

Department of Justice
Executive Office for United States Trustees

Final Agency Action
Case No. 01-0003

[decided July 24, 2001]

Review of the Decision of the
United States Trustee for [redacted]
Regarding [redacted]

[Redacted] (“trustee”), a member of the chapter 7 panel for 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 terminate her receipt of new case assignments. I affirm the United States Trustee’s decision based upon the record before me.

Course of this Proceeding

This is the second administrative review involving this trustee. See Case No. 00-0003 (Aug. 14, 2000), available at <http://www.usdoj.gov/ust/foia/admin-decisions/case00-0003.pdf>. In that decision, the Director upheld the decision of the United States Trustee dated June 14, 2000 suspending the trustee’s receipt of new case assignments.

The initial suspension was based, inter alia, upon a Report of Field Examination dated April 24, 2000 (“First Field Examination Report”) which concluded that

the quality of the trustee’s internal controls, financial record keeping, reporting procedures, and asset administration practices are **inadequate** for safeguarding bankruptcy estate funds in accordance with the [1998] Handbook [for Chapter 7 Trustees].

First Field Examination Report 3. 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 U.S.

Department of Justice, Executive Office for U.S. Trustees, Handbook for Chapter 7 Trustees at 9-22 and -23 (Mar. 1, 2001) (hereinafter “Handbook for Chapter 7 Trustees”).

The Director in Case No. 00-0003 identified three deficiencies remaining from the First Field Examination Report:

- The trustee did not actively supervise estate professionals to ensure prompt and appropriate execution of duties, compliance with required procedures, and reasonable and necessary fees and expenses.
- The trustee did not liquidate assets in a timely manner.
- The trustee’s files in one case did not contain any evidence to indicate that an analysis of the tax consequences of a sale of real property was performed prior to the sale.

Case No. 00-0003 at 4.¹ The Director concluded that 18 other deficiencies noted in the First Field Examination Report were “resolved or appear resolved.” *Id.* at 3 n.3. Based upon these three deficiencies, the Director upheld the suspension.

By letter dated September 15, 2000, the trustee was informed that the Region would conduct another Field Examination “when you have corrected the deficiencies previously noted and are ready for another visit.” United States Trustee’s Notice of Removal from Panel of Trustees dated May 17, 2001 (“Notice”) at 2. This letter also advised the trustee that:

The examination team will review the matters and cases previously examined to ensure correction of deficiencies **and will examine additional matters and cases for proper administration**. The United States Trustee will use the report of the examination team to determine whether you should be return[ed] to the rotation or whether he should take additional enforcement action.

¹The page numbering for Case No. 00-0003 used throughout this decision is based upon the redacted version of this decision available on the Department of Justice website at <http://www.usdoj.gov/ust/foia/admin-decisions/case00-0003.pdf>.

(emphasis added). Id. The trustee responded by letter dated November 8, 2000, stating that “I am ready for another field examination of my office.” Id. A second Field Examination was conducted January 8-11, 2001.

A Field Examination Report was issued on March 30, 2001 (“Second Field Examination Report”). The Second Field Examination Report concluded that the trustee’s financial record keeping, reporting procedures, and asset administration procedures were inadequate in safeguarding bankruptcy estate funds. Second Field Examination Report at 70. Based upon this report, the United States Trustee sent a notice to the trustee dated May 17, 2001 terminating her receipt of new cases. The trustee timely requested that the Director of the Executive Office for United States Trustees review this decision pursuant to 28 C.F.R. § 58.6.

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).

The Record in this Case

The record in this case consists of the Notice; the trustee’s Request for Review dated June 5, 2001 (“Request for Review”), which includes the Second Field Examination Report and her Response to the Second Field Examination Report (“Response to Second Field Examination”); the United States Trustee’s Response dated June 22, 2001² (“UST Response”); the trustee’s Reply dated July 9, 2001; and the Decision and Record in Case No. 00-0003.

The trustee in an affidavit attached to her Reply states that she had not previously received the 1999 Trustee Performance Review attached to the UST Response, and defends her

²By agreement of the parties, the United States Trustee was given until June 25, 2001 to file a response.

performance in the [F] case.³ The Trustee Performance Review, and the trustee’s performance in the [F] case, were not referenced in the Notice. For these reasons, I have not considered the 1999 Trustee Performance Review or the [F] case in reaching my decision.

