VOLUME 5: BANKRUPTCY FRAUD AND ABUSE ENFORCEMENT PROGRAM

CHAPTER 5-1: POLICY AND DUTY TO INVESTIGATE AND REFER

CHAPTER 5-2: DETECTING FRAUD AND ABUSE

CHAPTER 5-3: REFERRALS TO LAW ENFORCEMENT AGENCIES

CHAPTER 5-4: DECLINATION OF REFERRED CASES BY THE UNITED STATES ATTORNEY

CHAPTER 5-5: TRACKING CRIMINAL REFERRALS

CHAPTER 5-6: DISCLOSURE OF REFERRALS

CHAPTER 5-7: ALLEGATIONS INVOLVING LOSS OF ESTATE ASSETS BY A PRIVATE TRUSTEE OR AN EMPLOYEE OR AGENT OF A PRIVATE TRUSTEE

CHAPTER 5-8: BANKRUPTCY CRIMES

CHAPTER 5-11: GRAND JURY PROCEEDINGS

CHAPTER 5-12: IMMUNITY PROVISIONS

CHAPTER 5-13: PARALLEL PROCEEDINGS

CHAPTER 5-14: SENTENCING PROCEDURES AND RECOMMENDATIONS

CHAPTER 5-17: TRAINING RESPONSIBILITIES

CHAPTER 5-18: FORMATION OF WORKING GROUPS FOR CRIMINAL INVESTIGATION

CHAPTER 5-19: CIVIL REMEDIES FOR FRAUD AND ABUSE

VOLUME 5: BANKRUPTCY FRAUD AND ABUSE ENFORCEMENT PROGRAM

CHAPTER 5-1: POLICY AND DUTY TO INVESTIGATE AND REFER

5-1.1 POLICY OF THE DEPARTMENT OF JUSTICE

On October 10, 1995, Attorney General Janet Reno issued a memorandum reaffirming the position taken by the Department in 1992 which made "the aggressive prosecution of bankruptcy fraud a high priority of the Department of Justice." In the memorandum, General Reno stated "[i]t is imperative that the integrity of the bankruptcy system, an integral component of our national economy, be preserved and enhanced." She identified the basic components essential to a successful bankruptcy fraud effort--training; a team approach and coordination of all available resources; and prosecutorial discretion that focuses on the merits of a case rather than "a blanket declination policy based solely on dollar amounts." A complete copy of this memorandum is provided at Appendix 5-1.

5-1.2 DUTY TO INVESTIGATE AND REFER

5-1.2.1 United States Trustee, 28 U.S.C. § 586(a)(3)(F)

The United States Trustee has the duty of "notifying the appropriate United States attorney of matters which relate to the occurrence of any action which may constitute a crime under the laws of the United States and, on the request of the United States attorney, assisting the United States attorney in carrying out prosecutions based on such action." It is noteworthy that this section encompasses any crime, not just bankruptcy crimes, and imposes a duty to assist, as well as to report evidence of crimes.

5-1.2.2 Judges and Private Trustees, 18 U.S.C. § 3057(a)

A judge or private trustee "having reasonable grounds for believing that any violation under chapter 9 of this title or other laws of the United States relating to insolvent debtors, receiverships or reorganization plans

has been committed, or that an investigation should be had in connection therewith, shall report to the appropriate United States attorney all the facts and circumstances of the case, the names of the witnesses and the offense or offenses believed to have been committed. Where one of such officers has made such report, the others need not do so."

5-1.2.3 Chapter 11 Trustees and Examiners, 11 U.S.C. §§ 1106(a)(3) & (4)

A chapter 11 trustee or examiner has the duty to "investigate the acts, conduct, assets, liabilities, and financial condition of the debtor"; to file a statement of any such investigation conducted "including any fact ascertained pertaining to fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor"; and to transmit the statement to "any creditors' committee or equity security holders' committee, to any indenture trustee, and to such other entity as the court designates."

CHAPTER 5-2: DETECTING FRAUD AND ABUSE

5-2.1 DETECTION BY THE UNITED STATES TRUSTEE

5-2.1.1 Section 341 Meetings

The section 341 meeting provides an excellent opportunity to detect fraud and abuse. Questions by creditors, especially banks and other financial institutions, will often disclose the use of false social security numbers, the omission of assets, the improper disposition of property, as well as other irregularities.

The person conducting a section 341 meeting should verify the identity of the individual testifying and, in the case of a corporate debtor, the authority of the individual to testify on behalf of the debtor. All co-debtors should be present at the section 341 meeting, e.g., where a married couple files jointly, both spouses must be present and identified on the record.

The debtor should affirm, on the record, that he/she signed the petition and schedules submitted to the court, that he/she read them before signing them, and reaffirm that they are true and correct. If the debtor is hesitant on any of these issues, follow up questions should be asked. Creditors should be allowed sufficient time to ask questions, especially those relating to the accuracy of the filings or pleading. The hearing should be continued, rather than concluded, if satisfactory answers are not provided at the initial meeting.

5-2.1.2 Rule 2004 Examinations

The United States Trustee may also conduct an examination of debtor or other party pursuant to Rule 2004 of the Federal Rules of Bankruptcy Procedure. Where such an examination reveals evidence of fraud or abuse, it is important to ask follow-up questions to fully develop the relevant facts.

5-2.1.3 Use of Outside Agencies to Verify Accuracy of Information on Petition and Schedules

A debtor's petition and schedules should be examined for completeness and consistency. It is possible to verify the accuracy of information contained in a petition by checking it against information obtained from other agencies.

Examples of inquiries include: a suspicious social security number can be verified with the Social Security Administration; the status of loan payments and the transfer of property can be verified with the Federal Deposit Insurance Corporation; and the status of postpetition tax payments can be verified with the Special Procedures Branch of the Internal Revenue Service. In addition, under the provisions of 31 U.S.C. § 5319, information collected about monetary transactions over $10,000 may be secured by a request of the Director through the Financial Crimes Enforcement Network (FinCEN) of the Department of Treasury. Requests for FinCEN information are reserved for cases involving serious irregularities.

5-2.1.4 **On-line Investigative Public Records Information**

The Program has contracted with CDB Infotek to provide on-line access to public records information. Every office has access to the database by a dial-up line. The Infotek service can be a resource to identify and locate assets, verify social security numbers, and obtain litigation history information.

Information printed from the database should be handled as "Limited Official Use" information. See USTM 6-21.4 for additional information on document/information security.

5-2.1.5 **Investigations Must Have Legitimate Civil Purpose**

All investigations conducted by the United States Trustee, including section 341 meetings and Rule 2004 examinations, must relate to a valid civil enforcement goal of the United States Trustee. No investigation may be conducted purely for the purpose of developing evidence to support a criminal referral. U.S. v. Unruh, 855 F.2d 1363, 1374 (9th Cir. 1987), cert. denied, 488 U.S. 474 (1987). Criminal sanctions may not be threatened in the course of a civil proceeding.

5-2.2 **THIRD PARTY SOURCES**

5-2.2.1 **Referrals from Panel and Standing Trustees**

Case trustees should be encouraged to bring any evidence of fraud or misconduct to the attention of the United States Trustee. Trustees may become discouraged from making referrals because of the relatively few resulting criminal prosecutions. It is important to assure them that referrals serve multiple purposes, including tracking trends in fraudulent activity and documenting the need for additional investigative and prosecutorial resources. The United States Trustee should also emphasize that the level and effectiveness of a trustee's referrals are important elements in the performance rating process.

Case trustees should prepare their own criminal referral letters, under the supervision of the United States Trustee. Referrals of debtors should be transmitted under 18 U.S.C. § 3057, through the United States

Trustee. If a case trustee makes a referral directly to a law enforcement agency, a copy should be furnished to the United States Trustee.

5-2.2.2 Complaints from Various Third Parties

Creditors, employees, former business associates, estranged or former spouses, and significant others are all likely candidates to provide information about possible criminal misconduct. Often such complaints are made via the telephone or a complainant may request to meet in person to discuss his/her concerns.

It is generally advisable to request a complainant to provide a written summary of his/her complaint, together with all documentation or other evidence that supports the allegations. This not only assists in "weeding out" complaints that are based on mere suspicion or rumor, but it also provides a documented, first-hand statement that can form the basis of a criminal referral.

5-2.2.3 Third Party Motions, Adversary Proceedings, and Rule 2004 Examinations

The United States Trustee should monitor third party actions against a debtor for evidence of criminal misconduct. Particular attention should be given to cases where multiple relief from stay actions have been filed or where a creditor moves to deny a debtor's discharge. Rule 2004 examinations conducted in support of third party motions can yield useful facts relating to fraud and misconduct.

CHAPTER 5-3: REFERRALS TO LAW ENFORCEMENT AGENCIES

5-3.1 PRIOR APPROVAL FOR CERTAIN REFERRALS

5-3.1.1 Public Officials and Private Trustees or Their Employees

Where the subject of criminal conduct is a public official, a private trustee, or an employee of a private trustee, the United States Trustee must notify the Deputy Director in writing, with pertinent details on the

matter, and provide a copy to the General Counsel and Assistant Director for Review and Oversight. Thereafter, the United States Trustee should furnish copies of all correspondence related to the matter to the Deputy Director, the General Counsel, and the Assistant Director for Review and Oversight. The United States Attorney must also be notified of the existence of any inquiry into the conduct of such individuals.

5-3.1.2 Referrals Outside the Federal System

The General Counsel must be notified prior to any referral being made outside of the federal system.

5-3.2 PRIOR CONSULTATION WITH THE UNITED STATES ATTORNEY

Prior consultation with the United States Attorney regarding the referral process, preferably in the context of a working group or task force, is valuable to the development of an effective working relationship. (See USTM 5.18.) It is important to understand the level of available resources, the types of cases that are of particular interest, and any overriding enforcement policies, such as a threshold dollar loss, that are considered by the United States Attorney. While these considerations should not influence the number and type of referrals made, they can help focus resources on those referrals that are most likely to be prosecuted.

