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# USABulletin

August 1999

## **BANKRUPTCY FRAUD**

### **In This Issue**

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## Letter from the Editor

We are pleased to present an issue of the United States Attorneys Bulletin that addresses the problem of bankruptcy fraud. Investigating bankruptcy fraud often leads to the discovery of other white collar fraud cases, and many of the articles contained in this issue are instructive on broader criminal matters such as proving intent, defeating the advice of counsel defense, and the use of flight evidence. Our thanks go to all of the contributing authors who have graciously donated their time to produce the informative articles in this issue.

In this issue you will also meet James Robinson, our Criminal Division Assistant Attorney General. Mr. Robinson is a former United States Attorney and has had a distinguished career as both a litigator and legal scholar. He brings great talent, energy, and vision to the Criminal Division, and he is anxious to have a continuing dialogue with the prosecutors in the United States Attorneys' offices.

We feature a second interview with Jerry Patchan and Kevyn Orr, Director and Deputy Director of the Executive Office for United States Trustees. This interview introduces us to the U.S. Trustee Program and provides information that is helpful to making bankruptcy fraud investigations and prosecutions more streamlined.

Finally, we wish to thank Jennifer Bolen, our managing editor, for her fine work on the Bulletin and on other publications during her two-year detail with OLE. She has accepted a position with the United States Attorney's Office in the Eastern District of Tennessee. We wish her continued success in her new position.

Please keep your comments and suggestions coming. Call me anytime at (340) 773-3920, or email [avic01\(dnissman\)](mailto:avic01@dnissman.com).

**David Marshall Nissman**

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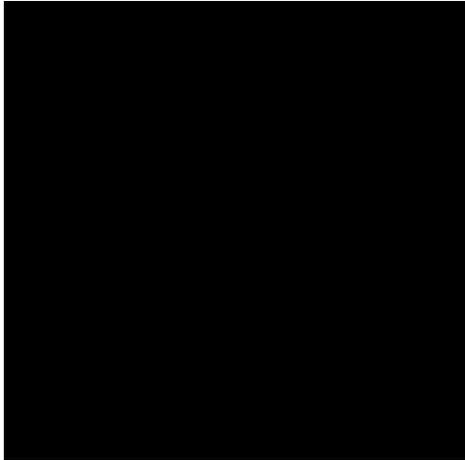
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# Interview with Assistant Attorney General James K. Robinson, Criminal Division



*James K. Robinson*

James K. Robinson (JR) was appointed Assistant Attorney General of the Criminal Division in 1998. He brings an impressive level of experience to this position. In 1977, he became the United States Attorney for the Eastern District of Michigan. Since then, he has been a private practitioner, president of the Michigan Bar, a law school professor, and the Dean of Wayne State University Law School. He is a published author and expert on evidence law. In 1993, Chief Justice Rehnquist appointed him to the Advisory Committee on Rules of Evidence of the Judicial Conference of the United States. On October 14, 1998, he shared his views of the Department, then and now, with David M. Nissman (DN), Editor in Chief, *United States Attorneys' Bulletin*.

**DN:** When you became the United States Attorney in Michigan in 1977, what was your view of the Criminal Division?

**JR:** My sense then was that the Criminal Division provided a resource for United States Attorneys' offices in matters that were beyond the normal course of activities in those offices. The Criminal

Division provided expertise on tough issues that came up only from time to time from a staff of people with a national view of criminal justice issues. There were requirements to get approvals on RICO prosecutions and a variety of other things which were, and are, designed to deal with sensitive, developing areas in the law. RICO was a good example of a statute that needed to be carefully shepherded to protect and develop the jurisprudence in a way that would be most advantageous to the Justice Department.

**DN:** What is your perspective today from the other side, as Assistant Attorney General of the Criminal Division?

**JR:** The dynamics between United States Attorneys' offices and the Criminal Division have always been quite interesting, and create a healthy tension. There is a sense that some things change, and some things never change. Years ago, the view was that there was too much of an obligation to seek and secure approvals from Main Justice on matters that ought to be within the prerogative of the United States Attorney. Today, my sense is that some people in Main Justice feel that too much authority has been shifted to the United States Attorneys. Yet, if you ask United States Attorneys, you find that many still feel as they did years ago, that there is too great an obligation to report or secure concurrence from Main Justice. I have a little different perspective today than I might have had 20 years ago, and that is understandable. I believe that at the end of the day most United States Attorneys will recognize that there are particularly sensitive issues where the Department should coordinate, particularly on difficult public relations issues, with Congressional initiatives like the 28 U.S.C. § 530B legislation, and with other oversight efforts. The Department must have the ability to bring some sense of overall national consistency and fairness to the enforcement of federal criminal law. This

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relationship between Main Justice and United States Attorneys will be a work in progress forever. It was true 20 years ago, and it is true today. There should continue to be a healthy, dynamic aspect to it. United States Attorneys are appointed by the President and confirmed by the Senate. They are the chief law enforcement officers in their Districts. It is appropriate that they view their responsibilities from a District perspective, and yet each recognizes that the Department needs to have the bigger picture in mind in setting policy. The role of the Criminal Division with regard to the enforcement of federal criminal law and cooperative arrangements with international, state and local law enforcement, is to provide that national, and increasingly international, perspective.

**DN:** What is the greatest change you see in the Department today?

**JR:** I would say that the most stunning development to me in the 20 years since I became United States Attorney has been the substantial increase in the amount of international work the Department is doing, not just at Main Justice, but in the United States Attorneys' offices as well. In the old days, we rarely dealt beyond the District, let alone the Nation's borders. Today many of the subjects and targets of criminal investigations are organizations whose operations are either national or international in scope. There is no question in my mind that international cases will continue to increase as a percentage of the work at the Department.

**DN:** We also have the opportunity to assist some new democracies in system building.

**JR:** Absolutely. Not only do we have the opportunity to assist new democracies as they develop their legal systems, but I think we have an obligation to do so. We have created two excellent training programs—the International Criminal Investigative Training and Assistance Program (ICITAP) and the Office of Overseas Prosecutorial Development, Assistance and Training (OPDAT)—and we have established International

Law Enforcement Academies in locations around the world. At the same time, it is important for us to not be arrogant about the way we do business. We can always learn from what other people do. Other legal systems around the world manage to get along quite nicely using approaches different from ours. The civil law systems are very different, and in many ways alien to us, but they seem to work. I hope we can learn more and judge less.

**DN:** What should the Criminal Division provide to the field in terms of resources?

**JR:** We should be a clearing house for expertise. If we don't have the expertise here, we ought to know where it is in the Department, and elsewhere, so that there will be a place where AUSAs and United States Attorneys can find expertise. One of the roles that the Criminal Division ought to be playing is to know how to match up people's needs with solutions to their problems. The Division should be trying to identify trends in criminal law enforcement in order to supply long range solutions to criminal justice problems. I think those are all things that appropriately ought to be done on a centralized basis, and I would like to think the Criminal Division can provide that sort of think-tank approach required to find the solution to these problems. There is a very important role for United States Attorneys to play in this area. United States Attorneys know better than anyone their districts and what crimes are being committed within them. Their role is essential in identifying problems and potential solutions, and crafting initiatives designed to solve them.

**DN:** Do you think the Department is too crisis oriented?

**JR:** Well, it is hard after putting out fires 12 hours a day to elbow away the time to do the kind of long range planning that really is necessary. It is a challenge, but it is part of our responsibility to try to make the time to do those kinds of things.

**DN:** How much contact do you have with your trial lawyers and with Assistant United States Attorneys?

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**JR:** The more contact I can have with attorneys in the Division, with United States Attorneys and AUSAs in the field, the more effective I can be. I have been making an effort to visit with United States Attorneys' offices whenever I have occasion to travel around the country. I have visited offices in Jacksonville, Nashville, Detroit, and San Francisco. The fact of the matter is that ever since I was United States Attorney, this was the one job in the Justice Department that I was interested in doing. I enjoy the challenge and the richness of the opportunity for public service. It is every bit as exciting and rewarding as I thought it would be. This is the greatest criminal law enforcement job in the country.

**DN:** What is your view of the current state of coordination between federal and local entities?

**JR:** I've been very pleased to see a greater concern for coordination since I came back to the Department. Of course, we can all do a better job. We should try to be proactive in the identification and solution of criminal law enforcement problems by bringing people and resources together from all levels of government—federal, state, and local. Sometimes there is competition between federal law enforcement agencies, so requiring and insisting that there be interagency cooperation between federal law enforcement agencies and the various departments of government is important. Increasingly, we see the need for the Department to interact aggressively and carefully with our international colleagues and with foreign governments because of the increasing globalization of crime. People can commit crimes here, flee across the border, come from foreign countries to commit crimes here and leave, and even commit crimes without entering the country. Our borders don't mean as much as they used to mean. We have to have careful working relationships through Interpol, and through direct one-on-one relationships with foreign investigative and prosecutive agencies.

Increasingly, United States Attorneys and federal law enforcement officers in the districts are really having meaningful interactions with local law enforcement, police departments, county

prosecutors, and state Attorneys General. They are developing joint programs to solve the unique crime problems that exist in each district and region. Artificial boundaries or organizational charts can get in the way of solving the problem. Sometimes there are natural tendencies to protect agency turf, and we all need to overcome those obstacles. It is a major management challenge, but it is an important one. The Criminal Division can play an important role as a fair and neutral broker dealing with jurisdictional disputes between federal districts, United States Attorneys offices, and law enforcement agencies.

**DN:** How important was it to you to fill the open positions in the Criminal Division?

**JR:** I view the responsibility to identify and fill those positions with the best people to be among the most significant contributions one could make. The way to mold the future of the Criminal Division is through selecting outstanding lawyers to fill those offices. When I became Dean of the law school, I had a similar opportunity to hire a third of the faculty in five years. You can make a big difference to an institution if you choose wisely, and I believe I have done so. I have chosen several highly qualified attorneys from United States Attorneys' offices and from within the Division to fill critical positions. All of the key positions are now full and, in the short time we have been working together, I believe we have become a highly effective team.

**DN:** What qualities do you look for in the people that you are now hiring?

**JR:** Among the most important qualities I look for are a sense of fundamental fairness, a total commitment to public service, and a clearly demonstrated technical competency as a trial lawyer or an appellate lawyer. There must be a real commitment to the mission of the Criminal Division, and to the criminal law mission of the Justice Department. Applicants need to have a fundamental sense that the role of a prosecutor is unique in our criminal justice system. There is a major quasi-judicial responsibility in the exercise

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of prosecutorial discretion. Opening an investigation has enormous consequences to targets and subjects, some of whom may turn out not to be guilty of any crime. We must handle ourselves with great care and sensitivity to the awesome responsibilities that prosecutors have. We are not there to put notches on a gun. Our role is to administer justice in an even-handed, vigorous, forceful, but ultimately fair, way. I felt that way when I was United States Attorney, and I feel that way today.

**DN:** What makes a good prosecutor?

**JR:** In my view, what distinguishes the great prosecutors from people who are just committed to getting a result is a sense of fundamental fairness, a sense that you are doing the people's business in a way that would make everybody proud that their government is doing these kinds of things. That means that we need to be extraordinarily sensitive to the powerful weapons we are using when we authorize search warrants, conduct court-sanctioned electronic surveillance, make arrests, and when we make charging, plea, and appellate decisions. We must always keep in mind that we have a quasi-judicial responsibility to make decisions, most of which are virtually unreviewable. We should make decisions that allow us to sleep well at night. The great thing about the job of the federal prosecutor is you can do the right thing and feel comfortable about making tough calls. Give people a fair shot, hear them out, and keep in mind that everyone is entitled to have a vigorous, careful, and honest defense in a criminal case. So long as defense attorneys are cutting the corners square, we should respect their critical role in the criminal justice system.

**DN:** What are some of your other goals and areas of interest in the Criminal Division?

**JR:** I would like to spend some of my energy trying to increase our emphasis on white collar crime, including the emerging problem of Internet related crime. I'd also like to concentrate on the traditional mainstays of the Department, such as fighting major narcotics trafficking, public

corruption, and organized crime. It is essential that the Department position itself to react vigorously and effectively to the national security threat of international organized crime. We must not wait to organize ourselves effectively until we have a problem that is too big to handle. We are already seeing some activities which lead us to believe that we need to be very seriously concerned about international organized crime groups penetrating our borders and creating serious problems for us, so we need to get ahead of the curve by organizing ourselves to meet that challenge.

**DN:** Describe what you see as the Internet crime problem we will encounter?

**JR:** The Internet is a fabulous tool that we are all using. Unfortunately, criminals are also taking advantage of the opportunity to commit vast consumer fraud. To name just a few examples of online fraud schemes we've already seen: auction houses where companies promise goods, take money, and intentionally refuse to deliver the promised products; securities trading; production of false immigration documents; financial fraud through the accumulation of personal financial data of unsuspecting Internet users; and fraudulent legal assistance. In one case, an Internet site offered people the opportunity for a quick divorce in the Dominican Republic without ever setting foot on Dominican soil in violation of Dominican law.

**DN:** Are consumers injured differently on the Internet when they are victims of fraud?

**JR:** They can be. For example, in the case of the Dominican divorce fraud, anyone who obtains such a "divorce" may find themselves ensnared in legal problems at a later date when the truth comes out that there is no valid divorce. So in this type of case, the injury is initially unknown and the damage delayed.

**DN:** Do we have a national strategy to combat cyber fraud?

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**JR:** We do. A few years back, the Criminal Division recognized the need for a core group of experienced attorneys available to work on these cases. So, the Division created the Computer Crime and Intellectual Property Section (CCIPS). CCIPS lawyers are on the cutting edge of high-tech issues, and they work with a number of different agencies to combat computer crime. The effort against cyber fraud is proceeding on many fronts, and it has recently received attention from the highest levels of our government. In fact, we are currently working on an Internet fraud initiative.

**DN:** What kinds of things have you started to do on the international front?

**JR:** I've met with Andres Pastrana, the new President of Colombia. We have major issues with Colombia involving narcotics trafficking. I've met Viktor Orban, the new Prime Minister of Hungary, and we have had discussions about organized crime in Hungary and in Eastern Europe. I have met with the Attorney General of Mexico, Jorge Madrazo, to discuss our relationship with Mexico. Increasingly, this job is an international job. The future of the Criminal Division includes a major role in international issues because it is not possible for any one United States Attorney to handle the problem of international crime. We need to proceed on a coordinated basis.

**DN:** I am curious to know, based on your long years of studying evidence, what evidence rule do you think needs refining?

**JR:** You asked me a question to which I could respond forever. The short answer is that the rules concerning scientific evidence deserve serious attention in light of recent legal and scientific developments in this area. Another very interesting area of evidence involves encryption. Law enforcement will increasingly deal with encrypted communications as time goes on. While we have the tools to decrypt these messages, we must be able to authenticate that information to a jury without disclosing the methods we use to break the codes. Otherwise, every time we introduce encrypted evidence we will give away our

encryption secrets, allowing criminals to defeat them in the future.

**DN:** What message do you have for AUSAs?

**JR:** The opportunity as a federal prosecutor to make fair and even-handed judgments while doing the people's work, and rigorously, but fairly, enforcing federal criminal law is an extraordinary honor and an awesome responsibility. Federal prosecutors can hold their heads up high and feel good every single day about their important work on behalf of the people of the United States. While we all have frustrations from time to time, being a federal prosecutor is the greatest job a lawyer can have. I look forward to the opportunity to work with you. ~

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# “An Ounce of (Fraud) Prevention is Worth a Pound of Cure”: The Attorney General’s Systemic Weakness Reporting Programs

*Shelley R. Slade*  
*Senior Counsel for Health Care Fraud*  
*Civil Division*

*Jonathan J. Rusch*  
*Special Counsel for Fraud Prevention*  
*Fraud Section, Criminal Division*

Preventing fraud directed at government programs, businesses, and individuals increasingly has become a cornerstone of the Department’s anti-fraud programs. The Attorney General views the prevention of fraud— through public education, client risk counseling, and other efforts—as an integral part of our day-to-day responsibilities in combating fraud. To that end, she has made clear that our promotion of fraud prevention efforts must extend well beyond the deterrent effect of federal fraud prosecutions and civil enforcement actions, to include *affirmative* steps to facilitate compliance with federal program requirements.

Key components of these efforts are the Systemic Weakness Reporting Programs that the Attorney General has established. This Article will describe two of these programs: the reporting program for health care fraud, administered by the Civil Division's Commercial Litigation Branch, and the reporting program for other types of fraud, administered by the Criminal Division’s Fraud Section.

## Background

There are essentially two prongs to the Department's fraud prevention efforts:

1) educating the public concerning fraud and abuse,<sup>^</sup> and 2) identifying the vulnerabilities in federal statutes, regulations, procedures, and interpretations that may contribute to fraud and abuse. The theory behind the latter effort is that the Department's investigators, prosecutors, and litigators are positioned to detect weaknesses in agency programs that open them up to fraud and abuse, such as deficiencies in agency procedures and loopholes in regulations. Indeed, opponents’ defenses often bring problems with the system sharply into focus. Sometimes the Department has legitimate grounds to pursue a fraud case notwithstanding the systemic weakness. On other occasions, the Department declines cases where it acknowledges that, for example, the government's payment of excessive benefits was caused not by the government contractor or beneficiary, but by

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<sup>^</sup> For example, the Department is expanding its Web site ([www.usdoj.gov](http://www.usdoj.gov)) to include Web pages about all major forms of fraud, both health care and non-health care. In addition, the Attorney General, the Deputy Attorney General, the Director of the FBI, and United States Attorneys around the country recently teamed up with the Office of Inspector General of the Department of Health & Human Services, the Health Care Financing Administration, the Administration on Aging, and the American Association of Retired Persons to conduct 35 "fraud fighter rallies" nationwide. These rallies, which were attended by more than 6,500 senior citizens, generated extensive press coverage of ways to report fraud. Also, in the area of health care fraud, the Department consults with the Office of Inspector General (OIG) with regard to the OIG's issuance of Compliance Guidance for specific health care industries, and advisory opinions concerning the anti-kickback statute.

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the government's own policies or ambiguities in the underlying statutes or regulations.

The Attorney General has encouraged Department attorneys and investigative agents to participate in the systemic weakness reporting programs. We have a duty to ensure that the shortcomings in agency programs, which create opportunities for fraud and abuse, are made known to agency personnel who can improve the programs.

### **The Systemic Weakness Reporting Process**

#### *A. Reporting Vulnerabilities in Health Care Programs*

In June 1997 the Attorney General issued a Protocol for the Reporting of Systemic Vulnerabilities in Health Care Programs. (Appendix A.) This Protocol encourages Department personnel to offer their opinions regarding ways in which the rules, policies, and procedures of federal health care programs render them vulnerable to fraud and abuse, and to recommend "fixes" for these problems, through reports made to the Civil Division. The Protocol calls for these reports to be made as soon as possible after a problem is identified, regardless of whether the rule, policy, or procedure is at issue in an ongoing case.

The procedures that implement the Attorney General's Protocol are set forth in an October 1997 Memorandum from Assistant Attorney General Frank Hunger. (Appendix B.) These procedures call for Department personnel to report systemic weaknesses on a form prepared by the Civil Division that can be made available, filled out, and submitted electronically. (Appendix C.)<sup>^</sup> The form seeks the advice, opinions, and recommendations of Department attorneys and investigators concerning possible legal advice to provide client-agencies regarding systemic vulnerabilities in health care programs.

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<sup>^</sup>To obtain an electronic copy of this form, contact Shelley Slade, Senior Counsel for Health Care Fraud, on e-mail, or at tel. no. 202-307-0264.

Once a health care report is submitted to the Civil Division, the Civil Division's Senior Counsel for Health Care Fraud works with the person who submitted the report to clarify the nature of the systemic weakness, and to determine if it is of national significance. If the weakness appears to be of national significance, the Civil Division provides legal advice to the client- agency regarding the nature of the problem and possible remedies.

Since the inception of the systemic weakness reporting program for health care reports, twenty reports have been submitted to the Commercial Litigation Branch. Of these twenty reports, the Commercial Litigation Branch has determined that fourteen involved issues of national significance within the scope of the program. (Two of the recommendations concerned matters outside the scope of the program, and four matters are still under consideration.) Based on these fourteen recommendations and follow-up communications, and after additional analysis and legal research, the Commercial Litigation Branch drafted advice for the Health Care Financing Administration, the Office of Personnel Management and the Food & Drug Administration.

#### *B. Reporting Vulnerabilities in All Other Programs*

With the health care systemic weakness reporting process as a precedent, the Attorney General's Council on White Collar Crime recommended that a similar systemic weakness reporting process be established for other types of fraud. On May 6, 1998, the Attorney General, in a memorandum to all Departmental components and to United States Attorneys, established the Fraud Prevention Initiative. (Appendix D.) As part of that Initiative, United States Attorneys' Offices, FBI field offices, and the Treasury Department have received copies of a form prepared by the Criminal Division for reporting systemic weaknesses. The Initiative's reporting procedures call for agents and prosecutors to offer advice, opinions, and recommendations, based on their investigations and cases, on statutes, regulations, and policies that may adversely affect the Department's ability to prosecute various types of fraud.

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Once a systemic weakness report is submitted to the Criminal Division, the Fraud Section's Special Counsel for Fraud Prevention contacts the office that submitted the report for any additional information, contacts the agency whose statute, regulation, or policy is at issue to identify the problem, and involves the reporting office as necessary in subsequent discussions to explore a solution.

To ensure that it is receiving information from all areas of the country, the Criminal Division not only receives and processes the fraud systemic weakness reports, but actively solicits information and ideas from federal prosecutors and agents. Since the establishment of the Initiative, the Special Counsel for Fraud Prevention has visited United States Attorneys' offices in a dozen cities around the country, and has met with supervisory agents of the FBI, the Postal Inspection Service, and the United States Secret Service in many of those cities as well. Both the systemic weakness reports and the information received in these visits have identified several issues relating to various forms of federal program fraud that the Criminal Division is now exploring with the affected agencies.

The Department regards the systemic weakness reports submitted to the Civil or Criminal Division on these reporting forms to constitute privileged recommendations, advice, and opinions of Department personnel. Likewise, the Department considers the advice provided to its client-agencies to be confidential, attorney-client communications.

### **Encouraging Future Participation**

The Department has taken steps to ensure that those who make significant contributions to fraud prevention will receive appropriate public recognition for those contributions. As part of the Fraud Prevention Initiative, for example, the Department has established a special annual award for fraud prevention. This award, which is open to federal prosecutors and agents, as well as other Departmental employees and even individuals or organizations in the private sector, is intended to recognize all types of fraud prevention programs and projects.

In addition, to acknowledge the valuable contributions of those who report systemic vulnerabilities in the health care fraud area, the Attorney General's continuing instruction is that the authors of outstanding reports should be recognized. In early 1999, the Attorney General, the Civil Division, and the Executive Office for United States Attorneys recognized five attorneys for preparing particularly outstanding systemic weakness reports during the first year of the program. Assistant United States Attorneys Barbara Bisno, Patricia Connelly, Suzanne Durrell, and Gail Nichols, and Trial Attorney Dan Spiro, each received letters of commendation from the Attorney General, and \$500 awards. These attorneys prepared thoughtful recommendations for change in the following areas: 1) certifications on claims forms; 2) billings by home health agency subcontractors; 3) regulations that implement the Prescription Drug Marketing Act; and 4) *ex parte* administrative proceedings. The Civil Division may nominate additional Department attorneys and investigators for monetary awards and special recognition in FY 1999.

It is vital to the success of these programs that every Assistant United States Attorney handling fraud cases consider whether he or she has detected a weakness in an agency rule, policy, or procedure that creates opportunities for fraud and abuse. If the answer is yes, the attorney should comply with the Attorney General's Protocol and the Fraud Prevention Initiative by spending a few minutes preparing the appropriate systemic weakness report. A timely filed systemic weakness report that highlights a significant problem may result not only in helping a federal agency to achieve substantial reductions in fraud losses, but also in strengthening our ability to prosecute fraud cases more effectively. ~

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### ABOUT THE AUTHORS

' **Jonathan J. Rusch** is Special Counsel for Fraud Prevention in the Fraud Section of the Criminal Division of the Department of Justice. In that capacity, he oversees the Department's Fraud Prevention Initiative. He also coordinates the Department's Internet Fraud Initiative and chairs the interagency Telemarketing and Internet Fraud Working Group. a

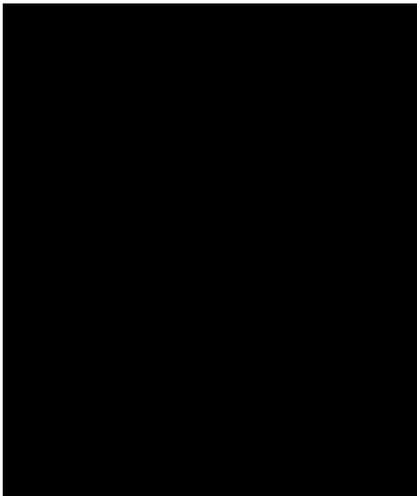
' **Shelley Slade** is Senior Counsel for Health Car Fraud in the Civil Division of the Department of Justice. a

If you are interested in the appendices mentioned in this article, contact Shelley Slade or Jonathan Rusch.

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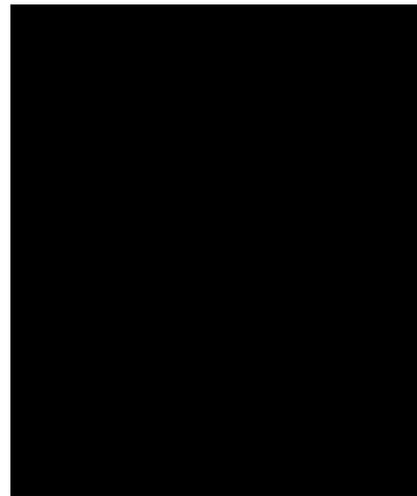
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# Interview with Jerry Patchan, Director, and Kevyn Orr, Deputy Director, Executive Office for United States Trustees



*Jerry Patchan, Director  
Executive Office for U.S. Trustees*

**J**erry Patchan is the Director of the Executive Office for United States Trustees (EOUST), and has held that position since 1994. Prior to that, he was the Deputy General Counsel for the Resolution Trust Corporation from 1991 to 1994, and a partner in the law firm of Baker & Hostetler from 1975 to 1991. He served as a bankruptcy judge for the Northern District of Ohio from 1969 to 1975, and was in private practice prior to that appointment. From 1978 to 1991, he served on the Judicial Conference of the United States' Advisory Committee on Bankruptcy Rules. He obtained his Juris Doctorate from the John Marshall School of Law at Cleveland State University.



*Kevyn Orr, Deputy Director  
Executive Office for U.S. Trustees*

**K**evyn Orr was appointed Deputy Director of the EOUST in 1995. Before joining the Department, he served in the Resolution Trust Corporation, and was named Assistant General Counsel for Complex Litigation and Bankruptcy in 1994. Prior to that, he was a partner in the Miami law firm of Stearns, Weaver, Miller, Weissler, Alhadeff & Sitterson, and then a litigator for the Federal Deposit Insurance Corporation. He obtained his Juris Doctorate from the University of Michigan Law School in 1983.

