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Report to the Chairman, Permanent Subcommittee on Investigations Committee on Governmental Affairs, U.S. Senate

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BANKRUPTCY ADMINISTRATION

Justification Lacking for Continuing Two Parallel Programs

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The Honorable Sam Nunn
Chairman, Permanent Subcommittee
on Investigations
Committee on Governmental Affairs
United States Senate

Dear Mr. Chairman:

Over the last several years, bankruptcy filings have increased more rapidly than during any other time in history. Since 1986, filings have increased 84 percent, from 478,000 to 880,000, and predictions are that over 1 million bankruptcies will be filed in 1992.

Two programs exist to ensure that bankruptcy cases are administered in accordance with the bankruptcy laws: the U.S. Trustee (UST) program and the Bankruptcy Administrator (BA) program. The UST program, which is under the Department of Justice (DOJ), administers bankruptcy cases in 88 of the 94 judicial districts. The BA program has the case administration role in the remaining six districts, which are in the states of Alabama and North Carolina. It operates as an independent program in the judicial branch.

This report responds to your request that we review certain aspects of these two parallel programs. Specifically, you asked us to compare the relative efficiencies, costs, and results achieved in comparable BA and UST districts, identify the major differences between the two programs, and determine the need for continuing two programs.

Results in Brief

Our review of four BA districts and four comparable UST districts found no systematic differences in the results achieved by the two programs. Frequently, we found more variation between districts within a single program than between the programs. The cost to operate the UST program was higher. But the UST program is also self-financing, while the BA program, because it has a different fee structure, is not.

For the most part, the programs use similar procedures for supervising trustees and monitoring individual bankruptcy cases. The UST program does have the noteworthy advantage of using Federal Bureau of Investigation (FBI) investigations and audits to enhance its oversight of trustees.

On the basis of interviews with bankruptcy officials in the BA districts, t BA program appears to have been enacted to accommodate local concer about problems that arose during the pilot test of the UST program. However, subsequent changes in the UST program have addressed these concerns and negate the justification for two parallel programs. Accordingly, because of the advantages in oversight and funding provid by the UST program and to make bankruptcy administration consistent across the country, we recommend that Congress incorporate the BA program into the UST program now rather than in 2002 as currently scheduled under statute.

On a related issue, we also found that the UST program has a fund surplu because fee revenues have exceeded program funding. As a result, unde current statutory provisions the UST program has millions of dollars in surplus funds that the law could require to be transferred to the Treasu Since the current funding mechanism was not designed to make money the government, the self-funding provision of the UST program should be modified to ensure that fees collected from debtors are used solely to m the demands of the program. When appropriate, the fee structure shoul be revised to help prevent future surpluses.

Background

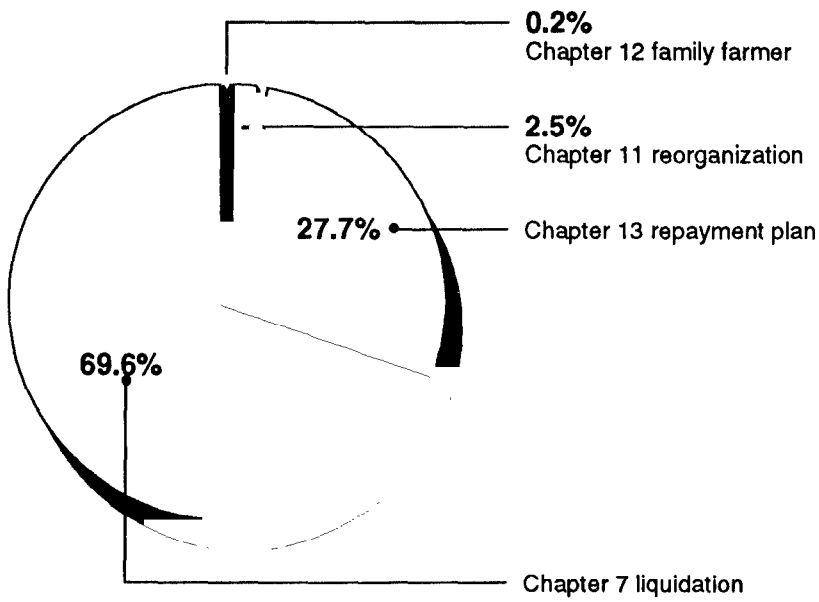
Bankruptcy in the United States was established to resolve conflicts tha arise among creditors of debtors who cannot pay their debts. Its basic objective is to ensure that all creditors are treated fairly. It also provide debtors with a "fresh start." Under the Constitution, bankruptcy is governed solely by federal law, with jurisdiction in bankruptcy cases vested in federal district courts across the country. District courts, in tu refer all bankruptcy cases and proceedings to bankruptcy judges, who preside over the cases in separate bankruptcy courts.

Most individuals who file bankruptcy surrender their assets to a trustee who converts them to cash for distribution to creditors (i.e., Chapter 7 liquidation). Some individuals elect to pay back a portion or all of their debt by monthly payments over several years (i.e., Chapter 13 repaymer plan). If the individual filing for bankruptcy is a family farmer, the law h a provision specifically for the repayment of that type of debt (i.e., Chap 12 family farmer).

Business debtors, like individual debtors, can elect to turn over their assets for liquidation or they can attempt to reorganize their debt, pay back their creditors, and continue in business (i.e., Chapter 11

reorganization). Since a Chapter 11 debtor retains possession of his/her assets during the bankruptcy, he/she is referred to as a debtor-in-possession. Appendix I provides additional information about the various chapters under which a debtor can file for bankruptcy. Figure 1 shows the percentage of all bankruptcies filed by chapter in 1991.

Figure 1: Percentage of All Bankruptcies Filed in 1991 by Chapter



Source: AO data.

Under both the UST and BA programs, the trustee is the person tasked with liquidating debtors' assets or disbursing debtors' monthly payments to creditors. Trustees are not employees of the court. Most of them are lawyers who fulfill the fiduciary and legal responsibilities of a trustee on a part-time basis. Under current bankruptcy law, selecting individuals to be trustees, appointing them to specific cases, supervising their performance, and monitoring the progress of their cases is the responsibility of the staff of the UST program in its 88 districts and the BA program in its 6 districts.

Evolution of Case Administration

Before 1978, bankruptcy judges were responsible for the administration of individual bankruptcy cases, including such tasks as appointing trustees to cases and monitoring individual cases. This responsibility placed

administrative, supervisory, and clerical functions on judges in addition to their judicial duties. Many in the bankruptcy community viewed judges' dual responsibilities—administrative and judicial—as a conflict in the bankruptcy system because in carrying out their administrative role, judges were exposed to inadmissible evidence that could bias them in making judicial decisions.

As a result of the dual responsibilities, there was a close relationship between bankruptcy judges, trustees, trustees' attorneys, and the bankruptcy bar that led to the perception that there was a "bankruptcy ring" that had the inside track on all bankruptcy matters. In addition, the time judges devoted to administrative matters left them with less time for judicial responsibilities.

In 1978, Congress passed the Bankruptcy Reform Act, Public Law 95-598, the first comprehensive revision to the bankruptcy statutes since 1938. To correct the perception of unfairness and cronyism caused by judges' dual responsibilities, this act created a separate agency—the UST program—to assume case administration responsibilities.

The 1978 legislation authorized the UST program to be pilot-tested in 18 of the 94 judicial districts. In the remaining 76 districts, case administration responsibilities were left to the judge, the bankruptcy clerk, and a deputy clerk for estate administration. In 1986, additional bankruptcy legislation expanded the UST program nationwide,[1] with the exception of the six judicial districts in Alabama and North Carolina. Congress authorized those two states to delay their entry into the UST program until 1992, subsequently extending the date 10 years to 2002. For those two states, a separate, parallel program with objectives identical to those of the UST program was created—the BA program.

Although they have identical responsibilities, the organizational structures of the UST and BA programs differ. UST legislation established 21 regions, each administered by a U.S. Trustee who is appointed by the Attorney General for a 5-year term. The Attorney General established the Executive Office for United States Trustees (EOUST) to provide legal, administrative, and management support to the individual UST districts. The centralized support and oversight that the EOUST and its regional offices provide to individual UST districts does not exist in the BA program. Each of the six BA districts is independent, operating as a separate entity. The BA program in

[1]The Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Public Law 99-554.

each district is headed by a Bankruptcy Administrator who is selected by the U.S. Court of Appeals for a term of 5 years. Bankruptcy Administrators receive only minimal administrative and legal support from the Bankruptcy Division of the Administrative Office of the United States Courts (AO).

In addition, fees paid in bankruptcy are not uniform. Debtors in the UST and the BA districts pay the same fees when filing for bankruptcy, but Chapter 11 debtors in BA districts are not subject to the additional quarterly fees that are levied on Chapter 11 debtors in UST districts.

Objectives, Scope, and Methodology

To compare the relative efficiencies, cost, and results achieved in comparable BA and UST districts, we selected the four BA districts that accounted for a large percentage of bankruptcy filings for that program. The three districts in North Carolina (Eastern, Middle, and Western) and the Northern District of Alabama accounted for 80 percent of all bankruptcy cases filed in BA districts in 1991.

We then identified four UST districts that were comparable to those four BA districts. We matched UST districts with BA districts using the chapter distribution of filings and qualitative factors, such as regional economy, local demographics, and multiple offices. Our methodology used district matches rather than a total program comparison because of the diversity of districts within the UST program. The BA program, in total, comprises six small, generally rural districts. By contrast, in addition to small districts, the UST program also has large urban districts. These large districts have very different caseload profiles from BA districts. The differences in caseload composition, as well as differences in the local economy and demographics, could significantly affect district costs and efficiencies. These differences limit the validity of comparing the two programs in total.