5-3.2.1 Formulating Mutual Policies on Referrals

Under some circumstances, it may be advisable to formalize an understanding with the United States Attorney and other investigative agencies as to what and how matters should be referred. For example, it may be appropriate to prepare a detailed referral package only in cases where the matter meets the minimum enforcement guidelines of the United States Attorney. Cases that fall below that threshold may be sent over with a less detailed referral, as appropriate. Copies of all referrals should normally be sent to the appropriate investigative agency(s) at the same time they are sent to the United States Attorney.

Consideration may be given to establishing different types or classes of referrals, with a description of the type of referral appropriate for each. Some different classes of referrals that might be considered include:

Class 1: The United States Trustee considers the case a priority and has already conducted an extensive civil investigation that has resulted in significant evidence of a federal crime. Class 1 cases may also involve special concerns such as trustee defalcation, misuse of funds by professionals, or other particularly serious law violations. The United States Trustee should request the appropriate investigative agency and the United States Attorney to give the case priority, consistent with resource availability.

Class 2: The complaint sets forth sufficient grounds to warrant further investigation and is accompanied by supporting documents and other relevant evidence, but the case does not meet the "highest priority" standard. The United States Trustee should prepare a detailed referral memorandum to the United States Attorney.

Class 3: The complaint either falls below established guidelines or lacks available supporting evidence. The United States Trustee should prepare a summary cover sheet and forward the matter to the United States Attorney and the appropriate investigative agency(s), along with a statement that the matter is furnished for their information and that the United States Trustee will consider the matter declined unless the United States Trustee is notified otherwise.

5-3.2.2 Consultation Regarding a Particular Referral

Where the referral involves a matter of particular concern to the United States Trustee, it may be beneficial to inform the United States Attorney and/or the Federal Bureau of Investigation of the existence of an investigation prior to preparing the referral package. Prior consultation can serve several valuable purposes -- it can determine the level of available investigatory and prosecutorial resources and encourage a reallocation of resources if necessary. It can also stimulate interest in the case by explaining its significance in the context of the bankruptcy system. Finally, if it appears that prosecution is likely, special effort may be devoted to preparation of the referral package.

5-3.3 THE REFERRAL PACKAGE

5-3.3.1 Tailoring the Package

The level of detail in a referral package may vary. The most complete packages should be prepared for those matters that are of high priority to the United States Trustee and are likely to result in prosecution. Other cases may warrant an abbreviated package or simply a cover sheet or form referral. Tailoring the package to the matter may increase the number of referrals, as well as help focus enforcement resources on those that are of the highest priority. The package described in the following paragraphs is appropriate for priority referrals.

5-3.3.2 Introductory Paragraph

The referral should begin with a brief introductory paragraph summarizing the main crimes involved. It is important to get to the crux of the charges right away, reserving a more complete explanation of the complexities and procedural history for the full narrative. Charges should be labeled in criminal terms, such as "concealment of assets" or "false statements," rather than in terms of civil issues such as "multiple filings" or "bad faith filing."

5-3.3.3 The Narrative

The most important part of the referral package is the narrative description of the facts. The narrative should read like a story, weaving the facts with the law to explain not only what happened, but the significance of the acts described. The narrative should address the nature and amount of loss, where appropriate. If no monetary value can be established, the significance of the crime to the bankruptcy process should be explained.

The narrative should identify the proposed defendant(s), as well as relevant witnesses and their relation to the facts, from which their potential testimony and significance to the case can be easily determined. It should also clarify any aggravating factors, such as the abuse of a position of trust or conduct undermining the integrity of the

bankruptcy system, that may justify prosecution regardless of the amount of loss.

To prove a bankruptcy crime, the prosecution must show a "knowing and fraudulent" intent; therefore, the narrative should address the specific intent requirements of the alleged violation. A defendant's knowledge and intent may be ascertained from circumstantial evidence, United States v. Martin, 408 F.2d 949, 954 (7th Cir.), cert. denied, 396 U.S. 824 (1969); but, it is important to articulate what factors indicate the subject intended to defraud.

The narrative should also indicate the potential defenses that are likely to be available. Though it is not necessary to resolve an issue or any discrepancy in versions of an event, it is important to fully disclose problems or concerns. The return of a concealed asset or the fact that assets in question were ultimately used to pay creditors is not a defense to a bankruptcy crime, United States v. Klupt, 475 F.2d 1015, 1018 (2d Cir. 1973); however, it is a factor that would be considered in determining whether to bring a criminal prosecution.

5-3.3.4 **Summary Information**

The narrative portion of the referral should be followed by summary information, that includes:

1. A list of proposed defendants, including, if possible, their addresses; telephone numbers; and the names, addresses, and telephone numbers of their respective attorneys.

2. A list of potential witnesses, including, if possible, their addresses; telephone numbers; and the names, addresses, and telephone numbers of their respective attorneys, if any.

3. An estimate of the amount of loss involved and/or damage to the bankruptcy system, if not covered in the narrative.

4. Any information regarding previous investigations, referrals, reconstructions, etc., done in connection with the case by either the United States Trustee or other individuals or agencies.

5. Any relevant exhibits, such as copies of the petition and schedules, related correspondence, tapes or transcripts of the section 341 meeting or 2004 examination, etc. Where exhibits are lengthy, may be sufficient to identify what exhibits are available; however, attaching a key exhibit, such as a deposition or witness statement, may be beneficial.

5-3.3.5 **General Information**

The referral memorandum should conclude by providing the following general information:

1. The name, address, and telephone number of the contact person in the United States Trustee's office for the referral. This should be an attorney.

2. A request that the United States Attorney and the investigative agency provide the name of the Assistant United States Attorney and agent assigned to the referral.

5-3.3.6 **Other Procedural Requirements**

All referrals should be personally reviewed and signed by the Assistant United States Trustee in charge of an office. In the absence of an Assistant, the United States Trustee may designate a senior attorney advisor to review and sign referrals.

Where the subject of a criminal referral is a public official, a private trustee, or an employee of a private trustee, or a referral is made outside the federal system, the General Counsel should be consulted. (See USTM 5-3.1.1, 5-3.1.2 and 5-7.)

A copy of any referral that does not assume an immediate declination (i.e., a class 3 referral) should be provided (without exhibits) simultaneously to the Executive Office for United States Trustees, Attention: General Counsel; and to Special Assistant United States Trustee, Joe B. Brown, in the Nashville, Tennessee, office.

CHAPTER 5-4: DECLINATION OF REFERRED CASES BY THE UNITED STATES ATTORNEY

5-4.1 REPORT OF DECLINATION TO THE ATTORNEY GENERAL

The United States Attorney is required to report cases that have been declined for investigation or prosecution to the Attorney General through the Fraud Section of the United States Department of Justice, Criminal Division. See 18 U.S.C. § 3057(b). In the absence of any comment by the Fraud Section, it is presumed that the Attorney General concurs in the United States Attorney's decision.

5-4.2 APPEAL OF DECISION BY UNITED STATES ATTORNEY NOT TO PROSECUTE

If a United States Trustee disagrees with a decision by the United States Attorney not to investigate or prosecute, the United States Trustee should attempt to resolve the disagreement with the supervisory Assistant United States Attorney or the United States Attorney. If no resolution is reached, the United States Trustee may, in consultation with the General Counsel, seek approval of the Deputy Director to request formal reconsideration by the Fraud Section of the Criminal Division.

CHAPTER 5-5: TRACKING CRIMINAL REFERRALS

5-5.1 TRACKING WITHIN THE UNITED STATES TRUSTEE PROGRAM

5-5.1.1 Tracking by the Office of Review and Oversight

The Office of Review and Oversight (ORO) maintains a data base to track criminal referrals made by the Program. At the end of each calendar quarter, ORO will furnish each United States Trustee with a

report detailing the referrals made by his/her region. The referrals will be divided into two categories.

1. Open referrals, which encompass all referrals last reported as either ongoing, open, or pending, as well as those with a pending indictment, information, or complaint.

2. Referrals with final dispositions, which encompass all referrals last reported as having been closed by the investigative agency, or declined by the United States Attorney or other appropriate authority, or which have a final conviction, acquittal, or dismissal of charges.

5-5.1.2 Tracking Within the Region/Office

Each region/office must track all referrals it has made until they are closed through declination, prosecution, etc., and submit an updated report to ORO each quarter providing information on new referrals and the status of all open referrals, paying particular attention to those that are more than one year old.

Where the United States Trustee knows that the case will be declined (i.e., a class 3 referral), the referral may be opened and closed at the same time on the quarterly report.

5-5.2 CASE TRACKING WITHIN THE UNITED STATES ATTORNEY'S OFFICE

Each United States Attorney's office uses a system that tracks cases from the time a file is opened until a case is closed. Cases that are declined with less than one hour's work are not reported on this system. Investigations and other proceedings where no formal charges have been lodged are called "matters," and each is given its own initial matter number. A matter becomes a "case" and is assigned a case number only after formal charges have been made via indictment or information. Usually, there is at least a 30-day lag in updates to the United States Attorneys' tracking system. At the present time, the system only tracks cases by the lead charge.

CHAPTER 5-6: DISCLOSURE OF REFERRALS

5-6.1 NEED FOR CONFIDENTIALITY OF REFERRALS

Department of Justice policy provides that criminal investigations may not be disclosed, absent unusual circumstances. Thus, the standard response to a question by the public, including the news media, of whether a matter has been referred for investigation or is under investigation should be: "We cannot either confirm or deny that such a matter has been referred or is under investigation." Any questions about indictments, pleas, and sentencing should be referred to the appropriate United States Attorney's office.

It is helpful to the system to have all criminal referrals processed through the United States Trustee's office. Where a panel trustee or a judge refers a criminal matter to the United States Trustee, he/she should be advised whether a referral was made. If the United States Trustee makes the referral, the panel trustee or judge does not have to make a duplicate referral. If the United States Trustee does not make a referral, the panel trustee or judge may have a duty under 18 U.S.C. § 3057 to make a referral if he/she has a reasonable suspicion that a crime has been committed. Pursuant to 18 U.S.C. § 3057, the panel trustee or judge has a right to make his/her complaint directly to the United States Attorney.

