

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

March 9, 2004

Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to appear before you once again on behalf of the Department of Justice to discuss the important work of the United States Trustee Program, outline for you some of our accomplishments over the last year, and walk you through the President's FY 2005 budget request for the Program.

The United States Trustee Program (the Program) is the component of the Department of Justice with responsibility for the oversight of bankruptcy cases and trustees. Our mission is to enforce the Federal bankruptcy laws, protect the bankruptcy system from fraud and abuse, and supervise the administration of bankruptcy cases. We carry out broad administrative, regulatory, and litigation duties under both title 11 (the Bankruptcy Code) and title 28 of the United States Code.

It is an exciting time in the history of the United States Trustee Program. We are transforming the agency into a litigating component of the Department dedicated to combating fraud and abuse. Although estimates of the amount of bankruptcy abuse vary widely, it is clear that fraud and abuse add up to billions of dollars at stake for creditors, as well as added costs for consumers. Overseeing nearly 1.6 million of the new bankruptcy cases filed last year, the Program is vigorously enforcing the nation's civil bankruptcy laws and assisting prosecutors in obtaining criminal convictions.

## **CIVIL AND CRIMINAL ENFORCEMENT**

### The National Civil Enforcement Initiative

In FY 2002, the Program launched a National Civil Enforcement Initiative (NCEI) with two major objectives:

- To identify and remedy debtor fraud and abuse, and
- To protect consumer debtors against unscrupulous attorneys and others who prey upon those in dire financial straits.

To accomplish these objectives, we are using existing statutory tools to combat fraud and abuse in the bankruptcy system and to protect consumers. Civil enforcement actions include taking steps to dismiss abusive filings, deny discharges to ineligible or dishonest debtors, limit improper refilings by debtors, curb unfair practices by attorneys, sanction unscrupulous bankruptcy petition preparers and scam operators, and attack identity fraud in bankruptcy.

Since the inception of the NCEI in October 2001, civil enforcement related projects have included the development and implementation of annual enforcement strategies in all 95 field offices; the appointment of national civil enforcement coordinators who oversee the Initiative by issuing standard guidance, providing technical assistance and training, and coordinating multi-district litigation; the formation of a civil enforcement resource team consisting of some of the Program's most experienced attorneys, financial analysts, and litigation support personnel; and the marshalling of resources to assist staff in their enforcement responsibilities.

The results of the NCEI are impressive. During fiscal year 2003, Program offices reported taking more than 41,000 formal and informal civil enforcement actions, yielding more than \$500 million in debts not discharged in chapter 7, fines, and other remedies. The potential benefit to creditors as a result of these actions is more than three times the Program's FY 2003 appropriation of \$155.7 million.

The ability to measure the results achieved by Program staff in civil enforcement is possible through the Program's development of an automated Significant Accomplishments Reporting System that is available to our staff on their desktop computers. This new system was launched in May 2003, and provides a tool for managers to measure both the amount of civil enforcement activity in their offices and the bottom line results of their efforts.

A significant benefit of the NCEI has been the invigoration of the Program's staff. Identifying abuse and successfully combating it is generating a feeling of pride and accomplishment among our staff at all levels. Field offices are sharing successful practices in their districts with others in the Program, and there is an energy that is spreading not only among the Program's regions and districts, but to the greater bankruptcy community as well. We are confident that our efforts to make this Initiative known to all parties in the bankruptcy system will increase voluntary compliance with the bankruptcy statutes and rules.

Some recent examples of the Program's civil enforcement successes include:

- **Substantial Abuse:** In the Middle District of Tennessee, joint debtors earned \$145,000 annually and sought to discharge \$184,000 in credit card debt while continuing to live an extravagant lifestyle, which included keeping a new Cadillac and a timeshare in Hawaii. After the U.S. Trustee filed a motion seeking dismissal for substantial abuse, the debtors converted to a chapter 13 repayment plan.
- **False Statements and Concealment of Assets:** In the Eastern District of Kentucky, a debtor failed to disclose various property interests, including ownership interests in six companies, free use of a Lexus, a 401(k) account, and a brokerage account. After trial, the court denied the debtor's discharge based upon the debtors' reckless disregard in completing his bankruptcy petition and his failure to disclose assets.
- **Bankruptcy Petition Preparers (BPPs):** In the Northern District of California, an elderly woman with dementia deeded her home jointly to herself and two Bankruptcy Petition Preparers (BPPs). To delay her creditors, the BPPs placed the woman in bankruptcy. The BPPs then sold the home below-market value and attempted to dismiss the bankruptcy case to collect their purported share of the equity. The Bankruptcy Court granted the U. S. Trustee's request for relief under § 110 and certified the case to the District Court. The District Court subsequently awarded the elderly debtor \$62,680 in

