

Civil Enforcement: An Early Report

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Civil enforcement, the most recent and by far the most challenging initiative in the history of the U.S. Trustee Program,² is off to an outstanding start. The following is a brief report on where the Civil Enforcement Initiative stands as it approaches its first full year of operation on September 30, 2002.

The objective of the initiative is as simple as it is ambitious. The U.S. Trustee Program is undertaking to reform the bankruptcy system by applying its resources to detect and redress abuse, raise the standard of practice among professionals, protect debtors from predatory practices, and thereby enhance the integrity and fairness of the system and the public's confidence in it.

The Civil Enforcement Initiative was launched on October 1, 2002, with the start of Fiscal Year 2002 and was announced by the Executive Office, under then Acting Director Martha Davis, in a press release dated October 30, 2001. The press release cited four fundamental priorities:

- Ensuring that Chapter 7 is not abused and that Chapter 7 debtors are held accountable. Chapter 7 debtors who do not comply with the law will have their cases converted or dismissed, or their bankruptcy discharges denied or revoked.
- Protecting consumer debtors, creditors, and others who are victimized by those who mislead or misinform debtors, make false representations in connection with a bankruptcy case, or otherwise abuse the bankruptcy process. Attorneys and bankruptcy petition preparers (non-attorneys who prepare bankruptcy documents for a fee) must engage in full disclosure, be free of conflicts of interest, and engage in ethical practices.
- Ensuring that Chapter 11 debtors proceed with their cases promptly and are informed of and held to account for their obligations under the Bankruptcy Code.
- Fighting fraud and abuse by making criminal referrals and assisting United States Attorneys in criminal prosecutions.

Increased Momentum

With the appointment on March 4, 2002, of Lawrence Friedman as Director of the Executive Office, the Initiative has become an even higher priority, with more focus, more resources, and more momentum.

The Civil Enforcement Initiative was inspired by several events. First, the U.S. Trustee Program was created to be the watchdog of the bankruptcy system and the Initiative is a natural outgrowth of its mission. Second, the recent bankruptcy reform movement, which started with the Bankruptcy Review Commission and its report to Congress in 1997, documented numerous

¹The views expressed in this article are those of the authors and do not necessarily represent, and should not be attributed to, the Executive Office for United States Trustees, the United States Trustee Program, or the Department of Justice.

² The first Initiative was to address the backlog of Chapter 11 cases that developed in the late 1980s and the second was to address the backlog of Chapter 7 asset cases.

abuses and recommended reforms. Congress, with strong bipartisan support, has introduced comprehensive bankruptcy reform in each of the last three legislative sessions. Meanwhile, consumer filings increased during one of the largest and longest economic expansions in the nation's history, a phenomenon that fueled debate. Finally, many of the proposals placed the U.S. Trustee Program at the center of proposed reform in such areas as means testing, debtor audits, debtor education, credit counseling, and Chapter 11 oversight. Thus, the historical role of the U.S. Trustee as guardian of the integrity of the system with its unique powers under Sections 110, 707, and 727 made it only natural that the Program exercise these powers with more energy and focus.

Although panel trustees play a critical role in the system, we are not asking them to shoulder new civil enforcement duties. We ask just two things from the trustees. First, as our first line of detection, we ask them to become more vigilant and active in referring abuse cases for civil enforcement, whether for possible action under Section 727, 707(b), or 110. Second, we ask that the trustees "police" themselves more carefully so that the Program's attorneys, analysts, and paralegals, rather than reviewing trustees' paperwork, can investigate and prosecute cases in court.

On April 5, 2002, in an address to Chapter 7 trustees, Director Friedman stated: "[T]he number one initiative of the Program is in the area of civil enforcement. This initiative is not mere words but represents a concerted effort and a change in the way we do business." In the few months since he was appointed Director, Larry Friedman has implemented a number of new measures to facilitate the realignment of resources into civil enforcement. Most notably for Chapter 7 trustees, starting July 1, 2002, the Program changed to requiring annual rather than semi-annual filing of case financial reports.

