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Report to the Chairman, Subcommittee on Economic and Commercial Law, Committee on the Judiciary, House of Representatives

July 1994

BANKRUPTCY ADMINISTRATION

Case Receipts Paid to Creditors and Professionals

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The Honorable Jack Brooks
Chairman, Subcommittee on
Economic and Commercial Law
Committee on the Judiciary
House of Representatives

Dear Mr. Chairman:

This report responds to your request for information on the total amount and distribution of bankruptcy estate receipts in cases terminated under Chapter 7 of the bankruptcy code in statistical years 1991 and 1992.[1] Specifically, you asked us to provide detailed information on the amount of total receipts paid to professionals, including trustees, attorneys, other professionals (such as accountants and appraisers); to creditors; and to others, such as the debtors.

Businesses or individuals who file for Chapter 7 bankruptcy surrender their nonexempt assets to a trustee who converts them to cash for distribution to creditors.[2] A Chapter 7 asset case is one in which there are proceeds from nonexempt assets to be distributed.[3] Congress is considering proposed changes in the bankruptcy system that include increasing compensation to trustees. Many trustees have said that they are not adequately compensated under the current fee system. To address how much creditors and professionals were paid, we analyzed asset cases terminating under Chapter 7 in statistical years 1991 and 1992, the latest data available at the time of our analysis. We discussed the results of our work with the Subcommittee, and this report summarizes the information provided.

Results in Brief

Of the 1.2 million Chapter 7 bankruptcy cases closed in statistical years 1991 and 1992, about 5 percent (56,994) generated some receipts for

[1]The Administrative Office of the U.S. Courts (AO) compiles data on a July 1 to June 30 year. It refers to this period as a statistical year. The data in this report cover the period July 1, 1990, to June 30, 1992.

[2]Statutory exemptions protect certain property of a debtor from creditors. Generally, a debtor has a choice between state or federal exemption systems, unless a state has opted out of the federal scheme of exemptions.

[3]By asset cases, we refer to those cases in which assets have been liquidated and the cash has been distributed to creditors, professionals, or debtors. Cases in which no assets were liquidated we refer to as no-asset cases. However, there may be significant assets in no-asset cases. This situation occurs when assets are transferred to the holders of valid secured claims rather than being liquidated. Data on this type of asset case were not included in the database we analyzed.

distribution to professionals and creditors. In total, these Chapter 7 asset cases generated about $2.0 billion in gross receipts. The 12 percent of these asset cases with more than $25,000 in receipts accounted for 90 percent of all receipts. Less than 1 percent of the cases generated receipts of more than $500,000, but these cases accounted for 57 percent of all receipts. These larger cases tended to be business cases rather than consumer debt.

Business cases generated the majority of receipts in Chapter 7 asset cases, took longer to close than consumer cases, and returned a greater percentage of receipts to creditors. The larger cases, as measured by gross receipts, tended to generate larger percentages of receipts for all creditors, while longer cases—regardless of case size—generated smaller percentages of receipts for all creditors. General unsecured creditors received a higher percentage of receipts in relatively small cases that closed in 3 years or less.

Of the $2.0 billion in gross receipts generated by the Chapter 7 asset cases closed, $553.8 million was disbursed to professionals (including $72.8 million to bankruptcy trustees), $1.2 billion to creditors, and the remainder ($217 million) to others, such as debtors. Those professional fees, including trustee compensation and expenses, accounted for more than half of the $1 billion we estimated it cost to process, administer, and close all Chapter 7 cases in these 2 years. The remainder were bankruptcy court operating costs, almost all of which were costs for the bankruptcy clerks of court to administer and close the 95 percent of Chapter 7 cases that produced no receipts for distribution (no-asset cases). In no-asset cases the only professional expense is the $45 per case paid to the trustee from the filing fee.

Trustees may receive income from three sources in Chapter 7 asset cases—filing fees, compensation for actual and necessary services, and income from self-retention as attorney or accountant for the trustee. When combined, these sources of income to trustees totaled an estimated $216 million for all Chapter 7 cases closed in statistical years 1991 and 1992.

For the Chapter 7 cases closed in statistical years 1991 and 1992, total direct trustee compensation from filing fees plus the trustees' compensation was about $129.3 million. This total comprised an estimated $56.5 million from the trustees' share of the filing fees paid from all cases closed, including no-asset cases and $72.8 million as their percentage of the $2.0 billion in gross receipts disbursed in Chapter 7 asset cases. The AO does not maintain data on trustee income from other types of compensation for asset cases, such as self-retention as attorneys or for other professional services. Relying on an Executive Office for U.S. Trustees (EOUST) estimate of 4.4 percent for the percentage paid to trustees or their firms, we estimated that trustees would have received about $86.8 million in income from self-referrals as attorneys or other professionals. These data indicate that self-referral may be a significant source of income for trustees.

When trustee compensation is measured on a per case basis, direct trustee compensation from gross receipts was less than $2,406 in 95 percent of the asset cases. Nevertheless, in about 79 percent of the Chapter 7 asset cases, trustee compensation exceeded 90 percent of the statutory percentage maximum permitted.

Background

Most bankruptcies are filed under one of four provisions of the bankruptcy code: Chapter 7 liquidation, Chapter 13 repayment plan, Chapter 11 reorganization, and Chapter 12 family farmer. Individual and business debtors can file for bankruptcy under Chapters 7, 11, or 13 as long as they meet the specific requirements of the chapter. Chapter 7 cases made up 70 percent of bankruptcy filings in statistical years 1991 and 1992.

Debtors—individuals or businesses—who file for Chapter 7 bankruptcy surrender their nonexempt assets to trustees who convert them to cash for distribution to creditors. Receipts obtained from Chapter 7 liquidations can come from bankruptcies filed under Chapter 7 or any other chapter, provided cases filed under another chapter are converted to and ultimately terminate under Chapter 7. Appendix I provides additional background information about the various bankruptcy chapters and the bankruptcy process.

In liquidating assets, it is a trustee's duty to collect and reduce the property of the estate to money and to close up the estate as expeditiously as is compatible with the best interests of the parties involved in the case. The Chapter 7 trustee has the related duty to maximize the value of the estate for all creditors.[4] Trustees also fulfill their statutory duties by paying creditor claims from estate receipts.

[4]After a Chapter 7 bankruptcy petition is filed, the debtor's property becomes an "estate" controlled by the trustee assigned to the case. The debtor is entitled to retain certain exempt property that is protected from creditors.

Professionals who provide services during the course of the bankruptcy, court fees, and certain administrative expenses have claims to receipts generated from the estate over the claims of unsecured creditors. Trustees monitor professionals' services, but professional fees are subject to the final approval of the bankruptcy court. Professionals include the attorney hired by the trustee and other professionals (including accountants and appraisers) hired by the trustee. In addition, other professionals include the attorney for the debtor.

Creditors in a bankruptcy case, in general, are entities having claims against the debtor that arose at the time of or before the bankruptcy petition was filed. With the exception of secured claims, which are protected by collateral and generally are first in line for distribution (if the claim is not covered fully, the remainder is an unsecured claim), the receipts from liquidating estate property generally are paid in the following order: priority unsecured claims and general unsecured claims (a more detailed discussion of each class of creditor is found in app. I). Any monies left over after all creditor claims have been paid are paid to the debtor.

Approach

The Subcommittee requested detailed information on the amount and distribution of bankruptcy estate receipts from Chapter 7 asset cases paid to professionals, including trustees, attorneys, other professionals (e.g., accountants); to creditors, including general unsecured creditors; and to others, such as the debtors. To generate this information, we analyzed data from the AO on 56,994 bankruptcy cases that terminated in statistical years 1991 and 1992 as Chapter 7 asset cases. We aggregated the data across the 2 years because we wanted to identify patterns associated with the payments to professionals (in terms of case characteristics, such as size of receipts generated) rather than look at yearly fluctuations in the payments.

We analyzed the data on amounts paid to professionals in the following categories: trustee compensation; fees for trustee attorney, debtor attorney, and other professionals, (such as accountants); and expenses of professionals (including trustee expenses). We analyzed payments to the three classes of creditors (defined in app. I). Finally, to determine if payments to professionals and creditors varied with the characteristics of bankruptcy cases, we compared payments to professionals and creditors across a number of case characteristics, including the nature of the debt (whether business or nonbusiness), type of case (whether filed voluntarily or involuntarily), the original filing chapter, the size of gross receipts generated by the case, and the length of time from filing to disposition.

Because the AO data did not contain creditor claim information, we were unable to analyze the number of creditor claims, the value of those claims, or the percentage paid on those claims. In addition, we were unable to determine the amounts requested on professional fee applications submitted by trustees.

We reviewed our scope and methodology with AO officials, and they concurred that it was a reasonable use of their data. Appendix II contains a more detailed description of our objectives, scope, and methodology. We discussed the contents of this report with the Chief of the Bankruptcy Division and his staff on March 23, 1994, and the Acting Director of EOUST and his staff on April 4, 1994. Their comments are presented on page 21. We did our work between July 1993 and January 1994 in accordance with generally accepted government auditing standards.

The Distribution of Chapter 7 Asset Case Receipts and the Costs of Processing Asset and No-Asset Cases

The bankruptcy system is designed to achieve a number of goals, including disposing of debt in an orderly way and providing debtors with some protection from creditors. The costs of bankruptcy include those costs borne by the estate, including filing and professional fees; and the costs borne by taxpayers, principally the costs of operating the bankruptcy courts other than the amount paid from the filing fee, such as the salaries and expenses of judges and their immediate staffs and the bankruptcy court clerks' offices.

Gross receipts from Chapter 7 asset cases terminating in statistical years 1991 and 1992 totaled about $2 billion (about $1 billion per year). Of the $2 billion, about $1.2 billion, (61 percent of gross receipts) was disbursed to creditors and equity security holders. About $554 million (28 percent of gross receipts) was disbursed as professional fees and expenses and trustee compensation; $217 million (11 percent of gross receipts) was paid to others, such as debtors.

The frequency with which individual categories of creditors were paid and the percentage of total receipts disbursed to professionals varied across both type of creditor and type of professional. For example, general unsecured creditors were paid something in 33,226 cases (58.3 percent of the 56,994 asset cases closed) and received 22.2 percent ($437.2 million) of all receipts disbursed.[5] Appendix III provides detailed information on the disbursements to creditors and professionals.

We estimated it cost the bankruptcy system almost $1 billion to process and close about 1.2 million Chapter 7 cases, including 56,994 asset cases, in statistical years 1991 and 1992. Professional fees, including trustee compensation and expenses, were about 56 percent ($554 million) of the $1 billion in administrative costs. We estimated bankruptcy court costs at about $428.5 million. The bulk of these estimated court costs were associated with closing consumer bankruptcies. In addition, the estimated total costs of all consumer bankruptcies ($521.3 million of the almost $1 billion) exceeded the $427.4 million gross receipts in these cases and were almost twice the amount ($273.6) disbursed to creditors. We used data from an April 1991 Federal Judicial Center bankruptcy court time study on the amount of time judges spend on various bankruptcy chapters to estimate bankruptcy court costs.[6] These costs included those derived from judges and their staffs' time and those derived from clerks of courts offices' time. Judges' and clerks' costs were estimated in relation to the average amount of time they spend on various types of bankruptcies. Details on the methods to estimate costs are in appendix II.