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Jerry Patchan (JP) and Kevyn Orr (KO) were interviewed on April 9, 1999, by Jennifer Bolen (JB), Managing Editor of the *United States Attorneys' Bulletin*.

**JB:** Give us an overview of the United States Trustee Program.

**JP:** The United States Trustees are concerned with protecting the integrity of the bankruptcy process. Their responsibilities include: appointing and supervising the private trustees who administer Chapter 7, 12, and 13 cases; ensuring that bankruptcy estates are administered promptly and efficiently, and that professional fees are reasonable; taking legal action to enforce the requirements of the Bankruptcy Code and to prevent fraud and abuse; referring cases of suspected bankruptcy fraud for investigation and criminal prosecution; and, in Chapter 11 cases, performing numerous duties to ensure that cases are administered expeditiously and fairly.

EOUST provides day-to-day policy and legal direction, coordination, and control, as well as administrative and management support for United States Trustees' offices around the country.

The Program was created in 1978 as a pilot project in 10 regions encompassing 18 judicial districts in order to separate the judicial and administrative functions in bankruptcy cases. The Program was expanded nationwide in 1986. This expansion was completed by 1989. The Program is divided into 21 regions, each headed by a United States Trustee. Basically, our territory extends from Guam in the West to the Virgin Islands in the East. However, North Carolina and Alabama are excluded from this list because the Senate decided to use Bankruptcy Administrators under the Judicial Branch in those locations. Consequently, EOUST has no oversight authority over bankruptcy proceedings in North Carolina or Alabama. In addition, there are 93 field offices, each managed by an Assistant United States Trustee. EOUST's executive office is in Washington, D.C.

**JB:** What is EOUST and what are its responsibilities regarding the implementation of the United States Trustees' Program?

**JP:** To some degree, EOUST is structured like the Executive Office for United States Attorneys (EOUSA). Essentially, our role is one of oversight and, like the United States Attorneys' offices, our United States Trustees' offices have a great amount of discretion in the handling of bankruptcy cases. For example, United States Trustees decide how to handle the cases in their region and when and if to initiate suit. The cases handled by the United States Trustees' offices start in court, but the practice is not uniform because courts vary quite a bit due to many variances including local legal culture. We've found that the best way to respond to these differences is to allow each United States Trustee's office to handle these matters. Sometimes this produces variation where there should be uniformity, but we're working on it.

**JB:** How many people work on EOUST's D.C. staff?

**KO:** Approximately 65 people serve on EOUST's DC staff. In addition, nationwide, including the United States Trustees and their staffs, we have approximately 970 employees. As Director, Jerry's role is similar to that of a Chief Executive Officer. This means that he, through directives from the Attorney General or under the bankruptcy statute, has the ultimate responsibility for the program's activities. His position is strategic. I am responsible for executing those directives and supervising EOUST's staff.

**JP:** The professionals on our staff include: lawyers, accountants, and analysts. Similar, I think, to the Financial Litigation Units in the United States Attorneys' offices. These professionals examine bankruptcy documents and testimony to determine whether, among other things, the law is being followed by all parties. We also develop information concerning abuse of the bankruptcy laws (which would warrant civil proceedings) or fraudulent or criminal conduct. When we find fraud,

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we refer these cases to the United States Attorney's office.

**JB:** Describe how the United States Trustees' offices interact with the United States Attorneys' offices?

**KO:** Section 586(a)(3)(F) of Title 28 requires United States Trustees to refer cases to and assist United States Attorneys' offices in the prosecution of bankruptcy fraud. This relationship can be informal or very formal, depending on the relationship between our offices.

**JB:** Let's say I'm an AUSA with a bankruptcy fraud case, what kind of assistance can I expect from the United States Trustee's office and how do I get that process started?

**KO:** First, EOUST has a National Fraud Coordinator who assists AUSAs with the review of indictments, assembly of evidence, and training on bankruptcy prosecutions. Second, the United States Trustees' Fraud Manual is available to AUSAs. Third, our Assistant United States Trustees are occasionally available to serve as Special Assistant United States Attorneys in bankruptcy fraud task forces.

**JP:** The United States Trustees refer cases of suspected bankruptcy fraud to the United States Attorney. Also, United States Trustee offices act as resources to the United States Attorney in that they are available to assist with the investigation of bankruptcy fraud and the preparation of the case for trial.

**JB:** Who is the National Fraud Coordinator for EOUST?

**KO:** Sandra Rasnak, an Assistant United States Trustee in the Chicago office. AUSAs should contact her if they desire the assistance Jerry described, or if they would like to know more about the United States Trustees' Fraud Manual.

**JB:** When the United States Trustee's office sends a referral to the United States Attorney's office, what does the referral package consist of?

**KO:** In a typical case, the referral package consists of a letter addressed to the United States Attorney or the Fraud Coordinator which embodies a basic explanation of who the debtor is, the facts comprising the potential federal crime(s), why the conduct falls under one of the criminal bankruptcy provisions (18 U.S.C. §§ 151-57), and a summary as to why the facts justify investigation and prosecution. Sometimes, the referral package includes forensic evidence, such as writing samples.

**JP:** By statute we have to refer every case that has a criminal aspect to it. However, we attempt to highlight those cases which have special criminal ramifications.

**JB:** Let's focus on training for a moment. Tell us about EOUST's current training program.

**KO:** We recently opened the National Bankruptcy Training Institute, which is housed at the National Advocacy Center (NAC) in Columbia, South Carolina. Before that, we would conduct periodic training in district offices throughout the country. Our Assistant United States Trustees and analysts receive regular training. We are also willing to train AUSAs and plan to do more cross-training of AUSAs and FBI agents at our new training site at the NAC. We have also recently developed taped presentations that we hope to use nationwide in our bankruptcy training program. We filmed them in Los Angeles and I think they will prove helpful in this area.

**JB:** Will these tapes be available to AUSAs? And, if so, how do AUSAs go about getting these tapes?

**KO:** Certainly, these tapes will be made available to AUSAs. If anyone is interested in reviewing these tapes, they should contact Maureen Tighe, who is the United States Trustee in Los Angeles, or Sandra Rasnak or me.

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**JB:** Because there are civil and criminal areas in bankruptcy cases, tell us how the United States Trustee Program handles the division of labor on these cases, and what type of red flags do your employees look for to distinguish a civil case of bankruptcy abuse from a criminal case of bankruptcy fraud.

**JP:** All of our individual bankruptcy cases have private trustees assigned to review the paperwork. These private trustees are generally lawyers or accountants who serve as members of a panel of experienced trustees. A private trustee's primary responsibility is to take testimony from the debtor and review the debtor's paperwork. Based on the papers submitted by the debtor and the private trustee's examination of the debtor, the private trustee recommends that the case be handled as an abuse of the bankruptcy law subject either to civil remedies or penalties for criminal fraud, or handled as a case in which the debtor is entitled to a discharge of debts. Most cases are precisely this—people or companies who have really hit the wall in their financial affairs. The Program oversees this process. The private trustees will advise us of any case which has an indication of statutory abuse or criminality. Sometimes, we are the trustee if there is a conflict of interest and you cannot get a private trustee quickly or if the case is very difficult. For example, we've just done a massive amount of work on a case out of the Northwest involving the sale of cattle. The private trustees did not want to handle this case.

**JP:** We maintain a list of "red flags"—indicia of bankruptcy fraud—in our training materials. AUSAs are invited to obtain these materials from us by contacting Sandra Rasnak. *Editor's Note:* A list of red flags is published on page 22 of this issue.

**JB:** Bankruptcy crimes often involve relatively small amounts of loss (amounts under \$5,000). Why should prosecutors devote their resources to bankruptcy fraud prosecutions?

**JP:** There are at least two important reasons why prosecutors should seek to prosecute bankruptcy

fraud. First, bankruptcy fraud threatens the integrity of the entire bankruptcy system, and it threatens public confidence in the integrity of that system. Bankruptcy prosecutions deter individuals who might otherwise take advantage of the bankruptcy system's reliance upon self-reporting of financial obligations. Second, bankruptcy fraud is often found in connection with other types of fraud, such as tax fraud, credit card fraud, bank fraud, use of a false Social Security Number, insurance fraud, and investment fraud, as well as a host of different consumer scams that prey on financially distressed people. Consequently, the "small" bankruptcy fraud may be just the tip of the iceberg. Close scrutiny of bankruptcy documents can yield a wealth of information about the other frauds.

**JB:** Why shouldn't a prosecutor simply leave the small cases to the local and state law enforcement authorities?

**JP:** The Bankruptcy Code is a federal statute, so the local and state authorities lack jurisdiction to enforce most bankruptcy crimes. We have the duty to police the bankruptcy system. Dollar-limit guidelines and resistance to taking small cases provide immunity to would-be abusers of the system.

**KO:** Also, prosecution of the smaller bankruptcy cases sends a deterrent message, like any other prosecution in the community, that we're not only going after the big, multi-million dollar bankruptcy cases.

**JB:** How can AUSAs benefit from the United States Trustee Program attorneys' experience in bankruptcy fraud cases?

**JP:** AUSAs can look to program attorneys for support in gathering and analyzing bankruptcy documents. Program attorneys are also available to serve as expert witness and provide testimony regarding bankruptcy crimes.

**JB:** I understand that the United States Trustee Program employs accountants. Are their services

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available to AUSAs in bankruptcy fraud prosecutions?

**JP:** Yes. AUSAs can use program accountants to document the bankruptcy paper trail. Specifically, these accountants are available to reconstruct financial records to determine how the fraud occurred. They are also available to testify as expert witnesses and in that regard help the court or jury understand the fraudulent financial transactions.

**JB:** How would you counter the perception that bankruptcy fraud prosecutions are too complicated and require too much time for the amounts typically involved?

**JP:** Most bankruptcy crimes involve lying, cheating, and stealing. They are merely variations of the crimes that AUSAs prosecute.

**JB:** How can prosecuting bankruptcy crimes help United States Attorneys fight other crimes?

**JP:** Bankruptcy documents are supposed to lay out the scope of the debtor's financial affairs. They often yield written evidence to use in prosecuting other white collar crimes that the perpetrator engaged in. Familiarity with the detail of financial and other information contained in bankruptcy documents signed by the debtor is a great tool for law enforcement officials. United States Trustee Program attorneys and financial analysts can identify and interpret this evidence for the AUSA to use in the prosecution.

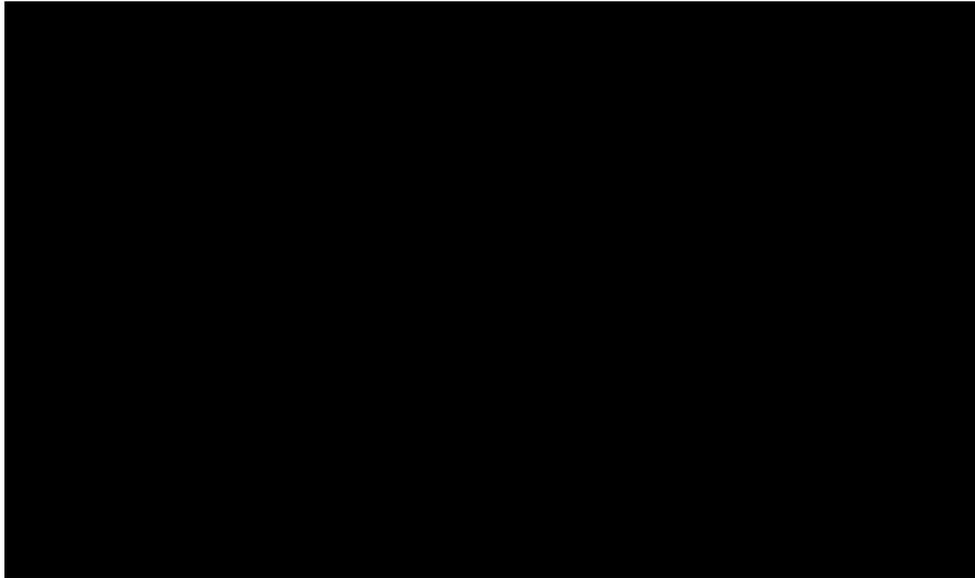
**JB:** Tell me about the bankruptcy fraud working groups that have been established in many districts.

**JP:** At least 70 districts have bankruptcy fraud working groups consisting of representatives from various law enforcement agencies such as the United States Attorney, the United States Trustee, the Federal Bureau of Investigation, the United States Postal Service, the Social Security Administration, and others. Working groups pool the various agencies' resources to assist in the

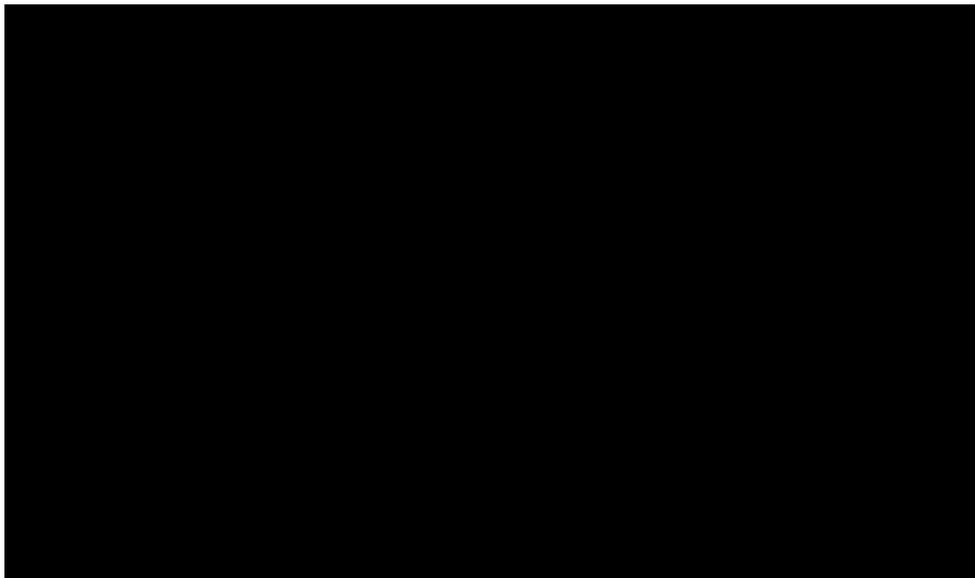
prosecution of bankruptcy fraud and related crimes. They hold regular meetings, provide training for working group members and for other entities, share information on suspected criminal activity, and examine and prioritize cases for referral to the United States Attorney's office.

**JB:** Jerry, what is your most significant accomplishment during your tenure as Director of the Program?

**JP:** It's awfully hard to pick one and say that the others are less important or less significant. And, I can't take full credit for anything as "my major accomplishment." I've built on things that were in place at EOUST prior to my arrival. People here have been working on a lot of good things for a long while. I would say that one very important accomplishment has been the development of better relationships with our constituents, e.g., with private trustees and standing trustees who handle wage-earner cases, with practitioners, with the bankruptcy bench, and with various law enforcement entities like the United States Attorneys' offices, the FBI, and the Social Security Administration. A major development has been the establishment of the National Bankruptcy Training Institute, which will provide an expanded training program to help all employees reach their professional potential. It takes professional training and talent to develop a long-term relationship and understanding of bankruptcy law and what we do and why we do what we do. The government's focus is on the integrity of the system. The practitioners are focused on the needs of their clients. It takes a skillful United States Trustee and very able Assistant United States Trustees to handle this well over a period of time. ~



*EOUST Training at the National Advocacy Center*



*EOUST Training at the National Advocacy Center*

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# National Bankruptcy Training Institute Opens at the National Advocacy Center

The National Bankruptcy Training Institute opened February 9, 1999, at the National Advocacy Center, with a ceremony that brought together Justice Department officials, bankruptcy judges, and Justice Department employees attending the Institute's first class session. The United States Trustee Program operates the Institute.

"The existence of our Bankruptcy Institute and a permanent site for our training was one of the goals set when I joined the Program," Jerry Patchan, Director of the Executive Office for United States Trustees in Washington, D.C., announced at the opening ceremony. "I realized that for the Program and its people to achieve their full professional potential, and be recognized for the valuable work they do in the bankruptcy system, we had to develop a comprehensive, systematic and effective training program."

Senator Ernest Hollings (D-SC) sent a congratulatory message noting that South Carolina is a particularly appropriate home for the Institute: South Carolinian Charles Pinckney, a delegate to the Constitutional Convention in 1787, proposed the constitutional provision enabling Congress to establish uniform laws upon the subject of bankruptcies. "With the participation of leading judges, legal scholars, practitioners and private trustees, the Institute will not only enhance the professional development of the personnel of the United States Trustee's Office, but will strengthen the entire bankruptcy process," Hollings stated in his message.

Patchan pointed out that the National Advocacy Center provides an ideal structure to plan and house the Institute's training courses. "It gives us access to state of the art training facilities, and puts us in a community of the most able and experienced of the Justice Department's legal trainers," he said.

The Institute will offer all Program employees regular access to a range of courses to enhance professional development. Just as important, it will allow the Program to maintain a permanent training site on the campus of the University of South Carolina and to develop an experienced corps of instructors.

Stephen I. Goldring, who heads the Institute, hopes to make it a national center for scholarship in bankruptcy, and a source of comprehensive skills and management training for Program employees. "The extremely knowledgeable staff of the Office of Legal Education in the Executive Office for United States Attorneys, with their years of experience in designing and presenting training seminars, will be an invaluable resource in developing our curriculum," he noted. "In the future we will invite judges, practitioners, and legal scholars to contribute to the training programs. The Institute will offer the opportunity for the exchange of ideas not only among Program personnel, but also among participants in the entire bankruptcy community."

Goldring was appointed in November 1998 as Special Assistant United States Trustee in charge of training and will serve as the "Dean" of the Institute. Previously, he served for 10 years as the Assistant United States Trustee in Pittsburgh. Before joining the Program, Goldring worked for 12 years as an Assistant United States Attorney in Pittsburgh, including 7 years as First Assistant United States Attorney. Goldring began his career in the Department of Justice in 1974 as an attorney with the Organized Crime and Racketeering Strike Force. He received his law degree in 1970 from Duquesne University Law School in Pittsburgh.

While Goldring's first priority is to develop a training curriculum, he also plans to work with personnel from the National Advocacy Center and

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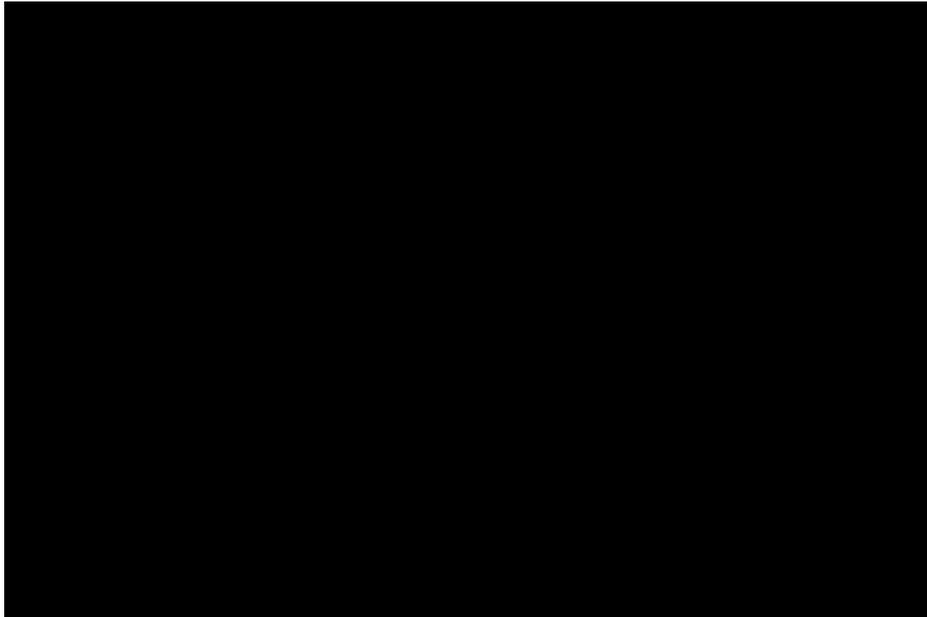
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the University of South Carolina to establish a program for distance learning and to set up a library of training videos. Other future projects include developing a web site for the Institute and creating print and online course catalogues.

To ensure that the Institute's courses meet employees' needs, Goldring intends to regularly seek employees' comments on desired topics and on training techniques they have found most effective. He will also establish an advisory group of Program employees to assist in course development.

The Institute has already received kudos from participants in the first training session, a four-day advanced course on Chapter 11. The mock courtrooms won favorable reviews, even from the Program financial analysts put on the stand as expert witnesses. Participants also had high praise for the convenient built-in electronic facilities for videotaping and projection. The comfortable common areas and dining hall provided a pleasant gathering place to get acquainted with colleagues from the Program and from other components of the Department.

Overall, the establishment of the Institute will bring many new and exciting opportunities, just as the Program enters its second decade as a permanent part of the national bankruptcy system. ~



*EOUST Training at the National Advocacy Center*

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# Tips for Developing a Successful Bankruptcy Fraud Program

*Maureen A. Tighe  
United States Trustee, Region 16  
Los Angeles, California*

Every district should have a bankruptcy fraud prosecution plan. It may be limited and small if bankruptcy fraud is not a big problem in your area, or it may involve the creation of a large task force if the referrals warrant it, but each district should have some considered approach to this crime.

Bankruptcy cases are being filed in significant numbers in every district in the country, and, given human nature, not everyone filing is being completely honest. Bankruptcy fraud has been a priority of Attorney General Janet Reno and, before her, Attorney General William Barr. The good news is that setting up an effective program is not difficult, and you will find that it helps your economic crime prosecutions overall.

Setting up a specific structure for a bankruptcy fraud prosecution program (the “program”) will ensure that your efforts do not go unnoticed and increase the chances for continuity should the original individuals move on to other projects. This article contains some ideas for structuring a bankruptcy fraud prosecution program.

## **Follow the Leader**

Each United States Attorney’s office (USAO) should assign the responsibility to coordinate the program to an Assistant United States Attorney (AUSA). All agencies should be informed of the appointment. The program coordinator should have a good overview of all referrals, players, and cases. Likewise, the program coordinator should seek the cooperation of all federal agencies involved in bankruptcy prosecutions.

If prosecuting bankruptcy fraud is a priority, the United States Attorney (USA) can ensure that

the program coordinator’s workload is appropriate. If the program coordinator is a novice to bankruptcy law, it is important that a civil bankruptcy AUSA or an attorney from the United States Trustee’s Office (USTO) is available for consultation.

## **Safety in Numbers**

A task force or working group is an important addition to a bankruptcy fraud program. It helps coordinate the different resources necessary for an effective program. The essential members of a bankruptcy fraud working group are the USTO and the Federal Bureau of Investigation (FBI). The United States Trustee (UST) makes most bankruptcy fraud referrals and the FBI has primary responsibility for the investigation. Other key members of the group are the Internal Revenue Service and the Postal Inspection Service. You should also consider including the Bankruptcy Court Clerk’s office, the Inspector General for the Social Security Administration, the Department of Labor, and the Secret Service. Bankruptcy fraud is found in connection with so many other violations that many different agencies can benefit from learning about various bankruptcy issues.

## **Regular Meetings**

Holding regular meetings of the working group is important; quarterly meetings are probably sufficient for most districts. Meeting regularly promotes effective communication and heightens awareness. Combining the efforts of different agencies is also beneficial. Routinely scheduled meetings maintain the group’s focus. Finally, distribute a contact list with everyone’s name, mailing address, e-mail address, and telephone and fax numbers. This list serves as an important networking tool and resource.

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## Get the Word Out

Issue a media release for every bankruptcy fraud prosecution to ensure the public is aware that the government prosecutes bankruptcy fraud. Your local newspaper may report only on the larger or more sensational cases, but the various bankruptcy newsletters are likely to cover every case. In Los Angeles, before the Bankruptcy Fraud Task Force was formed, there was a widespread belief that we did not prosecute bankruptcy crimes. To counter that perception, we made it a policy to issue a media release in every bankruptcy fraud case.<sup>^</sup>

Judges and panel trustees want to know about bankruptcy fraud prosecutions and appreciate any news you provide. Consider sending a copy of the press release, indictment, or other update to the judge and trustee in every case. By doing this, you will develop a network of tipsters and experts to help in other cases.

## Have a System

Set up a formal referral system for dealing with complaints and referrals. In our district, we try to have all referrals directed to the UST first. The UST can add information to the complaint or referral before sending it to the USA, or can warn the USA if someone is attempting to manipulate the referral process for purposes of a civil proceeding.<sup>^^</sup> The USA then sends each potential case to the FBI or other investigative agency.

A referral ranking or category system can be helpful in a district with too many referrals for the USAO to process. For example, in Los Angeles,

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<sup>^</sup> If you fax a copy of your media release to Public Information Officer Jane Limprecht at the EOUST, (202) 616-4576, she will make sure it is sent to the bankruptcy law trade publications.

<sup>^^</sup> 18 U.S.C. § 3057 requires trustees and judges to refer bankruptcy crimes to the USA. In the UST's view, this requirement is met if the crime is referred to us, because we pass them all on to the USA. Judges or trustees who disagree with this interpretation of the statute are asked to at least copy the UST on all referrals.

we find that having three different treatments of complaints helps us effectively review the extraordinary volume of referrals.

First, we receive hundreds of complaint letters from private parties that state a crime but provide no supporting documentation, detail, or evidence to enable an AUSA reasonably to evaluate whether to pursue the complaint. These complaints are sent directly to the FBI for investigation. The FBI often discovers that the subject of the complaint is already under investigation for another type of crime. The bankruptcy fraud complaint is then forwarded to the investigating agent.

The second category consists of complaints that provide solid evidence of a bankruptcy crime warranting further investigation, but that might not be prosecuted in all cases due to limited resources. These referrals are sent to the USA with a cover letter briefly describing the violation. The USA decides whether to send them to an investigative agency.

Finally, sometimes the crime is so large or so egregious that the UST engages in a significant initial investigation and develops a substantial referral package. The UST sends the referral package to the USA and, if the case is extremely significant, contacts the USAO's program coordinator.

This three-category system allows the Los Angeles office to coordinate around 300 bankruptcy fraud referrals each year among appropriate agencies. The UST does not have investigatory powers or resources to develop every referral. Using this system, we can prioritize cases and hone our referrals to the USA.

Any referral system should also identify who will respond to private citizens, judges, and trustees who make referrals. Citizens, judges, and trustees will help your efforts and often develop great referral packages if you keep them informed and avoid letting them feel like they are sending information into the proverbial black hole.

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## Education and Training

A successful bankruptcy fraud program must provide regular training for every group with bankruptcy-related responsibilities. Consider offering the following training and education opportunities.

If you have a working group or task force, each meeting should include an educational component. For example, discuss a recent appellate decision or a lesson learned in a recent prosecution. This information will make the meeting worthwhile and increase the group's expertise over time. I like to distribute at least one substantive handout at each meeting.

In addition, a basic "what is bankruptcy fraud" program can be valuable for AUSAs and agents who have never worked a bankruptcy fraud case. This training can be provided in one or two hours as part of any office's continuing education program. The program can educate non-bankruptcy employees about useful tools in analyzing economic crimes. Bankruptcy fraud occurs with many other crimes and can be an easier violation to prove. The UST Program is developing a bankruptcy fraud training video. Contact the UST in your district to arrange a course that includes this video.

