United States Trustee’s decision based upon the record¹ before me.

I. Course of this Proceeding

On May 2, 2000, the United States Trustee commenced a Field Examination of the trustee by reviewing in detail 13 cases administered by the trustee. A Field Examination is conducted by personnel of the United States Trustee Program and is designed to identify whether a trustee’s asset administration system and internal controls are adequate to safeguard bankruptcy estate funds. See 1998 Handbook for Chapter 7 Trustees (“Handbook”) at 9-16. On July 27, 2000, a Report of the Field Examination (“Field Examination Report”) was issued which concluded that

[b]ased on the transactions tested, it appears that the quality of the trustee’s internal controls, financial record keeping, reporting procedures, and asset administration procedures was **inadequate** for safeguarding bankruptcy estate funds in accordance with the [1998] Handbook [for Chapter 7 Trustees].

Field Examination Report at 3. Based upon this conclusion and the trustee’s inadequate or inappropriate banking procedures, as evidenced by the trustee’s commingling of estate funds with his law firm’s escrow account in the case of [S], Case No. [redacted], and inadvertently disbursing estate funds in that case to himself or his law firm from the law firm’s escrow account, the United States Trustee notified the trustee that new case assignments would be suspended for 30 days.² In addition,

the United States Trustee notified the trustee that, before reinstatement to the active rotation, the trustee must (1) meet with staff of the United States Trustee to determine if he has implemented proper cash management procedures, and (2) certify that he has read and is in compliance with the Handbook for Chapter 7 Trustees. The trustee timely filed his Request for Review with the Director of the Executive Office for United States Trustees.

II. Standard of Review

In conducting this review, the Director must 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.

See 28 C.F.R. § 58.6(i) (specifying the scope of the Director’s review).

III. Analysis

United States Trustees supervise panel trustees, 28 U.S.C. § 586(a)(1), and appoint them to individual chapter 7 cases. 11 U.S.C. § 701. They “monitor the performance of panel members . . . in order to determine whether they should be continued in or removed from panel membership.” H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 102 (1977). Under the law, “[t]he United States trustee is permitted to conduct his own investigation . . . to exercise effective supervision and make an effective evaluation of the performance of the private trustees on the panel.” Id. at 110.

Trustees are fiduciaries with wide-ranging responsibilities to effectuate the goals of the particular chapter under which a bankruptcy case is filed. Because they are fiduciaries, trustees are held to 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. 267 (1951). See also Meinhard v. Salmon, 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928) (Cardozo, C.J.).

Although the field examiners listed 18 deficiencies,³ the United States Trustee based the trustee’s suspension on the following three deficiencies, set forth in the Field Examination Report, Banking Procedures, Items 3-5:

Banking Procedures

- 3. The trustee commingled estate funds with the trustee’s law firm escrow account in [S]. (Handbook at 9-1).**

- 4. The trustee made a disbursement of estate funds to himself for sanctions in [S] by a check drawn on his law firm trust account. (Handbook at 9-13).**
- 5. The trustee paid himself an improper amount of sanctions in [S], by relying on the debtor's cover letter rather than reviewing the original court order. (Handbook at 9-14, subparagraph (7)(e)).**

Field Examination Report 4-5. The deficiencies stated in the Field Examination Report, if correct, represent a failure to safeguard estate funds and assets that justifies a 30-day suspension of assignment of cases. 28 C.F.R. § 58.6(a).

The underlying facts are largely undisputed. The United States Trustee and the trustee agree that the case at issue has been contentious and the trustee has faced many challenges, including the debtor's failure to produce required information and documentation. Request for Review at 2; UST Response at 2. The court authorized the trustee to employ his law firm as counsel for the trustee to assist in the case. Request for Review at 2; Trustee Exhibit 9. On the trustee's Motion to Show Cause, for Contempt, and for Sanctions, the court entered an order awarding sanctions of \$1,400 "against the Debtor in favor of the Trustee as compensation for the legal fees incurred by him in attempting to obtain the requested information and documentation." Trustee Exhibit 10 (Bankruptcy Court Order, September 16, 1996).