The United States Trustee should have an understanding with the United States Attorney for his/her district(s) on how complaints should be handled. Generally, United States Attorneys prefer that the United States Trustee offices screen complaints and be the central source for all referrals.

Once a referral is made, any information about the progress of an investigation should be on a strict, need-to-know basis and should be cleared with the United States Attorney.

Creditors and other individuals may provide information to the United States Trustee about criminal matters. If a referral has been made, the complainant should be advised that the matter has been referred and that

they should contact the United States Attorney's office for further information. If a United States Trustee decides not to make a referral based on the complaint of a private party, the individual should be advised of that fact. That individual is then able to take any other action he/she deems necessary, including making his/her own direct complaint to the United States Attorney. As a practical matter, where a referral is made, the complaining party will learn some details of the investigation, since investigative agents will usually have to contact him/her for additional information about the complaint.

5-6.2 DISCOVERY OF A UNITED STATES TRUSTEE'S CRIMINAL REFERRAL

A United States Trustee's referral of a bankruptcy fraud should not be discoverable. "There is a qualified privilege against disclosing material in the file of a government law enforcement investigation, civil or criminal, if: . . . the investigation is pending or, although presently closed, has a substantial possibility of being reactivated, and revelation of the material may prejudice the success of the investigation or a proceeding to which the investigation is directed." United States v. Am. Tel. & Tel. Co., 86 F.R.D. 603, 639 (D.C. Cir. 1979); In re Stockbridge Funding, 153 B.R. 654 (Bankr. S.D.N.Y. 1993)(recognizing a "bankruptcy crime--investigation privilege" for trustee's communications with United States Attorney).

Any efforts by any party to discover the contents of a criminal referral should be reported to the United States Attorney and should be resisted unless the United States Attorney desires to release the referral. The United States Attorney, as part of the discovery or plea negotiations, may want or need to release a part or all of a referral. After a conviction, the criminal referral should be released to the United States Probation Office for use in the preparation of the pre-sentence report.

CHAPTER 5-7: ALLEGATIONS INVOLVING LOSS OF ESTATE ASSETS BY A PRIVATE TRUSTEE OR AN EMPLOYEE OR AGENT OF A PRIVATE TRUSTEE

5-7.1 GENERALLY

The loss of estate assets or the inability to account for estate assets is a serious matter, and its expeditious resolution is a top priority. Allegations of the loss of estate assets by a trustee or anyone employed or retained by the trustee, regardless of the source, must be promptly investigated. When the United States Trustee believes that a trustee or an employee of a trustee is unable to account for estate assets, the procedures detailed in the following paragraphs must be followed.

5-7.2 PRELIMINARY ASSESSMENT AND REPORT TO THE EXECUTIVE OFFICE

The United States Trustee must immediately notify the Assistant Director for Review and Oversight and make a preliminary assessment of the likelihood of actual loss.

5-7.2.1 Actions if No Loss Has Occurred

If the preliminary assessment determines that no loss of estate assets has occurred, the United States Trustee should prepare a recommendation to the Assistant Director for Review and Oversight to terminate the inquiry. The United States Trustee should detail any action taken or to be taken to rectify any problems identified in the assessment. Upon concurrence of the Deputy Director, the inquiry shall be terminated.

5-7.2.2 Actions if Loss Has Occurred

If the preliminary assessment indicates a loss (including funds taken, advanced without order of the court, or borrowed and later repaid by the trustee) of estate assets, the United States Trustee shall immediately forward a written report to the Assistant Director for Review and

Oversight. The report should contain, at a minimum, the following information:

1. The name and location of the trustee.

2. Whether the trustee is active or inactive.

3. The number of open cases presently being handled by the trustees.

4. The names of any persons suspected of improper conduct in the handling of estate funds.

5. The number and location of bank accounts involved.

6. A factual narrative of the circumstances that can be verified as a result of the preliminary assessment.

7. The United States Trustee's recommendation of proposed action concerning the trustee and the estates under the trustee's administration.

In addition, certain situations, such as where there is evidence that the trustee mishandled estate assets or failed to take adequate precautions to safeguard the loss of estate assets, warrant immediate termination of future case assignments.

5-7.3 DISCUSSIONS OR NEGOTIATIONS REGARDING LOSSES

When there is a suspected loss of estate assets or an inability to account for those assets, there shall be no settlement negotiations, discussions, or agreements initiated or entered into regarding the return of funds, compensation, or resolution of the matter, absent the written approval of the Deputy Director.

5-7.4 ADDITIONAL ACTIONS IF TRUSTEE RESIGNATION OR REMOVAL MAY BE SOUGHT

If it appears likely that the United States Trustee will seek to remove the trustee from pending cases or initiate a criminal referral, or both, the United States Trustee should immediately notify the Deputy Director, to be followed by a written memorandum on the matter. Copies should simultaneously be provided to the Assistant Director for Review and Oversight and General Counsel.

Prior to requesting the trustee's resignation or instituting removal action in pending cases, the United States Trustee shall consult on the matter with the Deputy Director. If removal or resignation is initiated, consideration must be given to the appointment of a successor trustee or for the United States Trustee to serve as the trustee pending a further review of the case files.

5-7.5 INVESTIGATION OF A TRUSTEE'S FINANCIAL RECORDS

When the preliminary assessment indicates that assets cannot be accounted for or that embezzlement has occurred, an investigation of the trustee's case files and financial records will be initiated, with the approval of the Deputy Director. The Assistant Director for Review and Oversight, in consultation with the United States Trustee, will coordinate and oversee the selection of an investigation team, the determination of the type and amount of work required, and the nature and extent of records that must be gathered to carry out the investigation.

To facilitate the investigation, the United States Trustee should:

1. Prepare a list, reconciled with court records, of all open cases under the administration of the trustee.

2. If the trustee refuses to resign from assigned cases, prepare and file appropriate pleadings to remove the trustee from all cases. All motions to remove trustees must be reviewed and approved by the General Counsel.

3. Upon removal or resignation, request the court to order the suspension of further hearings pending a completion of the reconstruction. If the court does not grant the request, determine upcoming court hearings and section 341 meetings for the cases and arrange for coverage.

4. Obtain all of the trustee's case files and financial records, by court order if required, and secure them in the United States Trustee's office.

5. Compare the trustee's case files to the open case list to identify any missing case files and undertake reconstruction of any missing cases.

6. Compile the trustee's latest 180-day report forms.

7. Determine the location of all financial accounts with estate funds and obtain court orders freezing those accounts. Determine how the bank should handle outstanding checks (e.g., process through a particular date or call the United States Trustee for approval before processing). New accounts should be opened in the name of the successor trustee. Once new accounts are open, the balances from the frozen accounts may be transferred to them. Pending completion of the reconstruction, the successor trustee may be the United States Trustee.

8. Obtain copies of all docket cards or sheets on all open cases and place them in the case file.

9. Place all information concerning either blanket or individual bonds in each case file.

10. Contact professionals, such as auctioneers, to determine if funds are due to any estates, and advise the professional that no disbursements of funds should be made without the approval of the United States Trustee. If the trustee is removed or resigns, notify the computer vendor.

11. Review case files and document any missing records (bank statements, canceled checks, deposit slips, certificates of deposit, cashier's checks, etc.) relating to estate financial records.

12. The Office of Review and Oversight will coordinate all bank requests and may, in certain circumstances, initiate the request for copies of all missing financial records from the appropriate financial institutions.

The format and distribution of the investigative report will be prescribed by the Deputy Director. Because the reports may serve both civil and criminal purposes, no single format can be set.

Absent the approval of the Deputy Director, no case files, financial records, or other estate documents may be furnished to a successor trustee, other than the United States Trustee, until reconstruction is complete. Further, without approval of the Deputy Director, no disbursements should be made in any estates until the reconstruction is complete.

5-7.6 CRIMINAL REFERRAL

A criminal referral concerning a trustee or anyone employed by the trustee is a sensitive, high priority matter. It demands communication and close coordination between the United States Trustee, the Executive Office, and the United States Attorney. See USTM 5-3 for further information on referrals to law enforcement agencies.

CHAPTER 5-8: BANKRUPTCY CRIMES

5-8.1 BANKRUPTCY REFORM ACT OF 1994

The Bankruptcy Reform Act of 1994 made several changes to the criminal bankruptcy sections. The old sections continue to apply to crimes completed before the effective date of the Act, which was October 22, 1994. The new sections apply to all cases begun on or after the effective date. It is an open question as to whether crimes

committed after the effective date of the Act in cases that began before the effective date are covered by the old statutes or the new statutes. Until case law resolves the issue, the safest course of action is to use the older of the statutes.

No significant changes were made to 18 U.S.C. § 152. The paragraphs were numbered and the United States Trustee was specifically included in the statutory language. Although Congress stated the maximum fine as $5,000 and five years in prison, 18 U.S.C. § 3571 provides the maximum fine will be $250,000 for individuals and $500,000 for organizations.

18 U.S.C. § 153 was changed to extend coverage to more individuals who embezzle funds from estates. The law now includes anyone who has access to property or documents of the estate by virtue of their participation in the administration of the estate in some official capacity. It also, for the first time, specifically covers employees and agents of those who have this access.

18 U.S.C. § 154 was changed to allow the United States Trustee access to documents and accounts relating to the affairs of an estate without the necessity of a court order.

18 U.S.C. § 156 is a new section which prohibits a bankruptcy petition preparer from knowingly attempting to disregard the provisions of title 11 or the Federal Rules of Bankruptcy Procedure if such action results in the dismissal of the case or proceedings. The offense is punished as a misdemeanor. A "bankruptcy petition preparer" is anyone, other than the debtor's attorney or that attorney's employee, who prepares for compensation bankruptcy documents for filing. It should be noted that the Act also provides civil fines and injunctive relief against bankruptcy petition preparers who do not disclose their names, addresses, social security numbers, and their compensation for preparing the documents. 11 U.S.C. § 110.