The type of case—no-asset versus asset—affects the costs incurred in bankruptcy. Generally, Chapter 7 no-asset cases do not generate professional fees, trustee compensation, or expenses, and they do not take much of judges' time. Trustees in no-asset cases receive $45 per case, which comes from the filing fee, which is paid by the debtor. About 85 percent of the estimated $428.5 million in court costs were the clerks offices' cost of processing the 1.2 million Chapter 7 no-asset cases. Chapter 7 asset cases generate costs in terms of professional fees, and these cases take up more court time than no-asset cases. Because of their relatively small number, asset cases do not take up as much of the time and resources of the clerks' offices.

[5]As with all classes of creditors, data did not permit us to determine the percent of general unsecured creditors who made claims, whose claims were paid, or the percent of general unsecured creditor claims paid.

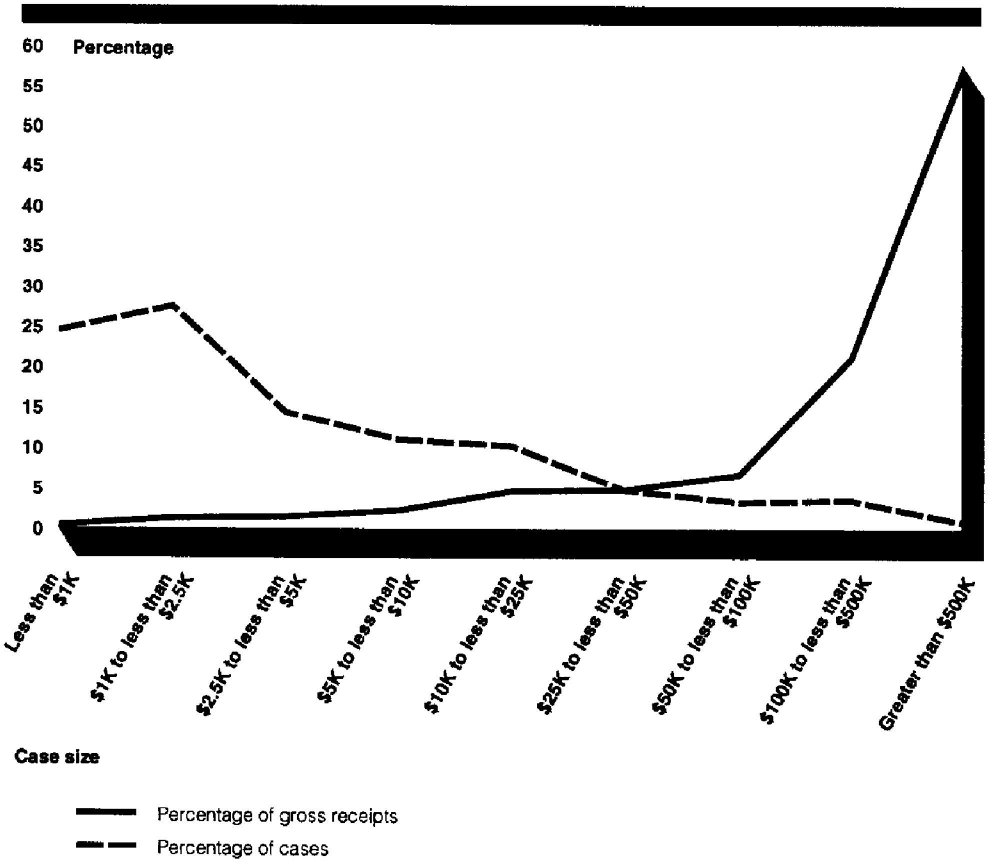
[6]Federal Judicial Center 1988-1989 Bankruptcy Court Time Study (April 1991).

Majority of Asset Cases Were Relatively Small in Size and Were Terminated in Fewer Than 3 Years

About 52 percent of the 56,994 asset cases terminating in statistical years 1991 and 1992 generated gross receipts of less than $2,500, and about 88 percent generated less than $25,000. Conversely, less than 1 percent of the cases generated gross receipts of $500,000 or more, and 83 percent of these large cases were business cases as opposed to consumer debt (see app. IV).

As shown in figure 1, the 12 percent of asset cases with $25,000 or more in receipts accounted for 90 percent of gross receipts. In addition, these larger cases comprised predominantly business cases. Those business cases with $500,000 or more in receipts accounted for 51 percent of gross receipts. Consumer cases of the same size accounted for 6 percent of receipts.

Figure 1: Percentage Distribution of Gross Receipts and Cases by Case Size (in Gross Receipts)



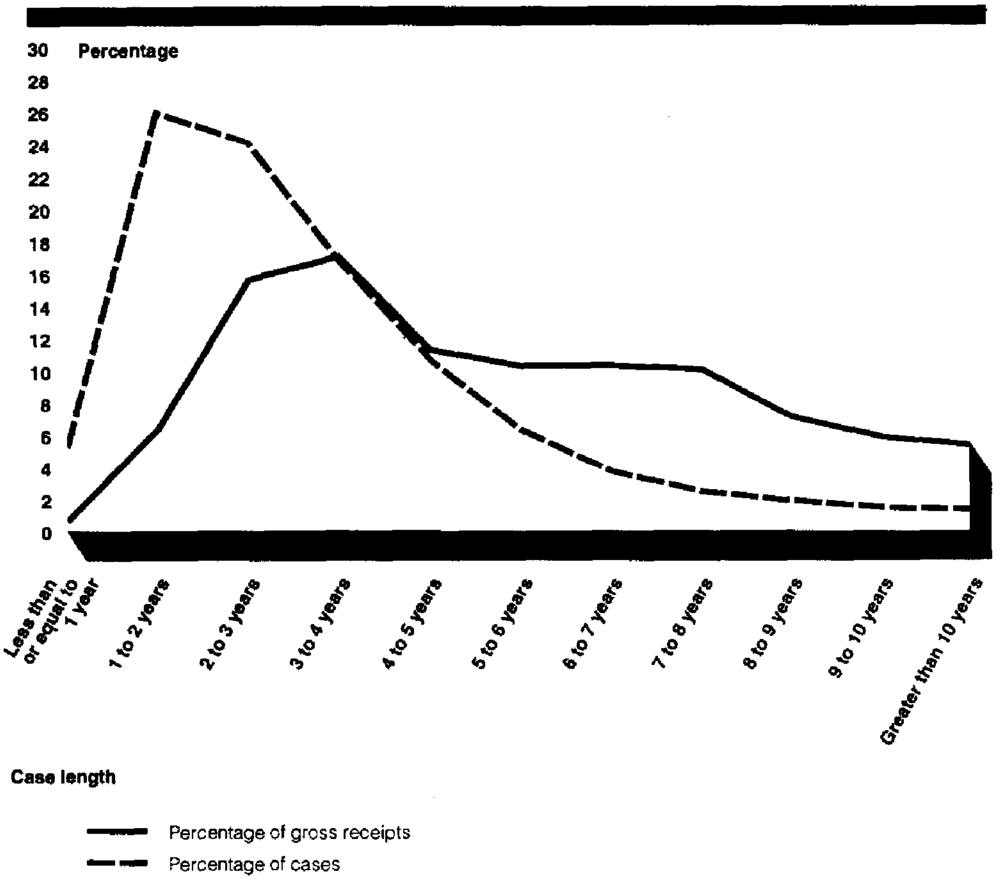
Source: GAO analysis of AO data.

Our analysis showed that business cases in general took longer to close than consumer debt cases. The median disposition time for consumer cases was fewer than 2.4 years, while the median disposition time for business cases was 3.8 years. In addition, business cases tended to generate larger amounts of gross receipts than consumer cases, regardless of how long they took to close. For example, business cases that required 3 to 4 years to close generated, on average, $76,976 in receipts, an amount 6 times larger than the average amount generated by consumer cases ($12,779) closed in 3 to 4 years.

We found that about 55 percent of asset cases closed in fewer than 3 years, and about 72 percent closed in fewer than 4 years (see app. V). In addition, 94 percent of the cases closed in fewer than 3 years had gross receipts of less than $25,000. Large, complex cases are likely to take longer than small cases with few assets, but there are no criteria on how long an individual case of specific size or characteristics should take to close.

Cases taking more than 5 years to close generated a disproportionately larger percentage of receipts in Chapter 7 asset cases (see fig. 2) than cases taking fewer than 5 years to close. About 17 percent of all cases took 5 or more years to terminate, but these cases generated about 49 percent of all receipts. The remaining cases—closed in 5 years or fewer (about 83 percent of all cases)—generated about 51 percent of receipts. Such cases were generally small, mostly consumer debt cases.

Figure 2: **Percentage Distribution of Gross Receipts and Cases by Case Length** (in Years)



Note: Time intervals are mutually exclusive. For example, the category of 1 to 2 years is defined as greater than 1 year but less than or equal to 2 years.

Source: GAO analysis of AO data.

Certain Types of Asset Cases Generated Disproportionately Larger Shares of Receipts

In addition to the larger and longer cases, other types of asset cases generated disproportionately larger shares of receipts. Cases filed originally as business, filed involuntarily, or originally filed under Chapter 11 all generated percentages of receipts that were greater than the percentages of cases falling into these categories. Table 1 shows various types of cases and the shares of receipts each type generated. Those cases generating disproportionately larger shares of receipts generally were business debt cases.

Table 1: Distribution of Asset Cases and Gross Receipts by Selected Case Characteristics

Case characteristics	Number of cases	Percentage of cases	Percentage of receipts
Total	56,994		
Type of debt			
Business	19,199	33.7	78.4
Nonbusiness	37,795	66.3	21.7
Type of case at filing			
Voluntary	56,421	99.0	92.0
Involuntary	573	1.0	8.0
Original filing chapter			
Chapter 7	42,301	74.2	57.1
Chapter 11	5,371	9.4	38.2
Chapter 12	115	0.2	0.3
Chapter 13	9,207	16.2	4.3

Note: Percentages do not always add to 100 because of rounding.

Source: GAO analysis of AO data.

Larger Asset Cases Disbursed Larger Percentages of Receipts to Creditors and Smaller Percentages to Professionals

We examined how case size related to disbursements to creditors and professionals. We found that as case size increased, the percentage of gross receipts paid to creditors as a whole tended to increase up to $10,000 and flatten out for cases with receipts between $10,000 and less than $500,000. The percentage of receipts going to all professional fees, trustee compensation, and expenses tended to decrease up to $10,000 and again flatten out for cases between $10,000 and less than $500,000.

