

The pivotal role of the bankruptcy trustee: Will Chapter 7's unsung hero finally get a raise?

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Dave Watkins of Bankruptcy Management Solutions and Ronald R. Peterson of Jenner & Block discuss the crucial role bankruptcy trustees play in bankruptcy proceedings and explain why they believe an increase in the compensation paid to these critical participants in the process is long overdue.

The U.S. bankruptcy system is highly regarded worldwide for enabling debtors to restructure and resolve financial obligations in an efficient manner, usually leading to a fresh start. One little-known reason for the success of the system is the role of the bankruptcy trustee.

However, trustees overseeing Chapter 7 matters, the most popular form of bankruptcy filing in the United States, have not seen a fee increase since 1995.

These same trustees, while relegated to a compensation rate that was set in 1995, have distributed and continue to distribute billions of dollars to creditors every year.¹ This year, pending federal legislation could effectuate a long-awaited fee increase.

Appointed by the Justice Department's Executive Office for United States Trustees, Chapter 7 trustees administer bankruptcy cases under Chapter 7 of the U.S. Bankruptcy Code, identifying and liquidating assets to be distributed for the benefit of creditors.

In calendar year 2016 Chapter 7 trustees collected and distributed over \$3 billion and were paid a total of just \$147,000.² In fact, aside from the IRS they are the country's largest collectors of unpaid tax obligations. On a larger scale, these trustees are vital to ensuring efficiency in the bankruptcy system, preserving its integrity and supporting public policy initiatives.

The Bankruptcy Administration Improvement Act, H.R. 3553, introduced in Congress last year, proposes to increase the trustees' flat-fee compensation from \$60 to \$120 per case.

Proponents hope the bill will pass this year based on concerns that current fees do not take into account the increased administrative requirements mandated by recent legislation such as the Bankruptcy Abuse Prevention and Consumer Protection Act and the revised bankruptcy form requirements established by the judiciary.

THE TRUSTEE'S ROLE IN THE CHAPTER 7 PROCESS

Today, about a thousand Chapter 7 trustees work within the U.S. bankruptcy system. On average, they administer nearly a million cases each year.

Trustees are not government employees; in fact, many have careers as attorneys or accountants in addition to their trustee role. So what exactly does a trustee do in a typical Chapter 7 bankruptcy case, and why does the U.S. bankruptcy system depend on it?

As soon as a debtor files a petition initiating a Chapter 7 bankruptcy, the U.S. Trustee appoints a panel trustee to oversee the matter. The panel trustee attends what is called a Section 341 hearing — which is required by the Bankruptcy Code — to review the petition and related documents to assess whether the debtor holds nonexempt assets that the trustee can liquidate to fund repayment to creditors.

The primary function of this hearing — and of the trustee — is to assess, recover and liquidate assets to benefit creditors.

Even if there are no assets to be liquidated, the trustee must take the same steps to investigate the debtor's financial status and must provide reports to the bankruptcy court and the Office of the U.S. Trustee. This process can require days, weeks, months or even years, increasing the time required by the appointed trustee to fulfill this duty without any additional compensation.

If the trustee identifies nonexempt assets, those assets must be administered for the benefit of the creditors. This may require additional time to unravel and handle the various assets involved in the case and to enlist other professionals, such as auctioneers and real estate brokers, to manage the sale of assets for liquidation.

Trustees are also the first line of defense against bankruptcy fraud, and they refer cases involving fraudulent actions to the Justice Department for prosecution.

While most bankruptcies are legitimate, dishonest debtors may try to hide or transfer assets and provide false information in their petitions and other forms, which ultimately robs creditors of their appropriate recoveries.

Trustees receive a flat fee of \$60 per case, the same fee they were paid 23 years ago. While they can earn a commission on any assets they find, liquidate and distribute to involved parties, approximately 95 percent of Chapter 7 cases are non-asset

cases, which means there are no estate assets available for liquidation or distribution.

Too properly prosecute their duties, trustees must complete the same tasks and processes regardless of whether a case has or does not have assets.

As if receiving a mere \$60 fee isn't discouraging enough, trustees are increasingly required to work for free under what is sometimes referred to as the "unfunded mandate." Debtors who appear in forma pauperis — extremely poor debtors who cannot afford any expenses in bankruptcy — have their cases handled by trustees who receive no fee at all.

As these cases typically do not have the benefit of debtor counsel, trustees often spend more time working with the debtor in these cases. This can be even more frustrating for trustees in instances when other professionals do receive compensation for such cases.

THE EVOLUTION OF THE BANKRUPTCY TRUSTEE ROLE

Over the past 50 years, the trustee role has evolved and expanded in scope to streamline the Chapter 7 bankruptcy process.

The official role of the trustee came with the enactment of the Bankruptcy Reform Act of 1978, which for the first time provided a formal framework by which trustees could be appointed to handle the burdensome administrative functions associated with the Chapter 7 process. The trustee took the place of guardian over the bankruptcy process.

Today, trustees have become a fulcrum in the process and help give honest debtors a fresh start while ensuring that creditors are repaid with whatever assets are available.

Over the past 23 years, the U.S. bankruptcy system and legislation have imposed additional burdens on the trustee ecosystem. While these new requirements are intended to improve the bankruptcy system, they have elevated the responsibilities of trustees without elevating their compensation.

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, also known as the Bankruptcy Reform Act of 2005, enormously expanded trustee responsibilities.

