Department of Justice
Executive Office for United States Trustees

Final Agency Action
Case No. 02-0007

Review of the Decision of the United States Trustee For [redacted] Regarding [redacted]

[Redacted] (hereinafter referred to as "the trustee" both in his capacity as a trustee and in his capacity as the Examiner in the [redacted] bankruptcy case), formerly a member of the panel of chapter 7 trustees for the [redacted] District of [redacted], seeks review under 28 C.F.R. § 58.6 of a decision by the United States Trustee for [redacted][1] to terminate his receipt of new case assignments. I affirm the United States Trustee's decision based upon the record before me.[2]

I. Course of this Proceeding

By Notice of Termination dated September 11, 2002, the United States Trustee terminated the trustee's appointment to the panel of chapter 7 trustees. As a result, the trustee was no longer eligible to receive new case assignments after the date of the Notice. Notice of Termination, at 1.[3] The decision to terminate was made pursuant to 28 C.F.R. § 58.6(a). Specifically, the United States Trustee cited two subsections of the regulation, (a)(3) and (a)(11), which state as follows:

> (a). . . . The reasons may include but are in no way limited to:
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> > (3) Failure to comply with the provisions of the [Bankruptcy] Code, the Bankruptcy Rules and local rules of court;
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> > * * * *
> >
> > (11) Action by or pending before a court or state licensing agency which calls the trustee's competence, financial responsibility or trustworthiness into question.

The United States Trustee terminated the trustee's eligibility to receive future case assignments based on his misconduct as Examiner in the bankruptcy case of [redacted] ("Debtor"), Case No. [redacted], [redacted] District of [redacted]. The United States Trustee stated that the termination was a result of the trustee's failure in that case to comply with the disinterestedness and disclosure requirements of Title 11 of the United States Code (the

"Bankruptcy Code") and the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"). Referencing the August 13, 2002, decision of the District Court for the [redacted] District of [redacted], the United States Trustee concluded that the trustee, acting as the Examiner, had sought to enter into agreements concerning his fees and had solicited payments directly and improperly from the Debtor's three largest unsecured creditors. The United States Trustee determined that, as a consequence of his actions, the trustee had therefore violated the requirement that he remain disinterested. The United States Trustee further noted that the trustee had failed to disclose his lack of disinterestedness as required by the Bankruptcy Code and Rules.

The trustee filed a timely Request for Review ("Request for Review"), which was received in the Executive Office for United States Trustees on November 1, 2002. The United States Trustee filed a Response to the Trustee's Request for Review ("Response"), which was received on October 16, 2002.

II. Standard of Review

In conducting this review, the Director must consider two factors:

1. Did the United States Trustee's decision constitute an appropriate exercise of discretion; and

2. Was the United States Trustee's decision supported by the record.

See 28 C.F.R. § 58.6(i) (specifying the scope of the Director's review).

III. Background

[Redacted] ("Debtor") filed a voluntary Chapter 11 bankruptcy petition on September 25, 1996. The Debtor is a non-stock, not for profit rural electric cooperative that provides electricity for 90,000 customers in [redacted]. At the time of its filing, the Debtor's bankruptcy case was one of the largest ever filed and remains as the largest ever filed in [redacted]. The Debtor's largest secured creditor was the Rural Utilities Service ("RUS") of the Department of Agriculture, which was owed $1.1 billion as a result of a number of low-interest loans. The Debtor's three largest unsecured creditors were Chase Manhattan ("Chase"), Bank of New York ("BONY") and Mapco Equities ("Mapco").

On October 7, 1996, [redacted], an unsecured creditor, filed a motion that sought the appointment of either a trustee or an Examiner. BONY, Chase and Mapco filed motions for the appointment of a trustee. On October 16, 1996, the bankruptcy court issued an order pursuant to 11 U.S.C.§ 1104(b), directing the United States Trustee to appoint an Examiner. In addition to the duties prescribed for an Examiner under 11 U.S.C. § 1106(b),[4] the bankruptcy court ordered the Examiner to perform additional duties. Those additional duties required the Examiner to

investigate and report on the allegations set forth in the various Examiner/trustee motions concerning "mismanagement and/or breaches of fiduciary duty" by the Debtor; to facilitate discovery concerning those motions; to resolve various disputes between the Debtor and its creditors; to attempt to negotiate a global settlement of the disputes in the case, and; to develop a consensual plan of reorganization.

Based upon the bankruptcy court's order, the United States Trustee appointed the trustee to serve as the Examiner in the [redacted] bankruptcy case. On October 18, 1996, the bankruptcy court entered an order approving the United States Trustee's choice of the trustee as the Examiner. Shortly thereafter, the trustee filed an affidavit attesting to his disinterestedness and stating that he held no interest that was materially adverse to any class of creditors.[5] Neither the order requiring the appointment of an Examiner, nor the order approving the selection of the trustee to serve as Examiner allowed him to receive a percentage fee, or allowed him to request compensation other than pursuant to a motion filed under section 330 of the Bankruptcy Code. On November 15, 1996, the bankruptcy court entered an order establishing a process for the interim compensation of the trustee and his counsel. That order allowed the trustee to submit monthly bills based on hourly rates to the Debtor. It further allowed for objections to be raised to those bills and for judicial review, but did not provide for any percentage fee compensation.

