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Consumer Bankruptcy: Nine Tips to Protect Your Clients From the U.S. Trustee Initiative Program

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The U.S. Trustee Initiative Program. The Office of the United States Trustee has been scouring cases recently, looking for indications that a debtor has the ability to make a reasonable payment to his creditors. The United States Trustee Program launched a nationwide campaign, dubbed the "Civil Enforcement Initiative," aimed at "advancing and protecting the integrity of the bankruptcy system." The initiative was developed when, after years of proposed legislation to stop alleged bankruptcy abuse, none of the proposed bankruptcy reforms became law. Thus, the U.S. Trustee's Office decided to adopt and implement some of the legislative policy themselves.

It appears that the initiative will focus on three key problem areas: (i) debtors who abuse the bankruptcy system and engage in bankruptcy fraud, by loading up on credit card debt or orchestrating a bust-out; (ii) debtors who have the ability to repay a reasonable

portion of their debts; and (iii) debtors (or their attorneys) who file sloppy schedules, or false and incorrect schedules; and attorneys who provide poor legal representation or charge excessive attorney's fees.

You can therefore expect to see a heightened amount of activity out of our district U.S. Trustee's office investigating cases to see if debtors have truly filed in "good faith." The following are my observations of this practice.

"Substantial Abuse" – Bankruptcy Code Section 707(b). The U.S. Trustee frequently relies on this section and alleges that a debtor is substantially abusing the bankruptcy system when it believes a debtor has not filed in good faith for one of the above reasons.

The Initiative Program Has Become the U.S. Trustee's Foremost

Priority. The Office of the U.S. Trustee is a division of the Department of Justice and has responsibility for overseeing all bankruptcy cases and trustees. Previously, a major portion of that office's time was devoted to overseeing the administration of Chapter 11 business cases. However, Chapter 11 filings have decreased markedly over the past few years, apparently resulting in the U.S. Trustee's office shifting their priorities from business cases to consumer cases.

What This Means To You and Your Clients. The initiative's heightened vigilance has added a whole new wrinkle to bankruptcy practice and made it more complicated. Several types of debtors now seem to be automatically red-flagged for review. Individuals with incomes of about \$75,000 or more per year often seem to be targets. If a debtor has a high income, and appears capable of making some

payment toward his or her debts, the U.S. Trustee's office may file a motion to dismiss the Chapter 7 case under Code section 707(b) as a "substantial abuse." Debtors at that point have the option of either disputing the U.S. Trustee's position (which could result in extensive litigation and additional counsel fees for the debtor), converting the debtor's case to one under Chapter 13, or agreeing to let the case be dismissed. If the debtor converts the case to one under Chapter 13, the U.S. Trustee's Office will not pursue its inquiry of the debtor's finances since the Chapter 13 trustee's office is capable of performing that function.

The U.S. Trustee's Office also seems to be red-flagging almost all cases in which scheduled unsecured consumer debts add up to over \$100,000. In either of these situations, the U.S. Trustee's Office will seek to audit and investigate the case before commencing any motions practice and will send out a highly-itemized document demand request. The time for the U.S. Trustee to object to dischargeability is the same deadline that the court sets for all creditors, which is 60 days from the date of the first-scheduled meeting of creditors.

Tip #1: Become Informed.

By reading this article, you will become more familiar with the basics of the initiative and you will be in a better position to avoid having one of your cases become a target. Certainly, staying up-to-date with developments is also important. Consider learning more by periodically visiting bankruptcy law web sites and joining the following organizations: the American Bankruptcy Institute (abi.org) has an excellent monthly journal (703-739-0800); the National Association for Consumer Bankruptcy Attorneys (nacba.org) is having this year's annual convention in Boston in April and they have already scheduled a seminar devoted to this issue entitled: "Civil Enforcement Initiative - Has the U.S. Trustee's Office Gone Too Far?" You can also easily read case law containing Bankruptcy Code 707(b) issues even if you do not subscribe to any research services. Try doing a Google search for "substantial abuse" + "707(b). Subscribe to Consumer Bankruptcy News (800-341-7874). Once you know what to expect and anticipate from the United States Trustee's Office, and how the courts

interpret issues that they may raise, you can better assist your clients.

Tip #2: Advise Your Clients

About the Initiative. When you conduct an initial intake with a client, it is important to discuss the initiative. In any gray-area case, make sure your client is aware of the possibility that the U.S. Trustee may audit and investigate their case. Have your client acknowledge this in a letter.

Tip #3: Ask Your Client if They Previously Filed.

One of the priorities of the initiative is to look for and investigate abusive serial filings. A debtor who has received a Chapter 7 discharge is not entitled to receive another one for a period of six years. Some Chapter 13 debtors are notorious serial filers in an effort to stave off a foreclosure proceeding. Some serial filers have filed numerous times within a relatively short period and have gotten away with it because they filed in different districts, possibly using slight variations of their name to avoid detection. Accordingly, make sure you question your client about any prior bankruptcy filings.

Tip #4: Pay Extra Attention to the Budget Schedules.