We reviewed our selection process with officials of the EOUST, who agreed with our final selections. Table 1 shows the comparable BA and UST districts we selected.

Table 1: Comparable BA and UST Districts GAO Analyzed

BA districts	UST districts
Eastern North Carolina (ENC)	South Carolina (SC)
Middle North Carolina (MNC)	Nebraska (NEB)
Western North Carolina (WNC)	Northern Florida (NFL)
Northern Alabama (NAL)	Middle Tennessee (MTN)

Our audit work was done between April and December 1991 in accordance with generally accepted government auditing standards. A more detailed description of our objectives, scope, and methodology is in appendix II.

Key Performance Indicators Demonstrated Programs Were Achieving Similar Results

Our analysis of cost and performance data on the four BA districts and comparable UST districts showed the following for those districts:

- The cost to operate the UST program was higher.
- Creditors in BA and UST districts obtained similar distributions from funds trustees generated from liquidating debtors' assets in Chapter 7 cases; unsecured creditors received a higher percentage of funds in the UST districts compared to the BA districts (i.e., 21 percent versus 14 percent).
- For Chapter 7 cases, three UST districts were slightly faster in processing their cases than their comparable BA districts. For Chapter 11 cases, two BA districts were faster than their comparable UST districts, and two UST districts were faster than their BA counterparts.

However, our analysis of these indicators showed that the overall variation between districts within a program was frequently greater than the difference between the two programs. For example, distribution for administrative expenses was 21 percent in both the UST and the BA districts. But among the BA districts, it varied from a low of 14 percent to a high of 26 percent; the range in the UST districts was from 16 percent to 29 percent.

Cost to Operate UST Districts Was Higher Than BA Districts

The cost to operate the four UST districts in fiscal year 1990 was higher than the costs for the four BA districts. Overall, for fiscal year 1990 the total cost for operating the UST districts was $1.56 million, or 22 percent higher than the $1.28 million needed to operate the BA districts. Table 2 depicts the fiscal year 1990 expenditures by line item.

Table 2: Fiscal Year 1990 Expenditures for Comparable UST and BA Districts

Cost category	BA districts	UST districts
Salary and benefits	$1,093,819	$1,081,819
Travel and transportation	22,922	63,291
Communications	22,334	37,979
Rental (GSA[a] and other)	56,694	279,684
Printing and reproduction	977	3,833
Supplies and materials	23,646	41,800
Furniture and equipment	47,915	28,557
Other services	13,958	26,508
Total	**$1,282,265**	**$1,563,471**

[a]General Services Administration.

Source: AO and EOUST data.

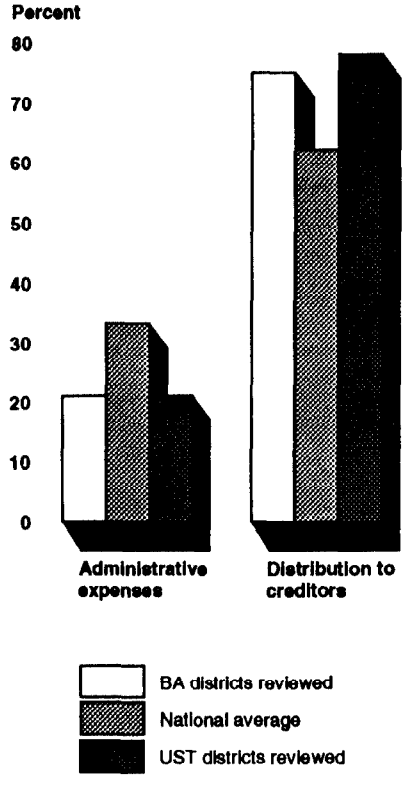
Table 2 does not include costs for administrative and legal support the EOUST and regional offices provided to their district offices, nor does it include the support the AO provided to BA districts. According to an EOUST official, the UST program's accounting system does not record data in a manner that allows those costs to be accurately distributed to individual districts.

Total Distributions to Creditors From Chapter 7 Cases Were Similar in UST and BA Districts

We found that creditors did about equally well in the UST and BA districts we reviewed. For 1990 and 1991, 75 percent of the funds from Chapter 7 cases in BA districts went to creditors (priority, secured, and unsecured), compared to 78 percent in UST districts. For Chapter 7 cases in BA and UST districts, 21 percent of the funds went for administrative expenses. The remaining funds for both BA and UST districts went for other miscellaneous payments, including payment to debtors.

In comparison to data on all 94 districts for that same period, both the BA and the UST districts we examined had substantially lower administrative expenses and higher distributions to creditors. The average for all 94 districts was 33 percent for administrative expenses and 62 percent for distribution to creditors. The remaining funds went for miscellaneous payments. (See fig. 2.)

Figure 2: Distributions From Chapter 7 Asset Cases for 1990 and 1991



Source: AO data.

Although the distributions for administrative expenses and creditors between the UST and BA programs were similar, there was a range of differences in the distribution percentages within each program. Appendix III provides these distribution data.

Unsecured Creditors Received Higher Percentage of Distribution in UST Districts

For 1990 and 1991, unsecured creditors in the four UST districts received a higher percentage of the funds distributed from Chapter 7 cases compared to unsecured creditors in the four BA districts. Of the total funds generated from Chapter 7 cases in the UST districts, 21 percent went to unsecured creditors, compared to 14 percent in the BA districts. (See table 3.)

Table 3: Distribution to Categories of Creditors for 1990 and 1991

	BA districts		UST districts	
Distribution of funds	**Amount**	**Percent**	**Amount**	**Percent**
Creditors:				
Secured	$12,759,697	47	$10,936,306	43
Priority	3,948,862	14	3,171,847	13
Unsecured	3,935,957	14	5,299,348	21
Equity holders	18,757	0	236,509	1
Subtotal	**20,663,273**	**75**	**19,644,010**	**78**
Administrative expenses	5,871,393	21	5,293,152	21
Other payments	895,165	3	347,063	1
Total cash receipts	**$27,429,831**	**100**	**$25,284,225**	**100**

AO officials told us that they view the distribution of Chapter 7 funds to unsecured creditors as a significant performance indicator—the higher the percentage, the better the performance.

No Pattern of Superior Performance in Processing Times for Cases in BA and UST Districts

We reviewed two performance indicators that reflect the speed with which districts process their cases—the pending-to-filing ratio[2] and the median disposition time. These indicators showed no consistent pattern of superiority in processing times in either the BA or the UST districts. These performance indicators reflect the cumulative results of how well all the key players in the bankruptcy process are doing their jobs—judges, clerks and their staffs, the bankruptcy attorneys, the trustees, and the BA or UST staffs. Officials from both AO and EOUST told us that judges probably have more influence on how quickly cases are processed than the BA and the UST staffs.

The pending-to-filing ratios showed that three of the UST districts processed their Chapter 7 cases faster than their comparable BA districts. In comparing the ratios for the four matched pairs of districts, the data showed that two BA districts processed their Chapter 11 cases faster than their comparable UST districts, and two UST districts were faster processing their Chapter 11 cases than their comparable BA districts.

The median disposition time reflects the age of the middle case that was processed to completion by the court during the year. When applying this

[2]The pending-to-filing ratio, obtained by dividing the number of cases pending at the end of the year by the number filed during the year, is a standard indicator of the average speed at which a district processes its cases. The pending-to-filing ratio can also be used as an indicator of how quickly Chapter 11 cases are processed.

statistic to Chapter 7 cases, it indicates how quickly the districts are processing their routine cases. In all eight of the districts we visited, the median case was processed very quickly because it produced no funds for distribution to creditors and required no action by a bankruptcy judge. In two of the district pairs, the BA districts had lower median disposition times than the UST districts. In the other two matched pairs, the UST districts had lower median times than the BA districts. Appendix III describes in detail these two performance indicators and shows how the ratios for the matched districts compare to the national averages.

Programs Differ in Trustee Oversight and Funding

While the BA and UST programs have many similarities in the eight districts we reviewed, we found the UST program provides additional trustee oversight through FBI background checks for trustees and through periodic trustee audits. This additional oversight bolsters the integrity of the UST program and its ability to prevent and identify trustee misconduct. The UST program is also self-financing, while the BA program is not.

Independent Audits and FBI Investigations Bolster Integrity of Bankruptcy System

The BA and UST programs have similar procedures and criteria for supervising Chapter 7 and Chapter 13 trustees and Chapter 11 debtors-in-possession, and for monitoring how well the trustees and debtors-in-possession administer the funds for which they are responsible. These procedures include periodic reports submitted by trustees on the status of their cases, a case-by-case analysis of how the assets were liquidated, and the planned distribution of the funds.

Similar criteria are also used in reviewing applications for compensation submitted by professionals hired by trustees, creditors committees, and debtors-in-possession. Similar information is used to assess the adequacy of disclosure statements filed in Chapter 11 cases, and similar reports and computerized tracking systems are used to monitor the progress of Chapter 7 and Chapter 11 cases.

Beyond these similarities, the UST program requires two other steps that enhance the integrity of the bankruptcy system: FBI investigations of new Chapter 7 and Chapter 13 trustees and periodic audits of Chapter 7 trustees. These additional steps have proven beneficial. According to UST officials, the FBI investigations screen out questionable candidates in two ways. First, the results of the investigations have provided the basis for denying permanent appointments to trustee applicants. Second, some

potential trustee applicants decide not to apply after finding out that they will be subject to a background investigation.

The periodic audits of trustees have also paid dividends. Of 30 trustees or their employees in UST districts indicted or convicted of bankruptcy crimes since 1987, 7 were identified as a result of these audits.