Prosecutors and law enforcement agents can benefit from an introduction to basic bankruptcy concepts. These courses have been popular around the country and may help prosecutors and investigators realize how often they encounter bankruptcy crimes, and how valuable knowing the basics of bankruptcy is. The course is intended to help prosecutors and investigators deal with bankruptcy investigations and prosecutions. Contact the UST in your district about presenting a program.

On another front, consider offering a training program for your district's Chapter 7 "panel" trustees on how to distinguish criminal from civil violations and what kind of cases they should report to the UST and USA. With the proper guidance, the panel trustees can provide valuable assistance to an agent or prosecutor.

## What Kinds of Cases Should You Prosecute?

There are many different philosophies and approaches regarding bankruptcy fraud prosecutions. One common stumbling block in bankruptcy fraud prosecution has been the mandatory minimum dollar loss guideline. Bankruptcy frauds come in all sizes, from the no-loss case to the multi-million dollar case. Setting an artificial loss cut-off may undermine true deterrence and enforcement efforts.

A significant problem in the bankruptcy courts is the high volume of small frauds that threaten to undermine the integrity of the entire bankruptcy system. Yet taking some small fraud cases is important. The bankruptcy community is usually small and insular, and word gets out that certain types of crimes are or are not prosecuted.

One technique for publicizing the prosecution of smaller cases is to batch them and announce them as a group. For example, a group of cases involving the use of a false Social Security number can be prosecuted together to highlight the problem of identity fraud. Similarly, you can combine small and large concealed asset cases to highlight the need to disclose all assets in bankruptcy.

Another way to make the most of limited resources is the "flip-flop" or "wobbler" approach. For smaller offenses, a pre-indictment offer of a misdemeanor plea can be made in exchange for forbearing to file a felony charge. Two statutes that lend themselves to misdemeanor pleas are 18 U.S.C. § 403, contempt, and 18 U.S.C. § 156, dismissal of a case for willful failure to follow rules. While the determination must always be made on a case-by-case basis, such a deal is an appropriate disposition in some circumstances.

## Two for the Price of One

Look for opportunities to combine bankruptcy fraud prosecutions with other violations. A white collar crime investigation is not complete until the investigator checks whether the subject has filed for bankruptcy. The bankruptcy schedules cannot only produce useful information for the

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investigation, but also provide evidence of non-bankruptcy crimes.

Often investment fraud and bank fraud are interwoven with bankruptcy fraud. Storefront “paralegal” services routinely combine bankruptcy fraud with immigration and credit repair fraud. Finally, bankruptcy fraud increasingly follows health care fraud. The additional losses, and the enhancements for bankruptcy fraud, can lead to additional jail time when bankruptcy fraud violations are added to existing criminal counts.

### **Conclusion**

Most people who file for bankruptcy are not only honest but in desperate need of the relief bankruptcy provides. Working together, we can preserve the system for the honest, but unfortunate, debtors and prosecute the creative white collar criminals. ~

### **ABOUT THE AUTHOR**

**Maureen Tighe** served as the Deputy Chief of the Major Frauds Section for the Central District of California before becoming United States Trustee for Region 16 (the Los Angeles area) in April 1998. At the USAO, she prosecuted more than 100 bankruptcy fraud cases. Before joining the USAO, she worked for two years as a litigation associate in Sullivan & Cromwell’s New York office. She graduated from Rutgers Law School in 1984. **a**

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## **Bankruptcy Fraud Warning Signs**

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- ' Concealment of assets
- ' Serial bankruptcy cases
- ' Failure to keep usual business records
- ' Incomplete or missing books and records
- ' Conduct well outside ordinary business or industry standards and practices
- ' Unusual depletion of assets shortly before the bankruptcy filing
- ' Recent departure of debtor's officers, directors, or general partners
- ' Unanswered questions or incomplete information on debtor's schedules and statement of financial affairs
- ' Frequent amendments to schedules, statements of financial affairs, and monthly operating reports
- ' Inconsistencies between recent financial statements, tax returns, and debtor's schedules and statements of financial affairs
- ' Absence of knowledgeable officers to testify at Section 345 meeting
- ' Inability to contact debtor's principals at debtor's stated location
- ' Frequent dealings in cash rather than recorded transactions
- ' Sudden depletion of inventory post-petition without plausible explanation
- ' Inflated salaries, payments of bonuses or cash withdrawals by officers, directors, shareholders, or other insiders
- ' Transfer of property to insiders, shareholders, and relatives shortly before bankruptcy
- ' Payoff of loans to directors, officers, shareholders, relatives, or other insiders shortly before filing
- ' Transactions with non-debtor subsidiaries, parent companies, or affiliated corporations owned by the same or related persons or entity
- ' A history of prior litigation or post-petition litigation involving breaches of contracts, fraud, misrepresentations, etc.
- ' Complicated corporate structures and relationships
- ' Creditor confusion concerning corporate structure
- ' Fire, theft, or loss prior to or after filing
- ' Failure to pay withholding and sales taxes
- ' Startup of a similar business near the time of the bankruptcy filing

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### **EOUST MANUAL AVAILABLE**

**The training manual for the Executive Office for United States Trustees is available to prosecutors and Department attorneys. You can obtain this Manual by visiting the EOUST web site at <http://www.usdoj.gov/UST>. Once you have reached the EOUST web site, look for the manual in the Freedom of Information Act section.**

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# Bankruptcy Crimes: Suggestions for Proving Intent

Dean Wyman, Senior Attorney-Advisor  
Office of the United States Trustee  
Cleveland, Ohio

Sections 152 and 157 of Title 18 delineate common bankruptcy crimes. Both sections require the government to prove intent. Under 11 U.S.C. § 152, the government must establish that the defendant acted “knowingly and fraudulently.” Similarly, the government must show specific intent to defraud under 18 U.S.C. § 157.

Bankruptcy law has its own terminology. Consequently, specialized lawyers practice in bankruptcy courts. Despite the jargon, many principles are simple. The underlying goal of bankruptcy is to give an honest debtor a fresh start under which his debts are modified or discharged. To accomplish this fresh start, the bankruptcy court requires the debtor to identify his assets, liabilities, and financial history. In a Chapter 7 case, the trustee takes charge of the debtor’s assets, sells them, and distributes the proceeds to creditors. In Chapter 13 cases, a standing trustee reviews assets to decide whether to recommend a repayment plan.

Typically, bankruptcy is a rapid practice where either side to a dispute rarely has the resources or the inclination for prolonged litigation. Most issues are negotiated to resolution under severe time and economic constraints. Often bankruptcy proceedings are abbreviated, with courts issuing rulings solely upon oral arguments and briefs. Bankruptcy courts and creditors rely upon the trust and veracity of bankruptcy lawyers and their clients. See *United States v. Ellis*, 50 F. 3d 419, 423 (7th Cir. 1995) (Bankruptcy process cannot function if debtors are dishonest about their credit history).

In exchange for the discharge of debts, debtors are expected to supply accurate information about their financial affairs. The most important

documents upon which courts and creditors rely are the petition, schedules, and statement of financial affairs. The purpose of these documents is to provide the debtor’s financial history. *In re McAllister*, 215 B.R. 217 (Bankr. N.D. Ala. 1996); *United States v. Stone*, 282 F. 2d 547 (2d Cir. 1960) (The purpose of a statement of financial affairs is to give dependable information). Statements made by debtors at meetings of creditors, conducted pursuant to 11 U.S.C. § 341, are also important. At these meetings, debtors are required to testify under oath about their financial affairs. Typically, the bankruptcy lawyer for the debtor will represent the debtor at these meetings. Unfortunately, some debtors do not tell the truth on documents or at the meeting of creditors. These false statements form the basis for many bankruptcy fraud prosecutions. The challenge, however, is to show that a debtor intended to commit bankruptcy crimes and to refute arguments that a debtor simply made a mistake.

## The Bankruptcy Environment

In 1997 approximately 1.4 million bankruptcy cases were filed throughout the United States. This represented an approximate increase of 19 percent from 1996, when around 1.18 million bankruptcy cases were filed. A petition, schedules, and statement of financial affairs accompany each of these filings. Debtors are required to use the official bankruptcy forms. These forms contain a declaration under the penalty of perjury in which the debtor states that the information contained in the documents is true and correct to the best of his knowledge. See Bankruptcy Rule 1008.

Often, however, debtors file amendments to correct or supplement their schedules. Under Bankruptcy Rule 1009, debtors have the unilateral right to amend their documents any time before the case is closed. Therefore, the bankruptcy rules

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contemplate that debtors may need to revise their schedules and statement of financial affairs. The notion that schedules are often inaccurate was endorsed by the National Bankruptcy Review Commission when it recommended that trustees should be directed to perform random audits of debtors' schedules to verify the accuracy of information. However, the commission concluded that "malfeasance is unlikely to be the cause of much of the alleged inaccuracy." NAT'L BANKR. REV. COMM'N FINAL REPORT, p. 108 (1997). Accordingly, imprecise and ambiguous financial reporting often marks the bankruptcy environment.

### Intent

The requirement that the government prove intent is rooted in federal criminal practice. *See Morissette v. United States*, 342 U.S. 246, 250 (1952). The rationale is that a jury should not convict a defendant unless the government proves that he made a choice "between good and evil." *Id.* An act is done knowingly when it "is done voluntarily and intentionally, not because of accident." *United States v. Smithson*, 49 F. 3d 138, 141 (5th Cir. 1995). Intent is an elusive concept and therefore courts uniformly permit the introduction of circumstantial evidence to establish intent. *See generally, The Reindeer*, 69 U.S. 383, 401, 17 L. Ed. 911, 2 Wall. 383 (1864) (Circumstances may be considered conclusive proof); *see also United States v. Grey*, 856 F. Supp. 1515, 1520 (D. Kan. 1994), *aff'd and rev'd on other grounds, United States v. Grey*, 56 F.3d 1219 (10th Cir. 1995) (Circumstantial evidence may be used to establish fraudulent intent to commit bankruptcy fraud).

One witness who may be important is the debtor's bankruptcy lawyer. Before issuing a subpoena for the debtor's attorney, prosecutors must obtain approval from Edgar N. Brown, Chief, Witness Immunity Unit of the Criminal Division. In bankruptcy cases, the attorney for the debtor ordinarily helps in the preparation of the petition, schedules, and statement of financial affairs. *See Matter of Olen*, 15 B.R. 750, 752 (Bankr. E.D. Mich. 1981). The bankruptcy attorney signs the petition as attorney of record and

in consumer cases certifies that he has explained to the debtor chapters of the bankruptcy code. *See* Official Form No. 1. The bankruptcy attorney typically explains to a debtor the bankruptcy forms and terminology. *See Columbus Bar Association v. Flanagan*, 77 Ohio St. 3d 381, 674 N.E. 2d 681 (1997). He also represents the debtor at the meeting of creditors. *In re Landis*, 2 B.R. 341, 342 (Bankr. S.D. Ohio 1980). Therefore, the bankruptcy attorney will usually confirm that the information placed on the schedules came directly from the debtor.

Still, there are limits to the testimony that prosecutors may elicit from bankruptcy counsel. The attorney-client privilege will not protect information debtors provide to counsel for purpose of "assembly into a bankruptcy petition and supporting schedules." *United States v. White*, 950 F.2d 426, 430 (7th Cir. 1991). However, the attorney-client privilege may bar any testimony from the attorney regarding any legal advice he gave to a debtor while preparing the petition and schedules. *United States v. Bauer*, 132 F. 3d 504, 508-09 (9th Cir. 1997).

### A. Secrecy and Deviousness

An underlying theme in bankruptcy is full disclosure. When transactions are hidden or deviously structured, a finding of intent is justified. *See United States v. Knight*, 336 U.S. 505 (1949). The case *United States v. Rauer*, 963 F.2d 1332, 1337 (10th Cir. 1992), illustrates a debtor who behaved deviously. In *Rauer*, an individual debtor deposited a cashier's check representing property of the estate into a bank account she had opened under an assumed name. The Court of Appeals ruled that the jury could have properly found that the debtor had engaged in fraudulent concealment because she falsely endorsed the cashier's check and further opened an account under a fictitious name.

A debtor may engage in duplicitous conduct before the bankruptcy case is filed. In *Metheany v. United States*, 390 F.2d 559 (9th Cir. 1968), a defendant was convicted of making false oaths in a bankruptcy case. At trial, he objected to the introduction of evidence which showed he issued

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checks pre-petition to fictitious payees. The Court of Appeals ruled that this evidence was properly admitted to establish the defendant's intent or motive to make false statements in the bankruptcy case.

Sometimes the debtor engages in devious behavior that is not difficult to unravel. In *United States v. Shaddock*, 112 F.3d 523 (1st Cir. 1997), the debtor held an undisclosed interest in a joint bank account. On the date of filing a joint petition, the debtor obtained funds from this joint bank account and purchased a bank check. During the next several months, the debtor continued to issue checks drawn upon the unscheduled account. At the meeting of creditors, the debtor did not correct her spouse when he denied the existence of the account. The Court of Appeals concluded that there was sufficient evidence of intent to conceal, especially considering the timing of the financial transactions affected by the debtor. *Shaddock*, 112 F.3d at 525.

The timing of transactions is a key to finding intent. In *United States v. Weichert*, 783 F.2d 23 (2d Cir. 1986), a business was operating under Chapter 11. A few weeks before the case was converted to Chapter 7, the debtor's principal orchestrated a scheme under which assets of the debtor were diverted to a newly formed entity with a name similar to the name of the debtor. The Court of Appeals concluded that the jury was entitled to infer intent to defraud from "the hurried formation" of the new entity and the diversion of assets "immediately prior to conversion" of the case to Chapter 7. *Weichert*, 783 F.2d at 25.

Another direct example of deceptive conduct was recounted in *United States v. Key*, 859 F.2d 1257 (7th Cir. 1988), where the debtor falsely stated the date on which she acquired corporate stock. At trial, witnesses testified that the debtor's husband instructed corporate employees to alter corporate records and to create new stock certificates with a false date. These witnesses also stated that the defendant "participated actively in the typing of the substitute corporation record book entries." *Key*, 859 F.2d at 1259. The debtor's signature and handwriting were found on these fabricated records. The Court of Appeals concluded that the testimony and documentary

evidence provided "overwhelming support" for the finding of intent to defraud. *Key*, 859 F.2d at 1260.

Proof that the debtor fabricated corporate records is an excellent indicator of intent. In *United States v. Center*, 853 F.2d 568 (7th Cir. 1988), an attorney was convicted of bankruptcy fraud. He acted as counsel for a Chapter 11, corporate debtor and prepared the bankruptcy schedules. More than a year after the case was filed, the attorney learned that the debtor omitted an asset in the form of a debt owed to it. Rather than amending the schedules, the attorney directed the backdating of corporate records to show that a post-petition set-off extinguished this omitted asset. The Court of Appeals affirmed the conviction, noting that the attorney knew "the transaction was legally impossible and that the entry reflected a legally invalid transaction." *Center*, 853 F.2d at 570.

#### B. Pre-petition Financial Statements

Debtors ordinarily seek protection in the bankruptcy court because they are experiencing financial distress. Often debtors prepare financial statements as a routine practice during the years and months before a bankruptcy case is filed. These statements may track the onset and direction of financial difficulties. The analysis of these statements is relevant to prove intent to defraud. In *United States v. West*, 22 F.3d 586, 595 (5th Cir. 1994), the Court Appeals ruled those pre-petition financial statements were properly admitted to establish intent:

[T]he financial statements prepared on West's behalf indicate that West's net worth fell dramatically after 1985. Because the deterioration of West's financial situation bears strongly on both his incentive and need to seek bankruptcy protection, such evidence is relevant . . . to West's motive for hiding assets . . . .

Consequently, a review of pre-petition financial statements may provide clues to the debtor's intent to defraud.

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C. *Examination and Comparison of the Bankruptcy Schedules*

A debtor is required to list all of his assets on his bankruptcy schedules. Review these schedules for indicators of the debtor's intent to commit bankruptcy fraud. In *United States v. Shapiro*, 101 F.2d 375 (7th Cir. 1939), the debtor filed schedules which listed only one asset, an account receivable with a value of \$500. These schedules did not reflect the debtor's tangible assets. The Court of Appeals concluded that the omission of these assets was not due to mistake or inadvertence. Rather, the Court of Appeals stated that the "size of the omissions indicated a criminal purpose." *Shapiro*, 101 F.2d at 379.

A comparison of the items that the debtor includes in the petition with the items that the debtor omits from the petition presents further evidence of intent. In *United States v. Lindholm*, 24 F.3d 1078 (9th Cir. 1994), the debtor filed a series of bankruptcy petitions, with the goal of invoking the automatic stay. In one filing, the debtor stated that he had only filed one prior case. After conviction, the debtor appealed and contended that there was insufficient evidence of intent. The Court of Appeals rejected this argument on several grounds, and concluded that the defendant:

[M]ade false statements by selectively listing one previously filed petition and actively omitting to mention the other petitions previously filed.

*Lindholm*, 24 F.3d at 1085.

The effectiveness of establishing a false oath by comparing assets the debtor stated he owned to those he failed to schedule was discussed in *United States v. Diorio*, 451 F.2d 21 (2d Cir. 1971). There, the debtor denied under oath that he held an interest in a defunct corporation. The debtor argued that the corporation was defunct and, as a result, he had a loss of memory of this corporation. However, he did list another defunct corporation in his "Statement of Affairs." The Court of Appeals concluded that the debtor's listing of the second

defunct company showed "a clear awareness on his part of the necessity of listing defunct corporations." *United States v. Diorio*, 451 F. 2d at 23.

Another approach to proving intent is to focus upon repeated omissions in the bankruptcy schedules. In *United States v. Cluck*, 143 F.3d 174 (5th Cir. 1998), a debtor was convicted of several counts of bankruptcy fraud. The gravamen of the allegations was that the debtor concealed assets, including accounts receivable and business receipts. The debtor argued that he lacked criminal intent and that he was only careless in completing the bankruptcy schedules. The Court of Appeals rejected this argument:

In this case, it is manifestly clear that Cluck's repeated omissions and history of coincidental and questionable transfers formed just the sort of "circumstances" that the Supreme Court had in mind in the *Reindeer* case.

*Cluck*, 143 F.3d at 179-180.

D. *The Recantation Argument*

When confronted with a false oath of evidence of concealment, a debtor will often amend his schedules and then claim he merely made a mistake.

The general rule is that recantation does not alone cure a false oath. As stated by the Supreme Court when it affirmed a perjury conviction:

The plain words of the statute and the public policy which called for its enactment alike demand we should hold that the telling of a deliberate lie by a witness completes the crime defined by law.

*United States v. Norris*, 300 U.S. 564, 576 (1937). However, the Supreme Court observed that a recantation may impact upon the finding of intent:

This is not to say that the correction of an innocent mistake, or the elaboration of an

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incomplete answer, may not demonstrate that there was no willful intent to swear falsely.

*Id.* at 576.

This general principle was applied in *United States v. Diovio*, 451 F.2d 21 (2d Cir. 1971). There, the Court of Appeals ruled that a jury charge covering recantation was proper when it distinguished between whether an honest discovery of an earlier mistake, or the “realization that the jig was up and that the falsity had already been uncovered or was about to be uncovered by others.” *Diovio*, 451 F.2d at 23.

Therefore, a review should be made of the circumstances surrounding the amendments to schedules. If the debtor amends schedules early in the case before he is examined at a meeting of creditors, the recantation may have validity. However, amendments filed later in the case should be scrutinized.

#### E. Direct Knowledge of Debtor

A debtor is not a passive observer of his bankruptcy case. At each stage of a case, he receives information about the rules he must follow. At the meeting of creditors, a trustee examines the debtor. Before the examination begins, the trustee gives the debtor a copy of an information sheet prepared by the United States Trustee. This sheet states in part: *It is important to list all your property and debts in your bankruptcy schedules.*

Other times, the trustee or her counsel will remind the debtor of his obligations. In *United States v. Grant*, 971 F.2d 799 (5th Cir. 1992), a debtor was convicted of concealing artwork in a bankruptcy case. The Court of Appeals affirmed that conviction and concluded that the debtor knew that he was without authority to take artwork belonging to the estate. The Court of Appeals highlighted that trustee’s counsel had informed the debtor of the “legal consequences of the Chapter 7 conversion” including the right of the trustee to take possession of assets. *Grant*, 971 F.2d at 808.

The bankruptcy court may also impart knowledge of the bankruptcy requirements to a

debtor. In *United States v. Christner*, 66 F.3d 922 (8th Cir. 1995), a debtor was convicted of concealing assets in a bankruptcy case. On appeal he argued that there was insufficient evidence of his intent. The Court of Appeals affirmed and recited that the bankruptcy court had “informed the defendant that the Bank has a right to know the location of its collateral.” *Christner*, 66 F.3d at 926. Instead of following the directive of the court, the debtor sold the collateral and diverted the proceeds.

The personal characteristics of the debtor may also influence the determination of intent. In *United States v. White*, 879 F.2d 1509 (7th Cir. 1988), a husband and wife were convicted of bankruptcy fraud. On appeal, the wife’s conviction was reversed and the case against the husband was remanded. However, the Court of Appeals found that the husband had sufficient knowledge of the bankruptcy requirements:

He was an experienced businessman who handled all the financial affairs of his household. It was not a case of a single oversight.

*White*, 879 F.2d at 1511.

#### Conclusion

Proof of intent is fact-specific. However, courts have reviewed circumstances that support a finding of intent to support bankruptcy fraud convictions. These patterns provide a template that may be used to establish intent. Transactions hidden by debtors show intent to defraud. Triggers for the finding of intent could be the formation of new businesses directly before the bankruptcy filing or the more pedestrian fabrication of records.

The documents filed by the debtor in the bankruptcy case are another source of evidence with which to establish intent. Often a comparison of the assets listed on the debtor’s schedules with the assets the debtor failed to list will point to intent to defraud. If the debtor has filed amendments to his schedules, prosecutors should examine the timing and completeness of these amendments.

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The bankruptcy proceedings should also be reviewed. The panel trustee will usually inform the debtor of the requirements to list all assets. Other times the court may comment to the debtor. A review of the transcripts of the meeting of creditors or court hearings may be helpful. These transcripts could provide support for the view that the debtor knew about the requirements of the Bankruptcy Code. ~

#### **ABOUT THE AUTHOR**

**Dean P. Wyman** is the Senior Attorney-Advisor with the United States Trustee's office in Cleveland, Ohio. He is also the Regional Criminal Referral Coordinator for Region 9 and a Special Assistant United States Attorney. He received his undergraduate degree from Miami University of Oxford, Ohio; his law degree from the University of Toledo College of Law; and his Masters in Business Administration from the Weatherhead School of Management of Case-Western Reserve University. He is the author of several bankruptcy articles, including "A 707(b) Sampler," which appeared in the May 1994 issue of *Norton's Bankruptcy Law Adviser*, and "May I Have My Balance Please? Allocation of Payments In Bankruptcy Cases," which appeared in the *Commercial Law Journal*, Summer 1995 edition. He is Vice-President of the Northern District of Ohio Chapter of the Federal Bar Association and a member of the Cleveland Bar Association and the American Bankruptcy Institute. a

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# Flight and Fugitive Issues in Bankruptcy Fraud Cases

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Recent experiences in the Central District of California suggest that individuals who conceal assets will often try to conceal themselves as well. Consider, for example, the case of Robert Masket, a Southern California businessman who commenced Chapter 11 proceedings after a divorce decree required him to pay over \$2 million to his former wife. Masket's bankruptcy schedules identified several income-producing properties, but only scanty liquid assets. Amidst rumors of a concealed Swiss account, Masket refused to produce his books and records to his bankruptcy trustee. After the bankruptcy court issued a contempt order, Masket sailed his luxury fishing boat to Mexico and was apprehended only six months after Mexico's issuance of the provisional arrest warrant, as requested by the United States Attorney's office.

In another case, Dan Young, the former CEO of a for-profit hospital chain, was charged with bankruptcy fraud and money laundering in October 1997. When civil proceedings against him reached their peak, Young vanished, leaving one Mercedes at his residence and another at the airport. Young remains at large and is thought to be in China.

In other bankruptcy fraud cases, defendants who have remained in the country have eluded arrest by simply using multiple names and moving frequently. Others have vanished *after* entering guilty pleas. Recently, one bankruptcy fraud defendant failed to report for a 15-month sentence and two other bankruptcy fraud defendants failed to report for "split" sentences. Another defendant, Michael Knighton, failed to appear at a sentencing hearing in which the Probation Office had recommended a 24-month sentence. Although Knighton was ultimately apprehended, he remained

at large for several months and committed another fraud scheme while in flight. All but one of these individuals had *no* criminal history.

Although it is impossible to say, definitively, why so many bankruptcy fraud defendants flee, certain hypotheses come to mind. The most common form of bankruptcy fraud, concealment of assets under 18 U.S.C. § 152(1), is, by definition, a crime of "hiding." For an individual who hides an offshore account or a secret corporation, the concept of hiding himself may not be such a great mental leap. In addition, people who commit bankruptcy fraud are frequently in the midst of failed or failing relationships. Individuals who file bankruptcy frequently do so in response to a divorce decree, the dissolution of a financial partnership, or the demise of a business plan. These events are certainly of a character to weaken one's "community ties." Smaller scale bankruptcy fraud defendants are also frequently engaged in crimes of "hiding" and breaking community ties. One of the individuals who failed to report for his "split sentence," for example, had engaged in a scheme of living "rent-free" by signing a series of lease agreements under false names and false social security numbers.

The end result in these and other cases is that justice is delayed and too often completely denied. In many instances, agents and AUSAs are forced to devote precious resources to tracking down convicted individuals.

## What Can Be Done to Prevent Flight in Bankruptcy Fraud Cases?

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One cannot assume that a first-time offender who is facing a “light” sentence does not pose a flight risk. AUSAs prosecuting bankruptcy fraud should carefully consider what bond, if any, is appropriate given the defendant’s full circumstances. In this regard, AUSAs should direct case agents investigating bankruptcy fraud to investigate the extent to which the target poses a flight risk. In particular, the following areas should be explored:

- ‘ How long has the target lived in his/her neighborhood? Does s/he rent or own? Is s/he current on the rent/mortgage?
- ‘ How many times has the target moved in the last ten years?
- ‘ Is the target working? How long has s/he been at the current job?
- ‘ Is the target speaking to his/her parents? (Many are not and Pretrial Services sometimes recommends a signature bond because “the defendant was born here and his whole family lives here.”)
- ‘ Is the target married? Happily married? If the target is in divorce court (many bankruptcy fraud targets are), find out from the lawyer on the other side whether or not the target has made all court appearances and whether or not the target has cooperated with efforts to take his deposition, participate in “meet and confer” sessions, etc. Find out also who has child custody and how often the target sees his children. (Again, if Pretrial Services opines a defendant won’t flee because his/her children are in the district, find out whether or not s/he has visited the children in the last year or so.) Is the target current on alimony and child support obligations?
- ‘ The above comments also apply to a target involved in any other civil proceedings.
- ‘ Verify the target’s citizenship. If the target is a naturalized citizen, consider the

possibility that s/he may have more than a passport.