On October 31 and November 1, 1996, approximately two weeks after the trustee was selected to be the Examiner, he conducted a court-ordered settlement conference in Washington, D.C. concerning disputes about the priority of claims between RUS on the one hand, and Chase, BONY and Mapco on the other. RUS had steadfastly maintained that it was entitled to payment on its secured, priority claim before any payments could be made to unsecured creditors.

During the settlement conference, the trustee shuttled between the room where representatives of RUS were located and the room occupied by the unsecured creditors. The trustee stated to representatives of Chase, BONY and Mapco that he intended to act more as a trustee than as an Examiner, notwithstanding his appointment as the latter. He further stated that he intended to bring what he referred to as "new value" into the Debtor's estate in order to fund a consensual plan.[6] As a consequence of taking on what he deemed to be trustee responsibilities, the trustee stated to these creditors that he wanted them to compensate his as if he were a trustee.[7] Specifically, in addition to his hourly compensation, he sought to be paid a percentage fee of 3% of all "new value" he brought into the estate. He further stated to [Mr. J. T.], counsel for BONY, that he wanted Chase, BONY and Mapco to agree to the concept of a percentage fee, or he would walk away from his efforts to negotiate a consensual plan. Although [Mr. J. T] testified to this in his deposition, the trustee denies making this statement. Representatives of RUS were not present during the trustees' conversation with these unsecured creditors. By the end of the settlement conference, the trustee believed that he had an agreement with Chase, BONY and Mapco, that they would support his request for the percentage fee, and that they would each pay a portion of those fees. The trustee continued his efforts to negotiate a consensual plan.

In a separate conversation with representatives of RUS at the settlement conference the trustee reiterated his desire to be paid a percentage fee. In response to this request, RUS stated that it would neither agree nor disagree at that time to the proposed percentage fee.

Following the settlement conference, the trustee continued to communicate with Mapco, BONY and Chase concerning his desire for percentage fee compensation. In late November, 1996, the trustee called [Mr. D] of Chase and complained that he had heard that Chase did not support the percentage fee concept. Mr. [D] assured the trustee that he did support such a fee. On December 3, 1996, he discussed the issue with [Mr. A. T.] and [Mr. R. H.], counsel for BONY. The trustee was concerned that BONY's local counsel had raised some questions about his receiving a percentage fee and was concerned that BONY had allowed a local counsel to create problems that might undermine his efforts to obtain a percentage fee. The trustee was informed that BONY had no objection to his desire for a percentage fee. In late January, after the Debtor had filed a proposed plan of reorganization, the trustee spoke by telephone with [Mr. D] of Chase. He sought to confirm his agreement with Chase reached at the Washington settlement conference. The trustee also telephoned representatives of BONY and Mapco and sought the same confirmation from them.[8]

Subsequently, the trustee sent letters to Chase, BONY and Mapco requesting written confirmation of the agreements reached at the 1996 settlement conference that each would pay him a 3 percent fee on the new value they received in the bankruptcy case and stating the amount he expected each unsecured creditor to pay. The trustee sought the following amounts: in a January 28, 1997, letter to [Mr. D] he requested that Chase pay him $835,335[9]; in a January 29, 1997, letter to [Mr. T], counsel for Mapco, he requested $180,000[10]; in a January 30, 1997, letter to [Mr. J. T.], counsel for BONY he requested $589,665[11]. In each letter, he expressed his preference that each creditor deposit the requested sums directly into an escrow account, although no court order authorized this procedure. Mapco and BONY responded by letters, denying that any such 1996 agreement existed. Counsel for Chase stated that the agreement was actually reached during the January 24, 1997, telephone call to [Mr. D], but agreed in principle to the request. Neither the oral, nor the written contacts between the trustee and Chase, BONY and Mapco concerning the requested fee agreements or the direct payments were disclosed to the RUS or the United States Trustee.

Throughout this time, the trustee filed two applications for interim compensation, the first on March 16, 1997,[12] and the second on July 24, 1997.[13] Included with those applications were statements pursuant to Bankruptcy Rule 2016(a) along with statements that he was disinterested. None of these statements disclosed anything concerning his efforts to solicit percentage fee payments from, BONY, Chase and Mapco. On a July 31, 1997, the trustee and Chase finally achieved a written memorialization of their agreement. It specified that the trustee would pursue a $4,248,000 fee to be paid by the Debtor in the first instance. The agreement also provided that in the event that the bankruptcy court required creditors to pay any part of the trustee's fee, Chase agreed to pay not more that $835,335 of that fee.