18 U.S.C. § 157 is the second new section. It creates a felony violation for anyone who devises or intends to devise a scheme or artifice to defraud and, for purposes of executing or concealing the scheme, files a petition under title 11; files a document in a proceeding under title 11;

makes a false statement, claim, or promise in relationship to a proceeding under title 11 either before or after the filing of the petition, or in relation to a proceeding falsely asserted to be pending under title 11.

5-8.2 GENERAL ISSUES

5-8.2.1 Definition of "Knowingly and Fraudulently"

Each section of 18 U.S.C. § 152 requires that the acts be done "knowingly and fraudulently." The term knowingly means that the defendant is aware of his/her act (or failure to act) and that his/her conduct is undertaken voluntarily and intentionally and not because of mistake or accident or other innocent reason. It is not necessary that the government prove the defendant knew that his/her acts or omissions were unlawful.

The term fraudulently means that the conduct was willful or done voluntarily and intentionally and with the intent to deceive, cheat, or defraud. An intent to defraud is accompanied, ordinarily, by a desire or purpose to bring about some gain or benefit to oneself or to cause some loss to some person. See 1 Devitt and Blackmar, Federal Jury Practice and Instructions, § 16.07 (4th ed. 1992).

5-8.2.2 Statute of Limitation

18 U.S.C. § 3282 provides that indictments must be brought within five years of the commission of the crime. However, 18 U.S.C. § 3284 provides that the offense of concealment of assets of a debtor under title 11 is a continuing offense and the five year statute does not begin to run until the debtor is discharged or a discharge is denied. In some cases, this section gives additional time.

When this statute was enacted, a corporation could be granted or denied a discharge in most cases. Under title 11, a corporation no longer receives a discharge. There is no direct case law on what effect this change in title 11 has on section 3284. A literal reading of section 3284 leads to the conclusion that there is no statute of limitations in cases involving a corporate bankruptcy concealment or in

the case of an individual who does not receive either a discharge or a denial of a discharge. An individual who dismisses his/her case before receiving a discharge would be in this situation. See U.S. v. Ganaposki, 72 F. Supp. 982 (M.D. Pa. 1947), which held that Congress did not have to set a statute of limitation and, under the clear language of the statute, the debtor did not receive a discharge and, thus, there was no statute of limitation. But see U.S. v. Fraidin, 63 F. Supp. 271 (D. Md. 1945), and Rudin v. U.S., 254 F.2d 45 (6th Cir.), cert. denied, 357 U.S. 930 (1958), which held that the time where the debtor could no longer get a discharge would be used.

The rationale of these cases would indicate that a debtor who dismisses his/her case or does not receive a discharge will either have no statute of limitations for the crime of concealment of assets or will have the statute of limitations begin to run on the date of dismissal or on the last day a discharge would have been possible. The safer course of action is to use the Rudin rationale.

The extension granted by section 3284 only applies to the crime of concealment. No additional time is granted for other offenses, such as false oaths on petitions and schedules, even though the false oath is used to conceal assets. U.S. v. Knoll, 16 F.3d 1313, 1318 (2d Cir. 1994), cert. denied, 115 S.Ct. 579 (1994).

18 U.S.C. § 3293 provides a ten year statute of limitation for the violation of those sections of the Code that deal with financial institutions. This includes section 1014 dealing with false loan and credit applications, section 1344 dealing with bank fraud, and sections 1341 and 1343 dealing with wire and mail fraud.

5-8.2.3 Attorney-Client Privilege

In certain situations, an attorney-client privilege can be waived. The court-appointed bankruptcy trustee may waive the attorney-client privilege of the corporate debtor for communications prior to the declaration of bankruptcy. Commodity Futures Trading Commission v. Weintraub, 471 U.S. 343, 353 (1985). Congress has been clear that the debtor's directors do not have the right to assert the corporation's attorney-client privilege against the trustee. Commodity Futures

Trading Commission v. Weintraub, 471 U.S. 343, 350 (1985). Corporate officers cannot assert an individual attorney-client privilege to prevent disclosure of corporate communications with corporation's counsel after the corporation's privilege was waived by the trustee. Matter of Bevill, Bresler & Schulman Asset Management Corporation, 805 F.2d 120, 125 (3rd Cir. 1986).

The chapter 7 trustee of a limited partnership debtor has the authority to waive the attorney-client privilege of the partnership in the case of a criminal bankruptcy fraud trial of a general partner. U.S. v. Campbell, 73 F.3d 44 (5th Cir. 1996).

There is limited authority that a trustee can waive the attorney-client privilege of an individual debtor, where there is no Fifth Amendment claim. In re Williams, 152 B.R. 123 (Bankr. N.D. Tex. 1992). There are no reported circuit court cases holding that a trustee can waive an individual debtor's attorney-client privilege where the debtor is asserting a Fifth Amendment privilege.

Case law support the proposition that no attorney-client privilege attaches to bankruptcy work papers where the information is imparted to bankruptcy counsel for the purpose of assembly into a bankruptcy petition and supporting schedules. This information is intended to be disclosed on documents filed with the court and not held in confidence. U.S. v. White, 950 F.2d 426, 430 (7th Cir. 1991). Likewise, where there is no evidence that a debtor sought legal advice regarding disclosure when the debtor did not reveal certain assets to their bankruptcy counsel, the attorney may disclose the fact that he/she was not told about the existence of such assets without violating the attorney-client privilege. U.S. v. White, 970 F.2d 328, 335 (7th Cir. 1992).

5-8.2.4 Fifth Amendment Privilege

Individual parties may exercise their right against self incrimination under the Fifth Amendment in any proceeding. However, a debtor who has sought the protection of the Bankruptcy Code may risk dismissal of the bankruptcy case for failure to provide relevant information about the

estate under a claim of Fifth Amendment protection. In re Connelly, 59 B.R. 421, 448 (Bankr. N.D. Ill. 1986). The debtor may also face denial of a discharge under 11 U.S.C. § 727(a)(4)(d), (5), and (6). The procedure for seeking immunity in order to force a debtor to testify is set out at USTM 5-12.

5-8.2.5 **Statutory Penalties**

The statutory punishment for violation of 18 U.S.C. §§ 152, 153, and 157 are up to five years imprisonment and a maximum fine of $250,000 for individuals and $500,000 for corporations (18 U.S.C. § 3571). Practically, however, the sentencing guidelines will determine the actual sentence based on the amount of loss, whether court orders were obstructed, the person's role in the offense, and other prescribed factors. See USTM 5-14.

5-8.2.6 **Protective Orders/Confidentiality Agreements**

A party may request a protective order or confidentiality agreement to deny criminal investigators, including grand juries, access to evidence developed in a civil proceeding. Requests directed to the United States Trustee for protective orders should be reported to the General Counsel immediately. Case trustees should be made aware that the Program's policy is not to enter into such agreements and should be advised to immediately contact the United States Trustee if any such agreement is requested in one of their cases.

5-8.3 **OVERVIEW OF 18 U.S.C § 152 VIOLATIONS**

This section sets forth the most common violations that may be committed by anyone who attempts to defeat the purposes of the Bankruptcy Code by fraudulent means. The section is subdivided into nine separate paragraphs. Each paragraph describes a separate crime as follows:

1. The concealment of property belonging to the estate of the debtor.

2. The making of false oaths or accounts in or in relation to any case under title 11.

3. The making of a false declaration, certificate, verification, or statement under the penalty of perjury in or in relation to any case under title 11.

4. The making of false claims against the estate of a debtor.

5. The fraudulent receipt of property from a debtor.

6. Bribery, extortion, or forbearance in connection with a case under title 11.

7. Transfer or concealment of property in contemplation of a case under title 11, or with the intent to defeat the provisions of title 11.

8. The concealment or destruction of documents relating to the property or affairs of the debtor.

9. The withholding of documents from the administrators of a case under title 11.

5-8.3.1 **Fraudulent Concealment of Property, 18 U.S.C. § 152(1)**

"[A person who] knowingly and fraudulently conceals from a custodian, trustee, marshal, or other officer of the court charged with the control or custody of property, or, in connection with a case under title 11, from creditors or the United States Trustee, any property belonging to the estate of a debtor: [shall be fined not more than [$250,000], or imprisoned not more than five years, or both.]"

5-8.3.1.1 Elements of the Offense

The government must prove:

1. The charged bankruptcy was in existence at the time of the offense.

2. The defendant fraudulently concealed property of the estate.

   The term concealed means any act done by the defendant that hides the existence of property from anyone entitled to know of it. The defendant does not have to physically hide the property. Failure to list property on schedules is sufficient to conceal it from a trustee.

   Property and assets are defined very broadly. The terms include both legal and equitable interests in both tangible and intangible property.

3. The property belongs to the estate.

   Even if the status of an asset is doubtful, it is the duty of the debtor to disclose its existence for a final determination by the court. Even if the property is ultimately determined not to be property of the estate under the technical rules of the Bankruptcy Code, it still may be property of the estate for the purposes of section 152. See U.S. v. Cherek, 734 F.2d 1248, 1254 (7th Cir. 1984), cert. denied, 471 U.S. 1014 (1985). Under these circumstances, however, proof of knowing and fraudulent intent may be difficult.

5-8.3.2 **False Oath, Declaration, Account, Verification, or Statement, 18 U.S.C. § 152(2)**

"[A person who] knowingly and fraudulently makes a false oath or account in or in relation to any case under title 11 [shall be fined not more than [$250,000], or imprisoned not more than five years, or both.]"

5-8.3.2.1 Elements of the Offense

1. The charged bankruptcy was in existence at the time of the false oath or account.

2. The statement was under oath.

3. The statement was to a material fact.

The question of whether the statement concerns a material fact is a question of fact for the jury. The Supreme Court case of U.S. v. Gaudin, 115 S. Ct. 2310 (1995), changed the long-standing rule that materiality was a question of law for the court. It is not necessary to show anyone was harmed by the false statement. It is sufficient that the false statement bears a reasonable relationship to a bankruptcy matter.