- ‘ Do the target’s travels suggest s/he has foreign assets or foreign residences? (e.g., a target who spends summers in Acapulco may have a Mexican bank account and a furnished residence that his creditors have not yet managed to seize.)

In any case involving substantial losses, an AUSA should consider seeking a third-party bond with a justified affidavit of surety and deeding of property. In a case involving both substantial losses and serious risk of flight, an AUSA should consider seeking detention.

Plea agreements should also advise the defendant that the government will only recommend a credit for “acceptance of responsibility” if the defendant demonstrates such acceptance by virtue of his or her conduct and complies with all of the terms of his or her bond.

### **Remedies After a Defendant Flees**

#### *Forfeiture of Bond*

If a defendant flees after the initial appearance but before sentencing, the AUSA should seek revocation of the conditions of bond, forfeiture of bail, and final judgment against the surety, if any. Federal Rule of Criminal Procedure 46 sets forth the procedure for forfeiture and provides that if there is a breach of condition of a bond, the district court “shall” declare a forfeiture. Fed. R. Crim. P. 46(e)(1). The court has wide discretion, however, to set aside a forfeiture if a defendant is subsequently surrendered or if it otherwise appears that justice does not require such a forfeiture. Fed. R. Crim. P. 46(e)(2). Interpreting the rule, appellate decisions have found that while forfeiture is “mandatory,” the district court has wide discretion in determining whether or not to grant relief from the forfeiture. *See, e.g., United States v. Stanley*, 601 F.2d 380, 381 (9th Cir. 1979).

#### *Multiple Sentencing Enhancements*

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A defendant who flees following a release on bond should be denied any point reduction for acceptance of responsibility pursuant to U.S.S.G. § 3E1.1 and should receive an enhancement for obstruction of justice pursuant to U.S.S.G. § 3C1.1. Both of these sentencing adjustments are applicable in cases where a defendant has fled, and the adjustments should ordinarily be made even if the defendant previously entered a guilty plea. Application Note 3(e) to U.S.S.G. § 3B1.1 provides unambiguously that the obstruction enhancement is applicable where a defendant “escape[s] or attempt[s] to escape . . . or willfully fail[s] to appear, as ordered, for a judicial proceeding.” Application Note 4 to U.S.S.G. § 3E1.1 provides that “conduct resulting in an enhancement under § 3C1.1 . . . ordinarily indicates that the defendant has not accepted responsibility for his criminal conduct.” In instances of flight following a guilty plea, appellate courts have affirmed district court rulings denying the point credit for acceptance of responsibility and assessing the additional enhancement for obstruction. *See, e.g., United States v. Loeb*, 45 F.3d 719, 721 (2d Cir. 1995) (“It is well-established that by willfully failing to appear for sentencing, a defendant fails to accept responsibility for the offense, regardless of whether there was a plea agreement stipulating credit for the adjustment.”). The *Loeb* decision also noted, “intentional flight from a judicial proceeding is grounds not only for a sentencing court to deny an adjustment for acceptance of responsibility, but also for the court to impose an offense level enhancement for obstruction of justice.” *Id.*; accord *United States v. Thompson*, 80 F.3d 368, 369 (9th Cir. 1996) and cases collected therein (obstruction enhancement and denial of acceptance credit proper for defendant who flees following a guilty plea).

In instances where a defendant flees and engages in further fraud schemes while on bond, AUSAs should also consider seeking an upward departure on the ground that the defendant’s criminal history category is understated. U.S.S.G. § 4A1.3 specifically endorses upward departures where a defendant’s criminal history category “does not adequately reflect the seriousness of the

defendant’s past criminal conduct or the likelihood that the defendant will commit other crimes.” As the Ninth Circuit found in *United States v. Segura-del Real*, 83 F.3d 275, 277 (9th Cir. 1996), in determining whether a defendant’s criminal history category adequately reflects the seriousness of his past conduct or likelihood of recidivism, this court may consider the defendant’s repetition of the same or similar offenses, and may base an upward departure on this circumstance: “[t]he recidivist’s relapse into the same criminal behavior demonstrates his lack of recognition of the gravity of his original wrong, entails greater culpability for the offense with which he is currently charged, and suggests an increased likelihood that the offense will be repeated.” *Id.*, quoting *United States v. Chavez-Botello*, 905 F.2d 279, 281 (9th Cir. 1990). A defendant’s post-conviction conduct may also be properly considered as justification for an upward departure of his criminal history category. *United States v. Myers*, 41 F.3d 531, 533 (9th Cir. 1994).

Application of these multiple sentencing enhancements may dramatically impact the sentence a defendant ultimately receives. In the case of Michael Knighton, for example, the defendant’s sentencing range prior to his flight was 24-30 months. Consistent with the foregoing authorities, the district court denied Knighton the credit for acceptance of responsibility, assessed a 2-point enhancement for obstruction, and also enhanced Knighton’s criminal history by one category. Knighton’s resulting sentencing range was 51-63 months, and the court found the maximum sentence was appropriate. Thus, the defendant more than doubled his sentence by fleeing the jurisdiction and engaging in a further fraud scheme while on bond.

### **Indictment for Flight**

In some instances—particularly when a defendant has already been sentenced and then fails to report to serve that sentence—AUSAs may be well-advised to consider indicting a defendant for

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flight. A defendant's failure to appear before a court following release on bond or failure to report to serve a sentence is a violation of 18 U.S.C. § 3146. The penalty for a violation of § 3146, as set forth in § 3146 (b)(i)-(iv), is tied to the maximum penalty for the underlying case from which the defendant fled. In the case of bankruptcy fraud, for which the maximum penalty is five years, the maximum penalty for flight or failure to appear is also five years. 18 U.S.C. § 3146(b)(ii). Notably, any prison sentence for violation of § 3146 must be *consecutive* to any other prison sentence. 18 U.S.C. § 3146(b)(2). The applicable sentencing guideline, U.S.S.G. § 2J1.6, also ties the penalty to the maximum sentence for the underlying offense. In the case of a failure to appear (or report for service of sentence) in a bankruptcy fraud case, a defendant's combined offense level is 17. U.S.S.G. §§ 2J1.6(a)(2) and (2)(B).

Notably, the statute provides that circumstances beyond a defendant's control constitute an affirmative defense. 18 U.S.C. § 3146(c). The sentencing guidelines also provide for a 5-level downward adjustment where a defendant voluntarily surrenders within 96 hours of the time s/he was originally scheduled to report. *See* U.S.S.G. § 2J1.6(b)(1)(A).

### **Limitations on Use of the Grand Jury**

AUSAs should familiarize themselves with the *United States Attorneys' Manual (USAM)* provisions regarding use of the grand jury to locate a fugitive. Section 9-11.120 of the *USAM* provides, "[i]t is improper to utilize the grand jury solely as an investigative aid in the search for a fugitive in whose testimony the grand jury has no interest." However, if the grand jury has a legitimate interest in the testimony of a fugitive, it may subpoena other witnesses and records in an effort to locate the fugitive. *Id.* The *USAM* further provides, "[i]f the present whereabouts of a fugitive is related to a legitimate grand jury investigation of offenses such as harboring, 18 U.S.C. §§ 1071, 1072, 1381, misprision of felony, 18 U.S.C. § 4, accessory after the fact, 18 U.S.C. § 3, escape from custody, 18 U.S.C. §§ 751 and 752, or failure to appear, 18 U.S.C.

§ 3146, the grand jury properly may inquire as to the fugitive's whereabouts." Section 9-11.120 of the *USAM* goes on to state, "unless such collateral interests are present, the grand jury should not be employed in locating fugitives in bail-jumping and escape cases since, as a rule, those offenses relate to the circumstances of defendant's disappearance rather than his or her current whereabouts."

### **Conclusion**

The recent experiences of the Central District suggest that bankruptcy fraud defendants may pose elevated risks of flight. Agents investigating bankruptcy fraud subjects should be alert to an individual's ruptured community ties, overseas assets, and other factors suggesting risk of flight. AUSAs prosecuting bankruptcy fraud should be mindful that an individual who is facing a "light" sentence and has no criminal history may, nevertheless, be subject to other circumstances increasing risk of flight. Although detention is only rarely appropriate in bankruptcy fraud cases, third party secured bonds (with deeding of property) should always be considered and plea agreements should reserve the government's right to seek appropriate adjustments to a defendant's offense level in the event s/he violates the terms of a bond. A defendant who does flee should be assessed multiple sentencing enhancements and may also be a worthy candidate for another prosecution. ~

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## ABOUT THE AUTHOR

' **Angela Davis** has been practicing in the area of bankruptcy, corporate and banking litigation, and financial fraud since 1986. She has been with the Department of Justice since 1993, and currently serves as an Assistant United States Attorney and Coordinator of the Bankruptcy Fraud Task Force for the Central District of California. She has taught at various DOJ programs, including the OLE program on advanced bankruptcy. Recently, she received a Director's Award from the Executive Office for United States Trustees. a

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# Many Hands Make Light Work—A Bankruptcy Fraud Concealment Case

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Last year, I received a phone call from a panel bankruptcy trustee, who told me that he was working on a Chapter 7 personal bankruptcy in which creditors were told that there appeared to be no assets for distribution. He also told me that he just received a call from the debtor's daughter, who told him that the debtor had more than \$100,000 in cash hidden in a safe and that the debtor had transferred other real and personal property to others. The panel trustee also told me that he called the United States Trustee (UST). The panel trustee's referral to me was consistent with his duties under 18 U.S.C. § 3057 and 28 U.S.C. § 586.

There is an identity of interests in a criminal proceeding and a bankruptcy proceeding when fraudulently concealed assets are at issue. This is because fraud victims are frequently bankruptcy creditors, and the goal of finding the concealed assets and distributing them to the victim-creditors is shared. This identity of interests poses unique

opportunities for cooperation and assistance during all phases of the case.

Shortly after speaking with the panel trustee, we assembled a team consisting of the panel trustee, an Assistant United States Trustee (AUST), and an FBI agent. The trustees brought a copy of the bankruptcy schedules and the tape of the 341 First Meeting of Creditors. The bankruptcy schedules revealed that the debtor claimed to have only \$525.00 in assets. The schedules also contained several entries that corroborated the daughter's story. For example, the debtor scheduled more than \$167,000 in liabilities, consisting entirely of credit card debt from approximately 33 different credit cards. He also claimed that he did not pay rent for the home in which he was living, and claimed it belonged to his sister. At his 341 Meeting, the debtor stated that he had no other assets and had made no transfers.

The Chapter 7 trustee's powers included seeking a turnover order from the bankruptcy court, or injunctive relief under 11 U.S.C. § 105 and Bankruptcy Rule 7065. The trustee could also seek an order permitting him to enter and secure the debtor's residence with security guards. However, each of these options posed

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problems. Most bankruptcy judges would hesitate to grant a temporary restraining order, or what would amount to a search and seizure based solely on the daughter's word, without notice to the debtor. Any notice would give the debtor time to hide the cash. Moreover, entering the premises posed security risks to the trustee and could prove costly to the bankruptcy estate.

We elected to seek a search warrant for the debtor's residence because it was the safest and most expeditious means of discovering and securing the evidence and assets. In a telephone interview, the debtor's daughter told us that the debtor visited her and told her that he had more than \$100,000 in cash hidden in a large safe located inside his home. He also told her that he had transferred some real property into her name. After arguing about the propriety of his actions, the debtor left. The daughter called the trustee shortly after that.

The debtor's daughter told us that she had seen a large, free-standing, 1000-pound vault in her father's kitchen, which contained approximately \$50,000 in cash and several firearms. She also saw many tools and equipment and a Buick Regal automobile that her father "babied." In previous conversations, her father told her that when he began having some legal problems a year or two ago, he transferred the car to a relative, and the title to the home to his sister in Florida.

With the help of the AUST and the panel trustee, we assembled the public records regarding the transferred assets by the next day that corroborated the transfers. These showed that the debtor owned the home in which he had been living, but transferred it to his sister in Florida over a year ago, for no consideration. The records confirmed that within one year of the filing of the bankruptcy, the debtor purchased real property and retitled it in the daughter's name. Lending credence to the daughter's story that this was done without her knowledge or consent, the title records showed that the grantee had not signed the deed, the address listed was the debtor's home address, and the tax bills were also sent to the debtor's home address. Because we used the grand jury only to obtain certain bank records, we shared most of our information freely.

The court determined that there was probable cause to search the debtor's home and issued a search warrant. During the execution of the search warrant, we found the house and garage filled with furniture and other items, which still bore price tags. We also found the Buick Regal and many documents evidencing the debtor's illicit property transfers. Finally, we found the vault, which contained more than \$120,000 in cash and 14 firearms.

We quickly indicted the debtor on one count of bankruptcy fraud (a false statement), but continued to investigate the unlawful transfers. We also learned that the debtor had a previous conviction for felony assault, leading to a felon in possession of a firearm charge. The Chapter 7 bankruptcy trustee filed adversary proceedings in the bankruptcy court, including proceedings against the third-party transferees.

We needed to decide how to proceed with respect to the seized assets and the property in the hands of third-parties. We again had a shared aim of returning the assets to the victims/creditors. We decided that the assembly, liquidation, and distribution of the real and personal property was best handled by the bankruptcy trustee. If the debtor/defendant would not cooperate, it could be done through a turnover order in the bankruptcy court or through criminal forfeiture. A turnover order would clearly be the most expeditious, but we would also need to preserve the evidence for any future criminal trial. While criminal forfeiture was an option, the bankruptcy trustee was attempting to obtain the agreement of each of the third-party transferees to turn over the assets.

The debtor pled guilty to a superseding Information charging him with two counts of bankruptcy fraud (concealment and false statements) and one count of being a felon in possession of a firearm. In the stipulation and plea agreement, the debtor admitted the concealment and transfers in contemplation of bankruptcy and agreed to relinquish any interest he had in the property. The debtor also agreed to pay full restitution for his bankruptcy liabilities.

Rather than administer the restitution through the criminal case, we found it more expeditious to rely on the bankruptcy process. In the plea

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agreement, the debtor agreed to cooperate with the United States Attorney and the bankruptcy trustee to identify all assets at the time of filing, turn over all assets other than the firearms to the bankruptcy trustee, and use his best efforts to have third-parties turn over any transferred assets. The firearms would be destroyed or, at the option of the United States Attorney, turned over to the bankruptcy trustee. The plea agreement stated that the trustee would administer the assets. The bankruptcy trustee would liquidate the assets, identify the creditors and report to the criminal court regarding the amount received by the victims/creditors. The defendant agreed that the *net* amount received by the trustee from liquidating the concealed assets would be credited toward his restitution obligation. To help maximize the recovery, the Chapter 7 trustee agreed to reduce his normal fee.

By the date of the sentencing, the bankruptcy trustee was close to completing the liquidation of the concealed assets. The debtor was sentenced to 57 months' imprisonment (the high end of the Sentencing Guideline range) and ordered to pay restitution in the full amount of his bankruptcy liabilities. ~

#### ABOUT THE AUTHOR

**Audrey Fleissig** has served as an Assistant United States Attorney for the Eastern District of Missouri since 1991. She is the bankruptcy fraud referral coordinator for her district and handles white collar crime cases. Before joining the United States Attorney's office, she was a partner with a St. Louis law firm, specializing in financial litigation. She graduated from Washington University School of Law in 1980 and currently serves as an adjunct professor in Trial Advocacy. [a](#)

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## Tracking Down a Trailer Bustout

*Joseph F. McGonigal, Attorney-Advisor  
United States Trustee Program  
Indianapolis, Indiana*

**T**he bustout co-conspirator wanted to talk in a bar. So, on a Friday afternoon in March 1993, the Chapter 7 case trustee and I picked him up and drove to a bar in Indianapolis. Anthony Cummings had been participating in a bustout scheme involving Quality Mark Manufacturing, Inc. (QMI) for the past several months. He and his partner, however, had a falling out over the distribution of the anticipated proceeds. QMI filed for Chapter 7 relief in January. Earlier that Friday, Cummings had approached the Chapter 7 trustee, stating that he wanted to explain his role in concealing assets belonging to QMI's bankruptcy estate.

At the bar, I told Cummings that we could not give him immunity or special treatment for disclosing incriminating information. Nonetheless,

Cummings told us that for many years he and another person involved in QMI had been creating businesses to bust out with the assets. He admitted that they had recently formed QMI's "successor" company, Trailer Marketing Inc. (TMI), to use QMI's assets at the expense of QMI's creditors. Cummings said QMI funds were used to renovate TMI's facility, and QMI assets were transported from QMI's plant to TMI property.

In February, Cummings, his QMI business associate, and QMI shareholder and legal counsel Andrew Mittower developed a plan to throw the Chapter 7 trustee off the trail of TMI operations in Salt Lake City, Utah. They decided to bring QMI assets to a storage facility in Elkhart, Indiana, and then placed an "anonymous" call to Mittower disclosing the assets' location. Mittower later falsely testified to the bankruptcy court that he received an anonymous call leading him to the assets.

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Cummings said TMI's Salt Lake City operation used QMI funds to pay startup expenses and to pay certain QMI creditors to obtain a good credit record, which would help TMI buy materials, build trailers, default on payments to creditors, and create another trailer company—in other words, to carry out another bustout scheme.

## Background

In the typical bustout, the perpetrator buys goods, sets up a business, sells the goods for cash, pockets the money, and then liquidates the business without paying suppliers and other creditors. Bustouts are often sequential, with the perpetrator folding up one business and immediately starting another one in another location—far from the original unpaid creditors.

Here is the background to Cummings' bustout story. QMI manufactured trailers, with business offices in Indianapolis and plants in Elkhart, Indiana, and Salt Lake City. Late in 1992, Mittower and other QMI officials devised a scheme to form TMI, transfer the assets of QMI to TMI, and close down QMI operations without paying creditors. Accordingly, QMI purchased large amounts of manufacturing equipment and supplies on credit. Cummings rented five large Ryder trucks and hired drivers. All of the QMI assets were transported from the Elkhart plant to the TMI facility in Bargersville, Indiana. Mittower prepared several documents relating to TMI's incorporation, TMI's alleged purchase of QMI assets, and TMI's purchase of the Bargersville facility.

On Friday, January 8, 1993, QMI creditors in Utah obtained a pre-judgment writ of attachment against certain Utah assets. Mittower suggested that, to avoid the writ, QMI file a bankruptcy petition in Indianapolis. The following Monday, he filed a Chapter 7 petition for the company.

QMI's creditors contacted the Chapter 7 trustee, who moved for turnover of assets and sought to have Mittower examined under oath. In the resulting deposition, Mittower lied about the false signatures, the concealed assets, and other matters. The group's subsequent attempts to get the trustee "off their back" led to the anonymous

call scheme, which was followed by several more instances of false testimony by Mittower.

Cummings' information led to Mittower's indictment and subsequent guilty plea on charges of bankruptcy fraud and perjury. On January 15, 1999, the District Court for the Southern District of Indiana sentenced Mittower to 33 months' imprisonment and ordered him to pay more than \$150,000 in restitution. In addition, Mittower resigned from the practice of law in July 1997.

Cummings plead guilty to one count of perjury in January 1998. He was sentenced in July 1998 to three years probation, including four months home detention.

## Developing the Case

Here, the United States Trustee's office (USTO) provided assistance to the United States Attorney (USA) in many ways, including:

- ' Participating at an early stage in a bankruptcy court hearing where witnesses gave material responses supporting a charge under 18 U.S.C. § 152.
- ' Interviewing co-conspirator Cummings, which led to the discovery of QMI assets.
- ' Conducting an on-site visit with the trustee, trustee's counsel, and local law enforcement to find concealed assets.
- ' Summarizing extensive transcripts of court hearings and the Bankruptcy Rule 2004 examination, and providing an index of actual and contradictory testimony.
- ' Participating in a preliminary interview of Mittower with the Assistant United States Attorney (AUSA) and the Federal Bureau of Investigation Special Agent, and a detailed debriefing of Mittower with the Special Agent.
- ' Participating in strategy meetings with the AUSA regarding the theory and direction of the case.

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' Helping the AUSA and the probation officer in determining the appropriate sentence under the Sentencing Guidelines, considering factors such as the loss, the existence of more than minimal planning, and violation of judicial process.

' Locating and coordinating evidence and exhibits such as bankruptcy pleadings, trustee final reports, a videotape of the site visit, and transcripts of the Section 341 meeting and the Rule 2004 examination.

While the USTO did not do so here, program personnel have served as government witnesses to explain the bankruptcy process to a jury or grand jury. Because our duties under 28 U.S.C. § 586 include attending Section 341 meetings, Rule 2004 examinations, and adversary proceeding, the USTs can help AUSAs by identifying conflicting and false statements made under oath. In addition, AUSAs and other law enforcement agents should consider contacting us when investigating any fraudulent behavior, because the targeted individual may have filed for bankruptcy somewhere in the country. Even if the target did not fill out all bankruptcy documents truthfully, bankruptcy schedules frequently contain a wealth of information because they identify the target's assets and potential victims of the underlying fraud. (Such exchanges of information among law enforcement agencies are already the norm in districts with Bankruptcy Fraud Task Forces; Region 10 has three task forces, in the Northern and Southern Districts of Indiana and the Southern District of Illinois.)

Case trustees and their attorneys can also provide crucial assistance in bankruptcy fraud prosecutions. Significant credit in breaking this case should go to the Chapter 7 trustee, and particularly to his counsel, who doggedly pursued QMI's assets after being contacted by the company's creditors. Their knowledge proved helpful to the development of the case.

## Conclusion

In the QMI case, using the combined skills and experience of the United States Attorney's office, USTO, FBI, Chapter 7 trustee, and trustee's counsel, we succeeded in identifying the bankruptcy fraud, preventing future bustouts, and bringing an unethical attorney to justice. The UST Program can offer the same kind of assistance to your office in many bankruptcy fraud cases. ~

## ABOUT THE AUTHOR

' **Joseph F. McGonigal** is an Attorney-Advisor for the United States Trustee's office in Indianapolis, and is designated a Special Assistant United States Attorney for the Southern District of Indiana. Before he joined the United States Trustee Program in 1988, he was an FBI Special Agent specializing in white collar crime and public corruption. He received his law degree from Indiana University Law School in 1992. a

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# Environmental Issues in Bankruptcy Cases: Protecting the Public Interest from Overzealous Debtors

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Reconciling the conflicting goals of environmental and bankruptcy law is a difficult process. Environmental laws like Superfund (the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA"), 42 U.S.C. § 9601 *et seq.*) provide a comprehensive framework for both immediate and long-term solutions to serious environmental and public health issues. They seek to hold companies accountable for what they have done in the past. However, many contaminated sites throughout the country, that do not qualify for the highest priority under the National Priority List, 42 U.S.C. § 9605, are not presently addressed through the Federal Superfund process. State governments or private parties may be initiating cleanup activities at such sites. Also, for some sites, no one may be addressing contamination problems because businesses have ignored or are unaware of the problems, and they have not come to the attention of the government. In the future, the clean up of these sites may fall to the United States.

Bankruptcy, in contrast, focuses on giving debtors an immediate fresh start free from its past problems. The idea underlying the Bankruptcy Code is to permit all of the debtor's creditors to share in the debtor's current assets in return for giving the debtor a fresh start. A fresh start may even maximize the value of the debtor's assets for the benefit of existing creditors, including the government. The tension between a statute that seeks to hold companies liable for their past actions, and one that seeks to give them a fresh

start free from their past, is thus inevitable and difficult to reconcile.

This article reviews the case law at the intersection of bankruptcy and environmental law, including: When do environmental claims arise and become dischargeable in bankruptcy? Do debtors' have ongoing responsibilities for property that they continue to own? Are environmental injunctive obligations dischargeable in bankruptcy? This article concludes by describing recent proposed changes in the law by the National Bankruptcy Commission and the Advisory Committee on Bankruptcy Rules, and providing some suggestions for spotting illegal proposals by debtors, for Plans of Reorganization or property sales that violate the governing rules for reconciling the goals of environmental law and bankruptcy law.

## **When do Environmental Claims Arise and Become Dischargeable in Bankruptcy?**

Many debtors contend that they should get a discharge and fresh start from all liability relating to any pre-petition act. This rule of law would mean that polluters could entirely avoid providing the government any fair opportunity to ever hold them responsible for their acts, especially if they file for bankruptcy where the government has insufficient knowledge or information to pursue them while they are in bankruptcy. It would be unfair to shield debtors from all responsibility for the cleanup of their polluting activities when the government could not participate with other creditors because it did not know about the debtor's contamination.

Such a result would be inconsistent with important purposes of both environmental and bankruptcy law. Environmental law seeks to make those responsible for contamination assume

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responsibility for its cleanup. Bankruptcy law seeks to permit all creditors, including environmental creditors, to share in the distribution of proceeds through the bankruptcy case. If some companies succeed in using bankruptcy to shed unknown environmental liabilities associated with industrial activities, this may influence the debtors' competitors to file for reorganization, to obtain the same business advantage.

Governments, on the other hand, once contended that cost recovery claims do not arise until incurrence of the particular costs. The problem that courts found with this approach is that the government could, in theory, control when a claim arose and became dischargeable by controlling the timing of cleanup activities.

The courts have adopted a middle ground. Under the prevailing case law, where there has not yet been any response action or environmental testing, or where the government has not yet tied a debtor to a site, the government's CERCLA claim has not arisen. In *In re Jensen*, 995 F.2d 925 (9th Cir. 1993), the Ninth Circuit held that, in determining when an environmental claim arises within the meaning of the Bankruptcy Code, the policy goals of both the bankruptcy laws and the environmental laws must be considered, harmonized, and balanced. If a claim is not within the fair contemplation of the parties, so that there is a fair opportunity to adjudicate it in the bankruptcy case, it would be unfair and inconsistent with the environmental laws to bar all recovery on the claim. Similarly in *In re Chicago, Milwaukee, St. Paul & Pacific R.R.*, 3 F.3d 200 (7th Cir. 1993), the Seventh Circuit held that a CERCLA claim arises when the claimant can tie the bankruptcy debtor to a known release that the claimant knows will lead to CERCLA response costs, and also when the claimant has conducted tests about the contamination problem. *See also In re Crystal Oil Co.*, 158 F.3d 291 (5th Cir. 1998) (adopting the Seventh Circuit's test); *In re National Gypsum Co.*, 139 B.R. 397 (N.D. Tex. 1992). *But see In re Chateaugay Corp.*, (LTV), 944 F.2d 997 (2d Cir. 1991) (discharge of cost recovery claim can occur if there were pre-petition releases or threatened releases of hazardous substances). Whether sampling or testing of a

contaminated site has occurred is important under this standard, because without testing, the government would not have a fair opportunity to participate in the bankruptcy case, as debtors would object to an environmental claim as speculative.

The emerging "fair contemplation" test, for when environmental claims arise in bankruptcy, is consistent with non-environmental mass tort cases where bankruptcy courts have also, on grounds of fairness, limited the reach of the Bankruptcy Code. *See In re Fairchild Aircraft Corp.*, 184 B.R. 910, 922-27 (Bankr. W.D. Tex. 1995) (Courts "find themselves having to reconfront the competing concerns of [fresh start] and of assuring that the entire process is fair. . . Not every conceivable obligation finding its source in the debtor's pre-bankruptcy past is necessarily an obligation that can be fairly handled by the bankruptcy process."), *vacated on other grounds*, 220 B.R. 909 (Bankr. W.D. Tex. 1998). A contrary rule of law, as sought by many debtors, would effectively deprive victims of wrongdoing with any fair opportunity for a day in court. Such a result would further weaken the legitimacy of the bankruptcy system from the viewpoint of a populace which may already view the system as unfairly skewed in favor of debtors.