On June 9, 1997, a consensual plan of reorganization was confirmed. In preparation for

filing his final fee request, on July 31, 1997, the trustee filed a Preliminary Pleading Regarding Application for Allowance of Compensation and Reimbursement of Expenses (hereinafter "Preliminary Pleading"), which for the first time disclosed the agreement with Chase, and the trustee's intent to secure payments from Chase, BONY and Mapco. The Preliminary Pleading provided, in part, as follows:

> As previously stated in pleadings, and as disclosed to the court, during the October 31 - November 1 conference in Washington, the Examiner discussed with [Chase, BONY], Mapco and RUS the Examiner's belief that he should be compensated for new value brought into the estate on a percentage basis (up to 3%). [Chase, BONY] and Mapco agreed with the percentage approach, while the RUS stated, at that time, it would not agree or disagree with a percentage compensation to the Examiner.
>
> The Court instructed the parties on July 1, 1997, to attempt to negotiate the Examiner's fee request. As a result of that directive, the Examiner has begun additional negotiations. As of the date of filing this pleading, those negotiations have been concluded only with Chase. . . .

Attached to the Preliminary Pleading was a letter from Chase, which confirmed the terms of the trustee's agreement with Chase. The filing of the Preliminary Pleading was the first time that the trustee's efforts to solicit payment of his percentage fee directly from Chase, BONY and MAPCO was publicly disclosed.

On September 17, 1997, the United States, on behalf of the RUS, filed an objection to the payment of the trustee's fees.[14] In that objection, the United States sought disgorgement of the trustee's fees in connection on the grounds that his efforts to solicit payments from Chase, BONY and Mapco was a conflict of interest. In August 1997, the United States Trustee asked for discovery into the trustee's fee arrangements. Shortly thereafter, the bankruptcy court enjoined filings and discovery relating to the trustee's attempt to obtain fees. In October 1998, the trustee filed his Final Application for fees and expenses. At a hearing in September 1998, the bankruptcy court extended the ban on discovery and indicated he would hear no evidence on the fee issues concerning Chase, BONY and Mapco. At that hearing, the trustee stated in open court that there had been no fee agreement with Mapco. In response to this statement, Mapco, Chase and Bony subsequently filed copies of the January 1997, letters that the trustee has sent them, in which he stated such agreements did exist. The trustee subsequently claimed that the statements in those letters that there were fee agreements between himself and Mapco, BONY and Chase were not true.[15] He stated further that he made those assertions as a negotiating tactic. *Id.*

During a September 28, 1998 hearing, the trustee claimed in open court that the bankruptcy court had authorized him to pursue negotiations with Chase, BONY and Mapco concerning his fee. Subsequently, Judge [R] decided to recuse himself from hearing issues concerning the trustee's fee. Bankruptcy Judge [S] was appointed to handle the matter. The

trustee filed his final fee application on October 13, 1998, seeking $4,410,000 in fees and $12,955 in expenses. Judge [S] continued the prohibition on discovery and evidence and, without conducting an evidentiary hearing, awarded the trustee $2,638,205. The United States Trustee and others appealed. The district court reversed the enhancement and also remanded for consideration of the disgorgement issue. After all bankruptcy court judges in the [redacted] District of [redacted] recused themselves from the disgorgement issue, the Sixth Circuit appointed District Court Judge [C] to hear the disgorgement issue. On August 13, 2002, the Judge issued his Memorandum Opinion and Order Requiring Disgorgement of Examiner's Fee and Examiner's Counsel's Fee (hereinafter "Opinion") requiring the trustee and his counsel to disgorge all fees. The United States Trustee, referencing the findings in that decision, issued the Notice of Termination to the trustee on September 11, 2002.

III. Analysis

United States Trustees supervise chapter 7 panel trustees. 28 U.S.C. § 586(a)(1). Trustees are fiduciaries with wide-ranging responsibilities to effectuate the goals of the particular chapter under which a bankruptcy is filed. Because they are fiduciaries, trustees are held to very high standards of honesty and loyalty. *See generally Woods v. City National Bank & Trust Co.*, 312 U.S. 262, 278 (1941); *Mosser v. Darrow*, 341 U.S. 267 (1951). *See also Meinhard v. Salmon*, 249 N.Y. 458, 464, 464 , 164 N.E. 545, 546 (1928) (Cardozo, C.J.).

Trustees have numerous duties in a chapter 7 case, which affect the rights of both debtors and creditors. Among their many duties, trustees are required to liquidate the property of the estate and close the case as expeditiously as is compatible with the best interests of all of the parties in interest. *See* 11 U.S.C. § 704(1). Because debtors and creditors rely on the trustee to administer estate funds fairly and impartially, it is important that trustees possess integrity and good moral character. Indeed these attributes are so important that the Department of Justice has promulgated a formal rule conditioning a trustee's appointment upon the possession of such attributes. *See* 28 C.F.R. § 58.3(b)(1); *see also* 28 U.S.C. § 586(d) ("The Attorney General shall prescribe by rule . . . qualifications for membership on the panels established by th United States trustee under paragraph (a)(1) of this section."). Further, because creditors and debtors have competing claims for a limited amount of estate assets, it is imperative that trustees remain disinterested and conduct themselves in such a manner as to avoid even the appearance of any conflict of interest. *See Mosser v. Darrow*, 341 U.S. at 271 ("Equity tolerates in bankruptcy trustees no interest adverse to the trust"); 11 U.S.C. §§ 701(a)(1) and 703(c) (trustees appointed by United States Trustees must be disinterested).