Specifically, creditors were paid about 40 percent of gross receipts for cases with less than $1,000 in receipts, about 64 percent for cases with $5,000 to less than $10,000, and 65 percent for cases with $50,000 to less than $100,000. On the other hand, all professional fees, trustee compensation, and expenses were about 54 percent of gross receipts for cases with less than $1,000, 32 percent for cases with $5,000 to less than $10,000, and about 29 percent for cases with $50,000 to less than $100,000.

Because of the Subcommittee's interest in trustee compensation and expenses, we grouped the data on all payments to professionals into two groups, and we compared the disbursements of receipts to the two groups to the total for all payments to professionals. The two groups were

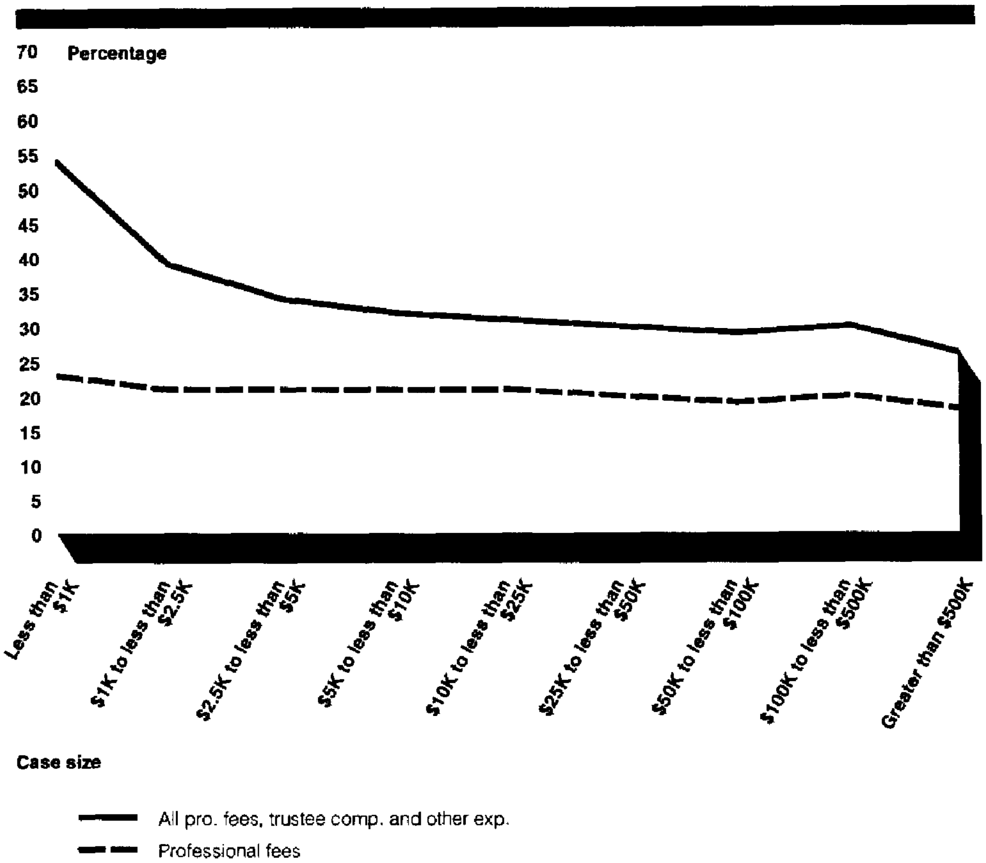
(1) trustee compensation and reimbursable expenses[7] and (2) professional fees. By statute, a trustee must be appointed to each Chapter 7 bankruptcy case, but a trustee need not necessarily employ an attorney or other professional, such as an appraiser or auctioneer, in each case. Thus, we wanted to distinguish between those resulting expenses incurred by statutorily required trustees in all cases and other professional fees.

First, we found that all payments to professionals (the solid line in fig. 3) decreased as a percentage of gross receipts with increasing case size up to cases of less than $10,000 in gross receipts. Beyond that case size, the percentage of gross receipts disbursed to all categories of professional payments was relatively constant. Second, the percentage of receipts paid as professionals fees (as indicated by the dashed line in fig. 3) was constant at about 20 percent across all levels of case size. Third, the percentage of receipts disbursed as trustee compensation and reimbursable expenses (the difference or gap between all professional payments and professional fees) followed a pattern similar to that of all payments to professionals. It decreased with increasing case size up to cases of $10,000 in receipts, and it was relatively flat for cases larger than $10,000.

Since maximizing disbursements to creditors is one of the purposes of bankruptcy, and in larger cases larger percentages of receipts are disbursed to creditors, then consistent with their statutory duties, trustees should make every effort to generate as many receipts as possible.

[7]Given the manner in which the data on reimbursable expenses were recorded, we could not distinguish those expenses incurred by trustees from those incurred by other professionals.

Figure 3: Percentage Distribution of Gross Receipts Paid by Case Size (in Gross Receipts) **to All Professional Fees, Trustee Compensation and Other Expenses, and to Professional Fees**



Source: GAO analysis of AO data.

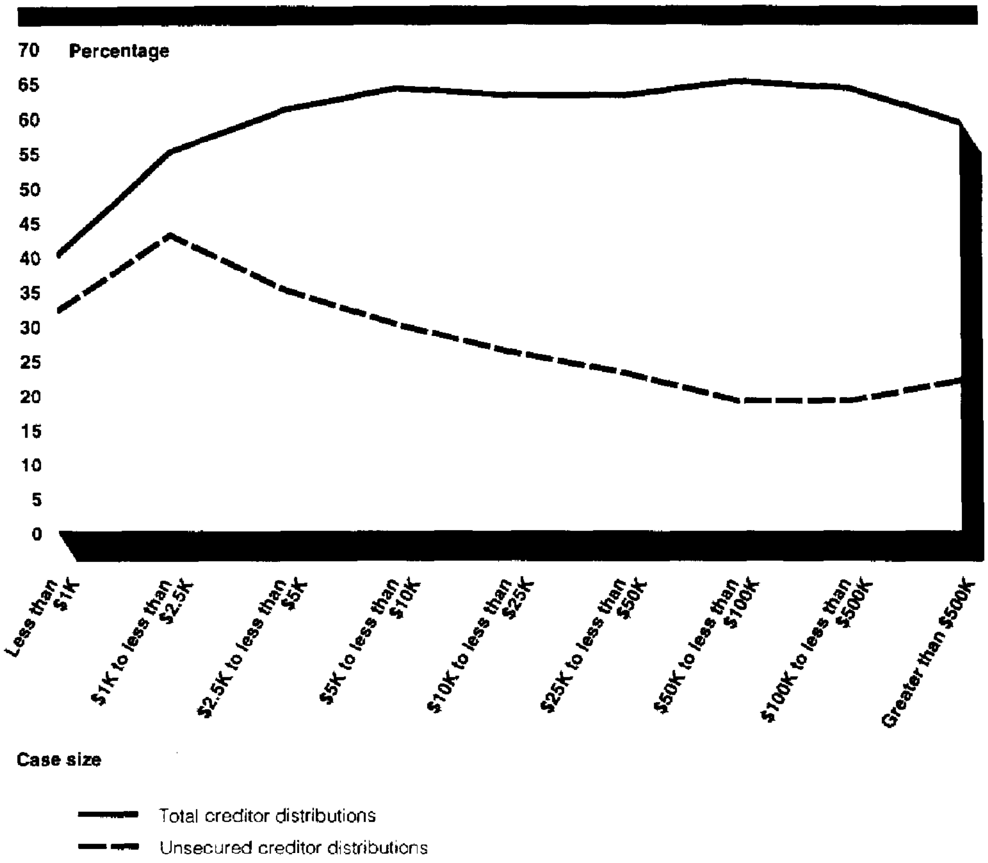
Larger Asset Cases Generally Disbursed Smaller Percentage of Receipts to General Unsecured Creditors

In bankruptcy, general unsecured creditors are the least protected group of creditors. In the data we examined, they were paid out of the proceeds of the liquidation in a larger percentage of the Chapter 7 asset cases (58.3 percent) than any other class of creditors. (See app. III.)

We also found that payments to general unsecured creditors varied with the amount of receipts in cases. The percentage of receipts paid to general unsecured creditors increased with case size up to $2,500 in gross receipts. For cases with $2,500 and up to $500,000 in gross receipts, the percentage of receipts paid to general unsecured creditors decreased. However, the percentage of receipts paid to secured and priority unsecured creditors combined increased, since professional fees, trustee compensation, and other expenses generally decreased with increasing case size. Thus, in cases with $2,500 and up to $500,000 in receipts, general unsecured creditors received lower percentages of the receipts, not because of increases in the percentages of receipts paid to professionals, but because of increases in the percentages of receipts paid to other creditors (fig. 4).

The decrease in the percentage of receipts disbursed to general unsecured creditors, however, does not necessarily reflect the amount of debt due to each class of creditor. In addition to the structure of the debt in these cases, there may be other reasons for these findings. For example, there may have been fewer general unsecured creditors in the larger asset cases, general unsecured creditors may have made fewer claims in these cases, or the amounts of their claims may have been smaller. Since the larger bankruptcy cases tended to be business bankruptcies, and businesses tended to have more secured and priority unsecured debt, it may be that secured and priority unsecured debt represented the largest proportion of all debt in these cases. If this were the case, the decreasing proportion of receipts disbursed to general unsecured creditors (with increasing case size) would simply have reflected the structure of debt in these cases.