Providing additional trustee oversight cost the UST program about $2 million in fiscal year 1990. The UST program paid $16,000 to the FBI to perform background investigations and $1.8 million to the DOJ Office of Inspector General to conduct audits of Chapter 7 trustees. Of those amounts, $600 was for FBI investigations in the four districts included in our study, and $38,859 was for Inspector General audits in those districts.

The BA program plans to adopt these additional improvements for its districts. According to AO officials, the fiscal years 1993 and 1994 budgets for the BA program included funding requests to develop procedures for auditing Chapter 7 trustees. In addition, the Judicial Conference[3] is considering whether funds should be requested to have the FBI conduct background investigations of some trustees. We were told that these improvements were not sought earlier because the BA program was going to merge into the UST program in 1992. AO officials believed that the 10-year extension will allow sufficient time to warrant making these enhancements.

Financing Provisions of the Two Programs Differ

Fees paid in bankruptcy are not uniform. Debtors in the UST and BA districts pay the same fees when filing for bankruptcy, but Chapter 11 debtors in BA districts are not subject to the additional quarterly fee that is levied on Chapter 11 debtors in UST districts. The BA program operates using appropriated funds, and the filing fees BA debtors pay are deposited into the Treasury's general fund. UST program filing and quarterly fees are deposited in a UST System Fund.

According to our calculations, the funds generated from filing fees in the six BA districts in 1990 fall short of covering the cost of operating the program. For 1990, we calculated that the BA program costs exceeded fees collected by about $290,000. If the quarterly fee for Chapter 11 debtors-in-possession had been in effect in the six BA districts, we

[3]The Judicial Conference considers administrative problems and policy issues affecting the federal judiciary and makes recommendations to Congress concerning legislation affecting the federal judicial system.

calculated that debtor fees could have exceeded the program's operating costs.

When the legislation creating the UST program was passed, Congress included a provision to make the program self-funding by the users of the system so that the UST program would operate at no cost to taxpayers. The income for this fund is generated from three main sources: (1) a specified portion of the fees debtors pay when filing for bankruptcy, (2) a new quarterly fee for Chapter 11 debtors-in-possession, and (3) interest income on the invested funds. The additional fees have not only made the UST program self-financing but have also created a surplus.

Issues Associated With UST Self-Funding Provisions

As stated earlier, funds generated by the UST programs are deposited in a UST System Fund. The legislation establishing the fund included a provision that if the balance in the fund from the fees collected exceeds 110 percent of the appropriated budget, the excess must be transferred into the general fund of the U.S. Treasury. Because of the increase in bankruptcy filings in 1990, the fund exceeded the 110-percent threshold.

According to the legislative history, the self-funding mechanism was designed to pay for the operation of the program, not to make money for the government. The program is running a funds surplus because bankruptcy filings and associated fees have exceeded program spending, and the law requires the surplus to be transferred. Therefore, a portion of the fees paid by debtors in UST districts has been turned over to the Treasury's general fund—$6.4 million in 1990 funds. If debtors had not paid this money as fees, it could have been used to fund continued operations of their businesses or could have been available to pay creditors.

EOUST officials believed that the $6.4 million could have been put to better use by funding additional staff for UST districts. The rapid growth in bankruptcy filings has generated a workload that UST staffs are struggling to keep up with. Between fiscal years 1986 and 1991, the number of bankruptcy filings increased 80 percent, while program staffing increased 14 percent. Budget limitations have limited available program funding. This, coupled with the 110-percent program spending limit, has resulted in funds that the program needed being transferred to the Treasury.

The officials believed that within their current personnel allocations, their staffs are not able to conduct the in-depth analysis required to ensure that

sound internal and financial controls have been implemented and that trustees are adhering to fiduciary standards. It should be noted that the Office of Management and Budget (OMB) has assessed the oversight and monitoring of private trustees as a "high risk area" for fraud and abuse.

Accounting Changes to the System Fund May Change How Excess Funds Are Calculated

The 1992 Appropriations Act[4] changed the manner in which the money in the fund is accounted for. Before this act, fees were deposited in an account and the 110 percent was calculated on that amount. The act increased the filing fee and quarterly fee for Chapter 11s and stipulated that the funds from that increase be deposited in a separate offsetting collections account. The congressional conference committee that recommended the Chapter 11 fee increase estimated that the increase would generate an additional $23.96 million in fiscal year 1992. These funds, which must be used to improve services, are going to be used to enhance the programs's supervision and monitoring of debtors and trustees. Adding the $23.96 million to UST's base budget of $57.1 million gives the UST program a total budgetary authority of $81.1 million for fiscal year 1992.

The confusion over whether there would be an excess of funds collected in 1991 hinged on the question of whether the 110-percent provision should be applied to the $81.1 million total or the $57.1 million base budget. If the provision is applied to the higher amount, no excess will be transferred to the Treasury, whereas if the provision is applied to the lower amount, an excess as great as $25.7 million will be required to be transferred.

In its August 12, 1992, response to an EOUST request for a legal determination on the provision question, DOJ's General Counsel stated that the calculation of the amount to be transferred to the Treasury should be based on the annual November 1 balance of all amounts in the Fund (including offsetting collections). Furthermore, the amount appropriated refers to the total amount of money available to the UST program for the fiscal year, including both the direct appropriation and the estimated amount of offsetting collections that are received during the current fiscal year. Applying the General Counsel's determination, there will be no funding problem for the short term. However, the potential still exists for further excesses to occur in the future that would be required to be transferred to the Treasury.

[4]The Departments of Commerce, Justice, and State, the Judiciary, and Related Appropriations Act, 1992, Public Law 102-140, dated October 28, 1991.

When the fund exceeds 110 percent for 2 consecutive years, the Attorney General is required to recommend to Congress how the fees should be modified so that the money generated approximates what is needed to run the program. This is to help ensure that debtors do not become a fund-raising method for the Treasury. In March 1992, DOJ submitted a draft bill to OMB that includes a provision that would eliminate the requirement that annual excess funds be transferred to the Treasury. However, OMB deleted this provision, so it is not included in the Department's June 1992 submission to Congress.

Impetus for the Bankruptcy Administrator Program Came From Problems in the UST Pilot Test

The legislative history for the Bankruptcy Reform Act of 1978 provides a detailed rationale for taking the administrative function away from bankruptcy judges and placing it in a separate branch of government. According to the history, having judges exercise administrative and judicial responsibilities placed them in an untenable position of conflict and seriously compromised their impartiality as arbiters of disputes in bankruptcy cases.

Problems stemming from the judges' dual administrative and judicial responsibilities plagued the bankruptcy system for many years. To solve this problem and to make bankruptcy more efficient and fair, the Bankruptcy Reform Act created the UST program to take over the case administration role. According to the act's legislative history, Congress reached the decision to place the program in DOJ after thorough deliberations. After considering two different suggestions for placing the UST program in the judicial branch, Congress adopted neither suggestion and concluded that placing the administrative duties in bankruptcy in the executive branch rendered the separation of administrative and judicial functions complete and placed the administrative duties in the branch most capable of executing the laws.

Our discussions with bankruptcy judges and BA program officials in Alabama and North Carolina indicated that the impetus for having the BA program in the two states was their extreme dissatisfaction with the operation of the UST pilot program in the Northern District of Alabama. For example, according to the BA program Administrator when the BA program took over after the pilot test, BA program staff could not get an accurate list of Chapter 7 trustees or a complete list of Chapter 7 cases that had been assigned to each trustee—basic information needed to carry out case administration responsibilities.

UST program officials admitted that their program has experienced problems. They believed, however, that a major change—as the UST program represents—is bound to cause tension and resistance. Removing the case administration responsibilities from bankruptcy judges and putting them in the executive branch affected all the major players in bankruptcy: judges, trustees, and bankruptcy attorneys. As previously discussed, compounding the resistance to a new program has been the rapid growth in bankruptcy filings and a small increase in the staffing of UST program offices. EOUST officials readily admitted that the huge growth in the volume of filings without a corresponding increase in staff has severely hampered their ability to supervise trustees and monitor cases.

However, we found that improvements have been made to the program since November 1989, when the current Director was appointed. The Director has replaced four USTs who did not perform adequately and established criteria to use in selecting persons to fill this position. We believe that the new USTs meet these criteria. In addition, USTs we interviewed told us that cooperation between individual USTs and the EOUST has been improved by the formation of a UST Advisory Group that provides Trustee input on the direction the program should take.

Conflict of Interest Concerns With the UST Program

In deliberations on the 1978 legislation, some thought that placing the case administration function in DOJ created a potential conflict of interest. In cases in which the U.S. government is a creditor, Justice attorneys—U.S. Attorneys—may represent the government's interests while other Justice officials—the UST program staff—oversee the administration of the case. While there were concerns that this arrangement could at least create an appearance that the government creditor could be given an advantage over other creditors, Congress rejected these concerns in both the 1978 and 1986 legislation.

In our discussions with officials in the BA districts and AO, they cited the potential conflict of interest created by placing the program in Justice as a concern with the UST program.

Studies in 1983 and 1985 by a private contractor hired by DOJ did not identify any examples in which a conflict of interest actually occurred. In our discussions with BA and UST program staff and judges in the districts visited, we asked them to identify cases in which UST staff acted to promote the claims of a government agency over other creditors' claims; no one could. AO officials cited two cases since 1989 in which they think

conflict of interest may possibly have been an issue. However, these two cases, even if substantiated, would represent a negligible proportion of the 3,700,000 cases the UST program has supervised since its nationwide expansion in 1987. These circumstances would suggest that no significant potential conflict of interest problem actually exists.