Because chapter 7 trustees are held to very high standards of conduct, they must maintain a reputation that is above reproach. Thus, in addition to adhering to all the requirements for case administration that are prescribed by the Bankruptcy Code, the Bankruptcy Rules, and local rules, 28 C.F.R. § 58.6(a)(3), trustees must conduct themselves in a manner that does not to cast doubt on their honesty, integrity, or ability to faithfully administer bankruptcy cases. If they

engage in misconduct in the course of their professional activities it may justify their removal from the chapter 7 panel. 28 C.F.R. § 58.6(a)(11).

In this matter, it is the conduct of the trustee in connection with his activities as the Examiner in the bankruptcy case of [redacted] that is at issue. It is axiomatic that an Examiner, like a trustee, is a fiduciary and must remain at all times a disinterested person with respect to all parties in the bankruptcy case. The disinterestedness requirement goes to the very heart of bankruptcy administration and is crucial to its integrity. *United States v. Gellene*, 182 F.3d 578, 588 (7th Cir. 1999). Pursuant to the Bankruptcy Code, a disinterested is a person that:

> does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders , by reason of direct or indirect relationship to, connection with, or interest in, the debtor or an investment banker specified in subparagraph (B) or (C) of this paragraph, or for any other reason.

11 U.S.C. § 101(14)(E).

In the Sixth Circuit, where the [redacted] bankruptcy is pending, the court of appeals has concluded that the disinterestedness requirement must be strictly enforced whether fiduciary has either an actual conflict of interest, or an apparent conflict of interest. *Michel v. Federated Department Stores, Inc. (In re Federated Department Stores, Inc.)*, *44 F.3d 1310 (6th Cir. 1995).* There can be no doubt that after soliciting a fee arrangement with Chase, BONY and Mapco at the 1997, Washington settlement conference, the trustee was no longer disinterested. The broad language of 11 U.S.C. § 101(14)(E) necessarily forbids such conduct and agreements that might interfere with a fiduciary's obligation to be independent and impartial with respect to all classes of creditors, not just the three who had negotiated to support the trustee's fee request. *See Mapother & Mapother v. Cooper (In re Downs)*, 103 F.3d 472, 477 (6th Cir. 1996) (fee arrangement between fiduciary and a creditor of the debtor rendered fiduciary not disinterested); *In re Crimson Investments, N.V.*, 109 B.R. 397, 402 (Bankr. Ariz. 1989) (because of fiduciary's receipt of "compensation from Debtor's creditors . . . had, and has, a pecuniary interest materially adverse to the interests of the secured creditors").

As a fiduciary in the [redacted] case, the trustee's conduct is measured by and must be held to the highest standards of loyalty. The trustee contends that no agreement was reached between himself and the representatives of these unsecured creditors at the Washington settlement conference. Consequently, he asserts that he was disinterested. Request for Review, at 16. Whether such an agreement was actually reached is not the critical factor in determining whether he remained disinterested. At the settlement conference, the trustee began to solicit a fee agreement Chase, BONY and Mapco, the three largest of the Debtor's unsecured creditors. He sought their agreement that they pay him a percentage fee based on any increases in the value of their claims over the administration of the case. He further sought their agreement that they would each pay a share of that fee. By the close of the settlement conference he believed that he had successfully negotiated such an agreement. Because he believed such an agreement was in place, he had every incentive to favor the three unsecured creditors to the detriment of the RUS.

Consequently, from the time of the settlement conference forward, he became a real party in interest and was no longer disinterested pursuant to 11 U.S.C. § 101(14)(E).

The most compelling evidence that the trustee believed he had an agreement with Chase, BONY and Mapco are the letters sent by him in January 1997, to [Mr. D] of Chase;[Mr. T], counsel for Mapco,[16] and; [Mr. J. T.], counsel for BONY.[17] In the letters to Messrs. [T] and [J. T.], the trustee wrote that at the Washington settlement conference they had agreed, on behalf of their clients, that he "as Examiner, would receive 3% of the new value your client received in the case." Those letters also undeniably demonstrate that he expected Chase, BONY and Mapco to be responsible for part of the percentage fee sought. In the letter to Mr. [T], the trustee stated that Mapco's share of his fee was $180,000, while in his letter to Mr. [J. T.] sought $589,665.00. In the letter to Mr. [D], the trustee stated that "Chase, through you, and I had an oral agreement reached during the Washington conference that I would receive compensation of 3% of the new value that Chase received in the case . . . " The trustee sought $835,335.00 from Chase as its share of his compensation. In all three of the letters, the trustee expressed a desire to have each creditor pay the requested amounts into an escrow account that would then be used to pay his fee, thereby ignoring the payment mechanism established by section 330 of the Bankruptcy Code, which requires a prior court order, and requires that the fees be payable by the debtor's estate, not from individual creditors.