4. The statement was false.

The government must prove the statement was known by the defendant to be untrue when made. A non-responsive, truthful answer to a question may not be false even if made with the intent to mislead. Bronston v. U.S., 409 U.S. 352, 359 (1973).

A person making the false statement may avoid prosecution if the statement is unequivocally recanted before it is apparent that its false nature has or will be discovered.

To avoid the rule that two witnesses are required to prove this offense where the defendant falsely testifies or produces other false information before a court, 18 U.S.C. § 1623, may be used. This section is discussed at USTM 5-9.13.

5-8.3.3 False Declarations, 18 U.S.C. § 152(3)

"[A person who] knowingly and fraudulently makes a false declaration, certificate, verification, or statement under penalty of perjury as permitted under section 1746 of title 28 in or in relation to any case under title 11 [shall be fined not more than [$250,000], or imprisoned not more than five years, or both.]"

The elements of the offense of a false oath (discussed at 5-8.4.2.1) apply to this section as well. The only difference is that the false declaration must be made under the penalty of perjury as provided by 28 U.S.C. § 1746. This section was added to allow prosecution where the statement is not under oath, but does have the statement above the

signature or on a certificate that it is made under the penalty of perjury as provided by 28 U.S.C. § 1746.

The United States Trustee should consider using the statement "under the penalty of perjury as provided by 28 U.S.C. § 1746" on any important statements or reports filed in connection with bankruptcy cases.

5-8.3.4 **False Claims, 18 U.S.C. § 152(4)**

"[A person who] knowingly and fraudulently presents any false claim for proof against the estate of a debtor, or uses any such claim in any case under title 11, in a personal capacity, or as or through an agent, proxy, or attorney . . . [shall be fined not more than [$250,000], or imprisoned not more than five years, or both.]"

A claim is a legal document submitted to the court by a creditor of the entity that has filed bankruptcy. It is immaterial whether the claim is reduced to judgment, liquidated, unliquidated, fixed, contingent, mature, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured. U.S. v. Connery, 867 F.2d 929, 934 (6th Cir. 1989).

5-8.3.4.1 Elements of the Offense

1. Bankruptcy proceedings have commenced under title 11.

2. The defendant presents or causes to be presented a proof of claim in the bankruptcy.

3. The proof of claim is false as to a material matter.

4. The defendant knew the proof of claim was false.

5-8.3.5 **Fraudulent Receipt of Property, 18 U.S.C. § 152(5)**

"[A person who] knowingly and fraudulently receives any material amount of property from a debtor after the filing of a case under title 11, with intent to defeat the provisions of title 11, [shall be fined

not more than [$250,000], or imprisoned not more than five years, or both.]"

This provision is very similar to 18 U.S.C. § 152(1) since it also reaches the concealment of assets from the trustee. The paragraph is designed specifically to reach defendants, including creditors, who assist debtors in concealing assets.

5-8.3.5.1 Elements of the Offense

1. The defendant receives a material amount of property from a debtor.

   There are no cases that define the term "material amount." In view of statutes which make theft of over $100 a felony, 18 U.S.C. § 641, that amount could be considered material. Other statutes make $5,000 a basis for federal jurisdiction. 18 U.S.C. § 2314.

2. Such transfer occurred after the filing of a case under title 11.

   Even though a transfer occurs before filing a bankruptcy petition, a conspiracy to violate this section could be charged if overt acts occurred after the filing. Knoell v. U.S., 239 F.16 (3d Cir. 1917).

3. The acts were done with the intent to defeat the provisions of title 11.

   This element adds little to the statute. In U.S. v. Lawson, 255 F. Supp. 261, 266 (D. Minn. 1966), the court held that this only meant that the act was willful.

5-8.3.6 **Extortion and Bribery, 18 U.S.C. § 152(6)**

"[A person who] knowingly and fraudulently gives, offers, receives, or attempts to obtain any money or property, remuneration, compensation, reward, advantage, or promise thereof for acting or forbearing to act in

any case under title 11 [shall be fined not more than [$250,000], or imprisoned not more than five years, or both.]"

5-8.3.6.1 Elements of the Offense

A person who, with criminal intent, attempts to gain anything from a case under title 11 by either acting or forbearing to act.

This is a very broad statute which covers all aspects of bribery and extortion in cases involving title 11. There is no requirement that the act or forbearance of acting be unlawful itself. Acting or not acting with the requisite criminal intent is sufficient. For example, a bidder agreeing to withdraw his/her bid in return for money is covered. U.S. v. Weiss, 168 F. Supp. 728 (W.D. Pa. 1958).

The issue of competing plans being withdrawn in return for payment of fees raises an issue under this statute if full disclosure is not made. U.S. v. Dunkly, 235 F. 1000 (N.D. Cal. 1916). Full disclosure of any offers to act or not act, e.g., compromise claims, would negate any suggestion of criminal intent.

5-8.3.7 **Fraudulent Transfer or Concealment, 18 U.S.C. § 152(7)**

"[A person who] in a personal capacity or as an agent or officer of any person or corporation, in contemplation of a case under title 11 by or against the person or any other person or corporation, or with intent to defeat the provisions of title 11, knowingly and fraudulently transfers or conceals any of his property or the property of such other person or corporation [shall be fined not more than [$250,000], or imprisoned not more than five years, or both.]"

This provision overlaps in many respects with 18 U.S.C. § 152(1). It clearly reaches acts committed before the filing of a bankruptcy petition if done in contemplation of such filing. All concealment and transfers done before filing a bankruptcy petition constitute one offense. After the filing of bankruptcy, each separate act constitutes a separate offense.

The paragraph also expressly reaches transfers of property, as well as the concealment of property. This provision is useful to reach the

transfer of funds and property between related persons or corporations just before filing a bankruptcy petition.

This section can reach improper transfers or concealment of assets of a confirmed chapter 11 plan. There is no requirement in this paragraph, as there is in paragraph 1, that it involve property of the estate. The only requirement is that the concealment or transfer of property be in contemplation of, or with the intent to defeat, the provisions of title 11. U.S. v. Messner, 107 F.3d 1448 (10th Cir. 1997).

5-8.3.7.1 Elements of the Offense

1. The defendant transfers or conceals his/her property or the property of another.

2. Such act of concealment or transfer was done in contemplation of a case under title 11 or with the intent to defeat the provisions of title 11.

Although the paragraph does not state from whom the concealment must be, it is safe to conclude that it must be from someone with an interest in the bankruptcy. The same group listed in 18 U.S.C. § 152(1) would clearly be included.

5-8.3.8 **Fraudulent Destruction or Alteration of Documents, 18 U.S.C. § 152(8)**

"[A person who] after the filing of a case under title 11 or in contemplation thereof, knowingly and fraudulently conceals, destroys, mutilates, falsifies, or makes a false entry in any recorded information (including books, documents, records, and papers) relating to the property or financial affairs of a debtor [shall be fined not more than [$250,000], or imprisoned not more than five years, or both.]"

Violations of this paragraph will normally involve violations of other paragraphs of section 152. There is no requirement that the false entries be under oath. The paragraph covers acts done in contemplation of bankruptcy, as well as acts done after filing.

5-8.3.8.1 Elements of the Offense

1. Proceedings in bankruptcy were filed, or contemplated and then filed.

2. The defendant does one of the acts listed in 18 U.S.C. § 152 with criminal intent.

3. The act affects or relates to the property or affairs of a debtor.

   Documents or information that would lead to sources of funds or assets or means of reorganizing an estate would be included.

   Recording a known fraudulent transaction would be a false entry, as would placing false credits or debits on a company's books.

5-8.3.9 **Fraudulent Withholding of Documents, 18 U.S.C. § 152(9)**

"[A person who] after the filing of a case under title 11, knowingly and fraudulently withholds from a custodian, trustee, marshal, or other officer of the court, or a United States Trustee entitled to its possession, any recorded information (including books, documents, records, and papers) relating to the property or financial affairs of a debtor, shall be fined not more than [$250,000], or imprisoned not more than five years, or both."

This paragraph will normally be used in connection with other paragraphs charging concealment of assets. A defendant, however, can be convicted of withholding records even if he/she is not convicted of the actual concealment of assets.

5-8.3.9.1 Elements of the Offense

1. A proceeding under title 11 was in existence.

2. The defendant withheld from the trustee or other person entitled to them any documents.

3. The documents affected or related to the affairs of a debtor.

5-8.4 EMBEZZLEMENT AGAINST THE ESTATE

5-8.4.1 18 U.S.C. § 153

"(a) Offense. A person described in subsection (b) who knowingly and fraudulently appropriates to the person's own use, embezzles, spends, or transfers any property or secretes or destroys any document belonging to the estate of a debtor shall be fined not more than [$250,000], imprisoned not more than five years, or both.

(b) Person to Whom Section Applies. A person described in this subsection is one who has access to property or documents belonging to an estate by virtue of the person's participation in the administration of the estate as a trustee, custodian, marshal, attorney, or other officer of the court or as an agent, employee, or other person engaged by such officer to perform a service with respect to the estate."

5-8.4.1.1 Definition of Officer and Custodian

Congress amended this section in October of 1994 specifically to include attorneys and employees of trustees and other administrators of the estate. Even under the old section, however, the term custodian reached anyone who came into custody of property involving an estate because of some official position. It has reached the attorney for the trustee. Jackson v. U.S., 72 F.2d 764 (3d Cir. 1934). It has also reached the treasurer of a debtor under reorganization who was employed with court approval. U.S. v. Lynch, 180 F.2d 696 (7th Cir.), cert. denied, 339 U.S. 981 (1950). See also the definition of custodian in 11 U.S.C. § 101.

Under the old statute, the term officer would reach any professional employed by a trustee and approved by the court, such as an auctioneer. 11 U.S.C. § 327. It would not, however, reach a regular employee such as a secretary or paralegal.

The new statute clearly applies to the attorney for the debtor. It also should reach the debtor in possession under chapter 11. A good argument can be made that such a debtor in possession does have access because of that person's participation in the administration of the

estate under court approval. If so, employees of the debtor in possession would also be covered. Until case law resolves this issue, however, a charge under 18 U.S.C. § 152(1) should also be used.