Two Agencies Agreed That Only One Program Is Needed

Officials from both the EOUST and AO agreed that it makes no sense to divide the case administration duties in bankruptcy between two programs as it is now. In both cases, these officials pointed out why their program is preferable to the other. EOUST officials believed that one major advantage of having the UST program in DOJ is in the enforcement of the bankruptcy laws. They believed their process for referring persons who violate bankruptcy laws is superior and that the UST program staff obtain better cooperation from federal prosecutors since they both reside in DOJ. They also said that absorbing the six BA districts into their program would be easily done. BA officials believed the case administration should be vested in an independent agency in the judicial branch similar to the Public Defender Program. They also believed that programs in the judicial branch operate more economically than programs in the executive branch.

However, as discussed earlier, in formulating the bankruptcy legislation of 1978 and 1986, Congress decided that DOJ was the more appropriate location for the case administration function.

Conclusions

We could not find any justification for continuing two separate programs. When Congress revamped the bankruptcy system in 1978, it considered various options for structuring the case administration function, finally deciding to establish the UST program in DOJ. The BA program evolved because of problems in one of the UST pilot districts during the program's developmental phase. Allowing Alabama and North Carolina to delay their entry into the UST program was preferable to authorizing a permanent dual system. But the recent 10-year extension gives the BA program the appearance of permanence.

Our review of the UST and BA programs in selected districts found that the UST program costs more, but the cost is paid for by the users of the system. Our analysis of key performance indicators in these districts found no systematic differences that would recommend one organizational structure over the other.

To limit the impact of the UST program on the federal budget, Congress incorporated a self-funding provision that is currently generating funds in excess of what is appropriated to operate the program.

Recommendations to Congress

To make bankruptcy administration consistent across the country, Congress should incorporate the BA program into the UST program.

To allow excess debtor fees to be used for program purposes, Congress should also take action to eliminate the provision in the legislation requiring the UST System Fund to transfer surplus funds to the Treasury. The legislation should retain the provision requiring the Attorney General to monitor program fees so that money generated approximates what is needed to run the program.

Agency Comments

In commenting on our draft report, DOJ endorsed the recommendation that the functions of the BA program be merged into the UST program. It pointed out that our detailed analysis supports this recommendation. DOJ also commented that vesting responsibility for supervising trustees to experienced attorneys is critical to a system that must establish a credible deterrent to misconduct and other forms of fiscal abuse by trustees, most of whom are lawyers. DOJ believed that placement of the program in DOJ is critical and that the goals of the Bankruptcy Reform Act of 1978 cannot be accomplished by placing the program in an independent agency or in the judiciary.

The AO, in commenting on our draft report, agreed with our finding that the BA program costs less than the UST program, but the AO believed that cost savings are significantly greater than what we have calculated. The AO pointed out that our cost comparisons did not include support costs that EOUST and regional offices provide to their district offices, particularly one of the UST districts we reviewed. For example, the AO stated that the true cost to operate the UST program in the Northern District of Florida was substantially higher because of the costs for UST personnel support that Northern Florida received from other offices. The AO estimated these costs at $100,000. Using this figure, the AO stated that UST costs for the four districts would exceed those of the comparable BA districts by 30 percent rather than the reported 22 percent. Applying these percentages to the $81.1 million budget authority for the UST program for fiscal year 1992, the AO calculated a cost savings of $18 million to $24 million.

According to EOUST officials, Northern Florida did not receive substantial direct personnel support from other offices as the AO asserted. One official instrumental in setting up the office said that a few people were sent to the office for 7 to 10 days and that the UST program could not afford to provide the support that the AO said existed. In addition, we have recognized that the UST program costs more and that accounting records do not provide the data to estimate the cost of support coming from outside the districts. Further, our report states the support the AO provides BA districts is also excluded. Recognizing that these costs should also be included in a cost comparison of the two systems, the AO said its costs would be much lower, but it did not provide any cost data.

The AO stated that clear statistical evidence exists that cases of all types are processed more quickly from filing to disposition in the BA districts and that all classes of creditors do as well or better in the BA districts compared with similar classes in the UST districts. The AO maintained that these comparisons should be made between the two programs rather than between matched districts. We disagree. As stated previously, the diversity of districts in the UST program limits the validity of a program-to-program comparison. The UST system contains some very large districts that account for the majority of cases. These larger UST districts may not have the same case composition (i.e., Chapters 7, 11, and 13) and would therefore have different case processing times from the UST districts selected for comparison with BA districts. BA districts generally have a small number of total cases with a large number of Chapter 13 cases, which take less time to process than Chapter 7 and Chapter 11 cases. Because the performance of the very large districts influences estimates of the UST system case processing times, a more meaningful comparison is between districts of roughly comparable size and case composition.

The assertion that all classes of creditors do as well or better in the BA districts is true only when one aggregates across types of creditors. However, aggregating across types of creditors implies that it may be equally as difficult to obtain assets for all creditors. This is not the case. One of the purposes of bankruptcy is to protect unsecured creditors. Obtaining assets for this group of creditors is more difficult than for other groups of creditors. On this indicator, the UST comparable districts and the UST program overall did better than the BA districts. Our analysis of AO data showed that in statistical years 1990 and 1991 combined, unsecured creditors did better in the four UST districts than in their comparable BA districts. Further, when all 6 districts in the BA program were compared to all 88 districts in the UST program, the UST program distributed to

unsecured creditors a larger share of funds (28.8 percent versus 17.4 percent) from liquidated assets and distributed funds to unsecured creditors in a larger fraction of all Chapter 7 asset cases (60.5 percent versus 47.5 percent).

The AO's response also stated that our report contains virtually no discussion of the BA and UST programs' roles in processing Chapter 11, Chapter 12, and Chapter 13 cases and no quantitative or qualitative discussion or comparison of the results achieved by the two programs in these cases. Appendix III addresses the pending-to-filing ratios for Chapter 11 cases in the matched districts we visited. Also, table III.5 depicts case administration activities used by the BA and UST districts in Chapter 11 and Chapter 13 cases. We purposely did not focus on Chapter 12 and Chapter 13 cases because UST and BA staffs consistently told us that only a small percentage of their time is devoted to those chapters. We found that for Chapters 7 and 11, the BA and UST program staffs monitor the progress and outcomes of individual cases. That is not so for cases filed under Chapters 12 and 13. The BA and UST staffs supervise the standing trustees for these cases, but they do not normally monitor individual cases. The BA and UST program staffs get involved in individual cases only on an exception basis. Consequently, only a minimal amount of their time is devoted to Chapters 12 and 13. The AO conducted an informal survey of the BA staff in the six districts that showed that a small fraction of time was devoted to a Chapter 13 case compared to more time for Chapter 11 and a Chapter 7 asset case.

The AO believed that the program's placement creates the potential for a conflict of interest, and it has cited several statements to this effect. However, as discussed previously, Congress was mindful of this possibility. The legislative history of the Bankruptcy Reform legislation recognizes that the potential for a conflict of interest exists in either program. Nonetheless, Congress decided that DOJ was the best placement for the program given the functions, powers, and duties of the UST program.

As agreed with the Subcommittee, unless you publicly release its contents earlier, we plan no further distribution of this report until 30 days from the date of this letter. At that time, we will send copies to interested parties and make copies available to others upon request.

Major contributors to this report are listed in appendix VI. If you have questions, please call me on (202) 566-0026.

Sincerely yours,

Harold A. Valentine
Associate Director, Administration
of Justice Issues

Contents

Tables

Figures

Abbreviations

AO	Administrative Office of the U.S. Courts
BA	Bankruptcy Administrator
DOJ	Department of Justice
EOUST	Executive Office for U.S. Trustees
FBI	Federal Bureau of Investigation
OMB	Office of Management and Budget
UST	United States Trustee

Background on Types of Bankruptcy Cases

Under current law, most bankruptcies are filed under one of four provisions:[5] Chapter 7 liquidation, Chapter 13 repayment plan, Chapter 11 reorganization, and Chapter 12 family farmer. Individual and business debtors can file bankruptcy under Chapters 7, 13, or 11 as long as they meet the specific requirements of the chapter. Chapter 12 is limited to family farmers.

Chapter 7 Liquidation

Of the 879,922 bankruptcies filed in 1991, 612,018 (70 percent) were Chapter 7s. After filing a Chapter 7 bankruptcy, the debtor's property becomes an "estate" controlled by the trustee assigned to the case. The debtor retains only certain property that is exempt from the bankruptcy. The trustee is selected from a panel of individuals approved to perform this work (i.e., panel trustees). The trustee's principal duty is to collect and reduce to money the property of the estate and to close the case as expeditiously as is compatible with the best interests of the parties involved (e.g., creditors of the debtor). In Chapter 7 cases, creditors routinely receive nothing from the bankruptcy process because debtors do not possess any property over and above that which is exempt, or the funds that are generated from debtors' estates are consumed by administrative expenses (e.g., trustee compensation, attorney and accounting fees). For example, in 94 percent of Chapter 7 cases closed during 1990, creditors received no distribution of funds from debtors' estates.[6]

Chapter 13 Repayment Plan

Chapter 13 is intended for debtors with regular income who desire to pay back creditors either a portion or all of their past debt. For 3 to 5 years the debtor makes monthly payments to a trustee, who distributes the funds to creditors in accordance with a plan confirmed by the court. To qualify for Chapter 13, a person's liabilities cannot exceed $100,000 of unsecured debt

[5]There are two other rarely used provisions for filing bankruptcy—Chapter 9 and section 304. Chapter 9 is for municipalities, and section 304 governs cases in which a debtor files bankruptcy in a foreign country but has assets in the United States. Of the 879,922 bankruptcies filed in 1991, 20 were filed under Chapter 9, and 4 under section 304. For this report, statistical data on bankruptcy filings were obtained from the AO, and we reported them on a statistical year basis. Statistical year 1991, for example, covers cases filed during the period from July 1, 1990, to June 30, 1991.