damages, based on a motion by the case trustee. The District Court also ordered the BPPs to pay a \$4,948 fine.

- **Attorney Misconduct:** In the Southern District of Indiana, attorneys at a law firm were collecting fees from clients without disclosure and without proper court authorization. Based on action by the U.S. Trustee, attorneys at the firm were barred from filing new bankruptcy cases in Region 10 (Central and Southern Districts of Illinois and Northern and Southern Districts of Indiana), removed as counsel in approximately 100 pending chapter 13 cases, and the court froze \$20,000 in fees for distribution to replacement counsel or overcharged debtors.

The Program's civil enforcement efforts also have led to significant decisions by Circuit Courts of Appeal. For example, the U. S. Court of Appeals for the Sixth Circuit recently decided a case in favor of the U. S. Trustee. In *In re Behlke* (6<sup>th</sup> Cir.), \_\_\_F.3d\_\_\_ (2004 WL 314905 6<sup>th</sup> Cir. Feb. 20, 2004), decided on February 20, 2004, the Sixth Circuit affirmed the dismissal of a chapter 7 case on grounds of substantial abuse pursuant to 11 U.S.C. § 707(b). The court ruling clarified existing law in a number of respects. Among other things, the court held that an "ability to repay" analysis could include a debtor's voluntary payments to a 401(k) retirement plan. The court also rejected arguments that there was no substantial abuse because the debtor could repay only a modest percentage of general unsecured debt. In *Behlke*, the Sixth Circuit held that it was not in error to dismiss the debtors' case when the debtors could repay 14 percent (\$22,824) of their unsecured debt over three years and 23 percent (\$38,040) over five years.

#### Debtor Audit Pilot Project

Since bankruptcy, like the income tax, is based on self-reporting, the accuracy and veracity of bankruptcy schedules are pivotal to the integrity of the bankruptcy system. In September 2003, the Program started a six-month Debtor Audit Pilot Project to develop better techniques to identify the presence or absence of significant errors in bankruptcy schedules.

The Program contracted with six certified public and forensic accounting and investigative firms to review an estimated 64,000 chapter 7 consumer bankruptcy petitions filed in 10 districts around the country. These firms are conducting "paper" audits in an estimated 1,400 of these cases. The cases are being selected in one of two ways for audit from cases filed between October 1, 2003 and March 31, 2004. First, one out of every 250 cases is randomly

selected for an audit. Second, cases are targeted based on certain income and debt thresholds that have been defined for each field office during the pilot. While Program staff have long conducted these types of reviews, this pilot is the first time that independent public firms have been retained to conduct the reviews. The pilot project will be fully completed by the end of the fiscal year.

### Criminal Enforcement

Some abuses of the bankruptcy system merit criminal sanction in addition to civil action. The U.S. Trustee Program advances criminal enforcement by identifying criminal violations and assisting in the investigation and prosecution of bankruptcy crimes. Program staff cooperate with and provide specialized expertise to other components of the Department, including the U. S. Attorneys and the FBI. Bankruptcy fraud is often linked to other crimes such as tax fraud, mortgage fraud, credit card fraud, and identity theft. Consequently, the Program's efforts involve extensive collaboration with many other Federal and state agencies.

In March 2003, the Department's Office of the Inspector General (OIG) issued a report regarding the Program's efforts to prevent bankruptcy fraud and abuse. The report generally endorsed our civil and criminal enforcement initiatives and provided helpful guidance on the implementation of those activities.