In his request for review of the United States Trustee's decision, the trustee stated that on February 13, 1997, he received a letter from the debtor and two cashiers's checks in the amounts of \$4,500 and \$500, which included funds that the debtor owed to the estate and the sanctions payment that the court had ordered the debtor to pay the trustee. Request for Review at 2-3; Trustee Exhibits 11, 13. The accompanying letter from the debtor stated the funds included \$1,600 for "Legal Services for Services of [Redacted] Law Firm." The trustee acknowledges that he deposited the total amount of the \$5,000 funds received into his firm's trust account instead of the bankruptcy estate account on February 13, 1997. Response at 3, 5; Trustee Exhibit 16. He stated that he "overnighted" a check in the amount of \$3,400, drawn on the law firm's escrow account, to be deposited into the bankruptcy estate account on February 14, 1997. *Id.*; Trustee Exhibit 15. The check was signed by the trustee's assistant. Trustee Exhibit 15. He also stated that he relied on the debtor's letter to determine the amount of the sanctions, instead of checking the court order that specified \$1,400, and mistakenly paid his law firm \$1,600. *Id.* at 4; Trustee Exhibits 10-11, 14. On February 13, 1997, a check in the amount of \$1,600, signed by the trustee's assistant, was written from the law firm's trust account to the trustee's law firm's operating account. *Id.*; Trustee Exhibits 14, 16.

The trustee admits that he erred by commingling the funds and offers no explanation or excuse for his error. Request for Review at 5. He asserts, however, that it was harmless error because the funds were deposited into the estate account within the same time period as they would have been had they been deposited into the estate account in the first place. *Id.* He also agrees that he erred in relying

on the debtor's letter instead of reviewing the court order to determine the correct amount of sanctions, but he states that this was a simple, inadvertent mistake and that the \$200 overpayment was repaid as soon as it was discovered. Id. Although the trustee does not disagree with the Field Examination Report's findings, he contends that these were minor and isolated errors that did not harm the efficient administration of cases, and that, therefore, a 30-day suspension for these infractions is too harsh. Id.

Based upon this information, I find that the trustee failed to exercise a trustee's basic duty to "be accountable for all property received." 11 U.S. C. § 704(2). The Handbook for Chapter 7 Trustees notes that estate funds are to be deposited to the estate bank account as soon as possible after receipt and prohibits commingling of estate funds. The Handbook also states that "bankruptcy-related funds may not be deposited to the trustee's business, personal, or law firm trust accounts." Handbook at 9-1. The record amply supports the conclusion of the field examiners that the trustee commingled estate funds with the trustee's law firm escrow account in the case at issue.

The field examiners found that, of the funds commingled with the trustee's law firm trust account, the trustee disbursed \$1,600 to himself or his law firm for sanctions, contrary to the procedures set forth in the Handbook, which states: "All disbursements should be made by estate checks drawn on the estate account." Field Examination Report at 5; Handbook at 9-13. The field examiners found that the \$1,600 disbursement was not reported on the trustee's interim reports because it was made out of the law firm account rather than the estate account and that, consequently, the United States Trustee and other parties in interest were unaware that the disbursement had been made. Id. at 5. This result demonstrates that the policy to deposit funds directly into the estate account is essential because there is no accounting for estate funds when the money is placed elsewhere. Thus, the combination of the commingling of funds and the disbursement of estate funds from the law firm escrow account rendered each finding more serious because it made detection of the erroneous disbursement virtually impossible. Id.

The court order entered in September 1996, provided that the debtor was to pay the trustee \$1,400 as sanctions, but the debtor's cover letter incorrectly stated that the checks included \$1,600 as sanctions. The trustee relied on the cover letter and disbursed \$1,600 to himself or his law firm, which was an overpayment of \$200. Field Examination Report at 5. These funds remained in the possession of the trustee until May 15, 2000, when the error, discovered during the field examination conducted during the week of May 1, 2000, was brought to the trustee's attention. Id. The field examiners found that the trustee had failed to indicate the trustee's review and approval of the order before payment, as recommended by the Handbook at 9-14. Id. It is important for trustees to review and approve the supporting documentation to ensure that any payment is made in the correct amount and to make a notation of any payment to prevent duplicate payments.

As the United States Trustee correctly noted, the fact that the trustee's disbursement to his law firm included \$200 of estate funds shows the need for the Handbook's prohibition against commingling of estate funds with law firm trust accounts. UST Response at 5. Also, if the trustee had followed the

Handbook recommendations and deposited all the funds in the estate account, reviewed all supporting documentation, made the disbursement by estate check, and personally signed the checks, the mistake would have likely have been discovered in the process. Id. Instead, the mistake remained hidden for over three years until the case was selected by chance for review during the field examination. Id.