The major factor in most substantial abuse cases is whether the debtor has the ability to repay a significant portion of his debts over a three year period. A debtor's ability to repay is easily gleaned from an analysis of the budget schedules in the petition. Make sure that all payroll deductions are reasonable and necessary. Consider having the client stop or reduce any large pension or pension loan deductions. Pay careful attention to the reasonableness of expenses. Some examples of expenses that attract attention include expensive cars, vacation homes, boats, and recreational expenses. Watch out for disposable income (the difference between net income and reasonable expenses), which is how lesser-experienced practitioners often get their clients in trouble.

Although it is important to assist your client with the preparation of all schedules, you should avoid being put in the defensive position that you assisted in fudging the figures or coaching the client to hide disposable income. If a client has too much disposable income,

then Chapter 13 should be considered rather than Chapter 7.

Tip #5: Prepare and Assemble Documents in Advance.

If your client has a large amount of income or a large amount of debts, consider obtaining certain documents from your client before you file the petition, as the U.S. Trustee may likely ask for copies of them. They include several years of recent bank account statements, tax returns, credit card statements, pay stubs, utility bills, and in general, proof of other expenses.

Tip #6: Develop a Strategy in Advance.

If you feel that 707(b) issues exist in your case, or if you feel that there is any other reason why the U.S. Trustee may want to scrutinize the case, develop a strategy and plan for defending the debtor's good faith now, rather than wait until the issue is raised by the Chapter 7 trustee or U.S. Trustee. In other words, prepare the debtor's explanation in advance.

Tip #7: Communicate with the Chapter 7 Trustee.

One of the obligations of a Chapter 7 trustee is to make a determination as to whether the case is filed in bad faith or whether the granting of bankruptcy relief would be considered a "substantial abuse" of the bankruptcy laws under Code section 707(b). If a Chapter 7 trustee feels that such an issue may be present, then he makes a "referral" to the U.S. Trustee. It is not up to an individual Chapter 7 panel trustee to seek dismissal of a case; only the U.S. Trustee can do that. Therefore, if you feel that a case may contain 707(b) issues, you should communicate with the trustee to avoid a referral. Consider sending a letter to the trustee prior to the meeting of creditors to explain why there may be a large amount of debt, or to point out why a debtor with a relatively high income is nevertheless filing in good faith.

Tip #8: Cooperate with U.S. Trustee on a Timely Basis.

The U.S. Trustee's office often rifles off an inquiry letter merely because a case contains a red flag. If you quickly respond to the inquiry, you will have satisfied the U.S. Trustee's Office's requirements, thereby placing the burden on them to review the documents and decide if there is any serious issue. If it appears that the

debtor is fully cooperating in good faith, then the U.S. Trustee's office may even be less inclined to spend a significant amount of time reviewing the papers.

Providing all of the requested documents can be somewhat burdensome, and in some cases, these papers can fill a box. Imagine the difficulty of the U.S. Trustee's Office sorting through such a large amount of materials. If the debtor is not able to immediately assemble all of the requested materials, you should nevertheless quickly send in whatever documents are available, together with an explanatory cover letter. If the U.S. Trustee's office fails to take any action (i.e., filing a motion or seeking to extend its time by stipulation) by the bar date, then they are forever precluded from doing so. If the U.S. Trustee requests an extension of time to review the materials, it is customary to give it.

Tip#9: Consider Alternatives to Chapter 7 If Necessary.

Unfortunately, not every debtor who has no non-exempt assets can simply jump into the Chapter 7 arena. For cases where it is obvious that filing would trigger an inquiry from the U.S. Trustee, consider Chapter 13 instead. Also consider negotiating with creditors as an alternative to bankruptcy. If, after filing a Chapter 7 case, the U.S. Trustee does bring a 707(b) motion, then the usual worst case scenario is that the case will be dismissed. The other alternatives include defending it or converting the case to one under Chapter 13.

Bonus Tip: Don't Let Yourself Become a Subject of Investigation.

One of the objectives of the initiative is to raise the standard of practice among professionals. A common complaint by everyone who regularly practices in Bankruptcy Court, including Judges, U.S. Trustees and panel trustees, is that the quality of debtor representation has declined tremendously over the past decade. This is directly attributable to an increase in the number of practitioners who do not regularly practice in Bankruptcy Court and who are not sufficiently familiar with bankruptcy rules, protocol or procedure. If the debtor's attorney's services are clearly inadequate, the U.S. Trustee may bring a proceeding to reduce or disgorge the attorney's legal fees. Accordingly, avoid filing schedules that are sloppy,

incomplete, or inaccurate. In addition, do a thorough intake, always advise the client about the entire bankruptcy process, and prepare the client for any court hearings, especially the meeting of creditors. Finally, do not assist in the fabrication of any information, especially that contained in the budget.

In a future article I will highlight some recent case decisions in which the U.S. Trustee sought to dismiss a Chapter 7 case as an abusive filing under Code section 707(b).

Editor's Note (revised 2008):
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