Figure 4: Percentage Distribution of Gross Receipts Paid by Case Size (in Gross Receipts) **to Total Creditors and to Unsecured Creditors**

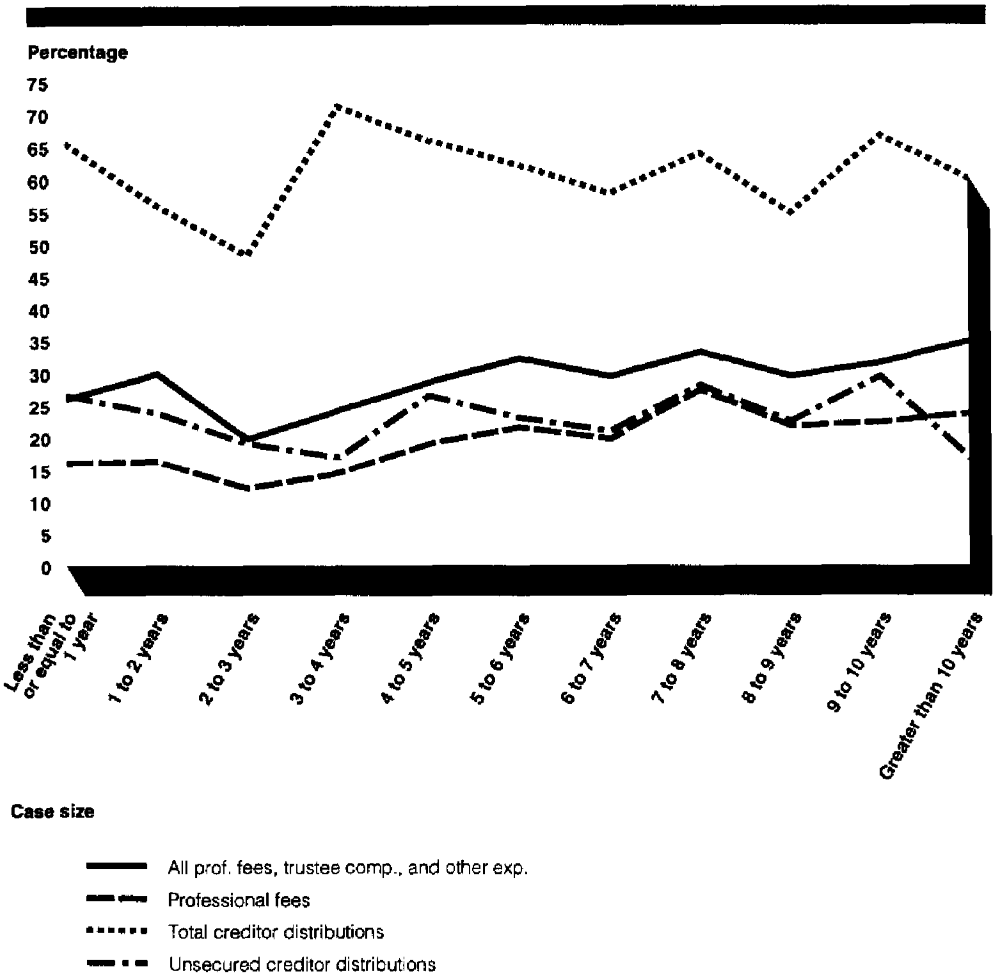


Source: GAO analysis of AO data.

Longer Asset Cases Disbursed Larger Percentages of Receipts to Professionals and Less to Creditors

As the length of cases increased, the percentage of receipts paid to all creditors fluctuated around an average of about 61 percent. The percentage going to all professional fees, trustee compensation, and other professional expenses generally tended to increase with the length of case (see fig. 5).

Figure 5: Percentage Distribution of Gross Receipts Paid by Case Length (in Years)



Note: Time intervals are mutually exclusive. For example, the category of 1 to 2 years is defined as greater than 1 year but less than or equal to 2 years.

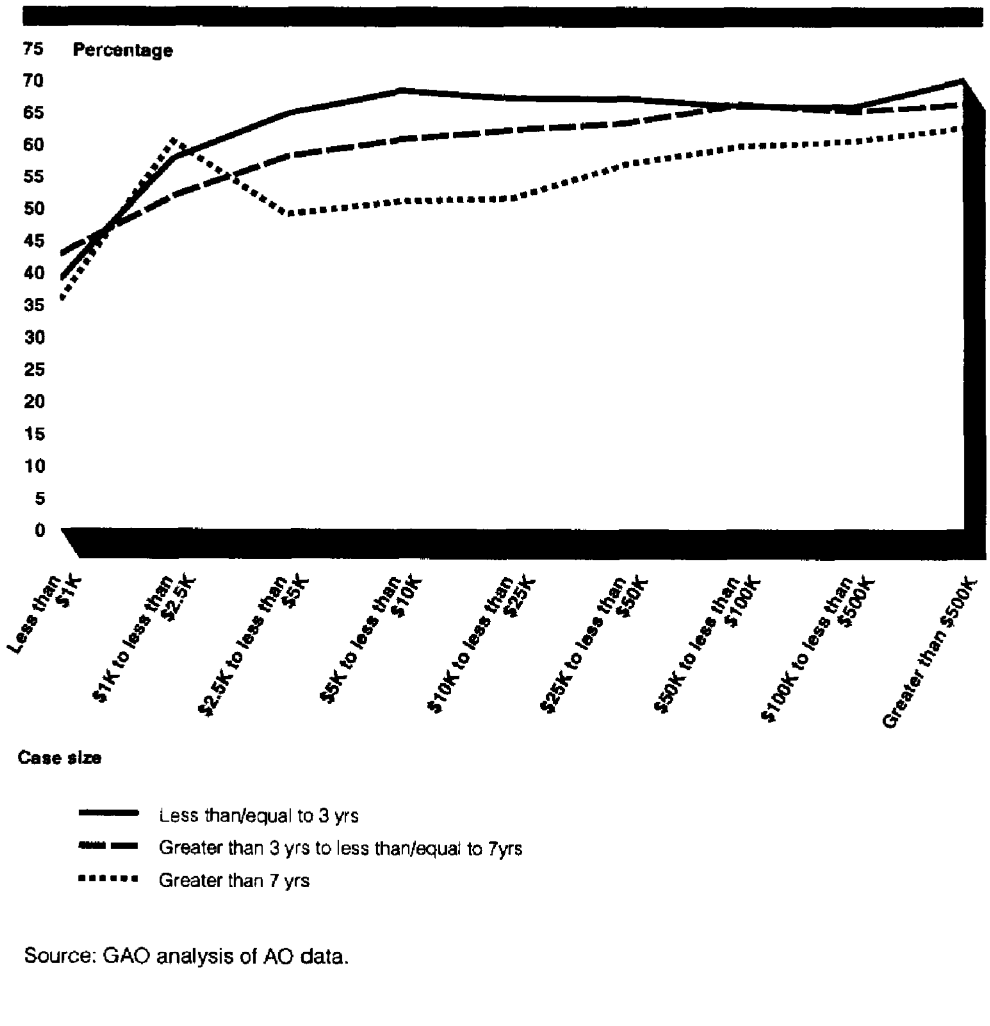
Source: GAO analysis of AO data.

Longer Cases at Each Case Size Paid Smaller Percentages to Creditors

The analysis discussed on p. 10 indicated that larger asset cases tended to take longer to close and disbursed larger percentages of receipts to creditors and smaller percentages to professionals. But, as shown in figure 6, generally longer cases disbursed larger percentages to professionals.

We analyzed how payments to creditors and professionals were affected by both size and length of case simultaneously. We categorized the length of cases into three groupings: (1) less than or equal to 3 years, (2) greater than 3 years but less than or equal to 7 years, and (3) greater than 7 years. We then analyzed the percentages of receipts paid to creditors and professionals for each category of case length for each of the categories of case size. We found that at almost every level of case size, the longer a case took to close the smaller the percentage of total receipts paid to creditors. This was true for creditors as a whole as well as for general unsecured creditors considered separately. Figure 6 displays the results for all creditors. (See app. III for more details.)

Figure 6: Percentage Distribution of Gross Receipts Paid to All Creditors by Case Size

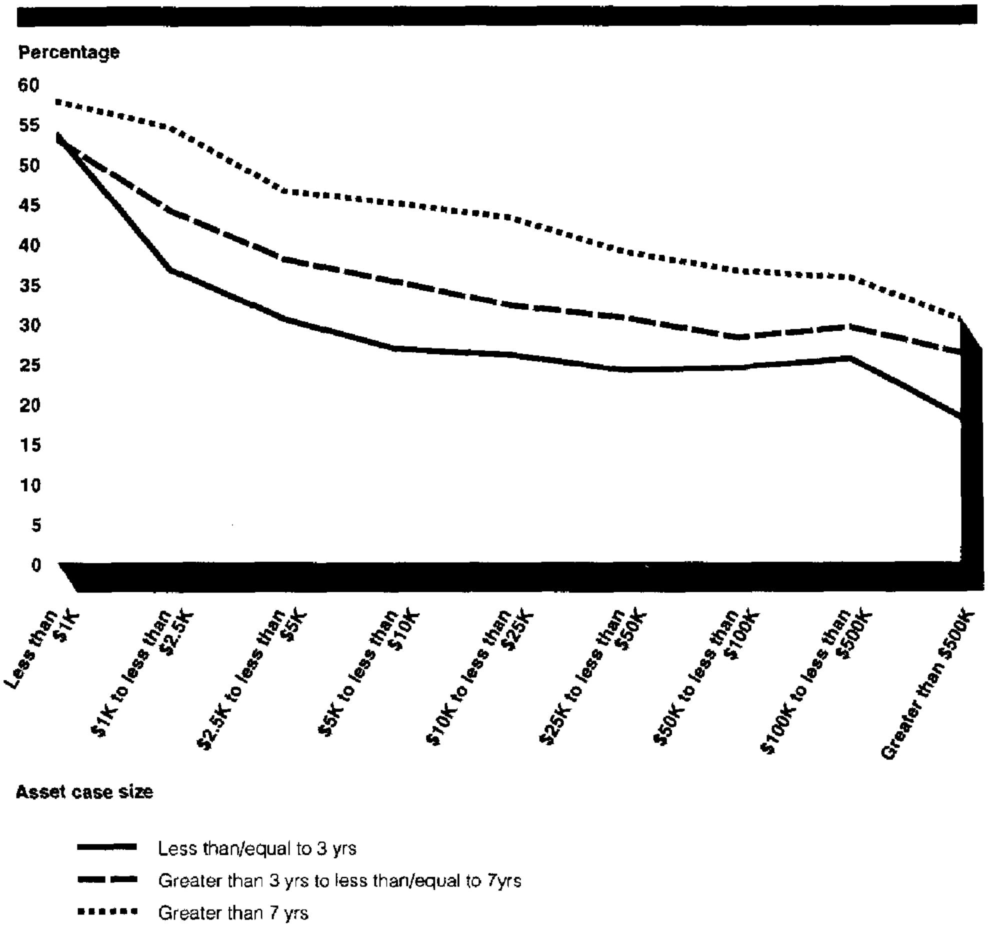


Source: GAO analysis of AO data.

Longer Asset Cases at Each Case Size Paid Larger Percentages to Professionals

As case size increased, a generally decreasing percentage of total case receipts was disbursed for professional fees, trustee compensation, and other expenses (fig. 7). However, in longer cases, larger percentages of receipts were disbursed to professionals at each level of case size. This confirms the prevailing belief that cases taking longer to close consume larger percentages of receipts for professional fees.

Figure 7: Percentage of Gross Receipts Paid for All Professionals' Compensation, Fees, and Expenses by Case Size



Source: GAO analysis of AO data.

General Unsecured Creditors Received a Disproportionately Larger Percentage of Receipts From Cases Filed Involuntarily

As shown in figure 4 the percentage of receipts disbursed to general unsecured creditors generally decreased as the size of asset cases increased from $2,500 to less than $500,000 in gross receipts. The exception to this trend occurred in cases in which at least one creditor filed against the debtor, that is, cases filed involuntarily. In these cases, the percentage of receipts disbursed to general unsecured creditors generally increased as case size increased. For example, general unsecured creditors in involuntary cases of less than $1,000 were paid about 7 percent; in cases with receipts of $25,000 to less than $50,000 they were paid 25 percent; and in cases greater than $50,000 they were paid 40 percent. While involuntary cases accounted for only about 1 percent of all asset cases, they accounted for about 14 percent of all payments to general unsecured creditors. Further, the largest involuntary cases accounted for less than one-tenth of 1 percent of all cases, but these 51 cases accounted for slightly more than 11 percent of all payments to general unsecured creditors.