### **What Ongoing Responsibilities Do Debtors Have for Property They Continue to Own?**

Even if an environmental claim for a contaminated site has arisen, a debtor and reorganized debtor (or buyer of a debtor's property) still have an ongoing responsibility for their property for ongoing releases that can cause an environmental claim to spring anew. This is based on the debtor's (or buyer's) post-bankruptcy ownership (or operation) of property. *See In re CMC Heartland Partners*, 966 F.2d 1143 (7th Cir. 1992). For response costs incurred during the bankruptcy case, the Government would have an administrative priority claim. *See Pennsylvania v. Conroy*, 24 F.3d 568 (3d Cir. 1994); *In re Chateaugay Corp.* (LTV), 944 F.2d 997 (2d Cir. 1991), *In re Smith-Douglass, Inc.*, 856 F.2d 12 (4th Cir. 1988); *In re Wall Tube & Metal*

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*Products Co.*, 831 F.2d 118 (6th Cir. 1987). Further, a reorganized debtor or buyer of property would be discharged only for response costs incurred pre-bankruptcy. A new claim arises for post-bankruptcy response costs. The rationale for this rule is the long held rule of law that no one can maintain a nuisance. A current property owner must deal with ongoing problems on his property, even if caused long before filing a bankruptcy petition. See 42 U.S.C. § 9607(a) (providing that current owners of facilities are liable for cleanup of their property).

### **Are Environmental Obligations Dischargeable in Bankruptcy?**

Another important issue in environmental bankruptcy cases is whether a debtor can use its bankruptcy as a shield against having to comply with legal obligations, as opposed to monetary claims, under environmental law. The Bankruptcy Code defines a "claim" to include a "right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such equitable remedy is reduced to judgment, liquidated, fixed, contingent, matured, unmatured, disputed, legal equitable, secured, or unsecured." 11 U.S.C. § 101(5).

Plainly prohibitory injunctions do not fall within this definition. As to mandatory injunctions such as cleanup orders, the key question is whether a breach of a cleanup order gives rise to a right to payment within the meaning of this definition. Governments have, with some success, contended that a breach of a cleanup order does not give rise to a right to payment within the meaning of this definition. A refusal to perform a cleanup action does not give rise to an alternative right of payment instead of dealing with the pollution. In other words, a polluter may not pay the government instead of cleaning up the hazards for which it is responsible. Accordingly, in *In re Torwico Electronics, Inc.*, 8 F.3d 146 (3d Cir. 1993), the Third Circuit held that New Jersey's equitable remedy for requiring the cleanup of contaminated property was not a "dischargeable claim" in bankruptcy, and that such injunctive obligations survive. The debtor's liability for cleanup of its

formerly leased property was an ongoing regulatory obligation, which did not run with the land, but run[s] "with the waste." *Id.* at 151; see also *Ohio v. Kovacs*, 469 U.S. 274 (1985) (injunction to clean up a hazardous waste site gave rise to a right to payment against the former site owner, where a receiver had been appointed pre-petition to take control of the site, thereby dispossessing the owner, and where the State of Ohio was found to be seeking money to clean up the site); *In re Chateaugay Corp. (LTV)*, 944 F.2d 997 (2d Cir. 1991) (cleanup obligations would not be considered claims just because they required the expenditure of money and would not be considered claims if intended to deal with ongoing pollution); *In re Industrial Salvage, Inc.*, 196 B.R. 784, 787-88 (S.D. Ill. 1996) (debtor must comply with environmental closure obligation where government has taken no action to transform closure obligation to a right to payment); *Roxse Homes, Inc. v. Roxse Homes Ltd. Partnership*, 83 B.R. 185 (D. Mass. 1988) (debtor must comply with pre-petition order for specific performance).

This argument has had greatest success under statutes such as the Resource Conservation and Recovery Act ("RCRA"), 42 U.S.C. §§ 6901 *et seq.*, where the government generally does not have any right to a monetary recovery. Even where the government may have an independent preexisting right to clean up the pollution and seek recovery, as under CERCLA, that independent right does not arise from a breach of the cleanup order. The polluter may not avoid complying with a CERCLA cleanup order by offering money, just as sellers of real estate cannot avoid specific performance by paying damages or penalties after a breach. The use of bankruptcy law should not provide a substantive right that does not exist under non-bankruptcy law. If non-bankruptcy law provides for requiring polluters to remedy their contamination, as opposed to paying money, bankruptcy law should not provide a haven for polluters to avoid these responsibilities. Nevertheless, it should be kept in mind that the case law on when environmental obligations are claims is much more favorably developed for statutes like RCRA than CERCLA-like statutes permitting cost recovery.

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## Proposal of the National Bankruptcy Commission on Future Claims

The existing law does not discharge reorganized debtors from liabilities that do not yet exist during their bankruptcy case. 11 U.S.C. § 1141(d)(1)(A). The reason for this is, if a claim has not yet arisen, providing a fair opportunity for the claim holder to prove his or her claim and share in the proceeds distributed in the bankruptcy proceeding is usually impossible.

The National Bankruptcy Commission has proposed to Congress that it change this long-standing feature of bankruptcy law by permitting debtors and buyers of debtors' property or business to obtain a discharge of certain types of mass future claims that are capable of estimation. *National Bankruptcy Review Commission Final Report* at 315-51 (1997). A future claims representative would be appointed to protect the interests of the future claim holders. The rationale behind the Commission's proposal is that, in certain cases, it is in the future claim holders' best interest to permit a business to continue operation by providing some relief from the prospect of future suits. Continued operation may maximize the return for both existing and unknown future claimants in circumstances where an otherwise profitable business could not continue in operation. On the other hand, permitting treatment and discharge of future claims in bankruptcy, without the actual participation of the affected claim holders, is at odds with concepts of due process and fundamental fairness. There is a significant risk that debtors might abuse a future claim provision to try to obtain liability baths while in bankruptcy without adequately providing for the discharged future claims of unknown absent claim holders.

The Commission's Report recognizes the need to balance these competing considerations and limit the application of its proposal to limited factual contexts involving only certain mass tort and mass contract claims. However, for reasons beyond the

scope of this Article,<sup>^</sup> the Commission's actual proposal is much broader than claimed or warranted, and falls short in adequately protecting the rights of future claim holders.

Any change in the law, with respect to future claims, would potentially have drastic impacts on the government's ability to protect against public health and the environmental threats caused by corporate debtors which are ongoing dangers unfairly contemplated at the time of a debtor's bankruptcy. The Commission's Report does appropriately recommend that mass future claims "not encompass police and regulatory causes of action" or interfere with the "obligation to comply with applicable laws nor the Government's ability to act in its police and regulatory capacity, [because] police and regulatory causes of action are of a different nature than mass future claims." *National Bankruptcy Review Commission Final Report* at 329.

A clear police and regulatory exception to the definition of mass future claim is essential to the protection of public and health safety, where continuing unsafe conditions or public nuisances

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<sup>^</sup> The Department of Justice has recommended to Congress that any future claims legislation provide appropriate safeguards to the rights of future claim holders, including that (1) in order for a plan of reorganization to be confirmed in a chapter 11 case treating future claims, the future mass claims representative must vote for the Plan and the Court must specifically find that the Plan's funding of future claims is adequate to ensure that future claims will be fairly treated; (2) provision of a binding treatment of future claims should not be permitted unless the debtor has made available or disclosed to the future claims representative and all known holders of future claims all non-privileged information that it has or is aware of that may relate to a fair estimation of future claims; (3) treatment of future claims should be permitted only where a court finds that advance resolution of mass future claims is the only alternative if the debtor is to be able to reorganize or sell the company as an ongoing concern; and (4) the debtor's plan must dedicate at least 51 percent of future profits or 51 percent of the reorganized debtor's stock to pay present or future mass claimants.

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may predate a debtor's emergence from bankruptcy. Unlike unidentified future mass tort victims, the government is known, and can act with a debtor to protect its own mutual interests if necessary and appropriate. Without an express exception for actions or proceedings by a governmental unit to enforce its police or regulatory power, adding future claims to the scope of the Bankruptcy Code would create potentially gaping loopholes in many federal and state environmental and non-environmental regulatory programs, including worker safety laws, housing laws, aviation and motor vehicle safety laws, consumer safety laws, labor laws, health care provider laws, mining laws, civil rights laws, farming laws, food and drug laws, pension laws, immigration laws, admiralty laws, and export and trade laws.

Thus far, Congress has not taken any action on the Bankruptcy Commission's recommendation on future claims. They have rejected or substantially changed many of the Bankruptcy Commission's other significant proposals.

### **Rules Committee Proposal to Improve Debtors' Environmental Disclosure**

The Advisory Committee on Bankruptcy Rules preliminarily approved a proposal requiring that business debtors provide information on environmental matters on their bankruptcy schedules. Under the proposal, new question 25 on the Official Form Statement of Financial Affairs provides disclosure by all site business debtors for which the government notified, in writing, of potential liability or violations of law; all sites that debtors have notified the government of releases of hazardous material; and all of the debtor's judicial or administrative environmental cases<sup>^</sup>. In addition, Exhibit C to the Debtor's Petition provides for the disclosure of all property owned by the debtor that poses a threat of imminent and identifiable harm to public health or

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<sup>^</sup>A separate proposal will require debtors to indicate in their notices to United States Attorney's offices the specific agencies that are creditors of the debtor.

safety. Final approval will follow a public comment process. Although these proposals fail to seek information about some categories of debtors' potential environmental liabilities, the proposal would be a significant and welcome improvement. The new information would enable United States Attorneys' offices (USAOs), which are often served with bankruptcy papers without being informed of the nature of any potential federal interest, to identify bankruptcy cases that should be monitored to protect the public interest under the environmental laws.

### **Identifying Objectionable Proposed Plans of Reorganization and Sales of Property in Environmental Bankruptcy Cases**

The Environment Division receives copies of very few proposed Plans of Reorganization or property sales under the Bankruptcy Code, 11 U.S.C. § 363, and relies on the EPA and the USAOs to identify illegal proposals that threaten the public's interest in a clean environment. Sometimes United States Attorney's Offices are the only recipients. Too often, overzealous debtors bury improper proposals in the middle of voluminous documents that, not surprisingly, may escape anyone's attention. Carefully scrutinize the legality of any Plan or 363 Motion in a case involving a debtor with industrial activities that might involve releases of contamination or environmental regulation. Some tips for finding improper proposals follow:

1. Look for language referring to discharge, release, or sales free and clear of claims. While some discharge and sale free and clear is often appropriate, check the language to make sure it is not broad. One debtor went as far as to propose as part of a Section 363 sale of property that there be a court-ordered moratorium on environmental enforcement at the property for three years! Of course, it claimed that such a moratorium would enhance the value of the estate to creditors. If we had not successfully objected, the buyer would have contended that it was the only entity in the country that did not have to comply with the Clean Air Act, Clean Water Act, and other important

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environmental statutes protecting public health and safety.

2. As discussed above, the Debtor or buyer of debtor's property is not entitled to be relieved of liability as the owner or operator of property. That liability springs anew based on a reorganized debtor or buyer's post-acquisition ownership or operation, although the debtor may have caused contamination long ago. In every case which we have identified a possible improper attempt to secure such a release of liability, the movants have agreed to clarify language along the following lines: "Nothing in [the Court's Order approving Plan or Sale] shall be construed as releasing or relieving any entity of any liability or responsibility under any environmental law as the owner or operator of property that the entity owns or operates after the effective date of this Order." Look for language that tries to release a debtor of all liability relating to its "past conduct" or "past acts." Such language is improper, because the Bankruptcy Code only releases claims that arise by the date of confirmation of a Plan. A Plan may not release claims that have not arisen such as environmental claims that are not within the fair contemplation of the parties. Likewise, a Plan can only discharge claims (rather than injunctive obligations) to comply with the law, such as cleanup orders. Plans that purport to discharge all "liability" may be illegal. Look for any attempt to enjoin the government. Injunctions are extraordinary remedies that may not be appropriate against the government. Look for language that attempts to release non-debtors (such as officers, directors, employees, parents, affiliates, lenders, other creditors) as part of a Plan of Reorganization. The Bankruptcy Code's discharge provisions do not apply to non-debtors. *See* 11 U.S.C. § 524(e).

#### **ABOUT THE AUTHOR**

' **Alan S. Tenenbaum** is a Senior Attorney with the United States Department of Justice's Environmental Enforcement Section (EES). He has been with EES since 1988 and supervises or handles many of DOJ's environmental bankruptcy cases for the Environmental Protection Agency (EPA) and other client agencies. He works with EPA's Bankruptcy Workgroup and is the Environment Division representative on the Department of Justice Bankruptcy Workgroup, which comments on proposed bankruptcy legislation. He is a 1981 graduate of Harvard Law School. **a**

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# For \$800 and the Deed to Your Home—Bankruptcy Foreclosure Scams Target Distressed Home Owners

*Jane Limprecht, Public Information Officer  
Executive Office for United States Trustees<sup>^</sup>  
Washington, D.C.*

**A**ttention Home Owner: Save your homes—Stop foreclosure now! Before you file bankruptcy call me first. We refinance mortgages regardless of your credit history!

Unless your home has been listed for foreclosure, you have probably never received an advertisement like this in your mailbox, but you may have seen similar solicitations printed in the local newspaper or posted on the grocery store bulletin board. These solicitations may signal that a lucrative type of fraud—the bankruptcy foreclosure scam—has established a foothold in your community.

In May 1998, the Bankruptcy Foreclosure Scam Task Force of the United States Bankruptcy Court for the Central District of California issued its final report<sup>^^</sup> describing several bankruptcy

foreclosure scams operating in the region; explaining how they hurt bankruptcy courts, lenders, and homeowners; and recommending ways to combat them in the Central District of California.

Bankruptcy foreclosure scams, however, should not be dismissed as solely “an L.A. problem.” The most complex and lucrative bankruptcy foreclosure scams have arisen in major metropolitan areas on the West Coast; in August, one Los Angeles area perpetrator was sentenced to 71 months’ imprisonment and ordered to pay more than \$72,000 in restitution for running a scam involving more than 200 fraudulent bankruptcy filings. However, Mom-and-Pop operations are appearing even in mid-size Midwestern cities. Some perpetrators are not only reaching across state lines to recruit local “customer representatives,” but are also seeking referral affiliations with local consumer bankruptcy attorneys.

Reports from United States Trustee Program personnel around the country make clear that bankruptcy foreclosure scams are geographically widespread, and varied in their methodology.

## Types of Foreclosure Scams

“For the cost of a bankruptcy filing fee, a debtor can immediately obtain one of the most powerful injunctions available under American law: the automatic stay,” the foreclosure scam task force pointed out. The task force report described bankruptcy foreclosure fraud as the practice of filing for bankruptcy to delay or defraud creditors,

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<sup>^</sup>This article is reprinted here with the permission of the American Bankruptcy Institute (ABI). For regular updates of bankruptcy legislative activity and other insolvency news, as well as ABI membership information, visit ABI World at <http://www.abiworld.org>. All views expressed in this article are the author’s and do not necessarily represent the views of, and should not be attributed to, the United States Department of Justice or the United States Trustee Program. The author wishes to thank all of the United States Trustee Program employees who provided invaluable information and assistance in the development of this article.

<sup>^^</sup>*Final Report of the Bankruptcy Foreclosure Scam Task Force*, United States Bankruptcy Court, Central District of California, May 1998 (“Task Force

Report”). The text of the report is posted on the American Bankruptcy Institute’s web site at [www.abiworld.org](http://www.abiworld.org).

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without intending to comply with the requirements for obtaining a bankruptcy discharge or completing a repayment plan.

The foreclosure scam most commonly associated with the West Coast is the fractional interest transfer. Typically, a partial interest—perhaps 5 or 10 percent—in property held by a homeowner facing foreclosure is transferred to a real or fictional entity already in bankruptcy. Because a bankruptcy debtor then holds the property interest, the original owner's creditor cannot foreclose until the bankruptcy court lifts the automatic stay.

Some scams involve fractional interests transferred with the knowledge of the original property owner. Often, however, the original owner first transfers the property to the perpetrator of a foreclosure scam, who then transfers the fractional interest without the original owner's knowledge. Sometimes a property is moved from case to case as the stay is lifted; one residential property was linked to 24 different bankruptcy cases.<sup>^</sup>

The task force report explained how one homeowner facing foreclosure was persuaded by a scam perpetrator to sign deeds of trust and grant deeds transferring fractional interests in her property. The homeowner paid the foreclosure consultant several hundred dollars per month so she could stay in her home. The fractional interest recipients included apparently fictitious individuals and homeless persons recruited for a fee to participate; eight recipients filed for bankruptcy one after the other. Each filing stayed foreclosure on the property, causing a 10-month delay between the first filing and the completed foreclosure.

Many other variations of bankruptcy foreclosure fraud are surfacing around the country. Probably the most widespread involves the use of foreclosure notices to identify individuals facing the loss of their homes. The scam perpetrator contacts the homeowner, advertising "mortgage assistance" or "foreclosure counseling." The scam promises to work out the homeowner's problems with the

mortgagee or to obtain refinancing for an up-front fee typically ranging from \$250 to \$850. The perpetrator may direct the home owner to "fill out some forms," including a blank bankruptcy petition, or may collect the information needed to complete a petition later. The perpetrator subsequently files a bankruptcy petition in the homeowner's name. The bankruptcy petition invokes the automatic stay, the imminent foreclosure is postponed, and the homeowner stops receiving collection calls and letters.

Usually, the perpetrator does not tell the home owner about the bankruptcy petition, instead convincing the homeowner that foreclosure activity has ceased because mortgage problems have been worked out. The perpetrator may tell the home owner to ignore any notice from the court. The home owner may even be told that the perpetrator has gone to court on the homeowner's behalf. When no one appears at the Section 341 meeting, the case is dismissed, the foreclosure goes forward, and the home is lost.

Permutations of this scam include the perpetrator's collecting monthly mortgage payments from the homeowner, falsely stating that they will be forwarded to the mortgagee. Each defrauded homeowner pays not only the up-front fee for "services," but also hundreds or thousands of dollars in mortgage payments.

In another increasingly common alternative, the scam perpetrator convinces the homeowner to quit-claim the residence to the perpetrator or to sell the residence for a nominal fee such as \$1. The home owner agrees to transfer title because he or she has little or no equity in the property. The perpetrator charges the homeowner "rent," a "consultant's fee," or "management fee" to stay in the residence while the mortgage problems are worked out, after which the homeowner will be able to "apply for repurchase" of the property or share the profits if the perpetrator sells the property.

It costs money for the perpetrators to file these bankruptcy cases. To avoid bankruptcy filing fees, some perpetrators transfer an interest of the home owner's quit-claimed property into the name of an existing bankruptcy debtor—perhaps a Chapter 11 business debtor across the country—in a variation of the fractional interest scam. Typically, the

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<sup>^</sup> "The Foreclosure Must Go On; L.A. Bankruptcy Judges Give the Hook to 'Artful Dodger' Debtors," 84-May A.B.A.J. 32.

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debtor learns that a property interest has been transferred into its bankruptcy estate when it is contacted by counsel for the property owner's secured creditor, who has learned it cannot foreclose because a bankruptcy debtor owns the property.

### **Detecting and Reporting Scams**

Bankruptcy foreclosure scams can be exceptionally difficult to detect because the cases are usually dismissed for failure to participate, leaving no sign of the defrauded home owner. Many cases go no further than the Section 341 meeting, so Chapter 7 and 13 trustees form the "front line" of foreclosure scam detection.

Warning signals include: a proliferation of *pro se* petitions filed with no schedules; a series of debtors with similar petitions or schedules; debtors' failure to show up at the Section 341 meeting; multiple debtors represented at the meeting by a bankruptcy petition preparer or other non-attorney; debtors who attend the meeting but are confused about whether they are in bankruptcy; and a rash of debtors who clearly lack sufficient income to fund a Chapter 13 repayment plan.

Bankruptcy judges are another valued source of information. Nationwide, judges have flagged suspicious cases. One judge noticed that an attorney was filing many cases that were not being properly serviced. This can suggest that a scam perpetrator is either referring home owners to an attorney to help them in filing bankruptcy, or sending completed bankruptcy papers to the attorney to file in court with or without the home owners' knowledge. Scam perpetrators use the latter method to avoid liability for violating 11 U.S.C. § 110's restrictions on bankruptcy petition preparers.

In addition, secured lenders can flag foreclosure scams because they have unique access to relevant documentation. A secured lender receives all of the bankruptcy cover sheets on a particular piece of property. These documents may show that different debtors are all linked to the property. The secured lender may be the only entity that can pull together this revealing information.

Consumer bankruptcy attorneys can also help identify foreclosure scams. A home owner whose bankruptcy case is filed by a scam perpetrator and dismissed for lack of participation may have to file for bankruptcy again. A client's story told to a bankruptcy attorney may reveal that the client is the victim of a bankruptcy foreclosure scam.

Debtors' counsel should be aware that perpetrators seek out attorneys—sometimes inexperienced attorneys without a well-developed reputation in the bankruptcy community—and offer case referral. Frequently, the attorney is expected to kick back part of the legal fee to the perpetrator in exchange for the referral.

Victimized homeowners report some scams, although many homeowners never realize they were defrauded. A victim who complains to the perpetrator after foreclosure occurs—assuming the perpetrator is still operating in the area—may be told that the mortgage problems were too serious to work out or the homeowner's credit was too bad to obtain refinancing. Sometimes, however, receipt of notice from the bankruptcy court prompts the homeowner to call the court, the United States Trustee, the case trustee, or a bankruptcy attorney. Homeowners who apply for credit have brought other complaints and discover a bankruptcy filing listed on their credit records.

Foreclosure scams are most likely to flourish and least likely to be detected in judicial districts inundated with bankruptcy filings. If the private trustee can quickly identify a case as improperly filed and obtain its immediate dismissal, avoiding a 6- to 12-month delay in foreclosure, a homeowner may be more likely to complain about a "mortgage consultant's" poor service. However, with high bankruptcy case loads causing substantial delays in relief from the stay, some defrauded homeowners decline to report the scams, apparently deciding that the extra months of living in their homes offset their losses.

The most dramatic method of detecting bankruptcy foreclosure scams is through undercover investigations like "Operation Churn 'N Burn," a 1995 sting that resulted in seven convictions. In Churn 'N Burn, fictitious foreclosure actions were filed in the county court. Scam perpetrators zeroed in on two apparently

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distressed homeowners, unaware that the “spouses” were FBI agents and their “home” was provided by the United States Department of Housing and Urban Development.<sup>^</sup>

Nevertheless, undercover operations targeting bankruptcy fraud are rare. In combating bankruptcy foreclosure fraud, the United States Trustee Program relies upon tipoffs from participants in the bankruptcy system—the trustees, bankruptcy judges, bankruptcy clerks, secured lenders, and attorneys.

### Who Are the Victims?

Bankruptcy foreclosure scams claim many victims, but the one that suffers the greatest harm is the bankruptcy system. The task force report noted that bankruptcy cases filed solely for delay require more clerical and judicial time and attention because they usually involve more relief from stay motions, orders to show cause, and motions and orders to dismiss. Nationwide, foreclosure scams may cause the inappropriate filing of thousands of bankruptcy cases.

Lenders also suffer from foreclosure scams, receiving no payments for months or years while the repeated transfers and bankruptcy filings invoke the automatic stay. When the case involves a federally insured mortgage loan, such as a Veterans Affairs or Federal Housing Administration loan, the government is ultimately a victim of bankruptcy fraud because it must cover the mortgagee’s loss.

Homeowners, who place their trust in scam perpetrators, can end up financially devastated. “We’ll help you keep your piece of America,” promised advertisements distributed by Dallas “consultant” Musu Cuch Ketter, who was sentenced to 24 months’ imprisonment and ordered

to pay \$58,000 in restitution for bankruptcy and bank fraud. Defrauded homeowners paid Ketter from \$2,000 to \$15,000 in fees and mortgage payments; around 30 homeowners are believed to have lost their homes due to her activities.

### Varied Remedies

Foreclosure scams look like easy money and often reach huge proportions. A successful criminal prosecution sends the message that scams will not be allowed to flourish. Gilfert Jackson of Los Angeles was sentenced to 71 months’ imprisonment and ordered to pay more than \$72,000 in restitution for operating a massive bankruptcy foreclosure scam involving more than 200 fraudulent bankruptcy filings.

Attorneys and analysts from the United States Trustee Program work closely with federal, state, and local prosecutors in cases involving bankruptcy foreclosure scams. United States Trustee Program personnel not only put together the initial referrals, but also assist in the investigation and development of the case. Criminal cases frequently involve charges under 18 U.S.C. § 157, which permits fines and imprisonment for the use of the bankruptcy system as part of a scheme or artifice to defraud. Alternatively, state and local authorities may bring charges under state anti-fraud provisions.

Bankruptcy fraud rarely ranks first among criminal prosecution initiatives because of limited investigative and prosecutorial resources. The bankruptcy foreclosure fraud task force asserts that “the criminal process is too slow and too limited to be the primary line of defense against bankruptcy fraud.” The amount of loss per case is small, witnesses often move without leaving forwarding addresses, paper trails are hard to follow, and positive identification can be elusive.

Thus, exploring other ways to fight bankruptcy foreclosure scams is crucial. United States Trustees have successfully litigated civil actions against foreclosure scam perpetrators under 11 U.S.C. § 110. In addition, active enforcement of state unauthorized practice of law provisions, and a vigilant state bar, can create an inhospitable

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<sup>^</sup> “Nine Indicted by U.S. for Bankruptcy Fraud; Foreclosures Key to Alleged Scam,” *Chicago Tribune*, May 19, 1995, 1995 WL 6208323; “Nine Charged in Bankruptcy Fraud Case,” *Chicago Sun-Times*, May 20, 1995, 1995 WL 6654358; “Justice Announces Indictments of Nine, Including Lawyer, For Bankruptcy Fraud,” *BNA’s Bankruptcy Law Reporter*, May 25, 1995, p. 607.

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atmosphere for petition preparers and lawyers who would engage in unlawful or unethical behavior.

The bankruptcy foreclosure fraud task force made several suggestions for combating bankruptcy foreclosure scams, including amending Section 362 explicitly to authorize the bankruptcy court to enter an “in rem” order—that is, an order stating that a lift-stay order will remain effective as to a particular property in any future bankruptcy case, without the creditor’s seeking further relief from the stay. The National Bankruptcy Review Commission made a similar recommendation in its final report,<sup>^</sup> and both major bankruptcy reform bills<sup>^^</sup> pending before the 105th Congress contain language to this effect. This position is not without controversy, however; despite the task force’s view, even some bankruptcy judges in the Central District of California believe they lack jurisdiction to issue such orders.

The task force also advocated amending Bankruptcy Rule 5005 to let the bankruptcy clerk reject a bankruptcy petition if the filer does not provide identification. This recommendation was intended to prevent scam perpetrators from filing petitions without the named debtors’ consent or with the use of false names or Social Security numbers. The United States Trustees are also considering steps they may take to protect against these abuses, including requiring identification at the Section 341 meeting.