5-8.4.1.2 Elements of the Offense

1. A case exists under title 11.

2. The defendant is a person involved with the administration of the estate in an official capacity, or is the employee of such a person, as an officer of the court, trustee, marshal, attorney, or custodian.

3. The defendant, with criminal intent, uses, steals property of the estate, or secretes or destroys documents of the estate.

4. The defendant had access to such property or documents by virtue of the defendant's participation in the administration of the estate.

   If property came into the defendant's hands because of an official position, the statute is violated even if it is later determined that the property was not that of the estate. Meagher v. U.S., 36 F.2d 156 (9th Cir. 1929).

5-8.4.2 **18 U.S.C. § 645**

"Whoever, being a United States marshal, clerk, receiver, referee, trustee, or other officer of a United States court, or any deputy, assistant, or employee of any such officer, retains or converts to his own use or the use of another or after demand by the party entitled thereto unlawfully retains any money coming into his hands by virtue of his official relation, position, or employment is guilty of embezzlement and shall be fined [$250,000], or imprisoned not more than ten years, or both . . ."

"It shall not be a defense that the accused person had any interest in such money or fund."

5-8.4.2.1 Differences from 18 U.S.C. § 153

This statute is in many ways broader than the old version of 18 U.S.C. § 153. There is no requirement that the embezzlement be with fraudulent intent. U.S. v. Sharpe, 996 F.2d 125 (6th Cir.), cert. denied, 114 S. Ct. 400 (1993). Also, the statute provides that even if the defendant had an interest in the property, it is not a defense. This should be useful when a trustee or other professional claims to have just been taking his/her fee up front before receiving court approval.

The statute also expressly covers the employees, assistants, and deputies of the listed individuals, something that 18 U.S.C. § 153 did not cover until the 1994 amendments. Thus, this statute can be used to prosecute any employee of the trustee who steals estate money which is in the trustee's custody.

The statute has a misdemeanor provision where the amount of money does not exceed $100. The United States Attorney may charge less than $100 and allow a defendant to plead to a misdemeanor even if the amount, in fact, exceeds $100.

5-8.4.2.2 Elements of the Offense

1. The defendant is a trustee or other officer of the court or an employee of that individual.

2. The defendant unlawfully used or retained money that came into the defendant's hands because of his/her official position. The statute only covers money; it does not cover other types of property.

5-8.4.3 **Adverse Interest and Conduct of Officers, 18 U.S.C. § 154**

"A person who, being a custodian, trustee, marshal, or other officer of the court--

(1) knowingly purchases, directly or indirectly, any property of the estate of which the person is such an officer in a case under title 11;

(2) knowingly refuses to permit a reasonable opportunity for the inspection by parties in interest of the documents and accounts relating to the affairs of estates in the person's charge by parties when directed by the court to do so; or

(3) knowingly refuses to permit a reasonable opportunity for the inspection by the United States Trustee of the documents and accounts relating to the affairs of an estate in the person's charge, shall be fined not more than $5,000 and shall forfeit the person's office, which shall thereupon become vacant."

This statute is classified as an infraction because it does not authorize any imprisonment. It does, however, provide for the immediate removal from office. This could be useful in any case where the judge is reluctant to remove a trustee or other professional. The term "office" is not defined in the statute, and there are no reported cases that indicate how broad the term "office" is interpreted.

Of note is that the statute has no de minimis provision. Under a literal reading of the statute, a trustee handling a large retail merchant could not buy any property of the retailer even if it was from the store and it was in the regular course of business. The United States Trustee should make trustees and other professionals aware of this statute.

5-8.4.3.1 Elements of the Offense--Improperly Acquiring Property of Estate

1. The defendant is a custodian, trustee, or other officer of the court in a case under title 11.

2. The defendant knowingly bought, directly or indirectly, any property of the estate.

5-8.4.3.2 Elements of the Offense--Improperly Refusing Access to Books and Records

1. The defendant is a custodian, trustee, or other officer of the court in a case under title 11.

2. The defendant refuses to permit reasonable inspection of books and accounts of the estate by a party in interest when directed to do so by the court.

3. The defendant refuses to allow the United States Trustee reasonable access to records of the estate. There is no requirement for the United States Trustee to have a court order for such inspection.

5-8.5 FEE AGREEMENTS, 18 U.S.C. § 155

"Whoever, being a party in interest, whether as a debtor, creditor, receiver, trustee, or representative of any of them, or attorney for any such party in interest, in any receivership or case under title 11 in any United States court or under its supervision, knowingly and fraudulently enters into any agreement, express or implied, with another such party in interest or attorney for another such party in interest, for the purpose of fixing the fees or other compensation to be paid to any party in interest or to any attorney for any party in interest for services rendered in connection therewith, from the assets of the estate, shall be fined not more than $5,000 or imprisoned not more than one year, or both."

There are no reported cases under this section. The intent of the section is to prevent parties in interest from dividing up the estate outside the control of the bankruptcy court. The statute requires that the acts be done knowingly and fraudulently. Failure of a party to make disclosure statements required under the Bankruptcy Rules would be evidence of such intent. The definition of parties in interest is extremely broad and essentially covers anyone involved in any way with a case under title 11.

5-8.5.1 Elements of the Offense

1. The defendant is a party in interest in a case under title 11.

2. The defendant, knowingly and fraudulently, enters into any agreement, express or implied, with another party in interest to fix the fee or compensation paid any party in interest.

3. That such fee or compensation was paid or intended to be paid from assets of the estate.

5-8.6 KNOWING DISREGARD OF BANKRUPTCY LAW OR RULE, 18 U.S.C. § 156

"(a) Definitions.--In this section--

`bankruptcy petition preparer' means a person, other than the debtor's attorney or an employee of such an attorney, who prepares for compensation a document for filing.

`document for filing' means a petition or any other document prepared for filing by a debtor in a United States bankruptcy court or a United States district court in connection with a case under this title.

(b) Offense--

If a bankruptcy case or related proceeding is dismissed because of a knowing attempt by a bankruptcy petition preparer in any manner to disregard the requirements of title 11, United States Code, or the Federal Rules of Bankruptcy Procedure, the bankruptcy petition preparer shall be fined under this title [not more than $100,000], imprisoned not more than 1 year, or both."

This section is useful against petition mills that file bankruptcy petitions, that are later dismissed, for people they know are not eligible for relief; or who, having filed the petition, knowingly take no action to complete the proceedings by filing schedules or notifying the debtor to attend meetings.

5-8.6.1 Elements of the Offense

1. A bankruptcy petition preparer prepares documents for filing for compensation in a United States court.

2. The bankruptcy case or related proceeding is dismissed.

3. Such dismissal was caused by the knowing attempt of the bankruptcy petition preparer to disregard the provisions of title 11 or the Federal Rules of Bankruptcy Procedure.

5-8.7 BANKRUPTCY FRAUD, 18 U.S.C. § 157

"A person who, having devised or intending to devise a scheme or artifice to defraud and for the purpose of executing or concealing such a scheme or artifice or attempting to do so--

(1) files a petition under title 11;

(2) files a document in a proceeding under title 11; or

(3) makes a false or fraudulent representation, claim, or promise concerning or in relation to a proceeding under title 11, at any time before or after the filing of the petition, or in relation to a proceeding falsely asserted to be pending under such title,

shall be fined under this title [maximum $250,000], imprisoned not more than 5 years, or both."

This statute allows prosecutors a significantly longer reach in the bankruptcy fraud area. Any defendant who undertakes a fraud scheme against anyone, or attempts to do so, and then carries out or conceals the scheme by using bankruptcy or by filing any documents in the bankruptcy, violates this statute. This section also is applicable against the defendant who tries to defraud someone by falsely telling them a case is in bankruptcy in order to forestall the victim's actions. The crux of this statute is the existence of a fraud scheme or attempted fraud scheme and any use of the bankruptcy system to try to carry out the scheme. For example, this statute should be applicable to petition mills that are set up to defraud the landlord of a few months rent, or to any bustout scheme. Likewise, a defendant who is actively defrauding anyone violates this statute if he/she files bankruptcy to delay or conceal the fraud.

Case law addressing the wire, bank, and mail fraud statutes (18 U.S.C. §§ 1341, 1343, and 1344), which have similar language, will be very

useful in determining the reach of this statute. Congress deliberately chose language from those statutes to insure a broad reach.

5-8.7.1 **Elements of the Offense**

1. The defendant has devised or has intended to devise a scheme or artifice to defraud another.

2. The defendant, for the purpose of executing or concealing the scheme or artifice or attempting to do so,

   a. files a petition under title 11; or
   b. files a document in a proceeding under title 11; or
   c. makes a false or fraudulent statement in connection with a proceeding under title 11 or a proceeding the defendant falsely asserts is pending under title 11.

CHAPTER 5-9: OTHER BANKRUPTCY RELATED CRIMES

5-9.1 **MISPRISION OF A FELONY, 18 U.S.C. § 4**

"Whoever, having knowledge of the actual commission of a felony cognizable by a court of the United States, conceals and, does not, as soon as possible, make known the same to some judge or other person in civil or military authority under the United States, shall be fined not more that $500 or imprisoned not more than three years, or both."

This statute, while a felony, carries a lesser penalty than most other bankruptcy criminal statutes. The United States Attorney may use this to prosecute individuals who aid in a bankruptcy violation, but are not the main participants.

5-9.1.1 **Elements of the Offense**

1. The defendant has actual knowledge of a crime under the laws of the United States.

   Violations of state law are not covered under this statute.

2. The defendant does some act to conceal the violation.

   Mere knowledge of the commission of a crime is not sufficient to convict. The defendant must do something to conceal the crime after learning of it. Where the defendant has an affirmative duty to report facts that would disclose a crime and the defendant does not make that report, then there is a concealment.