Chapter 7 Scrutiny

As part of the Civil Enforcement Initiative, in Region 1 and in many field offices throughout the country we are reviewing every Chapter 7 petition with a focus on key areas that include: credit card load-up or bust-out; ability to repay under Section 707(b); and sloppy schedules, excessive attorneys' fees, and Section 110 issues. When we find schedules that prompt questions, we make inquiry of debtors' counsel, asking for documents to explain or corroborate unusually high debt, income, or unusual expenses. We often ask for documents to verify Schedule J income, Schedule I expenses, credit card statements, and property appraisals. We try to do this informally but use subpoenas and Rule 2004 examinations if necessary.

We have found that, in the vast majority of cases, the debtors are honest and desperately in need and deserving of a fresh start. We want to protect those debtors and not burden them. We have also found that in the vast majority of cases debtors' counsel are professional, honest, and diligent. However, we have also found cases in which the debtor is not deserving or is not playing by the rules or is represented by someone who does not know or properly advise on the rules. Some of these cases are compelling. Some are infuriating. In those instances, the resources of our office are being re-channeled and refocused on addressing the abuse by filing complaints objecting to discharge under Section 727, motions to dismiss under Section 707(b), or motions to reduce excessive fees.

With cooperation from panel and standing trustees, we have also implemented debtor identification proceedings. In a pilot study in 2001, the Program found errors in Social Security numbers and names in approximately 1 percent of cases. One percent may not seem high, but one percent of 1 million petitions is 10,000 errors--a substantial number, especially if you are a victim of identity theft or a simple typographical error. A full report on the debtor identification pilot project can be found at <http://www.usdoj.gov/ust/otherinitiatives/debtorid/report.html> .

In the first six months of the Civil Enforcement Initiative--the six months ending March 31, 2002--Section 707(b) actions throughout the Program increased sharply, as did enforcement actions against attorneys, while objections to discharge and Section 110 complaints increased modestly. Numbers also show that we win the cases. Our success rate is at least 85 percent, and in many matters it is over 90 percent.

Numbers do not tell the story as well as do numerous specific cases. In one case, the debtors ran up \$650,000 in credit card debt. In another, the debtors valued their home in excess of \$600,000 and yet listed no personal property. In yet another instance, an attorney violated a series of judgments and orders totaling more than \$190,000 in sanctions and disgorgements. More and more such stories are coming to light as our Civil Enforcement Initiative moves forward.

Preliminary Conclusions

This column offers a first, preliminary report. More detailed reports will be issued in the ensuing months and years as civil enforcement takes root and grows. In the meantime, the following are a few preliminary conclusions:

- Abuse of the system is more widespread than many would have estimated.
- Sloppy, poor lawyering needs to be addressed. Trustees, judges, responsible practitioners, and debtors all have expressed frustration with the relatively few lawyers who do not know or play by the rules.
- Debtors need to be better advised, most notably by lawyers but also by others upon whom they rely, including paralegals and petition preparers.
- The schedules should be more reliable and better prepared, especially Schedules I and J. These schedules in particular are often “backed into,” with information entered to achieve a particular result.
- The Program should continue to improve its system for criminal referrals.
- Creditors need to play a more prominent role in the bankruptcy process.

In summary, the Civil Enforcement Initiative is addressing a desperate need. From reviewing petitions, we have found numerous and compelling instances where debtors do not deserve a discharge, do not need the relief requested, or have been poorly advised. The timing for the Initiative is right. If Congress passes reform legislation, the transition will be easier if we have already revised the standard of practice by debtors and professionals. If Congress does not pass a reform bill, we will continue to make the system more fair, efficient, and just.

Panel and standing trustees have been enormously helpful and we will continue to draw on your ideas, your expertise, and especially your referrals. Over time, civil enforcement will no longer be called an initiative, but will be accepted as the way by which we achieve and maintain the highest standards of professionalism and assure that the bankruptcy system operates as intended.