## Conclusion

Bankruptcy foreclosure fraud is a growing problem that threatens the integrity of the bankruptcy system as it takes advantage of families in distress. The United States Trustee Program is working hard to identify bankruptcy foreclosure scams around the country and to act through criminal referrals and civil suits, but we need help from members of the bankruptcy community.

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<sup>^</sup>*Bankruptcy, the Next Twenty Years*, National Bankruptcy Review Commission Final Report, October 20, 1997, pp. 281-87.

<sup>^^</sup>HR 3150 at § 121; S 1301 at § 303.

The United States Trustee Program welcomes information that will help detect bankruptcy foreclosure scams, and is indebted to those trustees, judges, clerks, secured lenders, bankruptcy attorneys, and private citizens who report suspicious fact patterns. We also appreciate the efforts of federal and state law enforcement authorities who target these operations. We will continue to coordinate with all participants in the bankruptcy system to eradicate this destructive form of fraud. ~

## ABOUT THE AUTHOR

**Jane Limpsecht** has served as the Public Information Officer for the Executive Office for United States Trustee since September 1997. Before that, she worked as a legal editor and reporter for *BNA’s Bankruptcy Law Reporter*. She received her Juris Doctor from the University of Wisconsin Law School in 1980, and worked for several years for the state legislature in Madison, Wisconsin, before moving to Washington, D.C. **a**

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# Civil Remedies for Bankruptcy Fraud

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Estimates of the percentage of bankruptcy cases that involve some sort of fraud, whether outright criminal fraud or the more ambiguous “abuse” of the bankruptcy laws, range from 3 percent to 50 percent. This disparity shows how hard it is to pinpoint the actual number of fraudulent filings. However, serious fraud occurs in enough cases that it must be addressed to maintain the integrity of the bankruptcy system. Criminal prosecution of bankruptcy fraud is the preferred method of addressing the problem, but reality tells us that the criminal system can only handle some of the cases uncovered.

For cases in which criminal prosecution will not occur at all or will not occur until a later date, litigants can choose from any number of civil remedies. First, the objective of the fraud, or bankruptcy “prize,” should be identified. Then a remedy can be selected that will effectively deny the prize sought. Most of these remedies are effective only against debtors who engage in fraudulent behavior, not against creditors or other parties who attempt to commit fraud through a bankruptcy case. Creditors and others are harder to reach through use of the civil powers.

The most important prizes in bankruptcy are: (1) the automatic stays, which prevent a creditor from pursuing any action against the debtor or the property of the estate to collect or enforce a pre-petition debt; (2) the discharge, which removes the debtor’s obligation to pay a debt; and (3) creditor inertia, which causes many creditors to write off a debt when they find a bankruptcy case is filed and to abandon collection efforts even if the case is subsequently dismissed. This article contains a discussion of the major civil remedies available and the types of fraudulent activities best addressed by each remedy.

## Dismissal of the Case

This is the most simple and efficient remedy. A request for dismissal of a case is brought by motion. The grounds are broad in all Bankruptcy Code chapters, which require only a showing of cause.<sup>^</sup> The effect of dismissal, unless otherwise ordered by the court, is to put matters back as they were before the filing.<sup>^^</sup> The court can also dismiss the case with prejudice or make a specific finding that the debts listed cannot be discharged even in a subsequent Chapter 7 case.<sup>^^^</sup>

This remedy can be especially effective in the following instances: (1) where the fraudulent conduct is aimed at obtaining a discharge before permitted by law or at using the automatic stay to thwart an otherwise proper purpose outside bankruptcy, such as to avoid paying judgments, alimony or child support or to stop eviction proceedings or lawsuits; (2) when the case was filed without the knowledge or consent of one or both debtors; or (3) when the debtor refuses to cooperate or provide information.

## Objection to Dismissal

Conversely, objecting to a debtor’s attempt to dismiss a case can also be an effective tool in combating certain types of fraud. A debtor may attempt to dismiss the case when someone is getting too close to the truth or is about to discover information that might reveal fraudulent activities. The debtor hopes that a dismissal will diminish interest in pursuing the matter. A debtor in a Chapter 13 case has an absolute right to dismiss the case, if the debtor has not previously converted

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<sup>^</sup> 11 U.S.C. §§ 707, 1112, 1208, and 1307

<sup>^^</sup> 11 U.S.C. § 349

<sup>^^^</sup> *In re Leavitt*, 209 B.R. 935 (Bankr. 9th Cir. 1997); *In re Walker*, 102 B.R. 612 (Bankr. N.D. Ohio 1989)

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the case. If there is good evidence of fraudulent behavior, however, some judges are willing to take creative action such as entering an order converting the case to Chapter 7 and making the conversion nunc pro tunc to a date before the attempted voluntary dismissal.

### **Denial or Revocation of Discharge**

The discharge is most frequently the object of desire in cases of concealed or fraudulently transferred assets. An objection to or revocation of the discharge must be pursued by filing an adversary proceeding, which is a lawsuit within the bankruptcy case. Unless the court extends the deadline, an action to deny a discharge must be initiated within 60 days from the first date set for the 341 meeting. The court strictly follows this deadline, so it must be watched carefully. The grounds for a denial of discharge are quite broad and include not only the debtor's fraudulent conduct in this case or a related case, but also the debtor's failure to keep adequate books and records, failure to explain the loss or diminution of assets, failure to turn over records to the trustee or United States Trustee, destruction of books and records or assets of the estate, and refusal to obey a court order.

In contrast, an action to revoke the discharge in a Chapter 7 case must be filed within one year of the entry of the discharge. The information that forms the basis of the action must not have been known before the entry of the discharge. The grounds to revoke a discharge are much more limited than the grounds to deny a discharge. Grounds for revocation are that the debtor either used fraud to obtain the discharge, came into possession of estate assets and failed to turn them over to the trustee, or failed to obey an order of the court.

Since the discharge is what the debtor usually wants, simply moving to extend the deadline to object to the entry of discharge is an effective way to keep the pressure on a debtor to cooperate and reveal assets that might not have been scheduled.

In a Chapter 11 case the only way to revoke the discharge is to move to revoke confirmation of the reorganization plan. The order revoking plan

confirmation also serves to revoke any discharge granted.<sup>^</sup> An adversary proceeding to revoke plan confirmation must be brought within 180 days of the entry of the confirmation order,<sup>^^</sup> and the only basis for the action is that the order was obtained through fraud.

Adversary proceedings can be complex litigation involving heated discovery battles and trials lasting several days to weeks. However, if the United States Trustee or any other party brings an adversary proceeding to deny the discharge or revoke plan confirmation, discovery will often lead to a wealth of information to support criminal prosecution.

United States Trustees have expressed the concern that success in obtaining denial of a debtor's discharge can rule out any chance of criminal prosecution, as the case will become unappealing to a jury. This should not be the case. A successful action for denial or revocation of discharge will have fleshed out the evidence and all probable defenses, making it easy for the Assistant United States Attorney to assess the merits of the case. Denial of discharge does not put money back in the hands of creditors, who will probably never collect what they are owed. Criminal prosecution of these cases serves as an effective deterrent for all debtors who think they can keep a "little something extra," be it a car, house, office building, or business. Criminal prosecution also helps dispel the public perception that everyone in bankruptcy hides assets and gets away with it.

### **Relief from Stay In Rem**

Generally, when a creditor wishes to take an action against a debtor that the automatic stay would normally prohibit—such as foreclosing on real property in which the debtor has no equity—the creditor moves the bankruptcy court for relief from the automatic stay. Essentially the creditor must prove that the asset has no value for

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<sup>^</sup> 11 U.S.C. § 1144(2)

<sup>^^</sup> FED. R. BANKR. P. 7001(5)

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the estate or that the creditor's action will not harm the estate.<sup>^</sup>

A new fraud scheme that uses bankruptcy for defrauding a creditor is called "dumping." Typically this scheme involves a property owner who wishes to stop a pending foreclosure action but does not want to file for bankruptcy. The owner, either directly or through an intermediary, transfers a fractional interest in the property to an unrelated person who is already in bankruptcy, usually without the knowledge of the third person. The quit claim deed is either recorded or a phony recording notice is made up and sent to the foreclosing creditor, typically via fax. The property owner thereby "borrows" the real bankruptcy debtor's automatic stay.

The creditor must seek relief from the automatic stay to proceed with the foreclosure. While the creditor always wins, the property owner can repeat this scheme often, in multiple bankruptcy cases and judicial districts. The creditor is forced to spend thousands of dollars in legal fees, and experience months of delay, because mortgage payments go unpaid and the property's value declines.

Some judges have been willing to enter an order for "relief from a stay in rem," which states that relief from the stay is granted as to the piece of property in any present or future bankruptcy filed in that court or any other. An in rem order can be particularly effective in a "dumping" case or a case where the debtor serially transfers property to cooperating parties who file bankruptcy cases. However, many judges are reluctant to enter an order for in rem relief from the stay, because the language of the order must be extremely broad to give the creditor any meaningful relief and because there is no specific legal authority for such an order.

In cases where the judge will not grant in rem relief, it may take other creative lawyering to address the harm, such as obtaining very detailed findings in the first case and asking all subsequent judges to adopt the findings. Some creditors have even continued with foreclosure without a relief

from stay order after obtaining a written declaration from the real debtor stating that the debtor has no interest in the property.

### **Motion to Appoint Trustee/Examiner**

A trustee is not usually appointed in a case filed under Chapter 11. Instead, the debtor is charged with the duties of a trustee and is called the "debtor in possession" or DIP. Of course, this is heaven for the unscrupulous debtor who wishes to use a bankruptcy to further some scheme. While the United States Trustee monitors Chapter 11 cases more directly than other cases, questionable activities can take place unless the fraud is obvious or a knowledgeable creditor reports the problem to the court or the United States Trustee. A Chapter 11 bankruptcy can provide the perfect opportunity for a debtor to bleed out any value in a company while ostensibly trying to work on a plan of reorganization, or to transfer all the business to a parallel company, leaving nothing but the debt in the debtor's company.

A party in interest or the United States Trustee can, upon motion, appoint a trustee or examiner, based upon a showing of "cause" such as fraud, deceit, or misconduct by the debtor, or a showing that the appointment would be in the best interests of creditors.<sup>^^</sup> A trustee steps into the shoes of the debtor and has all the powers of the debtor plus a few additional ones. This means the trustee can hire, fire, review all the books and records and obtain access to all information regarding the business. The attorney-client privilege frequently passes to the trustee as well.

An examiner has more limited powers. The court usually directs examiners to perform a specific task, such as reviewing the books and records and determining where the money is going or if the business is viable. An examiner can petition the court for expanded powers if he finds a problem or needs to do something else to perform his tasks.

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<sup>^</sup>11 U.S.C. § 362(d)

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<sup>^^</sup>11 U.S.C. § 1104

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When the debtor is attempting to siphon off assets, transfer funds, or continue a fraudulent scheme, the appointment of a trustee or examiner can stop the conduct dead or at least expose it.

### **Motion to Convert/Reconvert**

A Chapter 7 trustee's primary job is to liquidate the available assets of the estate expeditiously. Trustees are aware that not all assets are listed, so they frequently conduct some independent investigation or pursue leads given to them by disgruntled creditors or ex-spouses to identify and recover unlisted assets. Most commonly, the unlisted asset is an intangible such as a claim against another entity or an interest in a lawsuit. However, many debtors are foolish enough to fail to list easily traceable assets such as real property and motor vehicles. Once the trustee finds an unscheduled asset and begins to take control of it, many a Chapter 7 debtor decides to wrest that control away by converting the case to Chapter 13 or Chapter 11.

While a debtor has an absolute right to convert to a reorganization chapter if he has never converted the case, many judges feel the debtor lacks the absolute right to stay in a reorganization chapter when the conversion was made in bad faith. Under these circumstances, the remedy is to file a motion to reconvert the case based on the best interests of the creditors.

Similarly, if a Chapter 11 debtor is misbehaving or engaging in fraudulent behavior and the court is not inclined to appoint a Chapter 11 trustee, a motion to convert to Chapter 7 may be warranted. Upon conversion or reconversion a Chapter 7 trustee is appointed; the trustee should then take action to recover the asset or stop the misconduct.

### **Motion to Compel**

Being in bankruptcy is a privilege, not a right. As such, the debtor must fulfill certain duties and obligations to stay in bankruptcy. These duties include cooperating with the case trustee, if one is assigned, and with the United States Trustee, and revealing all pertinent information to any interested

parties. The debtor is also required to appear and be examined at the meeting of creditors and to file complete and accurate schedules and statements of financial affairs.

Sometimes a debtor who is using a bankruptcy to further some fraudulent scheme does not care if the case stays open once he has obtained the initial stay. This debtor has no desire to reveal all, much less be examined under oath. Such a debtor will simply fail to appear at the meeting of creditors, fail to file the schedules or statement of financial affairs, or fail to perform duties such as filing monthly operating reports for an ongoing business. The debtor hopes that the court will dismiss the case and nothing more will come of it.

The best remedy for this situation is to make sure the case is not dismissed and to use the court's power to compel the debtor to perform the avoided tasks. Failure to obey a court order can result in sanctions and imprisonment, and denial of discharge. Best yet, the debtor can be ordered to attend the meeting of creditors; if he does not do so, the court can order the United States Marshal to find the debtor and bring him in for the meeting.<sup>^</sup> A debtor trying to play this game is usually surprised to see his personal escort arrive to accompany him to the 341 meeting, and even more surprised to learn that he stays in custody until the trustee arrives to question him.

### **Sanctions**

A debtor's failure to perform a duty or attempt to mislead the court or interested parties can also result in sanctions.<sup>^^</sup> The idea of levying sanctions against a person in bankruptcy may seem strange. However, some debtors do have assets or money, which they filed for bankruptcy to protect. Often the threat of sanctions is enough to obtain at least minimal cooperation.

### **Petition Preparer Regulations**

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<sup>^</sup> FED. R. BANKR. P. 2005

<sup>^^</sup> FED. R. BANKR. P. 9011; 11 U.S.C. § 105

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Bankruptcy petition preparers are people who are not licensed to practice law but who prepare bankruptcy papers for a fee. The Bankruptcy Code regulates them and requires them to disclose information, such as their individual name, address, Social Security number, and fee.<sup>^</sup>

In many parts of the country a petition preparer operation is always the front for a fraudulent scheme of some sort. In other places, such as California, petition preparers are as often reasonably legitimate. Any petition preparer who fails to comply with the disclosure requirements faces possible sanctions and ultimately a permanent injunction against future petition preparation. The burden is on the preparer to comply, so enforcing compliance is straightforward and is accomplished by motion.

Petition preparers can also be a wonderful source of information. Because they are not licensed to practice law, their communications with the debtor are not privileged. If subpoenaed, they must tell everything the debtor said and provide copies of everything they obtained from the debtor or face personal penalties.

### **Permanent Injunction**

As mentioned above, if a petition preparer violates the Bankruptcy Code's disclosure requirements or engages in other improper conduct, a permanent injunction can be sought by filing an adversary proceeding in bankruptcy court. Preparers who take money from debtors and never do any work create a dilemma: no action has been filed in bankruptcy court, so it might be argued that the bankruptcy court lacks jurisdiction over the preparer. In such instances, the defrauded debtors are usually referred to the district attorney or small claims court. If, however, the preparer files just one bankruptcy case, the unfiled cases can be added to the adversary proceeding in the filed case.

### **Civil Contempt**

Contempt of court is another potential remedy for fraudulent behavior in a bankruptcy. Because an article on civil and criminal contempt appears elsewhere in this issue, I will merely point out that, like sanctions, contempt can be coercive and punitive to the debtor or other party using a bankruptcy to commit a fraud.

### **Conclusion**

These varied civil remedies can be used most effectively in tandem with a vigorous criminal prosecution program to combat bankruptcy fraud and restore the public's faith in the integrity of the bankruptcy system. Used alone, neither civil nor criminal remedies can be as effective as a coordinated system that addresses as many improprieties as possible. ~

### **ABOUT THE AUTHOR**

**Antonia Darling** has been the Assistant United States Trustee in Sacramento, California, since 1990. From 1983 to 1990 she was an Assistant United States Attorney in Shreveport, Louisiana, and she served as senior trial counsel for Disciplinary Enforcement for the California State Bar from 1977 to 1983. Darling received her law degree from Golden Gate University School of Law in 1977. a

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<sup>^</sup> 11 U.S.C. § 110

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# Civil and Criminal Contempt in Bankruptcy Court

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The number of bankruptcy filings has exploded to reach more than 1.4 million in fiscal year 1998. Although the number of Chapter 11 cases has dipped, the volume of consumer cases continues to grow. The increased filings have triggered problems associated with keeping order in the court. In many jurisdictions, overworked bankruptcy judges have to cope with thousands of diverse cases, ranging from complex business reorganizations to small consumer cases that involve *pro se* debtors or, worse yet, non-attorney petition preparers whose knowledge of and respect for the rules are often glaringly deficient. The need has never been greater for bankruptcy courts to insist upon prompt compliance with judicial orders that protect the integrity of the system and the rights of all parties to a bankruptcy case.

An important tool of bankruptcy courts is the power to hold parties in civil, or even criminal, contempt of court. By holding recalcitrant debtors, creditors, lawyers, and other parties in contempt, bankruptcy judges may impose appropriate penalties to vindicate the authority of the court, to compensate victims of the contemnors' acts of commission or omission, and to compel compliance with lawful court orders.

## Civil Contempt

Generally, bankruptcy judges have the power to enforce their orders by finding violators in civil contempt of court.<sup>^</sup> The purpose of civil contempt

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<sup>^</sup>A bankruptcy court's authority to hold a party in contempt derives from several sources, including the inherent authority of any court to

may be either coercive or remedial.<sup>^^</sup> Civil contempt penalties are not punishments, but are means by which to bring a party into compliance with a court order or to force the contemnor to compensate the victim of his acts committed in disregard of a court order.

A court considers two factors when determining whether to hold a party in civil contempt: whether the alleged contemnor had notice of the court order and whether that person complied with the order. Courts have held that the contemnor's intent or state of mind is irrelevant. Given the seriousness of the civil contempt finding and the penalties that may be imposed on the violator, "clear and convincing" evidence that a party has committed civil contempt should satisfy the court. Furthermore, the court may not impose a civil contempt penalty if the contemnor can prove an inability to comply (e.g., an impecunious contemnor cannot pay a fine) or if the underlying order is later found invalid.

The Federal Rules of Bankruptcy Procedure (Fed. R. Bankr. P.) set out the procedures a court must follow in civil contempt matters. Although contempt committed in the presence of the judge may be summarily disposed of by the judge, other instances of contempt require more deliberate steps. Under Fed. R. Bankr. P. 9020(b), before finding a party in contempt, the court must issue a written notice that provides specific details about the alleged acts of contempt, states the time and place

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regulate the conduct of those appearing before it, 11 U.S.C. §105 (the power to issue orders necessary or appropriate to carry out the Bankruptcy Code), 28 U.S.C. § 157(b) (jurisdiction of bankruptcy courts to hear "core" matters), and FED. R. BANKR. P. 9020 (discussed *infra*).

<sup>^^</sup>For a concise overview of civil contempt in a bankruptcy proceeding, see, e.g., *In re Walters*, 868 F.2d 665 (4th Cir. 1989).

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of the hearing on the charges, and allows a reasonable response time. The judge is disqualified from hearing a contempt charge involving disrespect or criticism of that judge.

A bankruptcy court order of contempt does not become effective for 10 days. The contemnor may object to the finding by filing exceptions with the district court that will consider the matter de novo. The district court may confine itself to the record below or take additional evidence. If no one files objections, the bankruptcy court order “shall have the same force and effect as an order of contempt entered by the district court.” Fed. R. Bankr. P. 9020(c).

Although civil in nature, penalties for civil contempt may be severe. Civil contempt penalties have been imposed for a variety of violations, including failure to attend Section 341 meetings, failure to disgorge fees, and violation of other court orders. Fines are commonly imposed. If, however, the court finds that the contemnor is unable to pay a monetary penalty, the court may be creative. For example, attorneys who fail to disgorge fees have been enjoined from practicing before the court that issued the disgorgement order until the fees are refunded.

Since the purpose of civil contempt is to coerce compliance, the court may impose a regimen of escalating penalties. For example, if the contemnor pays a fine but still disregards a court order, the court may impose additional fines. A contemnor who continues to violate a court order may even be incarcerated. It is increasingly agreed that bankruptcy judges may order the United States Marshal to take contemnors into custody and even to incarcerate them until they purge themselves of contempt. If the civil contemnor possesses the “keys to the jailhouse door,” he may remain in custody.<sup>^</sup>

Besides civil contempt, bankruptcy courts sometimes avail themselves of other similar remedies. For example: Fed. R. Bankr. P. 9011,

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<sup>^</sup> Among the earlier cases holding that bankruptcy judges may impose incarceration as a civil contempt penalty are *In re Duggan*, 133 B.R. 671, 673 (Bankr. D. Mass. 1991), and *In re Maxair Aircraft Corporation*, 148 B.R. 353, 359 (M.D. Ga. 1992).

which is nearly identical to Fed. R. Civ. P. 11, provides for sanctions against parties who sign and file court papers; some courts have used 11 U.S.C. § 349 to penalize debtors whose cases are dismissed (such as by enjoining refile for a period or by denying the discharge of debts in any future cases); and 28 U.S.C. § 1927 allows federal courts<sup>^^</sup> to sanction attorneys who “vexatiously” protract litigation.

### **Criminal Contempt**

The power of a bankruptcy court to find a party in criminal contempt of court remains unsettled.<sup>^^^</sup> Case law is evolving, however, to permit bankruptcy courts to impose sanctions that may be characterized as criminal in nature.

Criminal contempt differs from civil contempt in many material respects. The key distinction between civil and criminal contempt is that criminal contempt sanctions punish contemnors. Once criminal contempt has been committed, the defendant cannot cancel the sanction by purging herself of the contempt.

Contempt of court is a crime under 18 U.S.C. § 401. Case law establishes at least three elements of the crime: the court must have issued a reasonably specific order; the contemnor must have violated the order; and the contemnor must have acted willfully. Unlike in civil contempt, a criminal contempt conviction will be upheld even if the underlying order is later invalidated. The rationale for this principle is that criminal contempt vindicates the authority of the court.

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<sup>^^</sup> It is unsettled whether a bankruptcy court qualifies as a “court of the United States” for purposes of imposing § 1927 sanctions.

<sup>^^^</sup> The leading cases on each side of this controversy are *In re Ragar*, 3 F.3d 1174 (8th Cir. 1993) (held attorney who represented a Chapter 13 debtor after disqualification to be in criminal contempt) and *In re Hipp, Inc.*, 895 F.2d 1503 (5th Cir. 1990) (held that bankruptcy court lacked jurisdiction to hold creditor in criminal contempt for violating injunction against filing motions).

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A final key difference between civil and criminal contempt is that criminal contempt requires the same “beyond a reasonable doubt” standard of proof required for any other criminal conviction.

Although some courts and commentators have cast doubt on the power of a bankruptcy court to venture into the arena of criminal contempt, the Bankruptcy Rules clearly contemplate that bankruptcy judges will exercise criminal contempt powers. The notice requirement in Fed. R. Bankr. P. 9020(b) expressly requires that the alleged contemnor be informed in writing of whether the contempt charged is criminal or civil.

Those convicted of criminal contempt are sentenced under Sentencing Guideline § 2J1.1. Under that Guideline, the court is directed to apply whichever Guideline applies to an analogous crime. This means, for example, that a judge may look to Sentencing Guidelines covering such matters as obstruction of justice or fraud depending upon the nature of the acts committed.

No authority supports the power of a bankruptcy judge to impose a criminal sentence of incarceration. In *In re Finney*,<sup>^</sup> the bankruptcy court conducted the criminal contempt trial, found the defendant to be in criminal contempt, and then referred the matter to the district court for sentencing. Under Fed. R. Bankr. P. 9020(c), the defendant also had 10 days within which to file exceptions before the bankruptcy court judgment was final. This procedure has been followed in at least one other case.<sup>^^</sup>

Criminal contempt proceedings present many special issues. The defendant may be entitled to a jury trial, which only the district court can hold. A defendant has a right to a jury trial before a conviction for any crime other than a petty offense (i.e., a crime carrying a penalty of six months or less). In addition, the defendant may be entitled to

court-appointed counsel. Moreover, because a defendant is protected against double jeopardy, the courts and prosecutors should narrowly tailor the contempt charge so that it is not used to defeat a later indictment on other related charges. The double jeopardy problem might be more likely to arise for the unwary who convince a judge to impose a civil sanction that is later found a punishment. In *In re Power Recovery Systems, Inc.*, the United States Court of Appeals for the First Circuit stated expressly that a bankruptcy court’s label on its own judgment does not bind a higher court. 950 F.2d 798, 802 (1st Cir. 1991).

There are effective alternatives to seeking criminal contempt sanctions in bankruptcy court. For example, the government could ask the bankruptcy court to conduct an evidentiary hearing and to certify its findings to the district court for de novo consideration. In addition, the wrongdoer can be separately indicted for his contumacious acts.

United States Trustee (UST) attorneys are instructed to consult with the United States Attorney’s office before initiating or even participating in any criminal contempt proceedings. Furthermore, because of the minefield of special issues that attach to any contempt action, UST attorneys are well-advised to consult with their United States Attorney counterparts about civil contempt actions and potential sanctions as well.

## Conclusion

Debtors ranging from large financial services companies to consumers who have reached the end of their financial ropes walk through the doors of bankruptcy courts each day. With a full plate of issues before them on matters as diverse as tax liability and curing arrearages on home mortgages, bankruptcy judges play a crucial role in both the commercial and consumer realms of our economy. Given these broad responsibilities, bankruptcy courts should fully exercise their powers as federal courts.

United States Attorneys, United States Trustees, and other prominent litigants in the federal bankruptcy system should, in appropriate instances, ask bankruptcy courts to use the power of contempt to effect the purposes of the

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<sup>^</sup>167 B.R. 820 (E.D. Va. 1994).

<sup>^^</sup>*In re Darendia Downing*, 195 B.R. 870 (Bankr. D. Md. 1996) (after conviction and sentencing, and while the case was on appeal, the defendant was indicted for criminal contempt and for other crimes).

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Bankruptcy Code and to do justice. Federal government lawyers, in particular, have a responsibility to help the court in bringing and prosecuting contempt actions. As just described, the use of the contempt powers can inure to the benefit of the courts, and of the vast majority of diligent and honest litigants who rely upon the bankruptcy court to provide a “fresh start” for debtors and an efficient means for repaying creditors. ~

#### **ABOUT THE AUTHOR**

**Clifford J. White, III** is the Assistant United States Trustee for the District of Maryland - Southern Division. He joined the United States Trustee Program in 1991. White served as a Deputy Assistant Attorney General from 1986 to 1991 and as counsel in the United States Information Agency and Office of Personnel Management. He graduated with honors from George Washington University Law School. a

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# Prosecuting Bankruptcy Fraud: Meeting the Advice of Counsel Defense

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**B**ankruptcy fraud cases may be unlike most other matters handled by an Assistant United States Attorney or Criminal Division Trial Attorney.