3. The defendant does not promptly report the crime to an officer of the United States.

5-9.2 **BRIBERY OF PUBLIC OFFICIALS AND WITNESSES, 18 U.S.C. § 201**

This statute covers two distinct groups of offenses. The first, "Public Officials," would, within the bankruptcy system, cover the offices of the United States Trustee, the clerk's office, and judges. It would not cover private trustees or professionals. Prosecutions under this part of the statute are covered in the Department's publication titled, Prosecution of Public Corruption Cases (1988).

The second part of the statute covers any attempt to bribe a witness, or an offer by a witness to take a bribe, in any case before a court, Congress, or other officer authorized to take testimony or hear evidence under the laws of the United States. Thus, a debtor who pays a witness to give false testimony could be prosecuted under this statute. A witness corruptly seeking payment for false evidence could also be prosecuted even if no payment or testimony was actually given.

5-9.3 CONSPIRACY, 18 U.S.C. § 371

This statute covers two distinct categories of offenses against the United States.

5-9.3.1 Conspiracy to Defraud the United States

Where two or more individuals agree to defraud the United States or any agency thereof, and then do at least one overt act in furtherance of that agreement, the crime of conspiracy is completed. There is no requirement that the actual fraud be accomplished. Interference or obstruction of a legitimate government function is a violation, just as is a scheme to obtain government property or money by fraud.

This section is useful when more than one defendant is involved and the scheme is not fully carried out. Because of favorable rules of evidence in conspiracy cases, the United States Attorney often uses this statute.

5-9.3.2 Conspiracy to Violate Laws of the United States

The second part of this statute covers any agreement between at least two people to violate any law of the United States, followed by at least one overt act to accomplish that violation. It is not necessary that the actual substantive violation be completed or that the overt act itself be illegal. An agreement to violate state law is not covered by this statute. Conspiracy charges often may be combined with substantive violations that are completed because of favorable rules of evidence. It also will allow a conviction in some cases even though the jury finds the defendant did not complete the substantive act charged.

5-9.4 CONTEMPT OF COURT, 18 U.S.C. §§ 401 AND 402

5-9.4.1 What Constitutes Contempt

Contempt of court may be defined generally as an act of disobedience or disrespect toward the judicial branch of the government, or an interference with its orderly process. It is an offense against a court of justice or a person to whom the judicial functions of the sovereign have been delegated. U.S. v. Trudell, 563 F.2d 889 (8th Cir. 1977).

Criminal contempt is designed to punish a defendant for his/her conduct and to vindicate the authority of the court. Downey v. Clauder, 30 F.3d 681 (6th Cir. 1994). Criminal contempt, unlike civil contempt, cannot be purged by later compliance with a court's orders. International Union, United Mine Workers of Am. v. Bagwell, 512 U.S. 821 (1994). It is critical to specify that criminal contempt is being considered. Failure to give a person fair notice that criminal contempt is being sought will result in reversal. Downey at 686.

5-9.4.2 **Authority of the Bankruptcy Court**

The rule in some circuits is that the bankruptcy court does not have the authority to hold a defendant in criminal contempt for conduct outside the court's presence. See In re Hipp, 895 F.2d 1503 (5th Cir. 1990), and the cases cited therein. (After remand, the defendant was convicted of criminal contempt by the district court because he violated a direct, personal order of the bankruptcy judge, In re Hipp, 5 F.3d 109 (5th Cir. 1993).)

Following the Supreme Court decision in Chambers v. NASCO, 501 U.S. 32 (1991), the Ninth Circuit recently switched sides on this question and now holds that under Bankruptcy Rule 9020 bankruptcy courts do have contempt powers. In re Rainbow Magazine, 77 F.3d 278 (9th Cir. 1996). Under Rule 9020, the bankruptcy judge can find a person in civil or criminal contempt after giving detailed notice and holding a hearing. The bankruptcy judge's order of contempt has the same effect as a district judge's order unless, within ten days of service of the order of contempt, the contemptor files objections under Bankruptcy Rule 9033. If objections are filed, the matter is heard de novo on the record or on such additional evidence as the district court desires to hear.

Chambers, In re Rainbow Magazine, and In re Skinner, 917 F.2d 444 (10th Cir. 1990), give the bankruptcy court power to impose civil sanctions under either Bankruptcy Rule 9011 or section 105(a) of the Bankruptcy Code.

5-9.4.3 Authority of the District Court

The district court, as an Article III court, has unquestioned civil and criminal contempt power. If a bankruptcy judge is concerned about jurisdiction or the law in the circuit is unclear, cases involving contempt, especially criminal contempt, can be certified or referred by the bankruptcy judge to the district court for action.

Except in cases where the contempt is in the presence of the court and the contempt is handled by summary punishment, the United States Attorney will handle the case as the prosecutor. Only in unusual cases will the United States Attorney decline to prosecute a contempt matter referred by a district judge.

The area of contempt is complex. The United States Attorney's office should be consulted before contempt proceedings are undertaken. Criminal contempt may be the only viable solution to petition mills, serial filers, and other defendants who abuse the bankruptcy system in a systematic way.

5-9.5 THEFT AND EMBEZZLEMENT FROM EMPLOYEE PENSION PLANS, 18 U.S.C. § 664

Any embezzlement, theft, or conversion of any asset of an employee benefit or welfare plan is a violation of this section, provided the plan is subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA). 29 U.S.C. § 1001 et seq.. Almost any type of retirement or benefit plan that provides retirement, health, or other benefits for employees will be covered under ERISA.

Jurisdiction to investigate violations of ERISA falls under the Office of the Inspector General, Department of Labor. The Federal Bureau of Investigation also has jurisdiction.

5-9.5.1 Elements of the Offense

1. The plan involved is a plan within the meaning of ERISA. 29 U.S.C. § 1001 et seq..

2. The defendant willfully depletes the assets of the fund. The acts of the defendant must be with fraudulent intent. The defendant does not have to be a trustee or other fiduciary of the plan.

This statute will often have application in bankruptcy cases involving companies. The owners and officers of a failing business will view the assets of the company health and benefit fund as a resource to be used for other than proper purposes. The Department of Labor is aggressive in protecting the assets of these plans and usually will attempt to work the cases where there is evidence of fraud. They also have civil remedies that can assist employees in some cases.

5-9.6 ARSON INVOLVING INTERSTATE COMMERCE, 18 U.S.C. § 844(i)

This statute punishes any person who maliciously damages or attempts to damage by fire or explosive any building, vehicle, and real or personal property used in interstate commerce or affecting interstate commerce. Individuals who destroy records or other property of an estate violate this statute. Investigations of 18 U.S.C. § 844 are conducted by agents of the Bureau of Alcohol, Tobacco and Firearms (ATF) of the Treasury Department. Depending on local conditions, these agents may be able to work a case that other agencies do not have the resources to timely investigate.

The definition of "interstate commerce" or "affecting interstate commerce" covers almost any type of commercial activity. In any case involving possible arson, consideration should be given to contacting agents of the ATF.

5-9.6.1 Elements of the Offense

1. The defendant maliciously damages or destroys real or personal property.

2. The damage was done by means of fire or explosives.

3. Such property was used in interstate or foreign commerce or in any activity affecting such commerce.

5-9.7 FALSE STATEMENTS AND SCHEMES, 18 U.S.C. § 1001

This section prohibits anyone within the jurisdiction of any department or agency of the United States from knowingly and willfully falsifying, concealing, or covering up, by any means, a material fact, or making a false statement or using any false document knowing that it contains false or fraudulent information.

5-9.7.1 Differences from 18 U.S.C. § 152

There is no requirement that the statement or document be under oath. Thus, unsworn statements, either oral or written, may be prosecuted under this section. Operating reports and other statements of a debtor in possession would be covered. There is no requirement that an intent to defraud be proved, U.S. v. Vaughn, 797 F.2d 1485 (9th Cir. 1986), but, as a practical matter, unless there is some intent to defraud, the case normally will be declined.

5-9.7.2 Statements Made to Courts

On May 15, 1995, the Supreme Court resolved a serious split in the circuit courts of appeals over whether statements made or submitted to courts are covered by 18 U.S.C. § 1001. The Court overruled U.S v. Bramblett, 348 U.S. 503 (1955), and held in Hubbard v. U.S., 115 S. Ct. 1754 (1995), that the term "department" did not include the legislative and judicial branches. The false statements in Hubbard involved filing false pleadings with the bankruptcy court.

5-9.7.3 Elements of the Offense

1. The defendant made or used a false statement, falsified anything, or concealed or covered up anything concerning a material matter to an agency or department of the executive branch.

   For years, the issue of materiality was a question of law to be decided by the court. In U.S. v. Gaudin, 115 S. Ct. 2310 (1995), however, the Supreme Court held that issues of materiality are mixed questions of law and fact that must be submitted to the jury as an element of the offense.

The test is whether the statement or document has a natural tendency to influence or be capable of influencing the proceeding. There is no requirement that the statement or document actually harm a creditor or other person. U.S. v. O'Donnell, 539 F.2d 1233 (9th Cir.), cert. denied, 429 U.S. 960 (1976).

2. The act was within the jurisdiction of a department or agency of the United States. As noted above, this does not include statements made to courts or to Congress.

3. The act was done knowingly and willfully. An act can be done knowingly if the defendant has a reckless disregard of whether it is true and makes a conscious effort to avoid learning the truth. U.S. v. Evans, 559 F.2d 244 (5th Cir. 1977), cert. denied, 434 U.S. 1015 (1978).

5-9.8 FALSE STATEMENTS TO FINANCIAL INSTITUTIONS, 18 U.S.C. § 1014

This statute prohibits knowingly making a false statement or report, or willfully overvaluing any property or security, for the purpose of influencing any action of listed financial institutions in relation to loans or securities for loans. (10 year statute of limitation, 18 U.S.C. § 3293.)

5-9.8.1 Relationship to 18 U.S.C. § 152

In many bankruptcy cases, the debtor will have furnished financial statements to financial institutions around the time of the bankruptcy filing. A comparison of these financial statements with the bankruptcy schedules often shows significant differences. While the financial statements to banks use a fair market value and bankruptcy schedules tend to use forced sale values, the differences are often the result of fraud in one place or the other.