The biggest challenge it presented for trustees was increased reporting requirements, which Congress mandated without increasing fees to the trustee. BAPCPA tasked trustees with collecting, tracking and safeguarding additional documents, such as tax returns and other financial statements.

BAPCPA also added a requirement that a trustee locate and notify the debtor's ex-spouse(s) regarding any domestic support obligation. For the trustee, this involves tracking down often difficult-to-find third parties to inform them that the debtor has filed for bankruptcy and that they may be a creditor in the case.

The statute also complicated the typical course of a Chapter 7 bankruptcy by creating a means test by which debtors are required to report their gross income.

If gross income exceeds a certain threshold, the case is dismissed or converted to a Chapter 13 bankruptcy through which debts must be repaid to creditors.

As a result, the trustee's role expanded to include verifying the calculations and accuracy of all information submitted by debtors as part of the means test.

In addition to BAPCPA's changes, a recent effort by the courts to update petitions and forms has resulted in even more paperwork for trustees, in some cases nearly doubling the number of pages they must review and document.

While it was intended to make the process simpler, it has encumbered bankruptcy trustees by increasing the time needed to review cases.

WHY NO RAISE?

With all the responsibilities trustees carry, it's a mystery to many why they haven't been given a pay increase in 23 years.

The last fee increase for trustees was implemented in 1995, when their fees were increased from \$45 to \$60 per case under the Bankruptcy Reform Act of 1994.

Since that time, Congress has often inserted provisions increasing trustee fees in proposed legislation; generally speaking, these provisions have received broad bipartisan support and have passed the House on numerous occasions.

The Financial Netting Improvements Act of 2006, H.R. 5585, was proposed to improve the netting of financial obligations under bankruptcy. With broad bipartisan support, this bill was mostly focused on financial services provisions. Although it passed, a trustee fee proposal was removed from the bill in the Senate.

The same year, the Deficit Reduction Act of 2005 was enacted, which raised the Chapter 7 filing fee; however, these additional funds were not allocated toward trustee compensation.

In 2008 the Senate Judiciary Committee introduced the Federal Judicial Salary Restoration Act, S. 1638, which was aimed at increasing payment to federal judges and included an amendment to increase trustee fees as well. However, this legislation did not advance through Congress.

One issue that has delayed the passage and enactment of a fee increase has been the question of where the additional funds would come from.

Adversaries have voiced concerns that a fee increase might result in debtors having to pay higher filing fees when already in financial dire straits. However, it is clear to most on both sides of the issue that legislation to increase trustee fees is

appropriate given adjustments for inflation during the past 23 years.

Most agree that nothing else in our judicial system or society at large would reasonably cost the same as it did in 1995.

WHAT WOULD CHAPTER 7 PROCEEDINGS BE WITHOUT TRUSTEES?

The Bankruptcy Administration Improvement Act proposes to amend Title 11 of the U.S. Code to increase the amount of compensation paid to Chapter 7 bankruptcy trustees for their services.

Introduced into Congress with support from the bankruptcy and financial sectors, the bill is scheduled for a committee vote sometime this spring, which will determine its progress into the House or Senate.

If it does not pass, and trustee fees remain where they have been for the past 23 years, the fate of the role of the trustee is uncertain.

Many fear that without the opportunity for increased compensation, trustees will leave the system and, in doing so, create a void that will have a devastating impact not only on the U.S. judicial system but also on debtors themselves.

The absence of the trustee in the bankruptcy process could jeopardize the ability of debtors to seek out the fresh start the U.S. bankruptcy system is known to offer.

The success of the system relies on the efficient functioning of many parts, including bankruptcy judges, debtors' counsel, creditors' attorneys, court clerks and, last but certainly not least, the trustees.

With fewer resources for trustees and less time to uncover assets, Chapter 7 cases would be even more likely to become non-asset cases, leaving no opportunity to recover what is owed to creditors, including financial institutions, banks and credit card companies.

The ripple effect of this potentially includes financial institutions reducing the extent to which they extend credit.

Without the trustee, the system would be forced to shift burdens to other parties involved in the process, ultimately raising the costs to the system, the debtor and creditors due to the increased time and energy that others would need to dedicate toward trustee functions.

Some speculate that the government might need to take over the responsibility of trustees, which raises concerns that the process would become more bureaucratic and less efficient.

A shortage of trustees would result in slower processing of Chapter 7 cases, with less time allotted for proper examination and administration of each case.

The courts would also be backlogged with delays in appointing trustees due to their lack of availability and setbacks in reporting timelines because fewer people would be handling more cases.

When compared with the compensation available to other professionals in the bankruptcy process, the payment for trustees is clearly nominal. Some bankruptcy attorneys today charge up to four-figure hourly billing rates.

While the context for the various roles within the bankruptcy ecosystem may differ vastly, acknowledging the contrast between the private and public sector, one can reasonably assert that increasing compensation to all players in the process over time is a necessity to keep pace with the cost of living and to maintain a healthy, functioning team.

With a vote on the Bankruptcy Administration Improvement Act expected from the House in the coming weeks or months, proponents hope a fee increase for trustees will bring the long overdue recognition and compensation trustees deserve.

If the bill should not advance, the bankruptcy system and its professionals will need to brace themselves for new challenges in the Chapter 7 bankruptcy process.

NOTES

¹ *Bankruptcy FAQ*, Nat'l Ass'n of Bankr. Trustees, <https://bit.ly/2Kdp0QM>.

² <https://bit.ly/2HVfL9k>.

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