While it is common for many targets and defendants to blame others for their criminal acts, the targets and defendants in bankruptcy fraud cases may actually have a plausible defense when they attempt to shift the blame.

Because almost every debtor and creditor is represented by counsel in bankruptcy cases, and may have acted in good faith upon the advice of counsel to protect their statutory rights, Department attorneys must try to rule out the advice of counsel or good faith defenses before indicting a debtor or creditor. Each of these closely related defenses negates the mental state needed to obtain a bankruptcy fraud conviction. Because the principles of federal prosecution instruct that a prosecutor should only “initiate or recommend federal prosecution if he or she believes that the person’s conduct constitutes a federal offense and that the admissible evidence probably will be sufficient to obtain and sustain a conviction,” *USAM* at § 9-27.220, it is critical to eliminate the advice of counsel/good faith defense.

If the prosecution can establish that the client did not rely on counsel, or hid information from the attorney, such a course of conduct will constitute excellent evidence of fraudulent intent. The goal of this article is to provide guidance to bankruptcy fraud prosecutors on how to acquire the information they need from the target’s attorney.

## Scope of the Problem

Two primary bankruptcy fraud statutes, 18 U.S.C. § 152 and §157, require the government to prove an elevated mens rea. Section 152 requires the government to prove that any crimes charged under its various subsections were committed “willfully and knowingly.” Similarly, Section 157 convictions require evidence beyond a reasonable doubt of fraudulent intent. A defendant who can establish a colorable claim to have relied on the advice of counsel before engaging in the conduct charged has a strong chance of convincing a jury that he or she had no wrongful intent, and the case can be lost on that basis alone.

A defendant’s reliance upon counsel can be raised as one of two closely-related defenses, namely either the “good faith” or “advice of counsel” defense. While both are discussed below, prosecutors should take care to review the distinct elements of these defenses within the jurisdictions in which they practice. *See generally*, Maggs, *Consumer Bankruptcy Fraud and the “Reliance on Advice of Counsel” Argument*, 69 AM. BANK. L. J. 1 (WINTER 1995).

According to Devitt, Blackmar, Wolff, & O’Malley, Federal Jury Instructions (§ 19.06), the good faith of a defendant is a “complete defense” to those offenses that require proof of the “intent to defraud” or the “intent to obtain money or property by means of false or fraudulent pretenses, representations, or promises.” “A person who acts, or causes another person to act, on a belief or an opinion honestly held is not punishable under this statute merely because the belief or opinion turns out to be inaccurate, incorrect, or wrong. An honest mistake in judgment or an honest error in management does not rise to the level of criminal conduct.” *Id.* “The burden of proving good faith does not rest with the defendant because the defendant does not have any obligation to prove anything.” *Id.* It is the government’s burden to

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prove beyond a reasonable doubt that the defendant acted with the required mental state. If the evidence in the case leaves the jury with a reasonable doubt about whether the defendant acted with the required mental state, or in good faith, the jury must acquit.

The defendant's good faith is a factual matter for the jury to decide. *United States v. Turner*, 799 F.2d 627, 629-30 (10th Cir. 1986). A good faith instruction is not required unless the defendant introduces sufficient evidence to support it. *United States v. Scherer*, 653 F.2d 334, 337 (8th Cir. 1981). In *United States v. Levine*, 970 F.2d 681 (10th Cir. 1992), the court stated that "if a person acts strictly according to the attorney's advice 'relying upon it and believing it to be correct, only intending his or her acts to be lawful' then that person cannot be convicted."

DEVITT, BLACKMAR, WOLFF, & O'MALLEY also discusses the "advice of counsel defense." (§ 19.08):

If, before (taking any action) (failing to take any action), Defendant . . . while acting in good faith and for the purpose of securing advice on the lawfulness of (his) (her) possible future conduct, sought and obtained the advice of an attorney whom (he) (she) considered to be competent, and made a full and accurate report or disclosure to (his) (her) attorney of all important and material facts of which (he) (she) had knowledge or had the means of knowing, and acted strictly in accordance with the advice (his) (her) attorney gave following this full report or disclosure, then the defendant would not be willfully or deliberately doing wrong in (performing) (omitting) some act the law (forbids) (requires), as those terms are used in these instructions.

*Id.* Whether the defendant acted in good faith, whether the defendant made a full and complete report or disclosure to counsel, and whether the defendant acted strictly in accordance with the advice received, are all questions for the jury to determine." *Id.* The advice of counsel defense is a more specific form of the defense of good faith. See also Pattern Jury Instructions of the District Judges Association of the Eleventh Circuit, Criminal Cases, Special Instruction No. 14 (1985).

The most credible witness to establish whether a defendant acted in good faith and upon the advice of counsel is the bankruptcy attorney. Thus, before making the charging decision, prosecutors should engage in a two-step process: 1) get an interview with the defendant to see if he or she places the blame for the bankruptcy fraud on his or her attorney; and 2) if the defendant does raise these defenses, get an interview with, or grand jury testimony from, the bankruptcy attorney. If the bankruptcy attorney takes responsibility, the case may be over. If not, the case is probably stronger for having eliminated the best defense.

### **Dealing With the Attorney-Client Privilege**

The primary problem prosecutors will face in eliciting an interview or testimony from the defendant's bankruptcy attorney will, of course, be the attorney-client privilege. Consideration of the scope and limits of this privilege reveal that it is surmountable, and that several grounds exist that warrant allowing the bankruptcy attorney to testify.

Federal Rule of Evidence 501 establishes that federal law controls the scope and availability of any claim of privilege that a party may exercise. In full, the rule states:

Except as otherwise required by the Constitution of the United States or provided by Act of Congress, or in rules prescribed by the Supreme Court pursuant to statutory authority, *the privilege of a witness, person, government, state, or political subdivision thereof shall be governed by the principles of the common law as they may be interpreted by the courts of the United States in the light of reason and experience.*

(Emphasis added). Thus, Rule 501 establishes that a debtor/defendant or creditor/defendant may only claim as privileged discussions with his or her attorney if federal law supports such a claim.

Under federal common law, the attorney-client privilege only applies if the following conditions exist:

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- (1) the asserted holder of the privilege is or sought to become a client;
  - (2) the person to whom the confidential communication was made (a) is a member of the bar of a court, or his subordinate and (b) in connection with the communication is acting as a lawyer;
  - (3) the confidential communication relates to a fact of which the attorney was informed (a) by his client (b) without the presence of strangers (c) for the purpose of securing primarily either (i) an opinion on law or (ii) legal services or (iii) assistance in some legal proceeding, and not (d) for the purpose of committing a crime or tort; and
  - (4) the privilege has been (a) claimed and (b) not waived by the client.

*Diversified Industries Inc. v. Meredith*, 572 F.2d 596, 601-02 (8th Cir. 1977); *In re Campbell Sixty Six Express Inc.*, 84 B.R. 632, 633 (Bankr. W.D. Mo. 1988) (holding federal law governs the extent to which confidential communications are within the scope of the attorney-client privilege). *See also United States v. (Under Seal)*, 748 F.2d 871, 874-75 (4th Cir. 1984) (discussing federal privilege).

In bankruptcy cases, the question of whether a communication is privileged hinges upon whether the information involved is confidential. As a matter of federal law, pre-petition information concerning a debtor's assets and liabilities is not confidential information. Federal Rule of Bankruptcy Procedure 1007 requires the full disclosure of this information (b), which reads in relevant part as follows . . . *the debtor . . . shall file* schedules of assets and liabilities, a schedule of current income and expenditures, a schedule of executory contracts and unexpired leases, and a statement of financial affairs, prepared as prescribed by the appropriate Official Forms. (Emphasis added). *See also* FED. R. BANKR. P. 9009 (Forms). To guarantee the truthfulness of the petitions and schedules, the

debtor is required to verify the accuracy of them by unsworn declaration.

Because all of the debtor's assets and liabilities on the date the bankruptcy was filed are property of the bankruptcy estate under 11 U.S.C. § 541, every debtor has a duty to disclose this information. It follows that any discussions between the debtor and counsel about assets that had to be disclosed relate to public information and cannot be characterized as deliberations concerning confidential data.

The Seventh Circuit addressed the question of whether information used in preparing a debtor's petition and schedules is confidential in *United States v. White*, 950 F.2d 426 (7th Cir. 1991). In *White*, a paralegal employed by the debtor's attorney prepared the debtor's petition. The attorney did, before filing the petition and schedules, review the documents. After the government began investigating the debtor for failing to disclose assets in his bankruptcy case, the local United States Attorney contacted the debtor's attorney for information. The attorney agreed to share non-privileged information about how the petitions and schedules were prepared. The information provided was used to convict the debtor of bankruptcy fraud. On appeal, the Seventh Circuit addressed the propriety of the disclosures.

The *White* Court instructed that the attorney-client privilege is to be narrowly interpreted because it is in "derogation of the search for truth." Therefore, the burden of proving every element of the attorney-client privilege falls on the party seeking to invoke it. The claim of privilege cannot be a blanket claim; it must be made and sustained on a question-by-question or document-by-document basis. Applying these principles to both the underlying bankruptcy case and the prosecution, the Seventh Circuit held that "information . . . transmitted to an attorney with the intent that the information will be transmitted to a third party. . . is not confidential."

The Seventh Circuit rejected the debtor-defendant's claim of confidentiality: "When information is disclosed for the purpose of assembly into a bankruptcy petition and supporting schedules, there is no intent for the information to

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be held in confidence because the information is to be disclosed on documents publicly filed with the bankruptcy court." Since the information was not confidential, it was not subject to the attorney-client privilege, and the debtor's attempt to challenge the use of evidence on grounds of confidentiality was rejected.

Footnote two of the *White* case also provides useful clarification related to the issue of what is and is not confidential. The court noted that information not contained in a debtor's petitions and schedules is actually a "lack of communication" and not a "confidential communication." *Thus, there is no rule prohibiting an attorney from discussing what he or she has not been told by the client.*

The Sixth Circuit followed the *White* approach in *United States v. Hubbard*, 16 F.3d 694 (6th Cir. 1993) (the information elicited from Hubbard's attorney was not protected by the attorney-client privilege because what Hubbard communicated to his attorney was to be conveyed to the bankruptcy trustee and the court via written pleading and thus was not protected by the privilege: the privilege extends only to confidential communications, not all communications.”).

The *White* decision was followed by the United States Bankruptcy Court for the District of South Dakota in *In re French*, 162 B.R. 541 (Bankr D. SD. 1994). The Bankruptcy Court ordered a paralegal employed by debtor's counsel to answer questions about what she had been told about the debtor's assets when she helped him prepare the schedules. The debtor's schedules failed to disclose that he had \$50,000 in the bank on the date of filing. When questioned about this omission at a 2004 Exam, he blamed the omission on the paralegal. When the government took the paralegal's deposition, she refused to answer questions about how the schedules were prepared on the grounds of attorney-client privilege. The government filed a motion to compel her to answer the questions. The court permitted the discovery for two reasons: 1) The court held that the information was not privileged because the debtor was required to disclose such data; and 2) even if it were confidential, the debtor had implicitly waived the privilege by attacking the

assistance rendered by the paralegal and her employer. The debtor was later convicted of four bankruptcy crimes and had his Chapter 12 case converted to a Chapter 7 due to fraud.

Though both *White* and *French* address the confidentiality of information contained in a debtor's schedules, the rule they follow is not necessarily limited to information related to the schedules. Arguably, the full scope of information that should be disclosed in monthly reports required by the United States Trustee or in a reorganization plan are also within the scope of the *White/Hubbard/French* analysis, as would be information underlying a creditor's proof-of-claim.

The Ninth Circuit, however, has not looked upon the *White/Hubbard/French* rule with favor. In *United States v. Bauer*, 132 F.3d 504 (9th Cir. 1997), the Ninth Circuit reversed a defendant's bankruptcy fraud conviction because it considered the privilege to have been violated when the prosecutor elicited testimony from the debtor-defendant's attorney about advice “recommending disclosure of all assets on petition and explaining perjury implication of falsifying petition.” At issue was not what Bauer told or gave to his attorney (as in *White/Hubbard/French*), but what his attorney explained to him about the disclosure requirements of the bankruptcy system.

Although there was nothing discretionary about it, and Bauer could have learned the same information simply by reading the forms he signed and filed under the penalty of perjury, the Court considered the attorney's explanation of the obligation to disclose assets to be “legal advice.” The *Bauer* Court was not persuaded that the attorney was acting as a “conduit for transmission of a message” from the bankruptcy court. This holding makes little sense, because the Federal Rules of Bankruptcy Procedure, which the United States Supreme Court promulgates, require debtors to file the schedules and statement of financial affairs, and to verify the information in them under oath. Comprehending how the attorney was not acting as a conduit of information is difficult. His comments were not advice—they were a statement of the debtor's unquestionable duties. In a sentencing context, several circuits have held that

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the bankruptcy rules are judicial orders,<sup>^</sup> so the attorney was simply passing on court ordered rules to his client. There was nothing advisory about the information conveyed.

The Ninth Circuit distinguished the holding in *White* by claiming that the Seventh Circuit's holding was limited to the disclosure of documentary information. The *Bauer* Court overlooked the fact that the attorney in *White* not only provided documents to the prosecution, but he testified about the documents, as well. The Court did not identify any reason to draw a distinction between information given to an attorney in documentary form and data given in verbal form, if each was intended to be used in the preparation of required disclosures.

*Bauer* is a poorly-reasoned decision that counsel can probably get around if they focus on the information the client provided to the attorney for disclosure in the schedules, the statement of financial affairs, and other documents, which even the *Bauer* Court recognized as non-privileged, rather than trying to elicit testimony concerning specific advice given to the debtor by his counsel.

The prosecution in *Bauer* may have made a tactical error, as well, though it is difficult to tell from the decision. The prosecution did not need to elicit this testimony concerning Bauer's knowledge of the disclosure requirements in its case-in-chief. Introduction of the signed schedules, which contain clear instructions and a penalty of perjury warning, would have established that Bauer was informed of his duty. The same data may have been available in a tape or transcript of the First Meeting of Creditors (341 meeting). The only way Bauer could have rebutted this evidence of his knowledge would have been to take the stand and blame his attorney for not explaining the disclosure requirements to him. Once Bauer did this, the attorney would have been free to testify as a rebuttal witness to defend the charges against him,

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<sup>^</sup> See Craig Peyton Gaumer, *Protecting The Bankruptcy Process: The Propriety Of Enhancing A Bankruptcy Criminal's Sentence For Abuse Of Judicial Orders Or Process*, 16-Sept. Am. Bankr. Inst. J.12 (1997)

and could also have testified due to the implied waiver of the attorney-client privilege made when Bauer testified. See Greenberg, Klingsberg & Mulligan, *Attorney-Client Privilege*, 30 AM. CRIM. L. REV. 1011 (Spring 1993); Hellerstein, *A Comprehensive Survey of the Attorney-Client Privilege And Work Product Doctrine*, 540 PLI/LIT 589 (FEB. 1996) (litigation and administrative practice course handbook series of the Practising law Institute).

Besides arguing that the privilege does not exist or has been waived, prosecutors can also argue, if the facts fit, that communications between an attorney and his client fall within the "crime-fraud" exception to the privilege. See *United States v. Sabbeth*, — F. Supp. 2d —, 1999 WL 52368 (E.D.N.Y. 1998) . As a result, "all Courts agree that the lawyer-client privilege does not extend to [such] communications" which are said to fall within the crime-fraud exception. WEINSTEIN ON EVIDENCE, Section 503.31[1] at 503-91.287, 292 (5th Cir.1986). For the government to establish the applicability of the exception it "must demonstrate that there is a factual basis for a showing of probable cause to believe that a fraud or crime has been committed and that the communications in question were in furtherance of the fraud or crime." *Id.* The government does not need to prove that the attorney knew of the scheme to defraud; it must only establish that the client used the attorney's services to plan or engage in an unlawful scheme. *In re Grand Jury Proceedings*, 87 F.3d 377 (9th Cir. 1996).

### **How to Obtain the Necessary Information**

Once the bankruptcy fraud prosecutor has determined during the investigation that he or she needs information from the debtor-defendant's or creditor-defendant's bankruptcy attorney, the next question is how to obtain the information. While multiple methods may exist, a few tactics may be among the best.

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First, the prosecutor can simply invite the attorney to be interviewed, and explain in detail why the privilege does not exist, or why an exception applies. Some attorneys may be willing to talk if the prosecutor can make strong arguments concerning these points.

Second, the prosecutor can ask the defendant to waive the attorney-client privilege so that the case agent can verify the accuracy of the advice of counsel/good faith defense. This method should only be used where the defendant has criminal defense counsel, or else the prosecutor runs the risk of being accused of prosecutorial misconduct for taking unfair advantage of the defendant (Sixth Amendment issues might also be implicated). In business Chapter 7 and Chapter 11 cases, the trustee can waive the attorney-client privilege. *Commodity Futures Trading Commission v. Weintraub*, 471 U.S. 343, 353 (1985). Defense counsel can simply be told that if the privilege is waived and the attorney supports the defense, the criminal case will likely be declined.<sup>^</sup> After all, the Department is not in the business of indicting innocent persons. Third, the prosecutor should consider bringing the bankruptcy attorney before the grand jury. Case agents conducting an interview may not be able to elicit the precise information that the prosecutor wants or needs, or may not recognize the need to ask important follow-up questions. Obtaining the testimony before the grand jury gives the prosecutor more control of his case, and allows the prosecutor a chance to assess the veracity and demeanor of the bankruptcy attorney as a potential witness.

Most bankruptcy attorneys, if not all, may move to quash the grand jury subpoena based upon the privilege. However, they cannot invoke the privilege wholesale, and must first refuse to answer specific questions based on the privilege. At that point, the prosecutor should proceed to the District Court with a Motion to Compel, and must prove to the Court why the information is not privileged or why it comes within an exception. Prosecutors employing this method should make sure that they

have the required prior Department approval before they subpoena an attorney. The request form is reproduced at the end of this article.

## Conclusion

Bankruptcy fraud cases have attorneys everywhere. The trustee is typically an attorney or is represented by one. The Assistant United States Trustees are attorneys. Debtors and creditors have attorneys. Consequently, the attorney-client privilege issue is likely to arise in most bankruptcy fraud investigations and prosecutions, and prosecutors should plan and develop a concise strategy to address these issues. ~

## ABOUT THE AUTHOR

**Craig Peyton Gaumer** is an Assistant United States Attorney in the District of South Dakota, and has served in that capacity since 1991. He chairs the South Dakota Bankruptcy Fraud Task Force and is a member of EOUSA's Bankruptcy Fraud Working Group. He has served as the Chair of the American Bankruptcy Institute Commercial Fraud Task Force. He obtained his law degree in 1989 from Washington University. a

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<sup>^</sup>Of course, this negotiating tool should not be used if other charges would remain outstanding.

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# Sentencing Bankruptcy Crimes

Joe B. Brown  
United States Magistrate Judge  
Middle District of Tennessee<sup>^</sup>

Even as the Justice Department prosecutes bankruptcy crimes with increased frequency, some criminals escape with a lighter sentence than the guidelines call for because courts and prosecutors lack experience in sentencing these crimes. This article highlights some special considerations that apply to bankruptcy crimes that may not apply to other cases of fraud, theft, or perjury.

The most common bankruptcy crime is concealment of assets by a debtor in bankruptcy. The debtor seeks the benefit of the automatic stay to stop his creditors in their tracks. He may also seek a discharge of all dischargeable debts at the close of the bankruptcy process. The corrupt debtor attempts to conceal assets so there will be no distribution of his non-exempt assets to creditors. This scenario can result in several guideline applications that do not occur in the average white collar crime case.

Most bankruptcy crime prosecutions are brought under 18 U.S.C. §§ 152 through 157. In fact, § 152 and its nine subparagraphs cover about 90-percent of all possible bankruptcy crimes. Appendix A to the Sentencing Guideline Manual contains three different guidelines that can apply to § 152—Guideline 2B4.1 for theft, Guideline 2F1.1 for fraud, and Guideline 2J1.3 for perjury. Any or all of these can apply in a particular prosecution.

## Guideline Applications

Many bankruptcy fraud cases involve multiple violations that can be brought under separate counts of § 152. As part of the

bankruptcy process, the debtor must file, under the penalty of perjury, a petition and schedules of all assets and liabilities. Shortly after the case is filed and the debtor has obtained the benefit of the automatic stay, the first meeting of creditors (or “341 meeting” is held, where the debtor is placed under oath and questioned about his financial affairs by a United States Trustee, a standing trustee, or a case trustee. Creditors may also appear and ask questions. The corrupt debtor often commits separate offenses, such as concealing assets under Paragraph 1 of § 152 when he fails to list assets on the appropriate schedules, and perjury under Paragraph 2 of § 152 when he signs those schedules under the penalty of perjury. This pattern is repeated when the debtor lies under oath about his assets at the 341 meeting.

If a violation of only Paragraph 1 of § 152 is charged, Guideline 2F1.1 applies. Under this guideline, loss is a major consideration. (How to calculate loss will be discussed later in this article.) Other issues, however, are also relevant under Guideline 2F1.1. First, the enhancement for more than minimal planning under Guideline 2F1.2(b)(2)(A) normally applies. Bankruptcy involves a process that takes some preparation and time. The debtor must file the petition, schedules and other documents, and appear at the section 341 meeting and other proceedings. Therefore, bankruptcy fraud is not a spur of the moment, one-shot crime.

Even if the court is not convinced that there is more than minimal planning, there are usually multiple victims as provided under Guideline 2F1.2(b)(2)(B). Case law seems settled that each creditor is a victim, and most cases involve a bankruptcy trustee as well. *See United States v. Nazifpour*, 944 F.2d 472 (9th Cir. 1991); *United States v. Saacks*, 131 F.3d 540 (5th Cir. 1997). Some defendants have tried to argue that the trustee is the only victim, but the trustee clearly represents all unsecured creditors. Secured creditors are also defrauded in many cases. Thus, unless you have a rare case with only a single creditor, this two-level adjustment should apply.

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<sup>^</sup> The comments in this article are my own and do not necessarily represent the opinion of anyone else.

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## Violation of Judicial Process

Another potential upward adjustment is commonly missed. Guideline 2F1.1(b)(4)(B) directs a two-level increase for “violation of any judicial or administrative order, injunction, decree, or process not addressed elsewhere in the guidelines.” If the resulting level is less than level 10, the guidelines direct an increase to level 10. Thus, under this guideline section, any bankruptcy crime will be at least a level 10 despite the loss amount.

Almost every court to consider the issue has held that this increase applies to a debtor who conceals assets by providing false information on his bankruptcy petition and schedules. See the cases collected in *United States v. Messner*, 107 F.3d 1448 (10th Cir. 1997); *United States v. Saacks*, 131 F.3d 540 (5th Cir. 1997); and *United States v. Mohamed*, 161 F.3d 1132 (8th Cir. 1998). As a caution, if you are in the First or Second Circuit, look at *United States v. Shadduck*, 112 F.3d 523 (1st Cir. 1997) and *United States v. Carrozzella*, 105 F.3d 796 (2d Cir. 1997), which question the automatic application of this increase without specific findings by the district court about the exact order or process violated.

The majority interpretation of this adjustment is very reasonable. Bankruptcy fraud is a particularly egregious type of fraud because it directly involves the federal court system. By filing for bankruptcy, the debtor invokes the automatic stay and receives the protection of the Bankruptcy Code. The debtor abuses the judicial process in a fundamental way if he provides false information in the bankruptcy process.

## Expenditure of Substantial Resources

In cases involving high dollar loss, the guideline applicable to fraud or theft will usually be higher than the guideline applicable to perjury. However, the perjury guideline—Guideline 2J—is useful if the dollar loss is uncertain or relatively small. Guideline 2J1.3 has a base level of 12 despite the amount of loss. Obtaining a three-level enhancement under 2J1.3(b)(2) may even be possible if you can show that the perjury or false

statements under § 152 caused “[u]nnecessary expenditure of substantial governmental or court resources.”

The United States Trustee’s Office can help you decide whether the case in question caused “substantial” expenditure of governmental or court time. A lie that is quickly caught and corrected will not trigger this enhancement. Commonly, however, unraveling complicated dealings engaged in by a debtor to hide assets requires substantial effort and time by the United States Trustee and many court proceedings. AUSAs should not overlook this guideline application since it will bring the case to a level 15, regardless of the money involved.

It may be possible to secure an additional one-level enhancement by charging a fraud violation for filing false schedules and a false oath offense for lying at the section 341 meeting. Arguably, these are separate violations that should not be grouped and another level under Guideline 3D1.4 should be added.

## Professionals

Debtors and creditors trying to beat the system frequently use attorneys, accountants, and other professionals to aid them in their efforts. The two-level increase under Guideline 3B1.3 for use of a special skill should be sought in all cases against professionals. Moreover, a Chapter 11 bankruptcy debtor usually remains in control of his or the company’s assets as a debtor in possession (DIP). The DIP has all the authority of a case trustee and acts by operation of law as a fiduciary to the creditors of the bankruptcy estate. As such, the DIP seems to hold a position of private or public trust under Guideline 3B1.3, although this application of the guideline has not been widely argued.

Always seek an enhancement for use of a special skill or abuse of a position of trust in cases against a trustee or a trustee’s professional agent such as an accountant or an auctioneer. Such an individual either has a professional license or is appointed to that position and can act only with the approval of the bankruptcy court.

## Valuation of Loss

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Determining the loss is critical under both Guidelines 2B and 2F. Bankruptcy crimes present several unique issues relating to loss valuation. For most bankruptcy offenses, the money involved is the single most important factor that affects sentencing. The guidelines look to the greater of the gain to the defendant or the actual or intended loss to the victim or victims.

In bankruptcy cases involving theft or embezzlement, loss is calculated as in non-bankruptcy theft and embezzlement cases: loss equals the property or money stolen. Still, valuation of loss is often more complicated in concealed assets cases. A defendant who gives false information with intent to conceal assets intends to deprive the creditors of the value of that asset, so the value of the asset sought to be concealed is one proper measure of loss. *United States v. Beard*, 913 F.2d 193, 196 (5th Cir. 1990). If the property concealed has a clearly established value, such as a bank account or a car, valuation is simple. In other cases, the time for the valuation may be a consideration. The court held in *United States v. Smithson*, 49 F.3d 138 (5th Cir. 1995), that a stock option should be valued as of the date the bankruptcy case was filed, not the date the concealed stock option was later exercised.

A good general discussion of valuation can be found in *United States v. Anderson*, 68 F.3d 1050 (8th Cir. 1995). The debtor in *Anderson*, who had debts of about \$1.35 million, listed assets of \$446,000 when he actually had assets sufficient to pay all debts in full. He settled with his creditors for some \$590,000 before his case was closed. The court calculated the intended loss as the difference between the listed liability and the listed assets—a little over \$900,000. The court gave the debtor credit for the \$590,000 he paid before his case was closed and held him responsible for an intended loss of \$400,000. The court considered, but rejected, valuing the creditors' loss at approximately \$250,000, which was the amount by which the creditors reduced their claims based on the false asset amount listed.