In his Request for Review, the trustee challenges this evidence by stating that all deposition testimony on this issue demonstrates that there was no discussion or agreement at the Washington settlement conference that Chase, BONY or Mapco would pay any part of his fee. Request for Review, at 16. In attempting to explain why these letters affirm that such fee agreements were reached at that settlement conference, the trustee insists that the statements in his letters affirming those agreements were a negotiating tactic. In the deposition excerpts cited in support of this claim, the trustee testified about the relevant sentence in the letter to Mr. [D] as follows:

> At the time that I wrote this sentence, the conversations had been so general and so nonspecific that I didn't know whether Chase had agreed to that or not. I mean, I didn't - - they might have. I didn't know whether they had agreed or not. The purpose of this sentence is a negotiation. . . .[18]

During a hearing in open court in late September 1998, the trustee had maintained that there was no side agreement with Mapco concerning his fees.[19] When contradicted by counsel for Mapco, [the trustee] characterized his own statements in a pleading filed by him with the bankruptcy court as follows:

> A common tactic used in negotiations is to make a statement, *as if it were a fact*, even though the statement is incorrect and is known to be incorrect. The Examiner used this common place tactic in his January, 1997 letters to Chase and counsel for Bank of New York and Mapco, asserting, as a fact, that an agreement had been reached at the Washington settlement conference, wherein these

creditors would pay the Examiner 3% on any new value their clients received. [20]

The trustee's argument that he believed no agreement had been reached at the Washington settlement conference is problematic. The trustee distanced himself from these statements only after he was confronted with his own misstatement in court that no agreement had ever been reached at the Washington settlement conference and after the United States Trustee and RUS had questioned the trustee's conduct. Furthermore, as set forth above, the trustee's January 28, 1997, letter to [Mr. D] plainly demonstrates that during the January 24, 1997, conversation with Mr. [D] they had come to a fee agreement on the trustee's terms. The trustee therefore had no incentive to state that the agreement was reached at the settlement conference in 1996, because an agreement had been reached. Consequently, it is clear that his statement did not reflect a settlement tactic, but instead merely reflected his belief that he had reached the agreement with Chase in 1996.

It is worth noting that the trustee's negotiation tactic argument is a double-edged sword. If believed, it might support his argument that no agreements were reached at the Washington settlement conference. At the same time, if true, it demonstrates a troubling aspect of the trustee's character. Although a fiduciary, he states he was willing to make misrepresentations to the three largest creditors in the [readcated] bankruptcy case for the sole purpose of exacting from them an agreement for very substantial fees, which fees he sought to have them pay directly. Assuming that the letters were a negotiation tactic, they are undeniably misrepresentations. As the above-quoted explanations demonstrate, he either knew the statements were untrue, or he was unsure whether they were true, but he nonetheless made the statements as if they were fact. The trustee's contention that such misrepresentations are common place in negotiations is unpersuasive. That the trustee would make such misrepresentations to parties in interest in pursuit of an enhanced fee demonstrates that he does not possess the very high standards of integrity, honesty and loyalty required for fiduciaries and causes me to conclude that he might make similar misstatements when he acts as a chapter 7 trustee. *See generally Woods v. City National Bank & Trust Co.*, 312 U.S. 262, 278 (1941); *Mosser v. Darrow*, 341 U.S. 267 (1951).

I conclude, therefore, that even if the statements in the January 1997, letters were not true, but were instead a negotiation tactic, I would affirm the decision to remove the trustee from the chapter 7 panel on an alternate ground from those articulated by the United States Trustee. Specifically, I would affirm pursuant to 28 C.F.R. § 58.6(a)(9), because his self-professed misrepresentations demonstrate that he fails to meet the eligibility requirements of 28 C.F.R. § 58.3(b)(1) (requiring integrity and good moral character).

Even if the trustee did not reach an agreement with the representatives of Chase, BONY and Mapco at the Washington settlement conference, he undeniably created an actual conflict of interest with respect to Chase in January 1997. Specifically, on January 24, 1997, he called [Mr. D] of Chase and reached an agreement that Chase would support his request for a percentage fee of 3% fee on new value that Chase received in the case. That agreement is evidenced in several letters. As previously discussed, the trustee sent a confirming letter to Mr. [D] on January 28,

1997, which reflected an agreement reached between them on January 24, 1997. Therefore, even if no agreement was reached in 1996, an agreement was reached between the trustee and Chase on January 24, 1997. This agreement was further reflected in a February 4, 1997, letter from [Mr. M. Th], counsel for Chase, to the trustee.[21] In that letter, Mr. [Th] wrote that the agreement was reached with Chase concerning the trustee's fees during a telephone call with Mr. [D] on January 24, 1997. The letter further states that "Chase agreed in principle, subject to agreeing on calculation of the actual amount." Finally, Mr. [Th] wrote that "[Mr. D] . . . wishes me to confirm that Chase intends to stand behind that agreement." In response to a request in the trustee's January 28, 1997, letter requesting a memorialization of this agreement, Mr. [D] wrote to the trustee on July 31, 1997.[22] In that letter, he confirmed in detail the position of Chase that it would support the trustee's request for a $4,410,000 success fee. Mr. [D] further stated that Chase would pay up to $835,335.00, if the bankruptcy court awarded a success fee but required Chase to pay it. Thus, whatever arguments are made about the settlement conference, the trustee was plainly no longer disinterested, or conflict free from January 24, 1997, forward.