The Second Field Examination Report detailed the examination of 25 cases, 16 of which contained major deficiencies. The trustee in her Request for Review argues that the trustee could not correct “certain” deficiencies because none of these cases had been assigned subsequent to the trustee’s suspension. Request for Review 3. The trustee, however, does not detail what deficiencies in these existing cases could not be corrected. In an abundance of caution, I have not considered those portions of the Second Field Examination Report that address cases filed before 2000 (except those cases previously addressed in the First Field Examination Report). The trustee during her suspension had an adequate opportunity to correct her administration of recently filed cases. The Second Field Examination Report under this redaction now reviews 19 cases filed in year 2000, 11 of which contained deficiencies.

The Second Field Examination Report consists of three broad categories: “original cases re-reviewed,” “review of new cases relative to deficiencies noted in EOUST decision,” and “deficiencies in new cases not noted in EOUST decision.” This decision only addresses two of the deficiencies discussed in Case No. 00-0003 – the failure to supervise professionals and the failure to liquidate assets – and a new deficiency regarding the failure to file corporate tax returns that is closely related to the tax deficiency discussed in Case No. 00-0003. I conclude that the remaining deficiencies are either resolved or not sufficient to support termination.

Analysis

I. THE DUTIES OF THE UNITED STATES TRUSTEE AND CASE TRUSTEE

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. United States Trustees carefully “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. 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.

³The United States Trustee’s Notice of Suspension in Case No. 00-0003 included the trustee’s performance in the [F] case as a ground for suspension, but contained no details of her performance. The Director in that case did not consider [F] in reaching his decision. Case No. 00-0003 at 2 n.2.

Case 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 also held to very high standards of honesty and loyalty. See generally Woods v. City National Bank & Trust Co., 312 U.S. 262, 278 (1941); Mosser v. Darrow, 341 U.S. 267 (1951). See also Meinhard v. Salmon, 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928) (Cardozo, C.J.).

II. THE DECISION TO TERMINATE IS SUPPORTED BY THE RECORD

A. The trustee's failure to supervise professionals

The Director in Case 00-0003 concluded that the trustee had failed to actively supervise estate professionals. Case No. 00-0003 at 4-5. A failure to actively supervise professionals is a ground for suspension or termination. 28 C.F.R. § 58.6(a)(7) (grounds include “failure to adequately monitor the work of professionals or others employed by the trustee to assist in the administration of the case”).

The conclusion in Case 00-0003 was based upon two of the sampled cases. In the case of [N], the trustee did not have possession of the accounts receivable ledgers and did not know if her former accountant (who had previously withdrawn from the case) had attempted to collect the receivables. Id. This accountant had already received \$50,000 in approved fees. Id. The Director in Case 00-0003, based upon this record and the trustee's response, concluded that the trustee was unaware of whether accounts receivables were collected by the accountant and unaware that the accountant billed for collection activity even though the trustee viewed such activity as futile because of a large administrative claim. Id. The Second Field Examination Report further discloses that in October 2000 the former accountant sent a CD-ROM containing the financial records for the case. Second Field Examination Report 34. The trustee admitted at the Second Field Examination that she had not reviewed this information. Id. Instead, she filed a Trustee Final Report and Application for Compensation in November of 2000, even though no tax returns were filed in 1999 and 2000. Id. I conclude that the trustee has not corrected her deficiencies. In fact, she has exposed the estate to further loss from unpaid taxes and from her failure to review the financial records.

In the case of [W], the trustee employed an accountant to review accounting records for possible preference actions, but the accountant did not provide the trustee with a response for 21 months, just five days before the deadline to file any preference actions without any supporting documentation. Case No. 00-0003 at 5. As a result, the trustee did not file any preference actions. Id. The Director in Case No. 00-0003 suggested that an independent analysis be

undertaken to determine whether the estate has suffered any loss caused by the trustee's failure to file preference actions. Id. The Second Field Examination Report does not find that any such analysis was done, independent or otherwise. Second Field Examination Report 36. The trustee in her Request for Review ignores the issue of her apparent breach of fiduciary duty, merely stating: "To go back to document my file with 11 my [sic] phone conversations and requests for status reports at this time is impossible. I had a lot of contact with the CPA as with all my professionals, I just cannot document it after the fact." Response to Second Field Examination 9.