How much liability a debtor tries to discharge acts as a cap upon both actual and intended loss. It is hard to argue that the loss is more than the debts sought to be discharged. If a debtor undervalued

property by \$200,000 but owed only \$50,000, loss would clearly be limited to \$50,000. *United States v. Waller*, 29 F.3d 908 (5th Cir. 1994). There are a number of cases on valuation, including *United States v. Edgar*, 971 F.2d 89 (8th Cir. 1992); *United States v. Levine*, 970 F.2d 681 (10th Cir. 1992); *United States v. Nazifpour*, 944 F.2d 472 (9th Cir. 1991); and *United States v. Dolan*, 120 F.3d 856 (8th Cir. 1997); see also *United States v. Saacks*, 131 F.3d 540 (5th Cir. 1997).

### **Intended Loss: Amount Sought to be Discharged**

I have argued occasionally that the intended loss should ordinarily be the amount of debt sought to be discharged. The best case on this point is *United States v. Holland*, 160 F.3d 377 (7th Cir. 1998), where creditors held \$454,000 in judgments against the debtors who, in turn, concealed \$32,284 in an undisclosed bank account when they filed for bankruptcy. The district court valued the loss at the amount of debt sought to be discharged, not the value of the hidden bank account. The Seventh Circuit said:

Since the evidence showed that the acts of bankruptcy fraud were committed to obtain a discharge of the \$454,000 in default judgments, the district judge was justified in finding that the loss was \$454,000, thus increasing the offense level pursuant to United States Sentencing Guidelines § 2F1.1(b)(1)(J). Shirley's reliance on *United States v. Gunderson*, 55 F.3d 1328, 1331 (7th Cir. 1995), is misplaced, because the court there explicitly refused to choose between the prosecution's and defendant's methods of calculating intended loss. The Hollands' failure to disclose the assets of the bankruptcy estate was motivated to obtain a discharge of \$454,000 owed to Joe's and HEC's creditors. Consequently that is the intended loss.

*Holland*, 160 F.3d at 381.

A bankruptcy debtor seeks to discharge all dischargeable debts. The Bankruptcy Code provides very short deadlines for revoking a discharge, even if obtained by fraud. The argument that the intended loss is the amount of debt intended to be discharged is entirely reasonable and

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consistent with the theory of intended loss. The Fifth Circuit used this approach in *United States v. Saacks*, 131 F.3d 540 (5th Cir. 1997).

This argument can also be made with respect to a debtor who is ineligible to file for bankruptcy. I once successfully argued this theory before the district court in a case involving a debtor who was ineligible for Chapter 7 because he had filed under that chapter within the past six years. In his second bankruptcy case, he lied about the prior filing. The district court valued the loss at all the debt he sought to discharge.

*United States v. Cobleigh*, 75 F.3d 242 (6th Cir. 1996), also supports this theory. The *Cobleigh* court used the listed liabilities as a start in calculating the intended loss, although it ultimately reduced the loss by 50 percent after the debtor claimed he inflated his liabilities to ensure he received a discharge.

### Bankruptcy Schemes

Another very effective statutory provision is 18 U.S.C. § 157, enacted by Congress in 1994 to cover a wide range of fraud cases in which the bankruptcy system was used to help carry out the fraudulent scheme. Section 157 tracks, in large part, the language of the mail and wire fraud statutes, 18 U.S.C. §§ 1341 through 1344.

The Sentencing Commission has not yet designated the guideline sections that apply to this statute in Appendix A of the Guideline Manual. However, using the guideline section applicable to mail and wire fraud statutes appears reasonable because the language of those statutes is so close to that of Section 157.

### Conclusion

Bankruptcy crimes can affect a lone defrauded ex-spouse or an entire class of swindled investors. Beyond that, they also damage the integrity and credibility of the bankruptcy court system. It is well worth examining a case's special circumstances to ensure that the defendant receives a sentence truly reflecting the serious harm that

bankruptcy crime inflicts upon the bankruptcy system.<sup>^</sup> ~

### ABOUT THE AUTHOR

**Joe B. Brown** was appointed United States Magistrate Judge for the Middle District of Tennessee in August 1998. From 1991 to 1998 he served as Special Assistant United States Trustee in Nashville, with responsibility for coordinating the United States Trustee Program's criminal program. From 1981 to 1991 he was the United States Attorney for the Middle District of Tennessee; for 10 years before that he was an Assistant United States Attorney. He chaired the Sentencing Guidelines Subcommittee of the Attorney General's Advisory Committee from 1987 to 1991. **a**

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<sup>^</sup>For additional materials on this subject, contact the United States Trustee in your district. Several members of the United States Trustee's bankruptcy fraud working group are available for assistance on specific cases. The United States Trustee's Office in each district has a manual on bankruptcy crimes that goes into great detail regarding what constitutes the various bankruptcy crimes and the elements of each crime. Assistant United States Trustee Sandra Rasnak of the Chicago office can assist in any national coordination needed with the United States Trustee Program. At the district level, your local United States Trustee's Office can assist on procedures involving the bankruptcy process and can provide expert testimony at trial or sentencing. Assistant United States Attorney Craig Gaumer of the District of South Dakota has also written several articles on sentencing bankruptcy crimes.

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# The Criminal Side of Sears

Mark J. Balthazard  
Assistant United States Attorney  
District of Massachusetts

**O**n February 19, 1999, a subsidiary of Sears, Roebuck and Co. pleaded guilty to one count of bankruptcy fraud in violation of 18 U.S.C. § 157 and was sentenced to pay a record \$60 million fine. Sears' fraud involved its policy of not filing reaffirmation agreements with bankruptcy courts when Sears believed such agreements would be rejected, and leading *pro se* debtors to believe the agreements were court-approved, legally-binding obligations when in fact the underlying debts had been discharged.

## Background Information

To understand the fraudulent conduct fully, a brief description of bankruptcy discharge and reaffirmation agreements is necessary. When an individual files a Chapter 7 bankruptcy, the main benefit he or she gets is a discharge of pre-bankruptcy debts. This means that he or she not only gets rid of the debt, but that the creditor is enjoined from trying to collect on the debt. The Bankruptcy Code, however, permits debtors to reaffirm some of those debts rather than have them discharged. To do so, the debtor and creditor have to execute a written agreement that complies with all the requirements of the Code, including that the agreement be filed with the Bankruptcy Court. Also, when the debtor is acting *pro se*, the Bankruptcy Court is required to hold a hearing during which it must advise the debtor of the effects of reaffirmation and determine if the reaffirmation would impose a hardship on the debtor and is in the debtor's best interest. The purpose of the filing and hearing requirements is so the Bankruptcy Court can maintain oversight of reaffirmation agreements reached by debtors and protect debtors from being coerced into signing such agreements, and to assure that they fully understand the consequences of doing so.

Despite the clear language of the Bankruptcy Code requiring the filing of reaffirmation agreements, Sears' written policy from 1985 until 1997 was not to file such agreements when it believed the bankruptcy court would reject them, particularly when the debtor was acting *pro se* or if the debtor's attorney refused to sign the agreement. During that time, Sears entered about 180,000 of these agreements, which it did not file with the courts, and obtained about \$120 million in payments to which it was not entitled.

Sears' fraudulent reaffirmation practices begin in 1985. In response to an increase in bankruptcy filings, Sears' western United States operations began an aggressive program to seek reaffirmation agreements in nearly all bankruptcy cases filed. As part of that program, credit and legal department personnel drafted a bankruptcy manual. The manual stated that reaffirmation agreements had to be filed and stressed that after a debtor received a discharge, Sears was permanently enjoined from trying to collect its debt or having any contact with the debtor about the debt.

Nevertheless, the manual and subsequent versions went on to state that such agreements should not be filed with the court under circumstances where it was likely the bankruptcy court would reject them. Sears clearly understood that it was acting to avoid the Bankruptcy Court's legitimate review of such agreements, since the manual recommended not filing when, for example, a bankruptcy judge regularly rejected such agreements because the judge believed they were not in the best interest of the debtor.

Sears was not concerned about losing money from this practice because it found that even when the agreements were not filed, debtors continued to make their payments. This was not surprising since the Sears' employees responsible for getting debtors to sign the agreements were never instructed to tell them that the agreement would not be filed, that it was void and unenforceable and that the debtor had no obligation to make any payments. In fact, the agreements themselves suggested that they would be filed in court and

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were legally binding documents. The agreements were in the form of bankruptcy court pleadings, with a standard heading used on bankruptcy court pleadings. At the bottom of each agreement was a section entitled "Order Approving Reaffirmation Agreement" and a line for a bankruptcy court judge to sign where the debtor was acting *pro se*. The language of the agreement itself also reflected a binding obligation. It stated that debtors "reaffirm, promise, and agree" to pay Sears; that upon default of an installment, the entire balance was due and payable immediately; and that the debtor "promises, reassumes, and agrees to be bound by all the terms and conditions as set forth in the original security agreement" with Sears.

Debtors, particularly those unrepresented by counsel, did not know that the agreement was not legally binding and fully enforceable against them. Believing that it was, they made their payments. Furthermore, in direct violation of the discharge injunction, Sears sent those debtors monthly bills demanding payment. When debtors did not pay, they received dunning phone calls from Sears. Sometimes, Sears even sued in state courts to collect on pre-petition debts, relying on the assumption that the debtor would not know the reaffirmation agreement was not filed in court and therefore unenforceable, and would not raise that as a defense.

The fraudulent reaffirmation practices, which were begun at Sears' west coast operations, were expanded nationwide by early 1987. A large increase in consumer bankruptcies fueled the expansion of the program. In 1987 Sears received more than 130,000 bankruptcy notices on active accounts, amounting to a balance of more than \$100 million. In September 1990 the head of Sears' credit department advised all credit managers in writing that bankruptcy recoveries were an extremely high priority and that it was "imperative that every effort be made to maximize recoveries." He noted that the company's bankruptcy losses were going to exceed \$200 million that year. Attached to that memo was a series of questions and answers relating to bankruptcy, including the advice that if bankruptcy judges routinely reject reaffirmations, they should not be filed with the court, but instead kept in

Sears' files and customers' payments accepted. So while credit managers were being told of the high priority of increasing bankruptcy recoveries, they were also being told to bypass the bankruptcy judges that were getting in the way of those recoveries.

This conduct was perpetuated through the bankruptcy manual and by training sessions conducted nationwide. Senior executives within Sears' national credit department, as well as members of Sears' legal department, knew and condoned it.

Sears engaged in this conduct despite legal advice from inside and outside the company that the policy of not filing all reaffirmation agreements and sending bills to debtors was, at best, highly risky and at worst illegal. In 1985, shortly after the first bankruptcy manual was put in use, Sears obtained a legal opinion on its bankruptcy manual from an outside attorney. He advised that if Sears did not believe a court would approve a particular reaffirmation agreement, then the company should not enter into it. He stated that if such agreements ever became known in a later legal proceeding, Sears might be liable for punitive damages for operating outside the bounds of fairness as established in the Bankruptcy Code. Sears not only disregarded this advice, but its in-house counsel responded by criticizing bankruptcy judges who, he said, refused to approve such agreements "based merely on their own prejudices about what is best for the debtor."

The issue was again raised with counsel in the early 1990's, by a senior executive in Sears' Recovery Unit. He asked an in-house attorney whether the company could send monthly statements on non-filed reaffirmation agreements, knowing that was the regular practice at the time. The attorney replied that Sears could not send such statements, explaining that since the bankruptcy court had discharged the debt, it would be a violation of the Bankruptcy Code and the discharge injunction to send bills to collect on such debts. When that attorney was told that in fact such bills were being sent out, he advised that the practice should stop because it was against the law and the company could be subject to sanctions by the

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bankruptcy court and civil suits. That advice was also ignored.

The executive later reduced his thoughts to writing in an e-mail sent to his superior—then the third most senior person in Sears’ national credit department—as well as a member of the legal department. The memo stated that the policy of sending the monthly statements on unfiled reaffirmation agreements was a business decision made after weighing the small likelihood of getting caught versus the large advantages of obtaining hundreds of reaffirmations without filing them with the bankruptcy court. It stated that since the customer was obviously cooperating with Sears by signing the agreements, the risk was low that they would complain. It concluded that “probably the biggest risk that [Sears] would have would be if some attorney happens to run across it and thinks he might have grounds for a class action suit because of a bankruptcy code violation.” This document reflects clearly that the decision not to file the reaffirmation agreements, and to continue to send monthly statements to customers, was a business decision made with the recognition that such conduct was a violation of the law. Certain Sears executives were willing to take that risk because of the substantial financial benefit to Sears and the small risk of getting caught. Moreover, Sears executives decided that even if they were caught, that was the cost of doing business, with the most severe repercussions being a possible class action suit in which they would have to repay their ill-gotten gains.

An in-house attorney to several senior credit department employees also gave similar advice to stop sending such bills in 1996. The practice, however, continued despite this advice.

Sears’ fraudulent practices finally became known as the result of the actions of a *pro se* debtor in Massachusetts who signed an unfiled reaffirmation with Sears, but later sought to get the bankruptcy judge to discharge that reaffirmed debt. When Chief Bankruptcy Judge Carol Kenner learned that the reaffirmation agreement had not been filed, she summoned Sears into court and eventually learned that there were thousands of such unfiled agreements relating to Massachusetts debtors alone.

Judge Kenner’s discovery ultimately led to Sears paying restitution and penalties to debtors of more than \$180 million and civil fines of \$40 million to the fifty state attorneys general. Sears’ senior management recognized the wrongfulness of the company’s conduct and cooperated fully with the United States Attorney’s office in Boston. Sears waived the attorney-client privilege as to all historical matters, made witnesses available, and sorted through the documentary record to bring to the government’s attention the most incriminating materials.

The decision of the United States Attorney for the District of Massachusetts to prosecute Sears criminally was appropriate and necessary. For more than a decade, Sears engaged in a practice of effectively usurping the Bankruptcy Court’s role in the reaffirmation process. Sears’ conduct was the result of a conscious business decision made after weighing what it considered was the small risk of getting caught versus the substantial benefit of continuing to collect on debts. Sears’ actions showed contempt for the Bankruptcy Code, the Bankruptcy Courts, and the entire bankruptcy system. A criminal prosecution was necessary to vindicate the harm Sears caused to that system.

Congress contemplated prosecution of creditors for such conduct when it enacted 18 U.S.C. § 157 in 1994. The Congressional record states that the law could “apply to creditors as well as debtors. For example, if a creditor as part of a scheme to defraud a debtor or debtors, knowingly made false statements to a debtor concerning the debtor’s rights in connection with a bankruptcy case, that creditor could be subject to this section.”

While the typical bankruptcy fraud is committed by debtors who conceal or lie about their assets, the action of creditors such as Sears in preying on debtors was as much an abuse and fraud on the system. In order for the system to work, all participants must comply with the law and not abuse it for their own advantage. ~

#### **ABOUT THE AUTHOR**

’ **Mark J. Balthazard** has been with the United States Attorney’s office in Boston since 1989, where he works in the Economic Crimes Unit. From 1989 to 1992, he served as a Special

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Assistant United States Attorney through the United States Trustee's office in Boston and handled bankruptcy fraud cases. He has also been in private practice and served as an attorney at the Securities & Exchange Commission. In 1997, he received the Attorney General's Award for Distinguished Service in connection with his work on the investigation and prosecution of Damon Clinical Laboratories, Inc. He graduated from Boston University School of Law in 1984. a

#### **Summary of Sears' Fines and Penalties**

- ' \$60 million federal criminal fine;
- ' \$40 million civil fine to the 50 state attorneys general;
- ' Over \$180 million in restitution; and
- ' Federal Civil permanent injunction.

#### **Involvement of the U.S. Trustee's office**

The United States Trustee's office in Boston was instrumental in bringing to light the number of Massachusetts debtors who were defrauded by Sears. The United States Trustee's involvement led directly to the opening of the criminal investigation by the United States Attorney's office in Boston. The United States Trustee's office also participated in negotiations resulting in Sears' substantial civil settlements. ~

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# United States Attorneys' Offices/ Executive Office for United States Attorneys

## Honors and Awards

### 1999 Arthur S. Flemming Awards Program

Assistant United States Attorney Richard Craig Smith, Southern District of Texas, currently on detail to the Counsel to the Director's Staff, Executive Office for United States Attorneys, received the 50<sup>th</sup> Annual Arthur S. Flemming Award. This annual award recognizes outstanding young men and women who have made exceptional contributions to the Federal Government.

AUSA Smith received this award for his outstanding achievements as a federal prosecutor, exceptional dedication to the law, and commitment to serving the public by reducing crime. Faced with large-scale law enforcement problems along the Texas Southwest Border, Mr. Smith represented the government in many important public corruption cases, including a complex, high-profile case in which he played a key leadership role in coordinating the investigation and prepared for seven trials, all of which he successfully prosecuted. In his current position on detail to the Executive Office for United States Attorneys, Mr. Smith contributes to the development of programs concerning civil rights, immigration, narcotics, organized crime, human rights, and other vital Department policies that shape and guide daily prosecutions and litigation throughout the country. The award was presented to Mr. Smith on June 10, 1999, in Washington, D.C. ~

## Resignations/Appointments

### District of Colorado

On April 21, 1999, Thomas Strickland was sworn in as the Presidentially-appointed United States Attorney for the District of Colorado. ~

### District of Delaware

On May 17, 1999, Carl Schnee was sworn in as the Presidentially-appointed United States Attorney for the District of Delaware. ~

### Northern District of Indiana

On June 25, 1999, David A. Capp was sworn in as the AG-appointed United States Attorney for the Northern District of Indiana effective June 28, 1999. ~

### Southern District of Texas

On April 5, 1999, Mervyn M. Mosbacher was sworn in as the Court-appointed United States Attorney for the Southern District of Texas. ~

## EOUSA Staff Update

In February 1999, the Executive Office of United States Attorneys welcomed Assistant United States Attorney Mary Murguia, District of Arizona, as Principal Deputy Director of EOUSA. Ms. Murguia joined the United States Attorney's

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office for the District of Arizona in 1990. Since 1994, Ms. Murguia has been the district's Deputy Chief of the Criminal Section, in charge of the Violent Crime Unit. Ms. Murguia obtained her Juris Doctorate in 1985 from the University of Kansas. She completed her undergraduate education with a B.S. in Journalism and a B.A. in Spanish, in 1982 from the University of Kansas. ~

In March 1999, the Executive Office for United States Attorneys welcomed James L. Santelle, an Assistant United States Attorney for the Eastern District of Wisconsin, as a Deputy Director of EOUSA. Mr. Santelle joined the United States Attorney's office for the Eastern District of Wisconsin in 1985. Since 1993, Mr. Santelle has been the district's Civil Chief. Mr. Santelle obtained his Juris Doctorate in 1983 from the University of Chicago Law School. He completed his undergraduate education with a B.A. in English and History, in 1980 from Marquette University. ~

In February 1999, Assistant United States Attorney Kelly Shackelford, District of South Carolina, began a one-year detail with OLE as its new Deputy Director. She previously served OLE as an Assistant Director in charge of management training and related areas. As Deputy Director, she is responsible for assisting in the supervision of the seven teams that develop and facilitate the courses sponsored by OLE. ~

On February 1, 1999, Assistant United States Attorney Charlie Bourne began a detail with the Office of Legal Education. He is from the Southern District of Georgia, where he served in the Criminal Section. He is working at the National Advocacy Center. ~

In March 1999, Assistant United States Attorney Jon Gant of the Eastern District of Texas (Plano) completed an 11-month detail to Legal Programs. During his detail, he served as an attorney-advisor to the Department of Housing and Urban Development's (HUD) Enforcement Center.

In March, he accepted a permanent position with HUD. ~

On March 2, 1999, Assistant United States Attorney Janet Papenthien began a detail with the Office of Legal Education. She is from the Northern District of Iowa, Sioux City branch office, where she handled violent crime and white collar crime cases. She is working at the National Advocacy Center. ~

On April 6, 1999, Assistant United States Attorney Pat Stout began a detail with the Office of Legal Education. She is from the Northern District of Georgia, where she has handled a variety of civil cases with an emphasis in the employment discrimination area. She is working at the National Advocacy Center. ~

On April 26, 1999, Assistant United States Attorney Marialyn Barnard completed her detail with the Office of Legal Education and returned to the United States Attorney's office for the Western District of Texas, where she is handling civil affirmative and defensive cases. ~

In April 1999, Assistant United States Attorney Patricia A. Kerwin completed her detail with the Office of Legal Education and returned to the United States Attorney's office for the Middle District of Florida. ~

On April 11, 1999, Assistant United States Attorney Pam Moine completed her detail with the Office of Legal Education and returned to the United States Attorney's office for the Northern District of Florida, where she is handling defensive civil work with an emphasis in medical malpractice cases. ~

On April 21, 1999, Assistant United States Attorney Ann Dooley began a one-year detail with the Counsel to the Director's Office, EOUSA. She is responsible for monitoring issues on Violence Against Women, Indian Country, Child Support, Child Exploitation, and Obscenity. She is from the Northern District of Oklahoma, where she served as tribal liaison between the United States

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Attorney's office and eleven tribes in the district.  
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In May 1999, Kim Lesnak, Assistant Director, Law Enforcement Coordination/Victim Witness (LECC/VW) Staff returned to the United States Attorney's office, Northern District of Illinois. She served as the Assistant Director of the LECC/VW Staff for the past three and one-half years. She will continue to assist EOUSA in a number of nationwide programs and initiatives until her departure. Barbara Walker, Deputy Assistant Director of the LECC/VW Staff will serve as the Acting Assistant Director during this transition period. ~

In May 1999, Assistant United States Attorney Virginia Howard of the Northern District of Texas began a detail with Legal Programs. She is serving as EOUSA's liaison with the Civil Division and is working on *John Doe v. United States*. Before beginning her detail with Legal Programs, she was on detail to EOUSA's Legal Counsel's office. ~

In May 1999, Assistant United States Attorney Michael Cauley returned to the Middle District of Florida after completing a 14-month detail to Legal Programs and the Department of Housing and Urban Development. ~

In May 1999, Assistant United States Attorney Jamie Mittet completed a 14-month detail to Legal Programs and returned to the Western District of Washington. During her detail, she served as an attorney-advisor to HUD's Enforcement Center and as EOUSA's ACE Coordinator. ~

On May 3, 1999, Assistant United States Attorney Brian J. Quarles began a one-year detail with the Legal Counsel's Office, EOUSA. He is responsible for providing guidance to USAO and EOUSA personnel regarding ethics matters such as conflicts of interest, recusals, outside activities, and request for representation. He also provides advice to management on employee grievance matters and acts as agency counsel in personnel actions before the Merit System Protection Board.

He is from the Western District of Tennessee where he was assigned to the Civil Division. ~

On May 10, 1999, Assistant United States Attorney Samuel J. Louis began a one-year detail with Legal Counsel's Office, EOUSA. He is responsible for providing guidance to USAO and EOUSA personnel regarding ethics matters such as conflicts of interest, recusals, outside activities, request for representation and is the point of contact for the USAO regarding Hyde matters. He also provides advice to management on employee grievance matters and acts as agency counsel in personnel actions before the Merit System Protection Board. He is from the Southern District of Texas where he was assigned to the OCDETF section of the Drug Task force. ~

On June 1, 1999, Assistant United States Attorney Robert Troester of the Western District of Oklahoma began a detail with Legal Programs. He is serving as EOUSA's ACE Coordinator. ~

On June 28, 1999, Suzanne Little began a permanent position with EOUSA as the Assistant Director for the Freedom of Information Act Staff. She came to EOUSA from private practice where she was a respected criminal litigator who specialized in federal and state criminal defense. She has also served with the Office of Administrative Law Judges in the Department of Labor, the Department of Navy, and with the United States Attorney's office for the District of Columbia. ~

On June 28, 1999, Joseph Salama began service with EOUSA as the Assistant Director for the Case Management Staff. He previously served as the head of information technology for the Office of Naval Research and brings considerable technological expertise to his new position. ~

On June 28, 1999, Siobhan Sperin began service with EOUSA as the Deputy Assistant Director for the Case Management Staff. She came from the Department of Defense where she served as the Deputy Director, Joint Chiefs of Staff Year 2000 task Force. ~

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On June 30, 1999, Assistant United States Attorney Carolyn Adams, Northern District of Georgia, completed her detail with the Office of Legal Education. In August 1999, she will begin working for the United States Attorney's office for the Middle District of Florida, where she will handle criminal cases. ~

On July 6, 1999, Assistant United States Attorney Suzanne L. Bell began a one-year detail with the Legal Counsel's Office, EOUSA. She is responsible for providing guidance to USAO and EOUSA personnel regarding ethics matters such as conflicts of interest, recusals, outside activities, and request for representation. She also provides advice to management on employee grievance matters and acts as agency counsel in personnel actions before the Merit System Protection Board. She is from the Central District of California, where she served as an Assistant United States Attorney in the Civil Division. ~

On July 9, 1999, Assistant United States Attorney Kimberly A. Selmore, Middle District of Florida, completed her detail with the Legal Counsel's Office. On July 12, 1999, she began a detail in the Professional Responsibility Advisory Office. Her responsibility is to provide advice and guidance to Department attorneys on professional responsibility matters and the implementation of Section 530B. ~

On July 25, 1999, Eileen Grady became EOUSA's new Employee Assistance Program (EAP) Counselor. EOUSA recently instituted its own EAP program and looks forward to the continuity Ms. Grady will provide, since she served as one of the primary counselors for the United States Attorneys' organization while at Justice Management Division. She is a licensed clinical social worker who knows EOUSA and its employees well and has done substantial training for EOUSA in the past. ~

On July 30, 1999, Assistant United States Attorney Jennifer Bolen, Northern District of Texas, completed her detail with the Office of Legal Education. On August 16, 1999, she will

begin working for the United States Attorney's office in the Eastern District of Tennessee. ~

On August 27, 1999, Assistant United States Attorney Tim Wing will complete a 14-month detail with Legal Programs as EOUSA's Asset Forfeiture Coordinator. He will return to the District of Maine. The new Asset Forfeiture Coordinator will be Larry Wszalek, an Assistant United States Attorney from the Western District of Wisconsin. ~

In September 1999, Janet Craig, Civil Chief for the Southern District of Texas, will begin a detail with EOUSA to serve as the Legal Counsel. She has previously served with EOUSA as the Director of the Office of Legal Education and as the Acting Assistant Director for the Equal Employment Opportunity Staff. She will be replacing Marcia Johnson. ~

In September 1999, Marcia W. Johnson will complete her detail as Legal Counsel. She will return to the United States Attorney's Office for the Northern District of Ohio, where she will serve as the Chief, Civil Division. ~

## Office of Legal Education

### USABook Corner

The OLE Publications Staff has been busy preparing publications for Assistant United States Attorneys (AUSAs). Recently we distributed the handbook *Sentencing Guidelines and Collateral Review*. We are currently working on a new *Federal Criminal Practice Manual* and a *Brady/Giglio Handbook*, and will also publish a revision of the Grand Jury Manual. Keep your suggestions coming. We're listening! ~

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## **UPCOMING PUBLICATIONS**

Below you will find the current *Bulletin* publication schedule. Please contact us with your ideas and suggestions for future *Bulletin* issues. Please send all comments regarding the *Bulletin*, and any articles, stories, or other significant issues and events to AEXNAC(NBOWMAN). If you are interested in writing an article for an upcoming *Bulletin* issue, contact Nancy Bowman at (803) 544-5158, to obtain a copy of the guidelines for article submissions and publication deadline.

**Environmental I**

**Environmental II**