While an involuntary filing does not measure creditor activity throughout a bankruptcy, it does indicate early involvement by at least one creditor. These involuntary cases also were at least 2 to 3 times larger, on average, than any voluntary cases, and general unsecured creditors were paid more than 4 times the average amounts paid in voluntary cases.

Asset Cases Converted From Chapter 11 and Chapter 13 to Chapter 7 Affected Distributions to Creditors and Professionals

Some bankruptcies can be filed under one of several chapters if the debtor meets the requirements. In business bankruptcies, debtors can file under Chapter 11 and attempt to reorganize their debt, or they can file under Chapter 7 and liquidate. Cases filed originally under Chapter 11 can ultimately convert to Chapter 7 and liquidate if the reorganization fails. Thus, cases that convert to Chapter 7 liquidation represent a failure to reorganize or restructure business debt. To assess the degree to which converted cases generated a larger or smaller percentage of disbursements for professionals and creditors, we compared those business bankruptcies that converted to Chapter 7 after filing under Chapter 11 to those filed originally under Chapter 7.[8]

At every level of case size we examined in cases filed originally as business Chapter 7 and terminating as asset Chapter 7, a larger percentage of receipts was disbursed to all creditors and to general unsecured

[8]These two types of cases may differ in more ways than simply the chapter under which they were filed. Rather, their differences may be reflected in whether Chapter 11 or Chapter 7 was the original filing chapter and the debtor's belief that the business could be reorganized in the cases filed under Chapter 11.

creditors than in those cases that were originally filed under Chapter 11 but that ultimately converted and liquidated under Chapter 7. We found that about 63 percent of receipts were disbursed to all creditors in cases filed as Chapter 7 business as compared to about 57 percent in those cases filed originally as Chapter 11. Similarly, general unsecured creditors received 23 percent of receipts in Chapter 7 cases as compared to about 18 percent of receipts in Chapter 11.

In addition, the percentage of receipts disbursed to all professional fees, trustee compensation, and expenses in cases originally filed as Chapter 11 exceeded the percentage disbursed in business cases originally filed as Chapter 7. (See app. VI.) With the data available, we could not determine what portion of professional fees was incurred while a case was in Chapter 11 versus Chapter 7.

Because business bankruptcies generated different percentage disbursements to creditors and professionals depending upon the chapter under which they were originally filed, the decision as to the chapter under which the case is filed may be important to creditors.

The pattern of the percentage of disbursements to creditors and professionals in consumer cases that converted to Chapter 7 differed from that found in business cases. Similar to the comparison above, we compared the percentage disbursement of receipts to creditors and professionals in consumer cases filed originally under Chapter 13 to cases filed originally as Chapter 7. We found that 19 percent of receipts were disbursed to professionals in cases filed originally under Chapter 13 compared to 27 percent in those cases filed originally as Chapter 7 consumer cases. For creditors as a whole, the situation was reversed. Overall, creditors received 72 percent of receipts disbursed in cases filed originally under Chapter 13, but they received only 64 percent in cases filed originally as Chapter 7 consumer cases. However, general unsecured creditors received a smaller percentage disbursement in cases filed originally under Chapter 13 (13 percent of gross receipts) than they received in those cases filed as Chapter 7 consumer cases (33 percent). (See app. VII.)

Disbursements to Trustees Were Near Statutory Maximum

Chapter 7 trustee income is derived from three basic statutory sources and is subject to certain statutory limitations. First, for both no-asset and asset Chapter 7 cases, trustees are paid $45 per case from the $120 Chapter 7 bankruptcy filing fee. Second, for Chapter 7 asset work, the court may allow reasonable trustee compensation not to exceed amounts set out in a statutory maximum fee schedule. More specifically, trustee compensation is not to exceed 15 percent of the first $1,000 or less, 6 percent of the amount in excess of $1,000 up to $3,000, and 3 percent of any amount in excess of $3,000. Trustees do not always receive, and are not automatically entitled to, the maximum percentages permitted by law. A trustee's request for compensation may be monitored by the U.S. Trustee and must be approved by the court. Third, with court authorization, a trustee can also receive income from self-retention as an attorney or accountant to perform certain duties outside his or her trustee responsibilities. Finally, Chapter 7 trustees can potentially receive compensation from cases converting to Chapter 7 from other chapters for acting as the trustee in those cases. However, the AO data did not tabulate these amounts.

We estimated that trustees were paid about $56.5 million from the basic $45 fee for asset and no-asset Chapter 7 cases closed during statistical years 1991 and 1992. From AO data we computed that $72.8 million (of $2.0 billion in receipts) was disbursed to trustees from case receipts as compensation in Chapter 7 asset cases. Thus, we estimated total trustee compensation from Chapter 7 cases closed in these 2 years at $129.3 million. This amount does not include any income the trustees received from self-retention as attorneys or accountants or from acting as trustees in cases terminated under other chapters, such as Chapters 11 or 13.

The AO data did not include information on payments to trustees from self-retention as attorney or accountant. However, EOUST in the Department of Justice collected data on self-referrals for cases closed from August 1, 1992, through December 31, 1993. These data show that of $152.7 million in payments to trustees from self-retention as attorney, $67.7 million was paid to the trustees or the trustees' own firms. In addition, $5.2 million was paid to trustees or their firms for other professionals (see app. III). These data indicate that income from self-retention as attorney for the trustee may be a significant source of trustee income. Relying on an EOUST estimate of 4.4 percent for the percentage paid to trustees or their firms we estimated that trustees would have received about $86.8 million in revenue from self-retention as attorneys or accountants. Through a combination of filing fees, trustee compensation, and other professional fees, trustees received an estimated $216 million in income for all Chapter 7 cases closed in statistical years 1991 and 1992.

When we measured trustee compensation from case receipts in Chapter 7 asset cases on a per case basis, we found that trustee compensation was less than $199 in 50 percent of the cases; in 75 percent, trustee compensation was less than $410; and in 95 percent, it was less than $2,406. In 79 percent of all cases trustees were paid more than 90 percent of the statutory maximum amount permitted—a pattern of compensation that was relatively constant across various case characteristics, including size and length of cases.

Policy Issues Regarding Bankruptcy Trustee Compensation

Congress has discussed raising the statutory maximum percentages of receipts that may be paid to bankruptcy trustees. Several issues are important in making this decision. First, the principal argument for raising the percentage maximum is to encourage trustees to seek additional assets for the estate. However, in the aggregate, it is not clear whether there are more assets to pursue in most Chapter 7 cases. Trustees can try to find additional assets from existing asset cases or from the much larger pool of no-asset cases. Our analysis showed that in statistical years 1991 and 1992, 95 percent of Chapter 7 cases terminated as no-asset cases, an increase from 90 percent in 1986. Thus, the small and declining proportion of asset cases suggests that the no-asset pool of cases is unlikely to generate additional receipts.

Second, if there are relatively few additional assets, it is not clear how increasing the statutory maximum will encourage trustees to pursue more assets. On the other hand, if the statutory percentage maximums were increased, as under the current proposal, and if trustee compensation were awarded at or near the statutory maximums, as occurs currently, then for a case generating $25,000 in receipts, trustee compensation could increase from $975 to about $3,300 for the same amount of trustee work.

Agency Comments

We discussed the contents of this report with the Chief of the Bankruptcy Division and his staff in the AO and the Acting Director of the EOUST and his staff. The two agencies agreed with the message of the report and said that it represented a factual presentation of bankruptcy data. They also suggested some technical comments to clarify some of the information in the report. We have incorporated those comments where appropriate.

As agreed with the Subcommittee, unless you publicly release its contents earlier, we plan no further distribution of this report until 15 days from the date of this letter. At that time, we will send copies to the Director of the Administrative Office of the U.S. Courts, the Executive Director of the Executive Office for U.S. Trustees, and other interested parties and will make copies available to others upon request.

The major contributors to this report are listed in appendix VIII. Should you need additional information on the contents of this report, please contact me on (202) 512-8777.

Sincerely yours,

Laurie Ekstrand

Laurie E. Ekstrand
Associate Director, Administration
of Justice Issues

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Abbreviations

AO	Administrative Office of the U.S. Courts
EOUST	Executive Office for U.S. Trustees

Background on Various Bankruptcy Chapters and the Bankruptcy Process

Bankruptcy filings have increased dramatically since the mid-1980s. Data from the Administrative Office of the U.S. Courts (AO), which compiles data on bankruptcy filings and closings, showed that between 1986 and 1992 the total number of bankruptcies filed rose from 477,856 to 972,490. Both Chapter 7 and Chapter 13 filings more than doubled over this period. Chapter 7 bankruptcy filings increased from 332,675 to 679,662; Chapter 13 filings increased from 120,726 to 267,121. Chapter 11 filings in 1986 were 24,442, but after decreasing slightly, by 1992 the 24,029 Chapter 11 filings returned almost to their 1986 level. Finally, Chapter 12 filings, which were first allowed in 1987, have decreased from 4,824 to 1,634 in 1992.

Chapter 7 cases represented the largest number of bankruptcy cases. The following table shows filings and terminations for statistical years 1991 and 1992.

Table I:1 Bankruptcy Cases Filed and Terminated in Statistical Years 1991 and 1992

	Number of cases
Cases filed	
Chapter 7 cases	1.3 million
Chapter 11 cases	46,522
Chapter 12 cases	2,992
Chapter 13 cases	511,313
Cases terminated	
Total Chapter 7 cases (asset and no-asset combined)	1.2 million
Chapter 7 asset cases[a]	56,994

[a]Of these cases, 8,923 were "nominal asset" cases. These are asset cases in which professional fees consumed all receipts, and creditors were paid nothing from the proceeds of the liquidation. Included in the nominal asset cases may be cases in which assets were transferred to secured creditors outside of the liquidation.

Source: GAO analysis of AO data.

The increase in bankruptcy filings has led to a number of related concerns, including (1) the ability of the bankruptcy courts to process filings; (2) the potential for expanded opportunities for debtor fraud and abuse; (3) the impact on trustee workload, trustee fraud, and trustee fiduciary responsibility to the estate, including trustees' ability to monitor the work of other professionals; and (4) the reasonableness of professional fees and expenses in bankruptcy cases.

In a Chapter 7 bankruptcy case, or when a case converts to Chapter 7, a disinterested and qualified interim trustee is assigned by the U.S. Trustee to each case. Ultimately, a permanent trustee represents and administers the estate.[9] In liquidating assets, it is the trustee's duty to collect and reduce to money the property of the estate and to close up the estate as expeditiously as is compatible with the interests of the parties involved in the case.