A key improvement in the criminal enforcement area has been the Program's creation, in July 2003, of a Criminal Enforcement Unit (CrEU) to strengthen its criminal referrals; serve as a resource on bankruptcy fraud issues nationwide; train Program staff, private trustees, and law enforcement personnel; build relationships with the law enforcement and bankruptcy communities; and support the prosecution of and, in some cases, directly assist in the investigation and prosecution of bankruptcy crimes.

The CrEU is headed by a veteran prosecutor, formerly with the Public Integrity Section of the Criminal Division. He is assisted by an Assistant U.S. Trustee, who has been active in our criminal enforcement effort for many years, and a team of three career prosecutors located around the country, who have devoted their professional lives to the investigation and prosecution of complex white-collar crime and have strong ties to U. S. Attorneys offices.

Program staff assist the U. S. Attorneys in the prosecution of criminal referrals by participating in investigations and at trial by serving as expert witnesses or as Special Assistant U. S. Attorneys (SAUSAs). In addition, approximately two-thirds of the Program's 95 field offices participate in bankruptcy fraud working groups headed by U. S. Attorneys.

Most criminal cases identified by the Program involve the concealment of assets. For example, a Federal jury recently convicted husband and wife chapter 7 debtors in Des Moines, Iowa, of concealing approximately \$6 million in real estate, equipment, livestock, and cash during their bankruptcy proceeding, *United States v. Alfred and MaryAnn Ryder*. This case was referred to the U. S. Attorney by the U. S. Trustee.

Many different fraudulent schemes involve the bankruptcy system. Among other duties, the CrEU will focus on emerging bankruptcy crimes.

- One emerging fraudulent scheme targeted by the CrEU is the credit card bust-out. The primary objective of a bust-out is to use multiple credit card accounts to obtain hundreds of thousands of dollars through credit card cash advances or the purchase of goods that are then sold for cash. In a credit card bust-out, individuals run up large credit card debts and then file bankruptcy to discharge the debt. Typically, the purchases and cash advances occur within a two to three month period. Often, individuals are recruited by others who promise to split the cash and proceeds. After the fraud is perpetrated, the recruiters may recommend a bankruptcy lawyer who files the paperwork and arranges for the debts to be discharged. Possible charges in these schemes include: Bankruptcy Fraud, 18 U.S.C. ' 157(1); Credit Card Fraud, 18 U.S.C. ' 1029(a); Mail and Wire Fraud, 18 U.S.C. ' 1341 and ' 1343; and Bank Fraud, 18 U.S.C. ' 1344. Recently, the Program assisted the United States Attorney for the District of New Jersey to obtain a credit card bust-out conviction involving fraudulent charges totaling \$6.8 million over a 7-year span, *U.S. v. Ali Qaraeen*.
- Other emerging areas are the use of mortgage foreclosure and equity schemes that utilize the bankruptcy system's automatic stay provisions and schemes where individuals use falsified or forged bankruptcy documents by individuals in an attempt to persuade creditors that they have either filed bankruptcy or received a bankruptcy discharge.

A second key improvement in the Program's criminal enforcement efforts has been the development of a new, automated Criminal Enforcement Tracking System (CETS) that more accurately tracks allegations, as well as referrals made to law enforcement authorities. The new national system contains a number of important features:

- *Preliminary Allegations:* The new system permits the tracking of pre-referral matters. For example, if a private party notifies a U. S. Trustee of a potential bankruptcy crime, a file can be opened in CETS in a "pre-referral" status, allowing staff to track the matter until it is either referred to law enforcement or closed out.
- *Criminal Referrals:* Using a national numbering system, the system will track all actual referrals, from the date of referral to the date of disposition. We will work with the Bureau of Justice Statistics and the Executive Office for United States Attorneys (EOUSA) to determine if it is possible to match our referrals with official disposition data maintained by EOUSA.
- *Type of Crime:* Field offices will identify the type of crime that may have been committed (e.g., concealment of assets, destructions of records). This new tracking system will help us not only to measure the volume of our criminal referrals, but also to identify types of crime referred and trends.

CETS is in the pilot stage and will be fully implemented in the field by the end of FY 2004.