[6]If a Chapter 7 debtor has no assets over and above his exemptions, then the case is referred to as a "no asset" case. If the debtor has assets that are liquidated and distributed to creditors, then the case is called an "asset" case. If all the funds are consumed by administrative expenses, then the case is called a "nominal" asset case.

and $350,000 of secured debt.[7] Normally, one Chapter 13 trustee will be appointed to handle all cases filed in a particular court or for a specific geographic area; this person is called a standing trustee. A Chapter 13 trustee's active case load can range from about 1,400 to over 10,000 cases. In 1991, Chapter 13s accounted for the second largest group of filings—244,063, or 28 percent of the total filed.

Chapter 11 Reorganization

Chapter 11 was designed for business debtors, although individuals are not prohibited from using it. The purpose of a Chapter 11 reorganization is to restructure the finances of a business so that it may continue to operate, pay creditors, and produce a return for its stockholders. Unlike Chapter 7, Chapter 11 debtors remain in possession of their assets (i.e., debtor-in-possession). A trustee is appointed only for cause, such as when fraud, dishonesty, incompetence, or gross mismanagement is suspected on the part of the debtor-in-possession. In 1991, 22,464, or 2.6 percent, of the total bankruptcy filings were Chapter 11s. Although accurate data are not available, an AO official told us that about 10 percent of Chapter 11 bankruptcy successfully achieve the objectives of their plans.

Chapter 12 Family Farmer

Chapter 12 was added to the bankruptcy law in 1986. Previously, farmers needing financial rehabilitation filed under Chapter 11 or Chapter 13. Most family farmers had too much debt to qualify under Chapter 13, and many found Chapter 11 complicated, expensive, and, in many cases, unworkable. Chapter 12 was modeled after Chapter 13. It was designed to give family farmers a chance to reorganize their debts and keep their land. In 1991, 1,353 Chapter 12 bankruptcies were filed nationwide; however, the Chapter 12 provision is temporary and will terminate in 1993.

[7]A secured debt is a debt in which the creditor has a security interest created by an agreement between the creditor and the debtor. After entering into such an agreement, the secured creditor is entitled to take possession of the property covered by the agreement if the debtor defaults. In an unsecured debt there is no security agreement, and the creditor cannot take possession of the property.

Objectives, Scope, and Methodology

For this report, statistical data on bankruptcy filings were obtained from the AO, and we reported them on a statistical year basis. Statistical year 1991, for example, covers cases filed during the period from July 1, 1990, to June 30, 1991. We matched UST districts with BA districts using the chapter distribution of filings and qualitative factors, such as regional economy, local demographics, and multiple offices. We selected comparable UST districts by using four case filing measures: the total number of bankruptcy filings in statistical year 1990 and the 2-year average filings—statistical years 1989 and 1990—for Chapters 7, 11, and 13. We identified as many UST districts that were similar to BA districts on the total number of filings and as many of the 2-year average measures as possible. When more than one district qualified as a match on the distribution of filings, we used qualitative factors, such as local economy, court culture, or presence of district offices, to select among the qualifying districts.

To compare relative costs and results achieved in comparable districts, we

- reviewed the costs to operate the eight districts during 1990,
- analyzed data from statistical years 1990 and 1991 from the AO on funds generated by Chapter 7 cases closed during that period to determine the percentage of funds consumed by administrative expenses versus distributed to creditors, and
- analyzed bankruptcy case processing measures developed by a Case Processing Measures Committee composed of bankruptcy judges and bankruptcy clerks from six judicial districts and an AO analyst to compare how different types of cases move through the bankruptcy system.

We also attempted to measure the relative efficiencies of comparable districts by analyzing data on operating costs and workload of cases filed, pending, and terminated. Neither the AO nor EOUST has done a formal analysis to determine the amount of time its staff devotes to the different types of cases. However, the AO did conduct an informal survey of the amount of time BA program staff spent on oversight of bankruptcy cases. We used those estimates; program cost data; and data on the volume of cases filed, pending, and terminated by bankruptcy chapter, to develop measures of the relative efficiencies of the four pairs of comparable districts that we analyzed. However, when we discussed the results of this analysis with AO officials, they cautioned that their survey data should not be used because it was too unrefined and not a formal work measurement study approved by the AO.

To identify the major differences between the two programs, we reviewed the guidelines for each program and discussed the objectives and accomplishments of each program with officials from each program's respective headquarters office. We also made on-site visits to the four BA districts and the four comparable UST districts. At each location, we interviewed key UST or BA program staff about the specific procedures they use to supervise trustees and monitor estates. We also interviewed bankruptcy judges, the bankruptcy clerk or designee, and Chapters 7 and 13 trustees about their responsibilities in administering cases. We also obtained their opinions of how well the UST or BA program staffs carry out their responsibilities, the benefits of the programs, and suggestions for improving what the UST and BA staffs do.

To determine the need for continuing two programs, we reviewed the legislation that created the two programs. We also discussed the rationale for the two programs with headquarters officials for both programs and with officials in the eight districts we visited.

Data Used to Estimate Distributions of Assets

The data on the distribution of assets in Chapter 7 asset cases came from AO bankruptcy files. We obtained computer tapes containing information on bankruptcy activity for statistical years 1990 and 1991. The statistical year runs from July 1 through June 30. We performed a limited verification of the data as discussed later in this appendix.

The AO receives two reports on each bankruptcy case. The opening report is completed when a bankruptcy case is filed. The report contains, among other things, information on the type of bankruptcy, the nature of the debt, the chapter under which the case was filed, estimated value of the assets, and the estimated number of creditors. Upon termination of a case, a closing report is filed, which provides information on the distribution of the assets. These 2 reports are completed by the bankruptcy clerks in each of the 94 districts. For the most part, the reports are transmitted manually, but in some districts the data are transmitted electronically.

The quality of the data on the tapes varies. An AO official told us that the quality of data on the opening reports for statistical years 1990 and 1991 was good. There are few missing values, coding errors, and incomplete reports. On the other hand, we were told that the data on the closing reports have two problems: incompleteness and inaccuracy in the reporting of financial information. These problems had some impact on our calculations.

The problem of incomplete data arises when the AO cannot match opening and closing reports with 100-percent accuracy. The AO estimated that it has been unable to match closing reports to opening reports in about 5 percent of cases nationally. The impact of the matching problem affects the estimates of the number of cases pending at any given time. The estimates of pending cases will be larger (about 5 percent nationally) than the true number of pending cases.

The financial information contains coding errors that affect reported magnitudes of assets or distributions. The most common error is misplaced decimal points. We were informed by an AO official that most of the major coding problems occurred in the data compiled before statistical year 1990. However, we were told that the statistical years 1990 and 1991 financial data could be used for depicting trends in the financial data.

We limited our use of the financial data to Chapter 7 asset cases only. Even though Chapter 11 cases generally involve more assets than Chapter 7 cases, data on the distribution of assets in Chapter 11 cases are not recorded. The AO tracks Chapter 11 cases for 6 months after the reorganization plan is confirmed. However, since confirmation plans generally contemplate payments for many years, a very small fraction of payments are made or assets distributed during the 6-month observational window during which the AO gathers data on asset distribution in Chapter 11 cases. Consequently, the data on actual distributions of assets to creditors—as opposed to payments proposed in the plan—are not available beyond the 6-month window.

Our method required that we compare the distribution of assets in Chapter 7 asset cases in the BA and UST programs. To do so, we used the data on assets after taking the following steps to eliminate the effect of coding errors on our calculations:

- We verified that cases terminated in the correct statistical year and eliminated those that were included on the tape for a particular statistical year but had actually terminated in an earlier year. For example, for statistical year 1990, this amounted to about 900 cases.
- We eliminated cases that failed to meet a simple test for accuracy.

Our test consisted of creating two variables that were the sums of the values for specific types of distributions. We compared those sums with the reported values for gross cash receipts and total disbursements. The values of the four variables should be equal, and we eliminated cases in

which they were not. For statistical year 1990, we dropped about 2,300 Chapter 7 asset cases from a nationwide total of 29,633 Chapter 7 asset cases terminated in that statistical year. We did not attempt to determine the source of error in the cases we dropped. After we corrected for these errors, our universe consisted of Chapter 7 asset cases terminated in statistical years 1990 or 1991 in which the recorded values of gross cash and total disbursements equaled the values of the sums of the types of distributions and disbursements.

