

Department of Justice
Executive Office for United States Trustees

Final Agency Action
Case No. 97-A-5

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

Mr. [REDACTED]^{1/} seeks review of a decision by the United States Trustee for Region [REDACTED] not to reappoint him to the panel of chapter 7 trustees for the United States Bankruptcy Court for the District of [REDACTED].^{2/} Based upon the record before me,^{3/} I conclude that the trustee should be returned to the panel.

I. Course of this Proceeding

Prior to his non-renewal, the trustee had been a member of the panel of chapter 7 trustees for the United States Bankruptcy Court for the District of [REDACTED]. On March 18, 1997, the United States Trustee notified the trustee that she was not reappointing him to the panel when his current one year appointment expired. By letter dated October 7, 1997, the trustee sought administrative review of that decision from the Director of the Executive Office for United States Trustees. By letter dated November 7, 1997, the United States Trustee set forth her bases for not renewing the trustee (the "Notice"). The trustee responded to the Notice on December 12, 1997 (the "12/12/97 response"). The United States Trustee responded to the trustee's letter by letter

^{1/} For ease of reference, hereinafter "the trustee."

^{2/} United States Trustees are Justice Department officials appointed by, and who serve at the pleasure of, the Attorney General. 28 U.S.C. 581(a) and (c). The Director of the Executive Office for United States Trustees is a Justice Department official who acts under authority delegated by the Attorney General. Panel trustees, such as the trustee, serve under appointments that have a term not to exceed one year.

^{3/} The record in this matter includes the United States Trustee's decision; the trustee's request for review; the United States Trustee's response; correspondence submitted by the trustee to the Director; materials that the parties produced at the request of the Director; and documents that accompanied those various submissions.

dated January 9, 1998 (the “1/9/98 response”).

II. Standard of Review

In reviewing the United States Trustee’s decision, I 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.

I apply these factors because they are identical to those the Director must consider pursuant to a final Rule the Department of Justice recently promulgated to formalize the procedures to be used by the Director in reviewing decisions by United States Trustees to cease assigning future cases to panel and standing trustees. *Procedures for Suspension and Removal of Panel Trustees and Standing Trustees*, 62 Fed. Reg. 51740 (Oct. 2, 1997). The final Rule, which is codified at 28 C.F.R. 58.6, is not effective for non-renewal decisions, like the trustee’s, that were made prior to November 3, 1997. 62 Fed. Reg. at 51740. Nevertheless, I apply the Rule’s factors, which are set out in subsection 58.6(i), because they constitute a rational basis upon which to review the United States Trustee’s decisions in this case.

III. Analysis

The United States Trustee decided not to renew the trustee’s one year appointment to the chapter 7 panel based upon her conclusion that he was placing his interest in obtaining personal remuneration for his trustee services above the interests of the creditors — particularly the unsecured creditors — of the estates placed under his charge. Notice at 1-16. She concluded the trustee’s conduct constituted a breach of fiduciary duty and a violation of United States Trustee Program policy. *Id.* The United States Trustee specifically determined that the trustee had administered fully encumbered assets in cases to obtain a larger fee and this was done to the detriment of those estates’ general unsecured creditors. *Id.* She relied primarily upon statistical data to establish this point. *Id.* at 9-12; 1/9/98 response at 8-12. The United States Trustee also was concerned that the compensation sought by the trustee in one particular case, [REDACTED], was improper. Notice at 2-5; 1/9/98 response at 12-15.

United States Trustees supervise panel trustees. 28 U.S.C. 586(a)(1). They carefully “monitor the performance of panel members . . . in order to determine whether they should be continued in or removed from panel membership.” 1/9/98 response at 2 (quoting H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 101, 101-02 (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 trustee on the panel.” 1/9/98 response at 2-3 (quoting 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 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.). Any trustee who administers estates for his personal interest rather than the creditors' interests has violated his fiduciary duties and should be subject to appropriate supervisory action.

A chapter 7 case should be administered to maximize and expedite the payment of dividends to creditors and facilitate a fresh start for debtors entitled to a discharge. In this case, it was wholly appropriate for the United States Trustee to scrutinize the trustee's administration of assets, including fully encumbered assets, to determine whether the trustee was fulfilling his fiduciary duties. A fully encumbered asset is one in which a secured creditor's liens equal or exceed the asset's value. A trustee should not administer a fully encumbered asset if the proceeds obtained from its liquidation will primarily benefit the trustee or the professionals, or will unduly delay the resolution of the case. Administering an asset in such circumstances will not produce a meaningful distribution to unsecured creditors and may well reduce distributions due to delay; liability arising from the maintenance of the asset; the trustee's increased compensation (if he sought to charge the estate for administering the asset); or "adverse tax consequences." *Handbook for Chapter 7 Trustees* at 58. For these reasons, the *Handbook* provides that "[g]enerally, a trustee should not administer or sell assets that are fully encumbered unless the secured creditor has requested the trustee to administer its collateral and the trustee determines that administering the property would benefit the estate." *Handbook* at 58.