Another defense raised in the Request for Review is that Judge [C] erred in holding that the trustee was required to remain a "neutral" party. Request for Review, at 22. The trustee appears to argue that because he was akin to a trustee he could not remain neutral. He argues that he was required by the order mandating the appointment of an Examiner to undertake various duties, including maximizing estate assets. The trustee misses the point here. His efforts to maximize value for the estate have nothing to do with the fact he did not remain disinterested. The unacceptable conflict of interest he created was as a result of his efforts to maximize his Examiner's fees by soliciting three unsecured creditors to accept an agreement that would potentially bind each of those creditors to pay a portion of the fee sought according to how much they received on their claims. His actions set up a situation in which the fortunes of the three unsecured creditors became intertwined with the amount of fees he might collect. This created disincentive for him to act fairly toward the RUS, which was competing with Chase, BONY and Mapco for a limited supply of cash. This circumstance is a classic example of a conflict of interest. *See In re Crimson Investments, N.V.*, 109 B.R. 397, 402 (Bankr. Ariz. 1989) (because of fiduciary's receipt of "compensation from Debtor's creditors . . . had, and has, a pecuniary interest materially adverse to the interests of the secured creditors").[23]

A separate basis relied upon by the United States Trustee in issuing her Notice of Termination to the trustee was the fact that he failed to timely disclose his conflicts of interests as required and, in fact, misrepresented himself as disinterested in pleadings when he was not. As a fiduciary, the trustee has a duty to disclose any actual or apparent conflicts of interests. In *In re Roberts*, 75 B.R. 402, 411 (D. Utah 1987), the court addressing the failure of debtor's counsel to fully disclose, correctly observed as follows:

> In situations where counsel is aware of apparent conflicts which counsel believes are outweighed by other factors, the conflicts must be disclosed. The court then can exercise its independent judgment. The decision concerning the propriety of employment should not be left exclusively with counsel, whose judgment may be clouded . . . .

The duty of disclosure is a continuing one. Any change in circumstance must be disclosed. *In re Sauer*, 191 B.R. 402 (Bankr. Neb. 1995); *see In re Wild Horse Enterprises*, 136 B.R. 830 (Bankr. C.D. Cal. 1991); Fed R. Bankr. P., Rule 2016(b). Further, "the omission of material information in a bankruptcy filing impedes a bankruptcy court's fulfilling of its responsibilities just as much as a false statement." *United States v. Gellene*, 182 F.3d at 587 (internal quotation omitted). The trustee had an affirmative duty to disclose any fee arrangements with unsecured creditors so the appropriateness of his continued service as Examiner could have been subject to independent review by the bankruptcy court. *See, e.g. Diamon Lumber, Inc. v. Unsecured Creditors Committee*, 88 B.R. 773, 779 (N.D. Tes 1988); *see also* Bankr. P., Rule 2016(b) and *Winship v. Cook*, 223 B.R.782, at 790, 793 (Bankr. 10th Cir. 1998).

Bankruptcy Rule 2016(b) requires that "[a] supplemental statement shall be filed and transmitted to the United States trustee within 15 days after any payment or agreement not previously disclosed. The trustee violated his duty of disclosure in two ways. First, he violated his duty of continuing disclosure when he failed to supplement his original statement of disinterestedness, filed in October 1996.[24] Second, he filed two incorrect applications for interim compensation, the first on March 16, 1997,[25] and the second on July 24, 1997, that contained misrepresentation about his disinterestedness.[26] Neither application disclosed his belief that he reached an agreement with Chase, BONY and Mapco during the October 31 to November 1, 1996, settlement conference. Even assuming he did not believe he had reached those agreements earlier, he did not disclose the existence of his January 24, 1997, agreement with Chase. By failing to disclose his non-disinterestedness in those disclose those applications he violated Rule 2016(a).

The trustee answers these allegations in two ways. First, he contends there was nothing to disclose. He asserts there was no agreement reached concerning his fees at the 1996 settlement conference. He further asserts that any negotiations he may have conducted with Chase, BONY and Mapco were suspended prior to the time he filed his first Interim Application for fees in March 1997. The trustee's representations of the facts cannot be accepted. As evidenced in his January 1997 letters to Chase, BONY and Mapco, the trustee believed he had an agreements with Chase, BONY and Mapco as of October 31/November 1, 1996. He was obligated therefore to disclosed them. Further, whatever his claims concerning 1996 settlement conference, the fact that he reached an agreement with Chase no later that January 24, 1997, are irrefutably evidenced in his January 28, 1997 correspondence to [Mr. D] and [Mr. M. T.]'s February 4, 1997 letter is response thereto.

Second, he asserts that the information concerning his desire for a percentage fee was disclosed. He notes that he discussed the percentage fee concept with a representative of RUS at 1996, settlement conference.[27] He later discussed it with a RUS representative on November 21, 1996. The trustee also notes that a number of interested parties approached the bankruptcy court with their concerns about his desire for a percentage fee on November 13, 1996, and asserts the United States Trustee and the RUS must have had all the information at that time. Finally he contends that Assistant United States Trustee had a meeting with the attorney for Chase.[28]

concerning the trustee's desire for a percentage fee. From this he argues that the United States Trustee must have known.