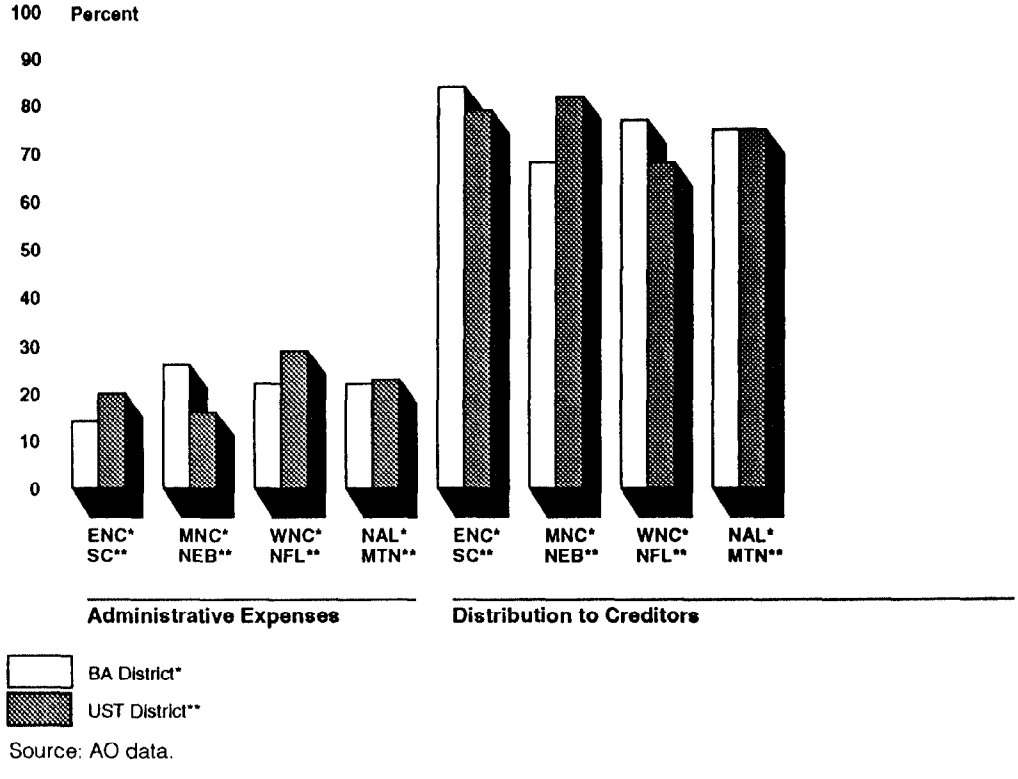
District-By-District Data on Performance Indicators Used to Compare Selected BA and UST Districts

This appendix shows the results of our analysis of various performance indicators we used in comparing the four UST and BA districts. We decided on a methodology of comparing matched pairs of districts because BA districts generally had a small number of total filings, with a large number of Chapter 13 cases, which were not characteristics of all 88 UST districts. To give perspective on how the 4 matched pairs compared to the 94 districts nationwide, in some instances we have included the average value for all 94 districts (i.e., national average). Appendix II discusses the source of the data we used.

Distributions Varied Substantially Within the BA and UST Districts

Although the distributions for administrative expenses and creditors between the UST and BA programs were similar, there was a range of differences in the distribution percentages within each program. For example, distributions for administrative expenses in the BA districts varied from a low of 14 percent to a high of 26 percent; the range in the UST districts was from 16 percent to 29 percent. Figure III.1 graphically displays the distributions by the matched pairs of districts.

Figure III.1: Distributions From Chapter 7 Asset Cases for Comparable Districts



Source: AO data.

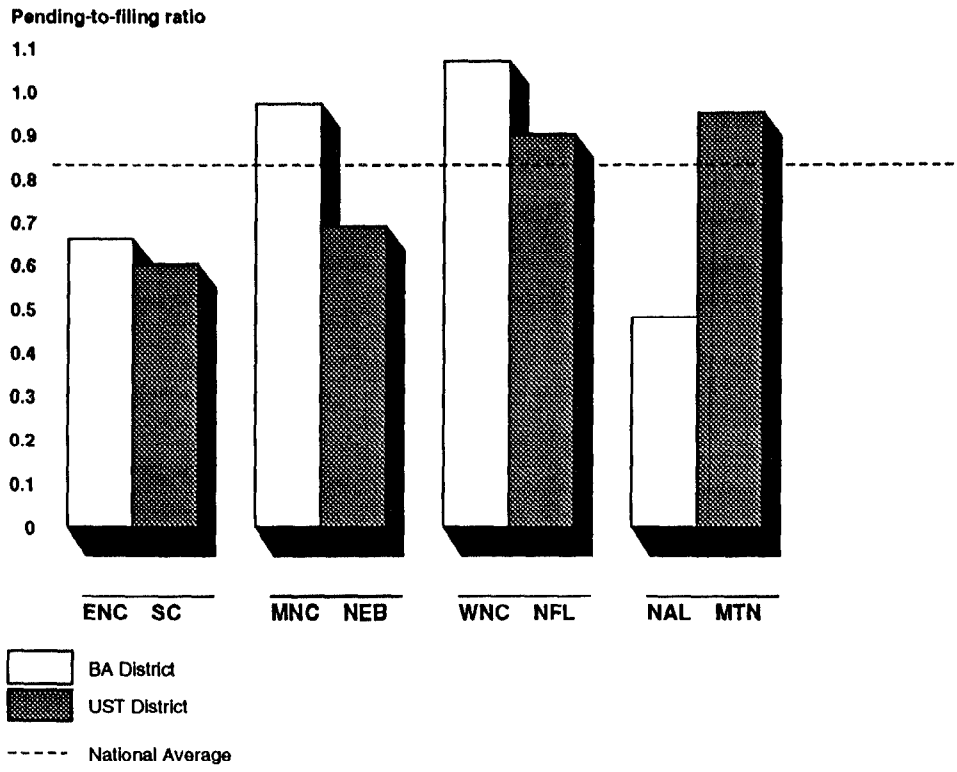
Pending-to-Filing Ratios for Chapter 7 Cases

This ratio is obtained by dividing the number of cases pending at the end of a year with the number filed during the year. It is a standard indicator of the average speed at which a district processes its cases. In calculating the pending-to-filing ratio, the lower the number, the faster the cases have been processed. For example, if 500 cases were pending at the end of a year in which 1,000 were filed (i.e., 500 completed), the pending-to-filing ratio would be .5, meaning it took an average of about 6 months from the time a case was filed until termination or completion. If another district also had 1,000 cases filed during a year but had 400 pending (i.e., 600 completed), the pending-to-filing ratio would be .4, or just under 5 months.

The data on pending-to-filing ratios were developed by the Case Processing Measures Committee. Those data showed that three of the UST districts had better pending-to-filing ratios than their comparable BA districts. Two of the BA districts and two of the UST districts exceeded the national pending-to-filing ratio, which was .83. Figure III.2 shows the ratios

for 1990 for the matched districts and how they compared to the national average.

Figure III.2: Chapter 7 Pending-To-Filing Ratios for 1990

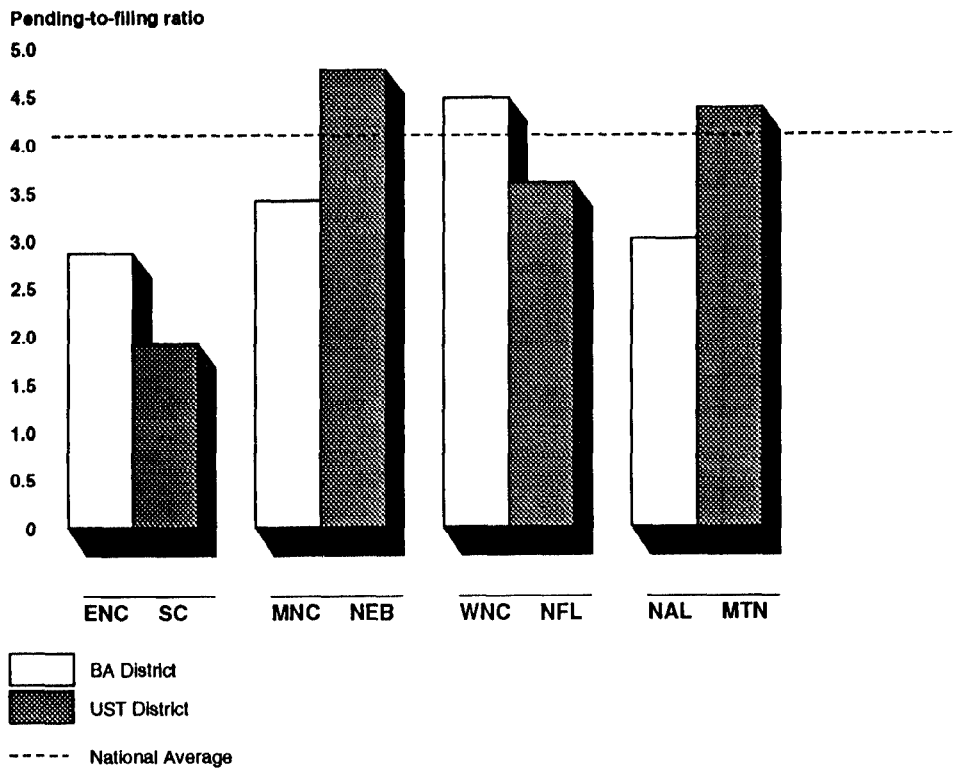


Source: AO data.

Pending-to-Filing Ratios for Chapter 11 Cases

We also used the data on pending-to-filing ratios for Chapter 11 cases to compare the matched districts. The data have an adjustment in them to remove the distortion caused by fluctuations in the number of Chapter 11 filings from year to year. The pending-to-filing ratios for the four matched districts showed that two BA districts processed their cases faster than the UST districts; in the other two comparisons, the reverse was true. Also, five of the eight districts had lower ratios than the national average, which was 4.09. Figure III.3 depicts the data on Chapter 11 pending-to-filing ratios.