The trustee makes a preliminary determination of a case's status as an asset or no-asset case, usually at or by the meeting of creditors. Afterwards, the trustee is responsible for administering the estates of those cases determined to have potentially liquid assets. Administration of the estates in asset cases includes liquidating estate assets and distributing proceeds to professionals, creditors, debtors, and other parties. In the no-asset cases, the clerks of the court are to notify creditors of the filing of the petitions. The trustees are to respond to inquiries from creditors regarding the estates and file the required documents with the courts. In the vast majority of cases—the cases in which no assets were liquidated—creditors receive no proceeds from the bankruptcies because the debtors do not possess liquidatable assets above those that are exempt. In a small percentage of the asset cases—referred to as "nominal asset" cases—creditors are not paid from the proceeds of the liquidation because the funds that were generated from the estate were consumed by administrative expenses that included trustee compensation, trustee attorney fees, and other professional fees and expenses. As noted earlier, the nominal asset cases may include cases in which assets were transferred to security creditors outside of the liquidations.

If there are assets, the trustee is to liquidate them. Trustee compensation, professional fees, and professional expenses generally arise during the asset disposition phase. Decisions made during this phase determine the amount of receipts and affect the amount of professional fees and expenses. Interim fees, compensation, and expenses may be awarded by the court to trustees and professionals. Disbursements to unsecured creditors are to be made at the end of a case, after professional fees, trustee compensation, and expenses are paid.

The three creditor classes are:

[9] After a Chapter 7 bankruptcy is filed, the debtor's property becomes an "estate" controlled by the trustee assigned to the case. The debtor's exempt property is protected from creditors.

- Secured: The creditor is protected by collateral underlying the debt.[10]
- Priority unsecured: Creditors are allowed expenses and claims[11] that have priority in the following order: administrative expenses; unsecured claims allowed under 11 U.S.C. Section 502(f); certain unsecured claims for wages, salaries, or commissions, including vacation, severance, and sick leave pay; certain unsecured claims for contributions to an employee benefit plan; unsecured claims of a person who is engaged in the production of grain or is a United States fisherman; unsecured claims of up to $900 of individuals from the prepetition deposit of money for property or services that were not delivered or provided; unsecured claims of governmental units, such as certain taxes; unsecured claims based upon any commitment by the debtor to maintain the capital of an insured depository institution.
- General unsecured: The creditor has no collateral underlying the debt and no priority.

In addition, there are equity security holders, who hold an equity security of the debtor—that is, a partnership interest, stock, a share of the business, or a right to purchase such a share. In general, equity security holders are paid only if and after creditors are paid in full.

In general, unsecured creditors are to be paid only after professional fees and expenses incurred by the trustee and debtor in the liquidation of the estate have been paid in full.

Most of the asset cases terminating in statistical years 1991 and 1992 were filed in earlier years. While the majority of these asset cases were filed under Chapter 7, about one-quarter of the cases were filed under other chapters. Slightly more than 9 percent of the Chapter 7 asset cases were originally filed as Chapter 11 and about 16 percent as Chapter 13. Cases may convert to Chapter 7 for liquidation as a result of such reasons as the U.S. Trustee or trustee initiates a request for conversion because of the debtor's inability to live up to the terms of the original chapter, debtors choose to convert, or creditors request conversion.

[10]Disbursements to secured creditors occur when the trustee liquidates property subject to a lien and then distributes the proceeds. This category does not cover cases in which the trustee simply turns over the property to the secured creditor nor those in which the trustee abandons the property and the secured creditor is permitted to foreclose.

[11]Under 11 U.S.C. § 507, court fees have the same priority as administrative expenses.

Scope and Methodology

The bankruptcy court data used in our analysis were provided by the Statistics Division of the AO. The data were generated by two reports that are prepared by each bankruptcy clerk's office—a bankruptcy opening report and a bankruptcy closing report. Both reports are forwarded to the AO for use in the compilation of national bankruptcy statistics. The opening report is prepared at the time a bankruptcy petition is filed. It contains information from the petition about the debtor, the type of debt, liabilities, and assets. The information provided in the opening report is subject to change if amended schedules are filed.

After a case closes, a closing report is prepared by the clerk's office. The closing report contains data on cash receipts generated during the bankruptcy and on the disbursement and distribution of those receipts. The disbursements include amounts paid as compensation to trustees; fees to professionals; professional expenses; and payments to various classes of creditors, equity security holders, and individual debtors.

Not all cases identified preliminarily as asset cases at the 341 meeting[12] end up generating cash receipts upon completion of the bankruptcy process. We analyzed the data on those Chapter 7 cases that generated cash receipts at the time the case was closed; we did not include those cases defined as asset cases in the preliminary determination made at the time of filing and recorded on the case opening report. We relied on the data in the AO closing reports to produce the information on the amounts and percentages of receipts paid to various classes of creditors, equity security holders, and professionals. We used information from the opening reports to determine some case filing characteristics (such as the chapter under which a bankruptcy was filed originally), and we used data from both reports to determine the length of time it took to close cases.

Data Verification Procedures

Before conducting the analysis, we performed a number of tests to verify the data. First, we discussed with the AO its procedures for gathering and processing the data. We found that the AO verifies case count data by sending the counts back to the clerks of court offices for verification. The AO has edit checks to verify entry of data on some case characteristics.

In addition, we conducted a number of edit checks of our own. First, we compared the amount recorded as gross cash receipts to the sum of all amounts disbursed and deleted cases in which these two amounts differed

[12]This is a meeting of creditors in which the debtor must appear and answer questions under oath from the trustee and creditors.

by more than $1,000. Second, we identified extreme values in the data and after identifying them discussed them with the AO to determine if they arose because of data entry errors. We were able to correct some systematic data entry errors (such as the addition of extra zeroes to dollar figures) after the AO verified the errors were data entry errors.

As a result of these procedures, we excluded about 1,200 cases from our analysis because of the data errors. We compared the excluded cases with the cases we analyzed on 15 different case characteristics and found that the excluded cases were distributed similarly to those we analyzed.

We also excluded one additional case that passed all of our edit checks because its inclusion would have skewed the results of the analysis. It was a case that terminated in statistical year 1991 with about $156 million in receipts, an amount far exceeding that of any other case in the database.

Overview of Case Characteristics

We described the relationships between case characteristics and cash receipts, payments to creditors, and payments to professionals. However, we also sought to identify the types of cases that were associated with higher or lower percentages of receipts disbursed to professionals (or creditors). In addition, we distinguished between classes of professionals and creditors. For example, we looked at trustee compensation and trustee professional expenses separately from other professional fees because, in general, trustees are required by law to participate in bankruptcy, and their maximum compensation is set by statute. In other words, these categories of payments are less discretionary than other professional fees. We also analyzed payments to general unsecured creditors separately from those to all creditors.

In analyzing these relationships, we noted differences in percentages of receipts paid to professionals and creditors. We could not fully explain why these percentages varied with case characteristics. We offered possible explanations for our findings where appropriate and attempted to identify key policy issues related to the empirical findings.

Review of Costs

We defined the costs to close bankruptcy cases terminating under Chapter 7 (both asset and no-asset cases) as the costs to the bankruptcy courts of processing cases plus the charges incurred by professionals in liquidating assets that generated receipts. The costs to the bankruptcy courts included judges' salaries and support plus the clerks of courts offices' salaries and support. The professionals' costs included trustee compensation, professional fees, and all reimbursable expenses.

We estimated that the costs to close the more than 1.2 million cases terminating under Chapter 7 in statistical years 1991 and 1992 were about $1 billion. These costs were distributed as follows:

Table II.1: Distribution of Estimated Costs to Close Chapter 7 Cases in Statistical Years 1991 and 1992

Dollars in Millions

Distribution	**Costs**
Bankruptcy Court	
Judges	$66.0
Clerks offices	362.5
Subtotal	**428.5**
Professionals	
Trustee compensation	72.8
Trustee attorney	172.3
Debtor attorney	117.5
Other professionals	81.8
Professional expenses	109.4
Subtotal	**553.8**
Total estimated costs	**$982.3**

The bulk of the estimated bankruptcy court costs—i.e., most of the $362.5 million for the clerks' costs—were associated with closing the more than 1.2 million bankruptcies (both asset and no-asset cases) that terminated over the 2-year period. Judges spent relatively little time on individual cases of this type, although we estimated that the very large number of these cases generated close to $51 million of all judges' costs. Conversely, the majority of clerks' offices costs were devoted to closing Chapter 7 consumer bankruptcies.

The vast majority of consumer bankruptcies terminated as no-asset cases that generated no receipts for disbursement to creditors. As shown in table II.2, our estimate of the total costs of all consumer bankruptcies cases ($521.3 million) exceeded the total gross receipts in these cases ($427.4 million) as well as being almost twice the amount disbursed to creditors ($273.6) in these cases. Thus, consumer bankruptcies, including asset and no-asset cases, imposed larger costs on the courts than either the total amounts disbursed to creditors or the total amount of receipts generated. In comparison, business bankruptcies generated relatively smaller court costs, generated relatively higher professionals' costs, produced much larger amounts of receipts for disbursement to creditors, and disbursed larger amounts to creditors than the estimated total costs to produce the receipts. Most of the costs in business bankruptcies were incurred by payments to professionals, in contrast to the consumer bankruptcies, in which the courts incurred the majority of costs.

Table II.2: Gross Receipts, Distributions to Creditors, and Estimated Costs in Cases Terminating Under Chapter 7 in Statistical Years 1991 and 1992

	Business bankruptcies (dollars in millions)	Consumer bankruptcies (dollars in millions)	Total cases (dollars in millions)
Gross receipts	$1,546.1	$427.4	$1,973.5
Creditor distributions	929.0	273.6	1,188.8
Secured creditors	384.7	105.4	490.1
Priority unsecured creditors	221.5	40.0	261.5
General unsecured creditors	311.1	126.0	437.2
Total estimated costs	461.0	521.3	982.3
Estimated bankruptcy court costs	22.2	406.3	428.5
Judges	15.2	50.8	66.0
Clerks offices	7.0	355.5	362.5
Payments to professionals	438.8	115.0	553.8
Trustee compensation	53.9	18.9	72.8
Trustee attorney	137.7	34.7	172.3
Debtor attorney	91.5	26.0	117.5
Other professionals	70.2	11.5	81.8
Professional expenses	85.6	23.8	109.4

Note: Dollar amounts do not always add because of rounding.

Source: GAO estimates and analysis of AO data.

Methods for Estimating Costs

As previously discussed, we estimated total costs as the sum of our estimate of costs to the courts of closing cases plus the sum of all payments to professionals involved in liquidating the cases. We did not include the filing fee as a cost. As a basis for computing the costs we used all cases terminated under Chapter 7 in statistical years 1991 and 1992. This number included both asset and non-asset cases, and it includes cases filed under chapters other than Chapter 7 but that terminated under Chapter 7. The reason for including no-asset cases in estimating costs stems from the fact that any case filed under Chapter 7 could potentially have assets that could be liquidated. It is not until after the section 341 hearing that a determination of the availability of assets is made, but by that time, a Chapter 7 no-asset case has already imposed costs on the clerks office and on the courts.

