APPENDIX F-3

Suggestions on Behalf of the United States Trustee Program

U.S. Department of Justice

Office of the United States Trustee

Executive Office

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Brady C. Williamson, Chairman
National Bankruptcy Review Commission
One Columbus Circle, N.E., Suite 5-130
Washington, D.C. 20544

Dear Chairman Williamson:

As a result of the United States Trustees' participation in various hearings before the Commission and the Working Groups over the past six months we have been asked to identify some proposals that would assist us in performing our role more effectively. I am pleased to submit some of those proposals.

In general, the United States Trustees would enthusiastically support any change in the Bankruptcy Code likely to eliminate fraud, expedite administrative procedures or curb abuses in the system. Although there have been many instances in the past when statutory changes were made to accomplish those goals, they were not always accompanied with appropriate tools or the clarity to enable the United States Trustees to perform the additional responsibilities placed upon them as effectively as possible. Some Courts have declined to follow legislative intent in the absence of clear language authorizing the United States Trustee to take action or requiring specific relief under appropriate circumstances. If the Commission recommends changes in the responsibilities of the United States Trustees within the system, we urge that the changes be accompanied with adequate wordings to allow the United States Trustees to accomplish the Commission's goals.

As always, I look forward to working with the Commission and invite any further questions you might have in this regard.

Sincerely,

Joseph Patchan
Director

Enclosure

SUGGESTIONS TO THE NATIONAL BANKRUPTCY REVIEW COMMISSION
ON BEHALF OF THE
UNITED STATES TRUSTEE PROGRAM
February 27, 1997

INTRODUCTION

The United States Trustees (USTs) have been asked what changes in the law would make them more effective. With that purpose in mind, the USTs have developed the following suggestions which are generally directed at clarifying those areas of the law in which they now spend considerable time and effort. The list is not meant to be exhaustive. The USTs have already submitted suggestions in the Department of Justice proposal, separate written comments to other pending proposals, and in oral testimony before the Commission and Working Group sessions. More will follow.

1. Strengthen and clarify the grounds for conversion or dismissal of chapter 11 cases under 11 U.S.C. 1112.

The USTs currently devote substantial resources to the oversight of debtors in chapter 11 cases. USTs insure that DIPs prepare and file schedules, a statement of financial affairs and operating reports, appear at initial interviews with the UST and testify at a meeting of creditors, maintain insurance on estate assets and make necessary tax payments during the pendency of the case.

When the DIP fails to comply with these basic fiduciary obligations, the UST takes appropriate action which may culminate in the filing of a motion to dismiss or convert the case pursuant to 11 U.S.C. 1112(b). However, Section 1112 as currently drafted defines the cause which will justify dismissal or conversion of the case only in very general terms (e.g. absence of a reasonable likelihood of rehabilitation).

Amendments to Section 1112 currently being discussed by the Small Business Working Group would significantly enhance the USTs' ability to take action in cases where the debtor mismanages the business or fails to file monthly operating reports, to maintain adequate insurance, to maintain post-petition obligations for taxes and other ongoing administrative expenses, to comply with Court orders, to provide documents or information relating to the affairs of the estate on the request of the UST, or fails to attend a 341 meeting of creditors, a status conference or an initial debtor interview. These amendments, by imposing specific affirmative obligations on chapter 11 debtors, and the proposal to shift the burden to the debtor of showing a reasonable probability of being

successful in chapter 11 would provide clear guidance to the Courts and parties regarding the debtor's obligations and would give the UST powerful new tools to move cases lacking a realistic prospect of reorganization out of chapter 11.

We would add one suggestion. Any proposed reference to the debtor's failure to attend an initial debtor interview with the UST should be accompanied by a statutory provision which establishes the initial debtor interview process and imposes an affirmative obligation on the debtor to attend. For example, Section 341 could be amended to add a new provision for the UST to convene an initial debtor interview with the chapter 11 debtor; similarly, Section 521 could be amended to require the debtor to appear at an initial debtor interview convened by the UST (and including perhaps the Section 341 meeting).

2. Clarify the grounds for dismissal of chapter 7 cases under 11 U.S.C. 707.

The USTs have been fairly successful in arguing that the debtor's ability to repay a significant portion of their unsecured debt is a key factor in determining substantial abuse under 11 U.S.C. 707(b). See, e.g., In re Krohn, 886 F.2d 123 (6th Cir. 1989); In re Walton, 866 F.2d 981 (8th Cir. 1991)(2-1 decision); In re Fonder, 974 F.2d 996 (8th Cir. 1992). Nevertheless, the standard has not been universally accepted and many continue to debate Congress' intent. See In re Walton, 866 F.2d at 985 (McMillian, J., dissent). At one end of the spectrum are those cases which hold that the ability to pay is the primary factor to consider in determining substantial abuse. In re Kelly, 841 F.2d 908 (9th Cir. 1988). At the other end of the spectrum is the totality of circumstances test enunciated in In re Green, 934 568 (4th Cir. 1991). Although the Fourth Circuit agreed that ability to repay is the ***primary*** factor, it concluded that "solvency alone is not a sufficient basis for a finding that the debtor has in fact substantially abused the provisions of Chapter 7." Id. at 572. Compare U. S. Trustee v. Harris, 960 F.2d 74 (8th Cir. 1992)(substantial abuse does not require egregious behavior or bad faith; it requires only the ability to fund a chapter 13 plan).