Figure III.3: Chapter 11 Adjusted Pending-To-Filing Ratios for 1990

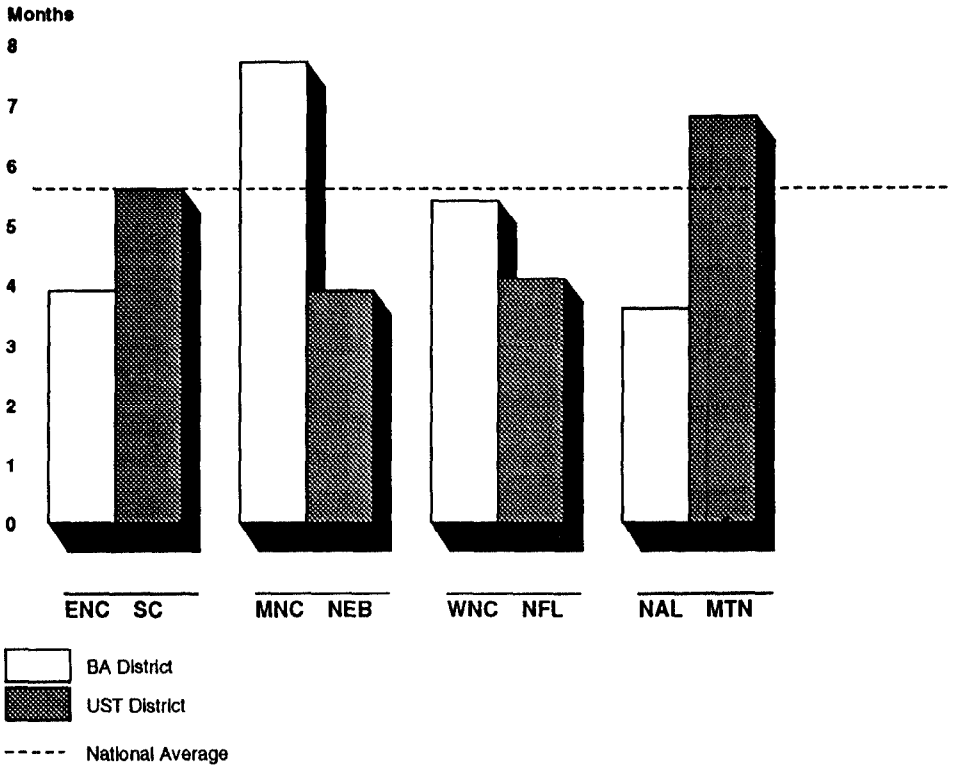


Source: AO data.

Median Disposition Time

The median disposition time reflects the age of the middle case completed during the year. When applying this to Chapter 7 cases, this statistic indicates how quickly the districts are processing their routine Chapter 7 cases. In all eight of these districts the median case would be processed very quickly, since it would produce no funds for distribution to creditors and would require no action by a bankruptcy judge. In two of the four pairs of comparable districts, the BA districts had lower median disposition times than the UST districts. In the other two matched pairs, the UST districts had lower median times than the BA districts. The median disposition time for Chapter 7s in all 94 districts was 5.6 months; 6 of the 8 districts had equal or lower median times than the national average. (See fig. III.4.)

Figure III.4: Chapter 7 Median Disposition Time for 1990



Source: AO data.

BA and UST Districts Used Similar Case Administration Procedures

In reviewing the procedures used in the four BA and four UST districts we visited, we found that the two programs used similar procedures for supervising trustees and monitoring estates, as shown in tables III.4. and III.5. It should be noted that the Chapter 13 trustee for Northern Florida is in Atlanta, so oversight is handled by the UST office there. In reviewing the operations at individual districts, we verified that these procedures were operational with program staff, trustees, and debtors-in-possession. We did not assess that quality of compliance by the UST and BA staff.

Table III.1: Case Administration Activities Used by Comparable BA and UST Districts for Chapter 7 Cases

Case administration activities	BA districts				UST districts			
	ENC	MNC	WNC	NAL	SC	NEB	NFL	MTN
Review petitions for abuse	x	x	x	x	x	x	x	x
Review trustee operations	x	x	x	x	x	x	x	x
Review case status reports	x	x	x	x	x	x	x	x
Receive bank statements/reports	x	x		x	x	x	x	x
Review fee applications	x	x	x	x	x	x	x	x
Review closing reports			x	x	x	x	x	x
Independent audit of trustees					x	x	x	x
Review trustee bonding	x	x	x	x	x	x	x	x
FBI background investigation					x	x	x	x

Table III.2: Case Administration Activities Used by Comparable BA and UST Districts

Case administration activities	BA districts				UST districts			
	ENC	MNC	WNC	NAL	SC	NEB	NFL	MTN
Chapter 11								
Require monthly financial reports	x	x	x	x	x	x	x	x
Visit debtor premises		x		x		x		
Encourage creditor committees	x	x	x	x	x	x	x	x
Review disclosure statements	x	x		x	x	x	x	x
Chapter 13								
Require annual budget	x	x	x	x	x	x	x	x
Require annual report	x	x	x	x	x	x	x	x
Require trustee bonding	x	x	x	x	x	x	x	x
Independent CPA audit	x	x	x	x	x	x	x	x
FBI background investigation					x	x	x	x
Other								
Computerized case tracking system	x	x	x	x	x	x	x	x
Download data from clerk's office	x	x	x	x	x	x	x	
Require interest-bearing accounts	x	x	x	x		x	x	x

Comments From the Department of Justice

U. S. Department of Justice

Washington, D.C. 20530

JUL 13 1992

Mr. Richard L. Fogel
Assistant Comptroller General
General Government Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Fogel:

The following information is being provided in response to your request to the Attorney General, dated July 1, 1992, for comments on the General Accounting Office (GAO) draft report entitled, "Bankruptcy Administration: Justification Lacking for Two Parallel Programs." We believe that GAO has performed an important service by professionally and impartially assessing the need for both the Bankruptcy Administrator and the United States Trustee programs. We are in agreement with the recommendation that the functions of the Bankruptcy Administrators be consolidated with the U.S. Trustees program.

In the last two years, GAO staff has engaged in three studies of aspects of the United States Trustee program. This draft report reflects the significant knowledge that GAO has gained about the administration of bankruptcy cases. While the draft report represents a fair statement of the status quo, we think that an additional perspective is important, the demonstrated performance of the U.S. Trustee program as an aggressive litigator in the public interest.

The responsibilities of both programs require supervising the conduct of debtors who seek the protections of the law, yet must meet concurrent obligations, as well as the conduct of private trustees who must adhere to the fiduciary standards of the law. As is appropriate for an activity that is largely regulatory and enforcement oriented, the U.S. Trustee program is managed by attorneys and the largest component of its staff consists of attorneys. These attorneys are held to the same high standard of excellence traditionally associated with the Department of Justice litigators.

These attorneys lead teams of accountants and paralegals in review of trustee reports, follow-up on audits of trustees, evaluation of trustee disbursement statistics, and annual assessments of each trustee's performance. Vesting responsibility for supervising the adherence of trustees to fiduciary standards in the hands of experienced attorneys assures that sophisticated judgment and advocacy skills are brought to bear in monitoring trustee conduct. This is particularly critical as the system must establish a credible deterrent to criminal misconduct and other forms of fiscal abuse by private trustees, most of whom are lawyers. In addition, our attorneys have made extensive contributions in both chapter 7 and chapter 11 cases in reducing exorbitant fee requests, dismissing or converting cases that were improperly filed, objecting to conflicts of interest, and removing or otherwise sanctioning trustees who violate their fiduciary obligations.

It is in this sense that the placement of the program in the Department is critical. The functions are not only those of an Executive Branch agency, but demand both litigation and enforcement mandates. The Bankruptcy Reform Act of 1978 made substantial changes in the law to bring about fundamental reforms. We do not believe that these goals can be accomplished by placing the functions in an independent agency, whose constituency would become those who are supervised, or in the Judiciary, where once again the adjudication and administration responsibilities would become interrelated.

The Department of Justice endorses the recommendation that the Bankruptcy Administrator program be merged into the United States Trustee program. There should be one system of administering bankruptcy cases and that should be the United States Trustee system. Not only does the detailed analysis of GAO support this recommendation, but so does the United States Trustee program's demonstrated performance as an aggressive litigator in the public interest.

Sincerely,

Harry H. Flickinger
Assistant Attorney General
for Administration

Comments From the Administrative Office of the United States Courts

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

L. RALPH MECHAM
DIRECTOR

JAMES E. MACKLIN, JR.
DEPUTY DIRECTOR

ADMINISTRATIVE OFFICE OF THE
UNITED STATES COURTS

WASHINGTON, D.C. 20544

July 15, 1992

Mr. Richard L. Fogel
Assistant Comptroller General
United States
General Accounting Office
Washington, D.C. 20548

Dear Mr. Fogel:

Thank you for the opportunity to comment on the draft General Accounting Office (GAO) report that compares the Bankruptcy Administrator (BA) program with the United States trustee (UST) program. With the recent explosion in bankruptcy case filings, the nationwide bankruptcy system plays an increasingly important role in our national economic system. The need to provide effective oversight of the fiduciaries who administer billions of dollars in assets in these bankruptcy estates has never been greater.

The Judicial Conference of the United States has consistently opposed placement of oversight of the administration of bankruptcy estates under the Department of Justice. In fact, until 1986 the Department of Justice itself also opposed placement of a permanent nationwide UST program in the Department.

See comment 1.

In addition to questions regarding conflict of interest, the Judicial Conference has long been concerned about duplication of clerical and administrative efforts in bankruptcy cases, excessive costs of the UST program, interference with court case management efforts, politics in the selection of United States trustees and staff and in the administration of estates, and potential erosion of the separation of powers between the Executive and Judicial Branches.

See comment 2.

The GAO was asked to "compare the relative efficiencies, cost, and results achieved in comparable BA and UST districts, identify the major differences between the two programs, and determine the need for continuing two programs." The GAO concludes that, although the BA system is considerably less expensive than the UST system, there are no systematic differences in the results achieved by the two programs, and that Congress should incorporate the more economical BA program into the more costly UST program.