### Training

Our civil and criminal enforcement efforts and our transition to a litigating component of the Department have been bolstered by the training we offered at the National Bankruptcy Training Institute (NBTI) located at the National Advocacy Center (NAC) in Columbia, South Carolina. Using the resources available at the NAC, we have reached out to many participants in the bankruptcy process to improve skills and share ideas and techniques that improve the administration of bankruptcy cases and help to combat fraud and abuse.

Over the last three fiscal years, the NBTI has hosted more than 1,800 students at 42 training courses in four major categories: civil and criminal enforcement; litigation; business and

finance; and management and administration. Our enforcement classes emphasize proven field practices and methods for identifying fraud and abuse. In addition, all courses, including those for non-attorney personnel, have a unit on civil enforcement. Participants in the training have included not only Program staff, but also private trustees and individuals from other components of the bankruptcy system.

## **OTHER PROGRAM ACTIVITIES**

In addition to its focus on civil and criminal enforcement, the Program continues to carry out its many other duties. Other major areas of activity include our chapter 11 reorganization responsibilities and the oversight of private trustees.

### Chapter 11 Reorganization Responsibilities

The United States Trustee Program oversees the administration of chapter 11 debtors and enforces the Bankruptcy Code to help ensure that all parties, including small creditors, are protected in accordance with the law. As part of this oversight, the Program prescribes and analyzes periodic financial and operating reports, appoints official committees to represent the interests of large and small creditors, monitors professionals employed in the cases to protect against conflicts of interest, reviews professional fees, and takes action to convert or dismiss faltering cases.

In the last three years, some of the largest bankruptcy cases in history have been filed. With the accompanying allegations of financial impropriety and fraud, the potential loss of confidence in our business infrastructure and its corporate leaders has increased exponentially. As a result, in appropriate cases, the Program has taken additional steps to ensure the accountability and transparency of the bankruptcy system.

In the Enron and WorldCom cases, the Program appointed special examiners to investigate alleged fraud and mismanagement. In Enron, the Program appointed eminent bankruptcy expert Neal Batson and, in WorldCom, the Program appointed former Attorney General Richard Thornburgh. Over a period of approximately 18 months, each examiner completed exhaustive studies of the causes of the companies' collapse and identified those who may be liable to the shareholders and creditors.



The Enron examiner identified \$7 billion in pre-bankruptcy transactions that were improper and which contributed to the collapse of the company. He also identified \$6 billion in improper claims against the estate by banks and other financial institutions which contributed to the fraud. Finally, the examiner identified lawyers, directors, and others whom he concluded may be sued by Enron or others whose investments and retirement savings were wiped out.

The WorldCom examiner revealed gross corporate mismanagement, including alleged inappropriate conduct by some senior officials who remained employed by the company after the bankruptcy filing. The examiner's reports detailed tax avoidance schemes deemed improper and which continued long after the bankruptcy filing. The examiner identified accountants, officers, institutions, and others who may be liable to the debtor for their nonfeasance or improper actions, and estimated that that the company potentially may try to recover billions of dollars.

### Oversight of Private Trustees

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 loss of estate assets when embezzlement, mismanagement, or other improper activity is 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:

- The Program and the trustees are jointly focusing their efforts on the National Civil Enforcement Initiative.
- The Program and trustee associations are working together to provide educational seminars on meaningful topics designed to improve core competencies, such as finding assets, maximizing returns to creditors, and enhancing the integrity of the bankruptcy system.

- The Program has worked jointly with the National Association of Bankruptcy Trustees and the National Association of Chapter Thirteen Trustees to develop Standards of Excellence and to improve the quality and effectiveness of trustee performance.
- Program staff and private trustees have worked successfully to develop critical management reports, updated standards for insurance and bonding, and a new information technology security initiative.

### **FY 2005 BUDGET REQUEST**

The Program is entirely self-funded through user fees paid by participants in the bankruptcy system. Approximately 60 percent of our funding comes from quarterly fees paid in chapter 11 (reorganization) cases and 40 percent from filing fees, interest earnings, and other miscellaneous revenues.