We used data from the Federal Judicial Center 1988-1989 Bankruptcy Court Time Study (FJC Time Study) and from the Fiscal Year 92[13] budget in estimating the costs to the courts of closing the approximately 1.2 million Chapter 7 bankruptcy cases that closed in statistical years 1991 and 1992.

From the FJC Time Study, we used the case weights that were developed to measure the average amount of time a judge spent working to close a case that had certain filing characteristics—for example, a business bankruptcy filed under Chapter 7. The case weights were based on judges' reports of the actual amount of time they spent on a sample of cases that opened under various chapters. The case weights—or average amount of judge time per case—varied with the type of case. For example, the weights ranged from a low of about one-tenth of an hour per case in Chapter 7 nonbusiness cases to a high of more than 7-1/2 hours in cases filed under Chapter 11.

To estimate the total judges' costs, we first estimated the total number of judges' hours involved in closing the cases. We then estimated the number of judges that these hours would require and estimated the costs of these judges. First, to estimate the total amount of judge time involved in closing the approximately 1.2 million cases terminating under Chapter 7, we multiplied the number of cases with specific filing characteristics by the judges' case weights for the cases. For example, in our sample of about 1.2 million cases terminating as Chapter 7, there were 4,371 cases that opened under Chapter 11. These 4,371 were multiplied by the Chapter 11 case weight of 7.559 to produce an estimate of 14,158 hours of judges' time to close those cases. We repeated this process for cases filed as Chapter 7 business, Chapter 7 nonbusiness (including those cases that terminated as Chapter 7 no-asset), Chapter 12, and Chapter 13. We estimated that 166,153 hours of judge time across the 2 years were required to close the 1.2 million cases as a result of this process.

On the basis of the FJC Time Study estimate of 1,500 hours per year per judge, we estimated that the 166,153 hours would require 53.2 judges. We used the figure of $598,872 per year from the AO as the annual recurring

[13]These data were the most recently available at the time we did the analysis.

cost of a bankruptcy judgeship. This figure includes judges' salaries and benefits, supporting personnel, operations and maintenance, security, and administration. We then multiplied the annual recurring cost of a bankruptcy judgeship by the 53.2 judgeships to produce the estimate of $66.0 million in judges' costs.

The case weights were developed from a sample of cases, and there is sampling variability associated with the estimates of judges' time. The FJC study provides 95 percent confidence intervals for the case weights. We used these confidence intervals to estimate upper and lower bounds for our estimate of judges' costs. The estimates based on the 95 percent confidence intervals around the estimated $66 million in judges' costs were $59.6 million to $72.4 million.

To estimate the costs to bankruptcy clerks of courts offices, we followed a similar procedure. However, the FJC Time Study did not calculate case weights for the clerks offices; rather it reported data on the percentage of clerks office functions devoted to bankruptcy cases having various characteristics. These data showed about how much time the clerks office spent on cases of a particular chapter relative to the number of cases filed under those chapters. To estimate clerks costs, we used a weight that we computed as the ratio of the percent of clerks office workload (as reported in the FJC Time Study) over the percent of case filings. These ratios identified the degree to which cases filed under various chapters required shares of clerks office functions that were out of proportion to their share of case filings.

Clerks costs included personnel costs plus operations and maintenance costs, both of which came from the fiscal year 1992 budget. A portion of the operations and maintenance costs in the budget were those attributable to judges; therefore, we separated judges' operations and maintenance from clerks'. We did so by estimating the proportion of operations and maintenance costs for judges, on the basis of the ratio of judges' salaries to judges' operations and maintenance costs, and we applied this ratio to the total budgeted amount for operations and maintenance. We subtracted the resulting estimate from the total, leaving an estimate of the operations and maintenance costs for clerks.

We then distributed the total personnel costs and the total operations and maintenance costs of the clerks offices across all cases terminating in statistical years 1991 and 1992. For cases terminating under Chapter 7, we distributed costs across the filing chapter. Selecting only those cases terminating under Chapter 7, we multiplied the distribution of costs by the case weighting factors we developed above. This process produced an estimate of the costs to the clerks offices of processing Chapter 7 cases regardless of the chapter under which they were originally filed.

Impact of Data Limitations

Data limitations precluded us from addressing a number of issues. First, we could not determine the value of assets brought into the bankruptcy against which to compare the liquidated receipts in order to assess how well trustees fulfill their duties. For a number of reasons we could not estimate the value of assets: There is no centralized collection of the estimated value of assets after amended schedules are filed. Consequently, no final estimates of the value of assets are available. Second, the AO has collected data on estimated assets only since 1987; cases filed before 1987 do not have estimates of the value of assets. As a result, these data were missing from about one-third of the cases used in our analysis. Third, debtors may be likely to understate the value of their assets on their petitions.

Using the bankruptcy opening report we did estimate the liabilities in the 56,994 Chapter 7 asset cases that we analyzed. We estimated between $11 and $17 billion in liabilities in these cases as compared to about $2 billion in receipts generated through the bankruptcy process.

Due to data limitations, we could not analyze disbursements to creditors and professionals in Chapter 11 cases, even though most of the professional fees in bankruptcy were generated by these cases. We were able to analyze only those cases that were filed under Chapter 11 but terminated under Chapter 7, and these results are discussed in the report.

We did our work between July 1993 and January 1994 in accordance with generally accepted government auditing standards.

Payments to Creditors and Professionals

The following tables provide details of payments to creditors and equity security holders and professionals referred to in this report. Table III.1 shows that the amounts paid to each class of creditors and equity security holders varied as did the percentage of cases in which they were paid something. As a class, general unsecured creditors were paid out of the proceeds of the receipts from the liquidation in more cases than any other class of creditors, receiving payments in 58.3 percent of all 56,994 asset cases closed. However, as far as both a percent of total receipts disbursed (22.2 percent) and average amount disbursed ($7,670), general unsecured creditors were second to secured creditors, who received 24.8 percent of receipts disbursed and an average of $8,600 in each case closed. By a large margin, equity security holders were the least frequently paid (0.3 percent of all cases closed) and received the lowest average amount per case closed ($241). The AO data does not include the number of creditors or equity security holders in each category who have made claims against the estate. Thus, it is not possible to determine the percentage of parties in each class who were paid at least part of their claims.

Table III.1: Receipts and Disbursements to Creditors and Equity Security Holders in All Chapter 7 Asset Cases Closed in Statistical Years 1991 and 1992

	All Chapter 7 asset cases (n = 56,994)			
	Total gross receipts and creditor and equity security holders disbursements ($ million)	**Percent of cases with disbursements to creditors and equity security holders**	**Creditor and equity security holders disbursements as percent of total receipts disbursed**	**Average amount disbursed per case**
Gross receipts	$1,973.5	[a]	[a]	$34,626
Creditor disbursements				
Secured	$ 490.1	19.8	24.8	$ 8,600
Priority unsecured	261.5	27.6	13.3	4,588
General unsecured	437.2	58.3	22.2	7,670
Equity security holders	13.7	0.3	0.7	241
Total all creditors and equity security holders	**$1,202.5**	**84.3[b]**	**60.9**	**$ 21,099**

[a]Not applicable.

[b]Represents the percent of all cases in which payments to at least one category of creditor and equity security holder were made. In many cases, payments are made to more than one category of creditor. Thus, percentages for individual categories total more than 84.3 percent.

Source: GAO analysis of AO data.

As shown in table III.2, a very different picture emerges when we analyze only those 48,071 cases in which funds were disbursed to at least one creditor or equity security holder category. For example, general unsecured creditors were paid in 58.3 percent of the 56,994 asset cases closed—more frequently than any other creditor category—and were paid an average of $7,670, the second highest amount for any creditor category. However, when we compute the average amount paid using only the cases (33,226) in which general unsecured creditors were actually paid, the average amount paid ($13,158) is the lowest average amount for any creditor category. Conversely, equity security holders were paid in only 0.3 percent of all asset cases (173) closed. But in those few cases in which they were paid, they received the highest average.

Table III.2: Creditor Disbursements in Chapter 7 Asset Cases Closed in Which at Least One Class of Creditor or Equity Security Holder Was Paid—Statistical Years 1991 and 1992

Creditors and equity security holder	Total amount disbursed to each category ($ million)	Average amount disbursed to each category[a]	Percent of total disbursements to each category	Number of cases in which at least one creditor or equity security holder class was paid
Secured	$490.1	$43,500	40.7	11,264
Priority unsecured	261.5	16,625	21.8	15,729
General unsecured	437.2	13,158	36.4	33,226
Equity security holders	13.7	79,191	1.1	173
Total creditor and equity security holder	**$1,202.5**	**$25,015[b]**	**100.0**	

[a]Not every category of creditor or equity security holder was paid in each of the 48,071 cases in which disbursements were made. Therefore, calculations in this column are based on total disbursements to each category divided by the number of creditors or equity security holders in that category who were paid.

[b]Represents the average amount paid to creditors or equity security holders in all 48,071 cases in which at least 1 class of creditor or equity security holder was paid.

Source: GAO analysis of AO data.

The total disbursements to all professionals was $553.8 million, or 28 percent of receipts. The amounts paid to each type of professional varied as did the percentage of cases in which they were paid, as shown in table III.3. The table shows both the amount disbursed as compensation to trustees and how much was disbursed to attorneys for the trustee. According to the AO, trustees often retain their own law firms as their attorneys in bankruptcy work. There is some debate about the impact of this practice on fees. Some people in the bankruptcy community have expressed concern that attorney fees may be higher when trustees retain their own firms as attorney for trustee because they may use the fees to subsidize the perceived low levels of trustee compensation. Others, however, suggest that trustees retaining lawyers from their own firms may reduce overall fees because of their familiarity with the cases. They also said trustees may have a hard time finding an "outside" attorney to take a case because of the generally small amount of money paid in a case and the delays that result from the requirement for court approval and payment at the end of the case.

Table III.3: Receipts and Disbursements to Professionals in All Chapter 7 Asset Cases Closed in Statistical Years 1991 and 1992

	All Chapter 7 asset cases (n = 56,994)			
	Total gross receipts and disbursements to professionals ($ million)	Percent of cases with disbursements to professionals	Professional disbursements as percent of total receipts disbursed	Average amount disbursed per case
Gross receipts	$1,973.5	N.A.	N.A.	$34,626
Disbursements to professionals				
Trustee compensation	$ 72.8	96.0	3.7	$1,277
Trustee attorney	172.3	40.8	8.7	3,024
Debtor attorney	117.5	34.9	6.0	2,061
Other professionals	81.8	21.4	4.1	1,435
Professional expenses	109.4	63.9	5.6	1,919
Total all categories	**$553.8**	**99.2[a]**	**28.1**	**$9,716**

[a]Represents the percent of all cases in which payments to at least one category of professional fees/expenses were made. In many cases, payments were made to more than one category of professional. Thus, percentages for individual categories total to more than 99.2 percent.

Source: GAO analysis of AO data.