The United States Trustee considered, as a mitigating factor, that the funds were in the law firm account for a short period, but he also considered that a disbursement was made to the trustee's law firm in an improper amount, and that the mistake was not discovered for three years by the trustee or his staff. UST Notice 2-3. There is no evidence to indicate that this was anything other than a mistake, but the failure of the trustee to adhere to basic financial safeguards compounded the mistake and rendered its discovery less likely.

I find that the United States Trustee was correct to conclude that (1) the trustee's mistakes evidenced poor administration of the case and (2) the lack of use of required safeguards and the inadvertent misappropriation to the trustee or the trustee's law firm imperiled confidence in the financial integrity of the trustee's operations. See UST Response at 5. Because the errors were found after a review of only 13 cases, there is reason to question the safety of the other estates. I find that the trustee's deficiencies in banking procedures resulted in a commingling of estate funds and an inadvertent misappropriation of estate funds that justify a 30-day suspension. In fact, the United States Trustee could have suspended the trustee for a longer period but exercised his discretion not to do so. Moreover, the trustee's contention that his errors did not harm the efficient administration of cases is troubling and indicates a simple warning would not have been sufficient.

The record supports the conclusions of the field examiners that the trustee's banking procedures and internal controls are inadequate. A 30-day suspension is an appropriate remedy to give the trustee an opportunity to undertake and complete corrective action regarding his cash management procedures and to meet with staff of the United States Trustee's office, who will ascertain whether appropriate procedures are in place, before the trustee takes on the administration of new cases.

IV. Conclusion

The decision to suspend this trustee for 30 days was an appropriate exercise of the United States Trustee's discretion. The record supports the conclusion that the trustee has failed to safeguard estate funds and assets. A suspension will give the trustee an opportunity to review his banking procedures and internal controls and take necessary corrective action. Accordingly, based upon my review of the record, including the written submissions of the United States Trustee and the trustee, I affirm the United States Trustee's decision to suspend for 30 days the trustee's eligibility for assignment to chapter 7 cases.

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

Dated: September 29, 2000

Kevyn D. Orr
Director
Executive Office for United States Trustees

[FOOTNOTES]

1. The record includes the United States Trustee's Notice of Suspension dated July 28, 2000 ("Notice"), which contains the Field Examination Report; the trustee's Request for Review dated August 14, 2000 ("Request for Review"), which includes his response to the Field Examination Report and 18 exhibits; the United States Trustee's Response dated August 29, 2000, ("UST Response") and three exhibits; and the trustee's previous performance reviews.
2. The trustee continues to receive new case assignments during the pendency of this review absent the issuance of an interim directive. 28 C.F.R. § 58.6(c). The United States Trustee did not issue an interim directive in this matter.
3. While less serious, the 15 remaining deficiencies in the Field Examination Report include several significant findings that help support the conclusion that the trustee's internal controls, financial record keeping, reporting procedures, and asset administration procedures were inadequate for safeguarding bankruptcy estate funds: The trustee (1) did not receive bank statements unopened; (2) made incomplete reconciliations in three cases in which the bank statement did not reconcile to Form 2; . . . (6) assigned too many cash related duties to his assistant who also had record keeping functions; (7) failed to record an estate receipt in the receipt log in five cases; (8) did not include all applicable columns in the case receipts log, specifically those for the purpose and date deposited; (9) did not indicate on the cash receipts log that he verified on a test basis the receipts to Form 2 and bank statements; (10) did not maintain a control numbers log for blank stock; (11) did not list assets in detail on Form 1 in four cases; (12) did not adequately supervise the auctioneer in a case because he failed to review the auctioneer's bond to ensure that the coverage was adequate for a sale; (13) did not have a method in place to monitor/track accounts receivable in a case; (14) did not supervise the accounts receivable collection agent in a case; (15) did not have a procedure in place to back up the computer system; (16) commingled estate files with the law firm files; (17) did not maintain no-asset case files for a period of two years after cases were closed; and (18) did not have a formal disaster recovery plan. Field Examination Report at 4-8.