The flaw in this argument is that the Bankruptcy Code and Rules require the fiduciary to make full disclosure in a specified, public way: by filing a certain statements as to disinterestedness and compensation agreements. The trustee did not do this and by so failing, he violated Bankruptcy Rule 2016.

The trustee repeatedly asserts that bankruptcy court privately authorized him to negotiate with Chase, BONY and Mapco. In support of this contention, the trustee offers only his uncorroborated deposition testimony. Assuming such a secret conversation might have taken place, the Record does not demonstrate with any level of certainty what exactly the bankruptcy court said. He might have simply indicated it was permissible for the trustee to inquire if there were any objections to the concept of a percentage fee. He might have said something more, although it is difficult to believe that a bankruptcy judge would have approved a course of conduct so at odds with the disinterestedness requirements of bankruptcy and the substantive provisions of the Bankruptcy Code and Rules.

The trustee's argument concerning Judge [R]s' ex parte statement is troubling. It demonstrates that the trustee is willing to disregard the specific mechanisms established for the purpose of compensating bankruptcy professionals. That mechanism is set forth in section 330 of the Bankruptcy Code. It mandates that all applications for professional compensation be determined after notice to the parties in interest and a hearing. Section 330 contemplates a fully public proceeding where adequate information is available and all interested parties have an opportunity to be heard. To the extent that the trustee's has shown himself willing to have exparte contacts with a bankruptcy judge for the purpose of secretly co-opting various creditors in support of his fee application, he has shown himself unwilling to abide by the Bankruptcy Code and Rules. In light of this and his other misconduct, I conclude that the United States Trustee was well within her discretion to remove him from the panel and her decision is fully supported by the record.

Finally, the United States Trustee also removed the trustee pursuant to 28 C.F.R. § 58.6(a). The underlying disgorgement proceeding called into question the trustee's competence, financial responsibility and trustworthiness, and therefore justified the United States Trustee's decision. Moreover, the fact that Judge [C] held that the trustee engaged in misconduct compels the conclusion that his removal was essential to safeguard the integrity of the chapter 7 panel. The United States Trustee's decision in this regard was within her discretion and is supported by the record.

IV. Conclusion

Based upon my review of the record, including the written submissions of the trustee and the United States Trustee, I affirm the United States Trustee's decision to terminate the trustee's membership on the chapter 7 panel.

The foregoing conclusions and decisions constitute final agency action.

Dated: November 15, 2002

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Lawrence A. Friedman
Director
Executive Office for United States Trustees

1. United States Trustees are officials of the Department of Justice who are appointed by and serve at the pleasure of the Attorney General. 28 U.S.C. § 581(a) and (c). The Director of the Executive Office for United States Trustees is a Department of Justice official who acts under authority delegated by the Attorney General.

2. The administrative Record in this matter includes the trustee's Request for Review of the Notice of Termination Issued by [redacted], United States Trustee for [redacted], the trustee's Motion for Stay of Interim Directive, the Response of United States Trustee to [the trustee's] Motion for Stay of Interim Directive, the United States Trustee's Response to Trustee's Request for Review, the Notice of Termination concerning future case assignments and the Interim Directive.

3. New case assignments end upon the expiration of a trustee's time to seek review by the Director or, if the trustee timely seeks such review, upon the issuance of a final written decision by the Director. 28 C.F.R. § 58.6. If, however, a United States Trustee specifically determines that one of four circumstances exists the United States Trustee may issue an Interim Directive, which immediately discontinues the assignment of new cases. 28 C.F.R. § 58.6(d) (setting forth the bases for issuing an Interim Directive). If a United States Trustee issues an interim Directive, the trustee may ask the Director to stay it. 28 C.F.R. § 58.6(e). The United States Trustee issued an interim directive in this matter. By motion served upon the Director on September, 30, 2002, the trustee requested a stay of the Interim Directive. Because of the factually complex nature of this matter, however, it was not possible to resolve that motion prior to issuing this decision.

4. Pursuant 11 U.S.C.§ 1106(b), an Examiner is required to perform the duties set forth in 11 U.S.C.§ 1106(a)(3) and (a)(4), which provide as follows:

> (a)(3) except to the extent that the court orders otherwise, investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of such business, and any other matter relevant to the case or to the formulation of a plan;
>
> (a)(4) as soon as practicable–
>
> (A) files a statement of any investigation conducted under paragraph (3) of this subsection, including any fact ascertained pertaining to fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor, or to a cause of action available to the estate; and
>
> (B) transmit a copy or summary of any such statement to any creditors' committee or equity security holders committee, to any indenture trustee, and to such other entity as the court designates;

5. Affidavit of Examiner That He Is Disinterested, dated October 18, 1996, United States Trustee Exhibit 9, at 51-52.

6. Although the concept of "new value" does not appear to be expressly defined in the record, it apparently is associated with the trustee's intention to maximize the value of estate assets. For example, in his January 28, 1997, letter to [Mr. D] (United States Trustee's Exhibit 9 (U.S. Appendix, at1 & 2), it appears that the trustee related new value to the amount of money Chase was to receive under a consensual plan (estimated at $.89 per dollar of Chases claim) to that amount Chase would have received under an offer the Debtor had made at the time of the October 31 to November 1, 1996 settlement conference in Washington, D.C. ($.25 on the dollar).