The lack of a clear standard hampers the USTs' ability to enforce the provisions of Section 707(b) uniformly throughout the country. If chapter 7 relief should be denied to a debtor who has the financial ability to repay creditors, whether 100% or some other percentage, then that standard should be incorporated into the statute in some form.

If the Commission concludes that substantial abuse is really

an issue of good faith, then one might question why the "for cause" standard of Section 707(a) by itself is not sufficient to address the abusive cases. See In re Zick, 931 F.2d 1124 (6th Cir. 1991), In re Jones, 114 B.R. 917 (Bankr. D. Ohio 1990), but see 6 Collier on Bankruptcy § 707.03[2] (Lawrence P. King ed. 15th ed. rev. 1996) ("the power to dismiss a chapter 7 case for lack of good faith [under § 707(a)], if it exists at all, is extremely limited"). To resolve any doubt about the scope of Section 707(a) and to delineate the distinction between Section 707(a) and (b), the Commission should clarify that bad faith constitutes cause for dismissal under Section 707(a).

Finally, Section 707(a)(3) provides that a chapter 7 case may be dismissed for failure to file the information required in section 521(1), but "***only*** on a motion by the United States trustee" (emphasis added). The information required under section 521(a) consists of lists of creditors, schedules of assets and liabilities, schedules of income and expenses, and statements of affairs. We see no apparent reason why these motions should be limited to the UST.

3. Clarify grounds and procedure for trustee removal under 11 U.S.C. 324.

Section 324(a) currently provides that the Court "***may*** remove a trustee . . . for cause." Since the statute does not define "cause," the grounds for removal rest with the discretion of the reviewing Court. The traditional standards require a showing of fraud or actual injury which means that most trustees face no risk of ever being removed. While there are sound policy reasons to uphold the trustee's business judgment and to discourage the filing of frivolous or abusive removal motions against trustees, there are equally compelling reasons to identify that conduct which is unacceptable under any circumstance, and which mandates the removal of the trustee.

If "may" were changed to "shall" and specific examples of cause were added, it would guide the Court's discretion, strengthen the USTs' oversight of trustees and provide a clear incentive for trustees to comply with their statutory duties. For example, the statute could provide that the Court shall remove a trustee for cause including the failure to perform the duties set forth in Section 704 such as failure to timely collect and liquidate assets, failure to expeditiously close an estate, failure to safeguard assets, and failure to render an accounting. Clarification along these lines would aid in the USTs' supervision of trustees and cases and contribute to a more efficient system of case

administration.

If would also be useful if Section 324(b) were clarified. The USTs interpret the language of Section 324(b) to mean that the trustee's removal in one case automatically removes the trustee from all cases without need of further pleading or proof by the UST unless the trustee comes forward and makes an affirmative showing of why the Court should order "otherwise." It would reduce litigation to clarify who bears the burden of convincing the Court to order "otherwise" and whether subsection (b) calls for a separate hearing or is simply a different stage of the subsection (a) hearing. The interplay between subsection (a) and (b) under the current scheme has caused confusion in pleading, evidence, and procedure.

4. Clarify the Court's authority under 11 U.S.C. 349 to dismiss a case with prejudice or to impose a bar on refiling beyond 180 days.

Section 349(a) should be clarified to confirm the Bankruptcy Court's authority in dismissing a case to impose limitations on future filings by the debtor as warranted by the circumstances of the situation. At a minimum, the semicolon between the word "dismissed" and "nor" in Section 349(a) should be changed to a comma to alleviate the result of In re Frieouf, 938 F.2d 1099 (10th Cir. 1991), cert. denied, 112 S.Ct. 1161 (1992). Serial or repeat filers are a chronic problem in many parts of the country. While the Commission may be exploring other remedies, this small change would at least resolve the current state of the law in some jurisdictions. Here too, where a Court dismisses a case with prejudice or bars refiling, damages, attorneys fees, or trustee's compensation should be permitted.

5. Modify 11 U.S.C. 349 and 11 U.S.C. 362(b) to make clear that Court can enter appropriate relief in dismissing a case, including in rem relief, to prevent serial filings of fractional interests in the same property or to limit the operation of the automatic stay in a subsequent case involving the same property.

One characteristic of many serially filed cases is that they involve fractional interests in the same property. In these situations, fractional holdings in the same property are transferred to multiple parties each of whom files seriatim after the previous case is dismissed (usually for failure to appear at the 341(a) meeting) to keep the automatic stay in place. One possible solution is to amend Section 349 to make clear that in

dismissing a case, the Court can order that a particular property is exempt from the automatic stay in any subsequent filing involving the same property without further order of the Court; in addition, Section 362(b) could be amended to make clear that the filing of a petition would not stay the commencement or continuation of an action against property of the estate that was specifically exempted from Section 362(a) under a prior Court order conditioning dismissal under Section 349.