For FY 2005, the Program is requesting essentially a current services budget with a modest enhancement for information technology. The President's budget request transmitted to the Congress in February totals \$174,355,000, 1,198 permanent positions (265 attorneys) and 1,190 work years. The request represents an increase of \$8.2 million over the FY 2004 enacted appropriation of \$166,157,000. The increase is comprised of adjustments necessary to maintain a current services base level, and an enhancement of \$2 million for our Information Technology (IT) program.

We have made significant progress in the last few years in our efforts to modernize information systems and implement sound IT investment practices. The Program has hired a Chief Information Officer and implemented an Information Technology Investment Management (ITIM) process. We have established an IT advisory group of key Program managers and an Executive Review Board to review IT investment concepts in conjunction with Program priorities and available resources. This process ultimately ensures that the Program is spending its IT dollars wisely and in accordance with performance management goals.

The requested FY 2005 increase will fund the following activities:

- Life-Cycle Replacement/Technology Refreshment of Equipment (\$1,375,000)  
This initiative will permit the Program to replace a portion of its equipment in accord with industry IT recommendations. The funding will replace our JCON and Database Management Servers and 500 personal computers.
- Electronic Case Filing (ECF) Initiative (\$625,000)  
This request will enhance the Program's Automated Case Management System to examine the feasibility of integrating the management of electronic documents received from the bankruptcy courts with the extraction of key data from those documents. It is an initial step in developing the capability to streamline the collection of bankruptcy case information, including amounts and types of liabilities, as well as types and values of assets. This information will be invaluable in our identification of abusive filings.

Our FY 2005 ECF Initiative builds on the Program's FY 2003 and 2004 efforts to work alongside the courts and with the private trustees to transition to the courts' ECF System. As of the end of 2003, approximately 60 percent of the bankruptcy courts had converted to the new ECF system, with the remaining bankruptcy courts planned for 2004. The implementation of ECF has allowed the Program and private trustees to enhance and streamline the exchange of electronic data.

In late 2003, the courts implemented a new ECF module, jointly developed with the U. S. Trustee Program that provides for the efficient exchange of bankruptcy data and associated electronic records. This new module paves the way for our FY 2005 request to enhance financial data extraction from electronic records and to further reduce manual review of bankruptcy petitions and schedules for potential fraud and abuse.

Other Information Technology accomplishments include:

- The creation of a central repository of all bankruptcy data that staff will begin to access in late FY 2004 to identify nationwide trends in serial filers, as well as other potential civil and criminal abuses at the national and local levels.

- With the migration to a centralized data system, the Program is working to establish a remote “continuity of operations” (COOP) site, which will serve as a back-up for all the Program’s electronic data. Should our primary IT operation be compromised in any way, the COOP site would become fully operational.
- Since May 2003, all Program staff have been entering their civil enforcement activities in “real-time” mode into the Significant Accomplishments Reporting System (SARS) readily available through their desktop computer. This new system gives Program managers a tool to summarize their offices’ immediate impact on the bankruptcy system and to monitor staff resources to ensure activities are occurring in accordance with Program goals.
- As mentioned earlier, the Program is currently piloting a Criminal Enforcement Tracking System (CETS), which allows the real-time tracking of criminal activities. This new system will be available to all offices in late FY 2004.

Our efforts to improve our IT infrastructure have enhanced the Program’s ability to collect performance data and integrate it with the budget. This has led to the creation of a new outcome performance measure -- “Potential Additional Returns to Creditors Through Civil Enforcement and Related Efforts.” This new measure provides an indicator of the public benefit of the United States Trustee Program’s work.

## **CONCLUSION**

I am proud of the efforts of the dedicated men and women of the United States Trustee Program. They have not only kept abreast of record-breaking filings and moved the cases through the bankruptcy system efficiently, but they have exercised creativity in identifying and addressing abuses. They also have demonstrated flexibility in streamlining procedures and processes so that they can devote their energy to addressing fraud and abuse. Through their commitment and tenacity, they are transforming this agency into a professional litigating organization that is being recognized within the greater bankruptcy community for its contributions to combating fraud and abuse.

In closing, I would like to thank this Subcommittee for the assistance you have provided the Program through your support of resource requests and your foresight and guidance on substantive issues. I look forward to continuing to work with you on matters of mutual interest and critical importance.