7. Under the Bankruptcy Code, a court may award trustees and other professionals "reasonable compensation for actual, necessary services rendered by such trustee, examiner, professional or attorney . . . based on the nature, the extent, and the value of such services, the time spent on such services, and the cost of comparable services other than in a case under this title." 11 U.S.C § 330(a)(1). With respect to trustees specifically, section 330(a)(1) of title 11 limits the amount a court may award to a trustee as a percentage of the amount of moneys disbursed by the trustee in a given case. Pursuant to section 326(a), a trustee may receive up to 3 per cent of any moneys disbursed by the trustee in excess of $1,000,000.

8. The trustee's deposition, Vol. I, at 168 (United States Trustee's Exhibit 10 (United States Trustee Supplemental Appedix In Support of Joint Motion Requesting Disgorgement of Examiner's Fees "U.S. Supplemental Appendix, at102); [Mr. D] Deposition,42-46 (U.S. Supplemental Appendix, pp 19-23); [Mr. T] Deposition at 15-17 (U.S. Supplemental Appendix, pp 170-171).

9. The January 28, 1997 letter of the trustee to [Mr. D] is contained in the United States Trustee's Exhibit 9 (appendix of the United States Trustee In Support of Joint Motion Requesting Disgorgement of Examiner's Fees, hereinafter "U.S. Appendix", at 1 & 2).

10. The January 29, 1997 letter of the trustee to [Mr. T.], United States Trustee's Exhibit 9 (U.S. Appendix, at 4 & 5).

11. The January 30, 1997 letter of the trustee to [Mr. J. T.], United States Trustee's Exhibit 9 (U.S. Appendix, at 4 & 5).

12. United States Trustee's Exhibit 9 (U.S. Appendix, at 120).

13. United States Trustee's Exhibit 9 (U.S. Appendix, at 126-127)

14. United States Objection to Payment of Examiner's Fees, United States Trustee's Exhibit 9, (U.S. Appendix at 62-71).

15. Examiner's Reply Memorandum In Support of His Final Fee Application, at 21, United states Trustee's Exhibit 9 (U.S. Appendix, at 136).

16. January 29, 1997 letter of the trustee to [Mr. T], United States Trustee's Exhibit 9 (U.S. Appendix, at 4 & 5).

17. January 30, 1997 letter of the trustee to [Mr. J. T.], United States Trustee's Exhibit 9 (U.S. Appendix, at 4 & 5).

18. Request for Review, Exhibit 17 (Deposition of the trustee, at 76-77).

19. Transcript of Hearing (September 18, 1998), United States Trustee Exhibit 9, (U.S. Appendix, at 41.

20. Examiner's Reply Memorandum In Support of His Final Fee Application, at 21, United states Trustee's Exhibit 9 (U.S. Appendix, at 136).

21. United States Trustee's Exhibit 9, (U.S. Appendix, at 13)

22. July 31, 1997 letter from [Mr. D] to the trustee. United States Trustee's Exhibit 9, (U.S. Appendix, at 74)

23. In the same section of the Request for Review (at 22-28), the trustee also asserts that Judge [C] was wrong in his conclusion that the trustee was no longer disinterested when he approached Chase, BONY and Mapco at the Washington settlement conference and suggested that they pay him a percentage fee from their funds. Request for Review, at 25. Specifically, the trustee asserts that Judge [C]'s decision is contrary to the decision of three federal judges. *Id.* The trustee's argument in this regard is without merit. The Record demonstrates that Judge [C] was the only judge to have examined this issue. Judge [R] issued a moratorium on any discovery and pleadings on this issue. Order, dated September 23, 1997, United States Trustee's Exhibit 3. This moratorium continued at all times while Judge [R] presided over the issue of the trustee's fees. Order, dated June 23, 1998, United States Trustee's Exhibit 4. Judge [R] subsequently recused himself from the fee issues and was replaced by Judge [S], who also continued the moratorium. When Judge [S]'s decision to grant the trustee over $2 million in fees, that order was appealed to the district court, before Judge [M]. Because the request for disgorgement had not been heard below, Judge [M] was unable to render any decision on that issue and remanded the matter to the trial court.

24. Affidavit of Examiner That He Is Disinterested, dated October 18, 1996, United States Trustee Exhibit 9, (U.S. Appendix, at 51-52).

25. United States Trustee's Exhibit 9 (U.S. Appendix, at 120).

26. United States Trustee's Exhibit 9 (U.S. Appendix, at126-127)

27. The Trustee's Deposition, Volume I, at 31, Request for Review, Exhibit 21.

28. [Mr. M. T.] Deposition and [Mr. D] Deposition, Request for Review, Exhibit 3.