A TRADITION OF SERVICE TO THE FEDERAL JUDICIARY

We are disappointed with the draft report, both in the findings and conclusions that it contains and in the matters that it omits. We find the draft report to be based on flawed methodology and inadequate analysis. We are aware, based on the complaints we have received, that many key players in the bankruptcy community are dissatisfied with the UST system. Moreover, the report's stated conclusions are simply not supported by the facts. This letter addresses our main concerns with the draft report. Greater detail on certain key issues is provided in the four enclosed attachments.

We do agree with the finding in the draft report that the BA program is much less expensive to administer than the UST program, although we believe that the cost savings are significantly greater than those cited in the draft report. We also believe that the BA system is substantially more efficient, and faster in processing cases than the UST system. The overall superiority demonstrated by the BA program over the UST program not only justifies its continuation in the six districts in North Carolina and Alabama, but justifies its expansion into other districts.

COST SAVINGS

The GAO reviewers acknowledge that the cost to operate the UST districts is higher than the cost for the BA districts by 22 percent. Moreover, their analysis does not include the substantial costs for operational support provided by a regional office and other UST districts to at least one of the UST districts reviewed by the GAO. If these hidden costs were included in the analysis, we believe that the actual excess cost of the UST program would be far greater.

With a total annual budget authority for the UST system of over $80 million, the GAO cost estimates indicate that a nationwide BA system would result in savings of $18 million per year. The cost savings would rise to $24 million or more annually if all of the hidden costs of the UST program were accounted for in the cost calculations. These cost savings are significant, particularly in times of limited budgets. A detailed discussion of the cost analysis in the draft report is included in Attachment A.

The draft report favors the UST system because it is self-funding. This is the result of a quirk in the 1986 statute that neglected to extend the self-funding mechanism to the six

districts exempted from the UST program. The Congress, of course, can easily authorize the BA program to receive the same fees as the UST program by statutory amendment.

EFFICIENCIES OF THE TWO PROGRAMS

The draft report notes that "GAO found no systematic differences in the results achieved by the two programs." We disagree. There is clear statistical evidence that cases of all types are processed more quickly from filing to disposition in the BA districts and that all classes of creditors do as well or better in the BA districts compared with similar classes in the UST districts. Further, the four UST districts selected for review in the GAO study perform more efficiently than the average UST districts. Thus, they are not representative of the overall operation of the UST system. (See Attachment B)

Moreover, we are greatly concerned that the report only scratches the surface in its comparison of the two systems. The report contains virtually no discussion of the BA and UST roles in processing chapter 11, chapter 12, and chapter 13 cases and no quantitative or qualitative discussion or comparison of the results achieved by the two systems in these cases. For example, between 1988 and 1990 the standing chapter 13 trustees in the Alabama and North Carolina BA districts reported disbursements of slightly over $250 million dollars, more than 93% of which was disbursed to creditors.

See comment 3.

Of course, we realize that statistical comparisons alone are not sufficient to gauge the relative merits of the two systems. There is no reference in the draft report, however, to the opinions of the key players in the bankruptcy system across the country--the judges, clerks of court, trustees, litigants, and attorneys. We are confident that a survey of their opinions would have found a much higher level of satisfaction with the BA program than with the UST program, as many in the bankruptcy community have suggested that the BA program is superior to the UST program. We have received numerous complaints from judges and clerks concerning the UST program, and know that many courts would opt out of the UST program and into the BA program if they were given the opportunity.

See comment 4.

The draft report repeatedly cites a perceived advantage of the UST program over the BA program in that it uses FBI investigations and audits to enhance its oversight of trustees. However, as noted in the draft report, the Fiscal Year 1993 budget request for the Judiciary contains funds for developing standards for auditing chapter 7 trustees. Further, the Judicial

Conference Committee on the Administration of the Bankruptcy System has approved a requirement that FBI background checks be conducted on all trustees in BA districts. Therefore, these cited differences between the two programs are now inconsequential.

INTEGRITY OF THE TWO PROGRAMS

The draft report states that Administrative Office and BA officials "cited the potential conflict of interest created by placing the program in Justice as their major concern with the program." (This is by no means the Judiciary's only concern, or even its primary concern, with the UST program.)

The draft report, however, responds that "no significant potential conflict of interest problem actually exists." This statement is at odds with numerous past statements made by Department of Justice officials and by Congressional staff. In 1984, for example, Attorney General William French Smith reported to the Congress that the potential for conflict of interest exists because the Department of Justice often has conflicting roles in bankruptcy matters. A 1989 Senate staff report on the INSLAW matter noted that under the UST program there was indeed a potential for biased handling of bankruptcy cases, and suggested that the UST program be removed from the Executive Branch or that the trustee recuse himself in cases where the Department of Justice is a creditor. Greater detail on these and other statements by Department of Justice officials and Congressional staff are included in Attachment C.

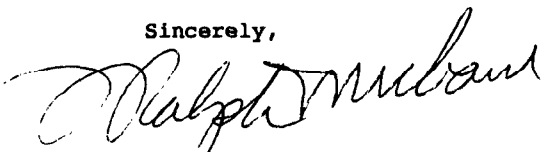
See comment 5.

The draft report fails to mention these statements. It also does not address the problem of hiring or appointing potentially unqualified individuals based on partisan political considerations. Although, as the draft report suggests, the current director of the EOUST has made more appropriate appointment and hiring decisions, there is an inherent problem with a system that allows non-merit appointments to positions requiring specific knowledge, skills and experience. In contrast to the UST system, BAs are appointed by the Courts of Appeal, following public notice and review by merit selection panels, which eliminates both partisan political appointments and the potential for abuse.

CONCLUSIONS

The draft report concludes that there is no justification for continuing two parallel programs. Despite its additional cost, the draft report recommends that the UST program absorb the more efficient BA program. We do not see justification in the draft report for the conclusions the GAO has made. The few apparent "advantages" of the UST system cited in the report either are inconsequential or are easily remedied by statutory amendment. The BA program has demonstrated its superiority. There is no reason shown in the draft report why the BA program should not continue until 2002 as currently contemplated under the statute. In fact, greater study should be undertaken to determine whether the BA program should be expanded so that more districts could benefit from its greater efficiency and cost savings.

Sincerely,



L. Ralph Mecham
Director

Enclosures

The following are GAO's comments on the Administrative Office of the United States Court's letter dated July 15, 1992. We did not include the enclosures because the letter sufficiently covered the AO's response.

GAO Comments

1. Some duplication of clerical and administrative efforts may exist because each agency wants to maintain separate files in order to perform its responsibilities. Before the UST program went nationwide, a study of the program by Abt Associates addressed these issues and considered any overlap between the UST, courts, and clerk's office to be minimal[8] and the overlap in review functions to be beneficial as a check and balance in the system. We believe some duplication is unavoidable given certain review functions by each agency and that it serves as an important cross-check. Officials in EOUST said they were committed to working with the AO to minimize any overlap. In this regard, an October 1991 memorandum of understanding states that officials of EOUST and AO meet periodically to discuss matters of mutual concern and to ensure that the UST program and the court share responsibility for the efficient and effective administration of bankruptcy cases.

2. The AO has misrepresented our position. We state in the report that the cost to operate the UST program was higher but the UST program is self-financing while the BA program is not. We also state that because of advantages in oversight and funding provided by the UST program, Congress should incorporate the BA program into the UST program.

3. The AO commented that it has received numerous complaints from judges and clerks concerning the UST program, and it knows that many courts would opt out of the UST program and into the BA program if they were given the opportunity.

The judges and clerks we spoke with in the four UST districts we visited did not make complaints about the UST program. A common theme judges and clerks expressed in both UST and BA districts was that the success or failure of the UST or BA program was contingent upon the quality of the people that operate the program. Uniformly, they gave us positive comments about the efforts of both the UST and the BA staffs. The bankruptcy officials in the UST districts we visited did not suggest that they would prefer to opt out of the UST program, nor did they assert that the BA program would be superior to the UST program.

[8]Ames, Nancy L., Lindsey D. Stellwagen, and Ralph T. Jones, An Evaluation of the U.S. Trustee Pilot Program for Bankruptcy Administration: Findings and Recommendations (Cambridge: Abt Associates, 1983). Also, August 1985 Update.

4. The AO's response indicates that the BA program intends to adopt Chapter 7 audits and FBI background investigations, two procedures the UST program uses. This suggests that the BA program is evolving to be more like the UST program. This raises again the justification for maintaining the two separate programs from both a consistency and an efficiency perspective.

5. The AO's response also questions the UST appointment process. It suggests that the process by which BAs are selected is superior to that used to select USTs because it is a merit selection process; as such, it eliminates both partisan political appointments and the potential for abuse.

In creating the UST program, Congress endorsed the need for more centralized oversight of bankruptcy administration. The UST positions were designed, in part, to meet this need. Congress recognized that, in placing the program in DOJ and having the USTs appointed by the Attorney General, there was a potential for conflict, but it decided that DOJ was the best location for the program given the functions, powers, and duties of the UST program.

Major Contributors to This Report

General Government Division, Washington, D.C.	Lynda Willis, Assistant Director, Administration of Justice Issues Robert L. Giusti, Assignment Manager William J. Sabol, Social Science Analyst Shannon Goetsch, Evaluator
Cincinnati Regional Office	Daniel J. Kirwin, Evaluator-in-Charge Norbert E. Trapp, Evaluator Jeffrey T. Hunter, Evaluator
Office of the General Counsel	Ann H. Finley, Senior Attorney

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