When average amounts per case are calculated using the number of cases in which a particular class of professionals received payments, the ranking of the average amounts shifts compared to the averages in table III.3, which were computed using all 56,994 cases. For example, in table III.3, trustee attorneys were paid an average of $3,024 across all 56,994 asset cases terminated. These 56,994 cases include cases in which trustee attorneys were and were not paid. However, for the 23,258 cases in which trustee attorneys were actually paid, as shown in table III.4, the average amount per case doubled to $7,408. Similarly, a large increase is shown for payments to other professionals, who received an average of $6,692 in the cases in which they were paid. However, professional only received an average of $1,435 across all asset cases terminated.

Table III.4: Professional Disbursements in Chapter 7 Asset Cases in Which at Least One Class of Professional Was Paid—Statistical Years 1991 and 1992

Professionals	Total amount disbursed to each category ($ million)	Average amount disbursed to each category[a]	Percent of total professional disbursements to each category	Number of cases in which at least one professional in class was paid
Trustee compensation	$ 72.8	$1,332	13.2	54,692
Trustee attorney	172.3	7,408	31.1	23,258
Debtor attorney	117.5	5,914	21.2	19,866
Other professionals	81.8	6,692	14.8	12,224
Professional expenses	109.4	3,003	19.8	36,432
Total all categories	**$553.8**	**$9,795[b]**	**100.0%**	

[a]Not every category of professional fees/expenses was paid in each case in which disbursements to professionals were made. Therefore, calculations in this column are based on total disbursements to each professional category divided by the number of cases in which payments were made to that category.

[b]Represents average of all categories for cases in which payments to professionals were made.

Source: GAO analysis of AO data.

Trustee Income From Self-Referral as Attorney or Other Professional

The AO does not maintain data on trustee income from self-referral as attorney for the trustee or accountant. However, since August 1992, the EOUST, in the Department of Justice, has collected such data for Chapter 7 cases closed in 88 of the 94 bankruptcy districts.[14] For example, the EOUST data recorded the amounts paid as "attorney fees" to trustees or their firms and the amounts paid as attorney fees to nontrustee firms. The data do the same for disbursements to other professionals. (See table III.5.)

[14]Trustees in 88 of the 94 bankruptcy districts report to the Executive Office of the U.S. Trustee. Trustees in the three districts in Alabama and the three in North Carolina report to the Bankruptcy Administrator in those districts. See Bankruptcy Administration: Justification Lacking for Continuing Two Parallel Programs (GGD-92-133, Sept. 1992).

Table III.5: Disbursements to Professionals in Chapter 7 Asset Cases: Comparison of Administrative Office and Justice Department Data on Cases Closed

	Gross amount disbursed (dollars in millions)		Professional disbursements as percent of total receipts disbursed	
	Justice Department data[a]	Administrative Office data	Justice Department data[b]	Administrative Office data
Trustee attorney	$152.7	$172.3	9.3%	8.7%
Trustee or trustee's firm[c]	67.7	N.A.	4.1	N.A.
Firm other than trustee's	85.0	N.A.	5.2	N.A.
Other professionals	79.6	81.8	4.8	4.1
Trustee or trustee's firm[c]	5.2	N.A.	0.3	N.A.
Firm other than trustee's	74.4	N.A.	4.5	N.A.

N.A. = not available

[a]Data collected by EOUST on cases closed from August 1, 1992, through December 31, 1993.

[b]Data from AO for statistical years 1991 and 1992.

[c]Indicates that the attorney for the trustee or other professional (such as an accountant) serving for the trustee was either the trustee or a member of the trustee's own firm.

Source: GAO analysis of EOUST and AO data.

Of the total compensation paid to attorneys for the trustees, 44 percent was paid to the trustees or their firms. For other professional services, trustees or their firms received 6.5 percent of the compensation. These data do indicate that self-referral as attorney for the trustee or other professional may be a significant source of income for trustees.

Distribution of Chapter 7 Asset Cases and Gross Receipts by Case Size

Case size	Number of cases	Percent of cases	Total receipts	Percent of total receipts
Less than $1,000	13,938	24.5	$7,670,563	.4
$1,000 to less than $2500	15,662	27.5	24,627,562	1.3
$2,500 to less than $5,000	8,183	14.4	28,803,778	1.5
$5,000 to less than $10,000	6,268	11.0	44,091,862	2.2
$10,000 to less than $25,000	5,820	10.2	91,429,486	4.6
$25,000 to less than $50,000	2,715	4.8	95,487,512	4.8
$50,000 to less than $100,000	1,885	3.3	132,096,199	6.7
$100,000 to less than $500,000	2,034	3.5	416,542,050	21.1
Greater than or equal to $500,000	489	0.9	1,132,705,260	57.4
All cases	56,994	100.0	$1,973,454,272	100.0

Note: Percentages do not add because of rounding.

Source: GAO analysis of AO data.

Distribution of Chapter 7 Asset Cases and Gross Receipts by Case Length

Length	Number of cases	Percent of cases	Total receipts	Percent of total receipts
Less than 1 year	3,004	5.3	$12,417,891	.6
1 to less than 2 years	14,779	25.9	125,904,007	6.4
2 to less than 3 years	13,735	24.1	308,231,632	15.6
3 to less than 4 years	9,594	16.8	336,890,210	17.0
4 to less than 5 years	6,064	10.6	222,414,874	11.3
5 to less than 6 years	3,586	6.3	202,924,862	10.3
6 to less than 7 years	2,130	3.7	203,481,534	10.3
7 to less than 8 years	1,408	2.5	198,808,264	10.1
8 to less than 9 years	1,087	1.9	140,527,010	7.1
9 to less than 10 years	837	1.5	115,779,996	5.9
Greater than or equal to 10 years	770	1.4	106,073,992	5.4
All cases	56,994	100.0	1,973,454,272	100.0

Source: GAO analysis of AO data.

Distribution of Receipts in Chapter 7 Asset Cases Filed as Chapter 7 Business and Chapter 11 by Size of Case

Table VI.1 shows the percentage distribution of receipts among professionals and creditors (including general unsecured creditors separately) in Chapter 7 asset cases filed as Chapter 7 business and Chapter 11 by size of receipts.

Table VI.1: Percentage Distribution of Gross Receipts in Chapter 7 Asset Cases Filed as Chapter 7 Business and Chapter 11 Cases by Size of Case

	Cases filed as Chapter 7 business			Cases filed originally as Chapter 11		
Gross Receipts	Professional fees, trustee compensation, all expenses	All creditors and equity security holders	General unsecured creditors	Professional fees, trustee compensation, all expenses	All creditors and equity security holders	General unsecured creditors
Less than $1,000	62.5%	35.0%	22.2%	82.9%	14.0%	2.3%
$1,000 to less than $2,500	48.0	49.3	29.9	68.7	27.0	5.0
$2,500 to less than $5,000	40.0	56.8	29.8	57.1	39.2	6.8
$5,000 to less than $10,000	36.6	60.0	30.0	53.4	41.9	7.7
$10,000 to less than $25,000	32.4	63.6	29.4	47.8	47.6	10.2
$25,000 to less than $50,000	28.1	67.0	28.3	43.4	52.2	10.6
$50,000 to less than $100,000	26.6	69.2	26.3	35.0	60.2	13.1
$100,000 to less than $500,000	27.4	68.8	24.0	35.1	60.5	14.9
Greater than or equal to $500,000	21.6	59.9	21.3	31.5	56.2	19.3
All cases	24.3	62.5	23.0	33.5	56.8	17.5

Source: GAO analysis of AO data.

Because the choice of original filing chapter may be influenced directly by the size of the business, we analyzed the data according to the size of case receipts. At every level of case size, cases filed originally under Chapter 11 disbursed a larger percentage of receipts to all professional fees and expenses and less to creditors (including general unsecured creditors) than did the Chapter 7 business cases.

The main reason for the larger proportion of receipts to professionals in cases originally filed as Chapter 11 was due to larger trustee attorney fees. Another contributing factor was that cases filed originally under Chapter 11 took longer to close as business cases originally filed under Chapter 7. For example, cases originally filed as Chapter 11 and as business Chapter 7 had median disposition times of 5.4 years and 3.4 years, respectively.

The Chapter 11 cases include payments made while operating as a Chapter 11 case, but it is not possible with the AO data to determine what portion of professional fees were incurred while a case was in Chapter 11 versus the portion incurred while in Chapter 7.

Distribution of Case Receipts in Chapter 7 Asset Cases Filed as Chapter 7 Consumer and Chapter 13 by Size of Case

Table VII.1 shows the distribution of gross receipts among professionals and creditors (with general unsecured creditors shown separately) for Chapter 7 asset cases filed originally as Chapter 7 consumer or Chapter 13 repayment.

Table VII.1: Percentage Distribution of Gross Receipts in Chapter 7 Asset Cases Filed as Chapter 7 Consumer and Chapter 13 Cases by Size of Case

	Cases filed as Chapter 7 consumer			Cases filed originally as Chapter 13		
Gross Receipts	Professional fees, trustee compensation, all expenses	All creditors and equity security holders	General unsecured creditors	Professional fees, trustee compensation, all expenses	All creditors and equity security holders	General unsecured creditors
Less than $1,000	51.3%	45.0%	40.2%	51.2%	25.9%	10.1%
$1,000 to less than $2,500	36.2	59.2	53.0	36.1	52.5	14.6
$2,500 to less than $5,000	31.6	63.7	52.1	25.0	68.8	14.1
$5,000 to less than $10,000	28.9	65.2	48.4	18.8	76.9	13.8
$10,000 to less than $25,000	27.1	62.4	39.9	16.0	80.3	15.1
$25,000 to less than $50,000	25.2	63.3	30.1	17.0	77.9	11.2
$50,000 to less than $100,000	26.4	62.5	17.6	21.0	71.3	13.6
$100,000 to less than $500,000	28.0	61.7	20.5	25.2	62.3	6.9
Greater than or equal to $500,000	23.3	67.5	41.7	12.8	74.7	15.0
All cases	27.1	63.6	33.4	19.4	72.0	13.0

Source: GAO analysis of AO data.

As in the Chapter 11 to Chapter 7 comparison, we controlled for case size in these data. Although there was some fluctuation in the data according to case size, none of the patterns described in the Chapter 11 conversions were reversed. The data suggested that secured and priority creditors received larger percentages of receipts in cases filed originally under Chapter 13 than in Chapter 7 consumer liquidation cases. They received these larger percentage disbursements in conjunction with smaller percentage disbursements to professionals.

On the other hand, the percent of receipts disbursed to general unsecured creditors was smaller in original Chapter 13 consumer cases than it was in Chapter 7 consumer cases. Available data did not permit us to analyze why this may have been the case, but there are several plausible reasons. One reason may have been the structure of consumer debt in these cases—that is, debtors had more secured and priority unsecured than general unsecured claims in original Chapter 13 cases. It may also have been due to the fact that during the Chapter 13, payments to secured and priority unsecured creditors took precedence over general unsecured claims and by the time the case converted, all or most of the assets had been depleted. If this were the case, after the case converted to Chapter 7, very little would have been left for disbursement to general unsecured creditors.

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