6. Clarify the obligation of debtors under 11 U.S.C. 521 and of trustees under 11 U.S.C. 704 to cooperate with the United States Trustee.

Although the USTs are charged with a wide range of supervisory responsibilities, nothing in the statute or in the Rules requires parties to cooperate with the UST. Rule X-1007, now repealed, specifically provided that the trustee or DIP "shall cooperate with the United States trustee by furnishing such information as the UST may reasonably require in supervising the administration of the estate." The Advisory Committee Note to Rule X-1007 contained helpful language about the duties of the parties to assist the UST and how the rule enabled the UST to superintend the activities of trustees and DIP.

Rule X-1007 was largely superseded by Rule 2015. The Advisory Committee Note to the 1991 amendments to Rule 2015, states that "the deletion of Rule X-1007(b) should not be construed as a limitation of the powers of the United States trustee or of the duty of the trustee or debtor in possession to cooperate with the United States trustee in the performance of the statutory responsibilities of that office." This is an important sentiment which deserves to be expressed rather than inferred from the statute. Note, for example, 11 U.S.C. 521(3) which makes it one of the debtor's express duties to "cooperate with the trustee as necessary to enable the trustee to perform the trustee's duties under this title." To impose a similar duty on debtors and trustees to cooperate with the UST would be very helpful.

7. Reexamine the election of trustees in light of the integrity of the system. 11 U.S.C. 702, 1104(b).

Elections do not occur often but when they do, they are frequently challenged. The Commission should consider whether the concept of trustee elections still serves a useful purpose, whether elections serve the best interests of all creditors or are tools that benefit only a few creditors, and whether trustee election procedures are adequate to safeguard the interests of creditors.

8. Create additional tools for USTs to fight bankruptcy fraud and abuse of the bankruptcy process.

Several sections of the Code should be modified or clarified to eliminate loopholes and to enhance the ability of the USTs to fight fraud and abuse.

! Add misdemeanor bankruptcy crimes to the bankruptcy fraud sections in Title 18 to encourage greater investigation and prosecution of small offenses.

! Modify Section 706(a), which allows a debtor to automatically convert a case from Chapter 7 to Chapter 11 or 13, to prohibit conversion as a method of avoiding an objection to discharge or a motion to dismiss based on fraud or other misconduct.

- **!** Add as a ground for denying or revoking a discharge that the debtor committed acts that constitute a bankruptcy crime in connection with the filing.

- **!** Expand the time to commence an action to revoke discharge based upon improper failure to disclose assets.

- **!** Provide enhanced civil penalties for conduct that might otherwise constitute a bankruptcy crime where no prosecution takes place.

9. Reexamine statutory duties to ensure that expectations are appropriately codified and clarify the consequences that flow from non-performance of duties.

As any other party in interest in a case, the UST must bring matters requiring attention to the Court for resolution. But unlike those other parties who have a financial interest at stake, the USTs' interest lies in the integrity of the process. Their participation in a case, whether as supervisor, administrator or litigant, is designed to protect the interests of the system. Those interests are embodied in the law. The clearer the law is, whether it involves the legal standard for dismissal of a Chapter 11 case or the basis for awarding compensation, the easier it is for the USTs to do their job. Our last suggestion is to endorse an approach that carries throughout most of the preceding eight suggestions: any move to clarify a provision of title 11 increases the USTs' ability to be more effective in enforcing the Bankruptcy Code and in making participants in the bankruptcy process play by the rules.

The developing proposal of the Small Business Working Group to amend Section 1112(b) (discussed in greater detail in Suggestion #1) is illustrative. By providing specific grounds for conversion or dismissal of a Chapter 11 case, the proposal creates a statutory presumption that the debtor must comply with certain requirements to remain in Chapter 11. Although none of the proposed requirements is new in concept, under the existing statute they must be shown to constitute "cause," or to demonstrate an "absence of a reasonable likelihood of rehabilitation" or an "inability to effectuate a plan." Codification greatly enhances the USTs' and the Courts' ability to use these factors to address faltering cases quickly.

Another statute, which has not been mentioned but which illustrates the need for clarification, involves Congress' 1994

amendment to 28 U.S.C. 586(a)(3)(A). The Executive Office for United States Trustees was directed to adopt procedural guidelines for USTs to follow in reviewing applications for compensation filed pursuant to 11 U.S.C. 330. Although the uniform guidelines were intended to "help foster greater uniformity in the application for and processing and approval of fee applications,"[1] Congress did not enact a corollary provision in title 11 to accomplish that result. To give the 1994 amendment its intended effect, Section 330 should be amended to require the Court to consider whether the applicant has complied with the UST's guidelines prior to rendering an award.

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[1] 140 Cong. Rec. H10,769 (Oct. 4, 1994).