Rather than administering fully encumbered assets, trustees should obtain a court order to abandon them whenever the administration of such an asset would produce "inconsequential value and benefit to the estate." 11 U.S.C. 554(a). Abandonment enables a secured creditor to protect its security interest in the secured property by exercising its rights under applicable state law and maximizes the distribution available for unsecured creditors.^{4/}

In this case, the United States Trustee relied primarily upon statistical evidence to justify non-renewal. Notice at 9-12; 1/9/98 response at 8-12. She contends the trustee distributed a lower percentage of total distributions to general unsecured creditors in his cases than the regional and national average for distributions to unsecured creditors in chapter 7 cases. *Id.*; Notice at Exhibits A and B.

In reviewing trustee performance, however, statistics should be the beginning point, not the ending point. A United States Trustee is right to be concerned when statistics indicate that a panel trustee has returned a lower average distribution to unsecured creditors than have other trustees. That may mean the trustee is not diligently representing the interests of the creditors,

^{4/} A secured creditor also has the right to seek a lifting of the automatic stay, 11 U.S.C. 362, and then employ its state law remedies to realize on its security interest.

there is a fundamental defect in the trustee's ability to administer cases, or the trustee is engaging in some scheme, such as over-administering cases, to produce excessive fees. Alternatively, there may be a legitimate reason why a particular trustee has achieved a lower average return.

When faced with a history of low return to unsecured creditors, a United States Trustee should analyze the trustee's specific cases to determine the cause. Where the United States Trustee encounters instances in which a trustee is seeking improperly to administer fully encumbered assets, it is incumbent upon the United States Trustee to file motions objecting to that conduct. The United States Trustee also should provide the trustee notice and guidance concerning this important deficiency, giving the trustee an opportunity to reform. When those admonishments result in no change in objectionable case handling procedures, the United States Trustee should take appropriate supervisory action.

In this situation, the distribution data cited by the United States Trustee provides support for her conclusion. In 1997, the trustee's payments to unsecured creditors fell below regional and national averages, while his payments to secured creditors exceeded them, as did his payments to outside professionals.⁵⁷ In 1996, by contrast, while the trustee's distributions to unsecured creditors were below national and regional averages, so were his distributions to secured creditors and to himself. Yet, the trustee's payments to outside counsel and professionals that year were well above national and regional levels. This type of fluctuating data does not enable me to draw firm conclusions regarding the trustee's conduct. While I am troubled by his low return to unsecured creditors, I believe that disciplinary action would need to be based upon a detailed analysis of this trustee's handling of individual cases. The United States Trustee did an analysis of the trustee's administration of a few cases originally filed under chapter 11 and later converted to chapter 7, but that analysis was not determinative of the issues raised by the United States Trustee, and the trustee raised legitimate points in response. See Notice at 11-12; 12/12/97 response at 17-20; 1/9/98 response at 9-10.

The United States Trustee also bases non-renewal upon the trustee's administration of the [REDACTED] case, in which the United States Trustee believes the compensation the trustee seeks is excessive and contravenes 11 U.S.C. 326(a). Notice at 2-5. On November 14, 1996, the United States Trustee filed an objection to the trustee's proposed compensation with the bankruptcy court. Id. at 3. At the time of her November 7, 1997 Notice in this matter, the bankruptcy court had not ruled upon the United States Trustee's motion. Id. at 4.

The United States Trustee acted appropriately in the [REDACTED] case by opposing compensation she concluded was inappropriate. Although there is no evidence in the record that the trustee has consistently sought inappropriate compensation in other cases, supervisory action could be fully warranted if the record established that he had engaged in such conduct.

⁵⁷ In 1997, the trustee's payments to outside counsel and himself were below national and regional averages.

The United States Trustee chose not to reappoint the trustee over a year ago and the trustee appealed seven months later, which was still prior to the effective date of the formal *Procedures for Suspension and Removal of Panel Trustees and Standing Trustees*. I acknowledge that it is difficult to develop a record to support actions taken long before a trustee calls them into question. Thus, while this record does not justify a non-renewal action, it is incumbent upon the United States Trustee to provide close scrutiny over this trustee's case handling procedures. If she finds improper conduct that diminishes distributions to unsecured creditors, unjustified payments to secured creditors or outside counsel or professionals, then she should take appropriate disciplinary action, based upon a fully developed record.

IV. Conclusion

Based upon my review of the record, including the written submissions of the United States Trustee and the trustee, I determine that Mr. [REDACTED] should be returned to the panel of individuals available for appointment as trustee in chapter 7 cases in the United States Bankruptcy Court for the District of [REDACTED].

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

Dated: April 22, 1998

Joseph Patchan
Director
Executive Office for
United States Trustees