In addition to the two cases discussed above, three other cases examined in the Second Field Examination Report reinforce the conclusion that the trustee continues to abdicate her duty as a fiduciary to exercise effective control over retained professionals. In the case of [A], the debtor's books and records were delivered to an accountant, who was never retained, for review. Second Field Examination Report 42. The trustee failed to make any initial demand related to any preference actions. Id. Supervision of the accountant was left to an attorney retained by the trustee. Id. The trustee's files contained no records of the preference actions investigated or pursued by the trustee's attorney. Id. The same pattern was repeated in the case of [G] – the trustee failed to make any initial demand regarding the 21 questionable transfers disclosed in the Statement of Financial Affairs, and did not maintain any ledger or listing of all preference actions investigated or pursued. Id. at 43. Finally, in the case of [B], the trustee failed to make any demand regarding two accounts receivable and the matter was placed in the hands of an attorney. Id. The first receivable was abandoned, but no basis for this abandonment was present in the file. Id. The second receivable was also abandoned, and the trustee could not explain why until she had discussed it with counsel. Id. The trustee admits error in these three cases but claims that the problem in these cases cannot be corrected. Response to Second Field Examination 4-5. I disagree. The trustee could have corrected her earlier inactivity by sending demand letters, obtaining periodic status reports from her retrained professionals, and properly documenting her administration of these cases.

Based upon these cases, I conclude that the trustee has not corrected her failure, previously set forth in Case No. 00-0003, to actively supervise the professionals she has retained.

B. Failure to liquidate assets

The Director in Case No. 00-0003 also upheld the trustee's suspension because her failure to take an active role in cases led inexorably to the conclusion that she failed to liquidate assets in a timely manner. Case No. 00-0003 at 5-6. The Director concluded that

While the trustee may have justified her acts after the fact, these instances evidence a failure on the part of the trustee to take an active role in these cases, but instead to place the responsibility for administering a case upon professionals whenever possible. This conclusion is strengthened by the lack of documentation in her files supporting any collection activity whatsoever.

Id. at 6.

The same pattern continues to be present. The Second Field Examination Report states that the trustee failed to timely liquidate assets in seven of the year 2000 cases examined. Second Field Examination Report 52-56. The trustee after the fact adequately explains the deficiencies as the result of her own inadequate documentation or as situations involving the exercise of her business judgment. See Request for Review 4-5; Response to Second Field Examination 17-19. This conclusion, however, does not exonerate the trustee. A trustee is required to adequately document her administration. See 11 U.S.C. § 704(2), (7); Fed. R. Bankr. P. 2015(a). Her repeated failure to adequately document her administration, even after suffering an indefinite suspension based upon numerous deficiencies, reflects negatively upon her ability to perform as a trustee.

C. Tax issues

The Director in Case No. 00-0003 also concluded that the trustee did not adequately consider tax issues in one of the reviewed cases. Case No. 00-0003 at 6. This case, [W2], involved the sale of a one-half interest in a condominium that resulted in the imposition of a tax on the capital gains which created an administrative insolvency. Id.

The Second Field Examination Report noted that corporate tax returns were not filed in a number of cases. Second Field Examination Report 66-69. The trustee's only response is that "I took my CPAs advice and I see that it was wrong." Response to Second Field Examination 21. Ignorance of the law is no excuse. A competent trustee should have a basic knowledge of the tax laws regarding bankruptcy. Not only does the language of the Internal Revenue Code require a trustee to file corporate income tax returns during her administration, see 26 U.S.C. § 6012(b)(3) (trustee in corporate case "shall make the return of income for such corporation in the same manner and form as corporations are required"), but a concise explanation of a trustee's responsibility for the payment of federal taxes is also set forth on page 8-6 of the Handbook for Chapter 7 Trustees and in IRS Publication 908 entitled "Tax Information on Bankruptcy." I conclude that the trustee continues to lack a basic understanding of tax issues – a failure that has caused harm to the estates she has administered.

III. THE DECISION TO TERMINATE IS AN APPROPRIATE EXERCISE OF THE TRUSTEE'S DISCRETION

The United States Trustee's decision to terminate did not occur in a vacuum. The trustee's prior suspension was upheld because of her failure to supervise professionals, failure to timely liquidate assets, and failure to adequately consider the tax consequences of her actions. This suspension gave a clear signal to the trustee that she must significantly improve the administration of her cases. The trustee was given the opportunity, at a time of her own choosing, to seek reinstatement once she believed that she had cured her deficiencies.

After providing a trustee with an adequate opportunity to correct deficiencies in her performance, a United States Trustee may appropriately choose to terminate a trustee who does not demonstrate marked improvement. The Second Field Examination Report does not reflect any significant improvement in the trustee's performance, especially in her supervision of professionals. Therefore, I conclude that the United States Trustee appropriately exercised his discretion in choosing to terminating the trustee.

Conclusion

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 terminate the trustee's eligibility for assignment to chapter 7 cases.

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

Dated: July 24, 2001

Martha L. Davis
Acting Director
Executive Office for United States Trustees