5-9.8.2 Elements of the Offense

1. The defendant made a false statement or willfully overvalued property or security, knowing the same to be false.

2. The purpose was to influence the action of a financial institution.

   There is no requirement that the financial institution actually be influenced or harmed, or that it even relied on the statement. It is sufficient if the act was capable of influencing the institution. U.S. v. Kay, 303 U.S. 1 (1938).

3. The financial institution was one listed in the statute.

   The statute lists almost every government agency dealing with credit and banks that are insured or supervised by the federal government.

5-9.9 MAIL, WIRE, AND BANK FRAUD, 18 U.S.C. §§ 1341-44

The mail and wire fraud statutes (18 U.S.C. §§ 1341 and 1343) prohibit any scheme or artifice to defraud or to obtain money or property by false promises, representation, or pretenses, or to attempt to do so.

As of September 13, 1994, the mail fraud statute also includes any matter or thing sent or delivered by any private or commercial interstate carrier. There is no requirement that the mail move in interstate commerce. Deliveries by private or commercial interstate carriers, such as UPS and Federal Express, are included even if the delivery is in-state.

The wire fraud statute requires that the wire, telephone, radio, fax, television, etc. message be transmitted in interstate commerce.

The bank fraud statute (18 U.S.C. § 1344) requires that the scheme or artifice, or the attempt, be directed against a financial institution as defined in 18 U.S.C. § 20. This includes all commercial banks insured or supervised by the United States. (There is a 10 year statute of limitation if the offense involves a financial institution, 18 U.S.C. § 3293.)

5-9.9.1 **Elements of the Offenses**

1. The defendant devised a scheme or artifice, or attempted to do so, to defraud or obtain money or property by means of false promises, representations, or pretenses.

2. The defendant used or caused the mail or private or commercial interstate carrier services to be used, or used any wire, radio, or television facility in interstate commerce, or sought to defraud a defined financial institution.

It is not necessary that the scheme be successful. The statutes also reach schemes or artifices designed to deprive anyone of the intangible right of honest services. This covers bribery of public officials, as well as bribery of employees of private businesses.

These statutes can easily reach bustout schemes in bankruptcy. They also reach credit card schemes where false information is furnished to obtain credit cards. In addition, they may reach typing mills and other types of fraudulent schemes. Jurisdiction for mail fraud rests with the Postal Inspectors; the Federal Bureau of Investigation has jurisdiction for the other statutes.

5-9.10 **OBSTRUCTION OF JUSTICE, 18 U.S.C. §§ 1503 AND 1505**

These sections prohibit anyone from corruptly using force, threats of force, or threatening communication to obstruct or endeavor to obstruct or impede the due administration of law before a court (section 1503) or before any department or agency or Congress (section 1505). These sections are designed to protect the integrity of the judicial and administrative systems. They also prohibit any retaliation against any juror or other officer carrying out duties involving the administration of justice. A threat against a United States Trustee employee conducting a section 341 meeting would be covered by this statute.

This section could arguably be applied to threats or actions against a case trustee and his/her employees for carrying out court directed duties or actions, such as conducting section 341 meetings or selling estate property.

5-9.10.1 **Elements of the Offenses**

1. The defendant corruptly uses force, threat of force, or threatening communications.

   Corruptly means with a specific intent to obstruct justice, i.e., with an improper motive or purpose. U.S. v. Haas, 583 F.2d 216 (5th Cir. 1978), cert. denied, 440 U.S. 981 (1979).

2. The acts were intended to influence, impede, or intimidate jurors or court officers or to obstruct the due administration of justice.

5-9.11 **OBSTRUCTION OF COURT ORDERS, 18 U.S.C. § 1509**

This statute prohibits anyone from willfully interfering or attempting to interfere with anyone carrying out court orders. The statute is a misdemeanor and could be used to prosecute defendants who refuse to obey turn over orders issued by the bankruptcy court. Use of this statute would allow the defendant to plead to a misdemeanor rather than a felony for section 152 violations.

5-9.11.1 **Elements of the Offense**

1. There is a judgment, decree, or order of a court of the United States.

2. The defendant, by threat or force, willfully obstructs or attempts to obstruct the exercise of rights or duties under that order.

5-9.12 **TAMPERING WITH WITNESSES OR VICTIMS, 18 U.S.C. § 1512**

This section was part of the Victim Witness Protection Act of 1982. It is designed to give broad protection to witnesses and victims, and to prevent any obstruction of investigations or proceedings. It prohibits any threats, intimidation, or retaliation against anyone because of their participation in investigative or judicial proceedings. It prohibits attempts to get anyone to withhold evidence, destroy or alter records or other evidence, or evade service of process.

This section is extremely broad and should be considered any time obstruction of justice is suspected. The Federal Bureau of Investigation has investigative jurisdiction in this area.

5-9.13 FALSE STATEMENTS IN A JUDICIAL PROCEEDING, 18 U.S.C. §§ 1621 AND 1623

5-9.13.1 Use of 18 U.S.C. § 1623 over § 1621

Section 1621 is the traditional perjury statute. It requires proof of perjury by two witnesses or one witness and independent corroborative evidence. U.S. v. Maultasch, 596 F.2d 19 (2d Cir. 1979). Section 1621 applies to any evidence or testimony given before a person authorized to administer an oath. It is not limited to testimony before a court or grand jury.

Section 1623 does away with the "two witness" rule and allows a defendant to be convicted where the defendant makes inconsistent statements in the same proceeding. With inconsistent statements, the government only has to show that the statements were irreconcilably contradictory and the defendant did not believe both to be true at the time they were made. The government does not have to prove which of the statements is false. This section can also be used to prosecute the "I don't remember" answer where it can be shown that the witness did know at one time and has, in fact, not forgotten. It also covers the use of false information or documents. The term "proceeding" covers any aspect of the same matter; two separate hearings in the same case would be covered.

Section 1623 applies only to statements made before a court or grand jury. It provides that it is a defense if the defendant recants a false statement in the same proceeding before the false statement substantially affects the proceeding or it is manifest that the falsity of the statement either has been or will be exposed.

Where false testimony is before a court or grand jury, section 1623 is almost always used.

5-9.13.2 **Elements of the Offenses**

1. The defendant must be under oath.

2. The defendant must make a false statement or, in the case of section 1623, use false documents or make either a false statement or irreconcilably inconsistent statements.

3. The false statement must be material. Materiality is a question of fact for the jury. U.S. v. Gaudin, 115 S. Ct. 2310 (1995).

4. The defendant must know the statement or document is false at the time it is made or used.

5-9.14 **RECEIVER MISMANAGING PROPERTY, 18 U.S.C. § 1911**

This statute prohibits any receiver, trustee, or manager in possession of property in any case pending before a court of the United States from willfully failing to manage or operate such property in accordance with the law of the state where the property is located.

5-9.14.1 **Application in Chapter 11 Cases to Debtor in Possession**

This statute is a misdemeanor which applies to a debtor in possession, as well as a trustee and other professionals who have charge of property. It may provide a misdemeanor charge that a defendant can plead to where the amount of loss is not sufficient to justify a felony charge.

5-9.14.2 **Elements of the Offense**

1. The defendant is a trustee, receiver, or manager of property in a case pending before a court of the United States.

2. The defendant willfully fails to manage or operate such property in accordance with the laws of the state where it was located in the same manner the former owner or possessor would have been bound to do if in possession.

5-9.15 MONEY LAUNDERING, 18 U.S.C. §§ 1956 AND 1957

These statutes were enacted in 1986 as part of the Anti-Drug Abuse Act. While they are primarily aimed at drug and drug-related offenses, they specifically include transactions that are based on violations of 18 U.S.C. § 152 insofar as they relate to concealing assets, false oaths, claims, and bribery.

Investigative jurisdiction may involve postal inspectors, Secret Service, Internal Revenue Service criminal investigators, or the Federal Bureau of Investigation, or a combination of agents. The penalties for violation of these sections are generally higher than for simple bankruptcy fraud. Prosecutions of these cases have a high priority with the Department of Justice. Accordingly, where it appears significant amounts of money (more than $10,000) have been moved about in bankruptcy cases, consideration should be given to these statutes.

5-9.15.1 Illegal "Financial Transactions," 18 U.S.C. § 1956(a)(1)

This section prohibits a person from conducting financial transactions with either: (1) the intent to promote a "specified unlawful activity" (which includes 18 U.S.C. § 152, but not the new § 157); or (2) the knowledge that the transaction is designed (a) to conceal or disguise the nature, location, source, ownership, or control of the proceeds of a specified unlawful activity or (b) to avoid a federal or state reporting requirement.

Financial transactions are defined to include any use of interstate or foreign commerce to move money or monetary instruments, or involves the transfer of title of real property or vehicle, vessel, or aircraft, or uses a financial institution.

A defendant who, while in bankruptcy, files false schedules concealing real property and thereafter transfers that property to another would violate this section.

5-9.15.2 **Illegal "Transporting Funds or Monetary Instruments," 18 U.S.C. § 1956(a)(2)**

This section is similar to 18 U.S.C. § 1956 (a)(1) except that instead of involving a "financial transaction" it requires the effort to move funds or monetary instruments to or from the United States from any point outside the United States.

5-9.15.3 **Illegal Use of "Financial Institution," 18 U.S.C. § 1957(a)**

This section is, in effect, a "receiving and depositing illegal proceeds" section. The offense is completed if the defendant: (1) engages in a monetary transaction; (2) at a financial institution; (3) with knowledge that the transaction involves the proceeds of some unlawful activity; (4) the unlawful activity is one of the specified unlawful activities; and (5) involves more that $10,000.

This statute would apply to a trustee or debtor in possession who stole money from an estate and then bought a $20,000 cashiers check to deposit in a secret bank account. While a literal reading of the statute would allow it to apply to any deposit of stolen bankruptcy money in a bank account by the thief, Department policy requires that the deposit be in a second transaction, i.e., once removed from the theft.

5-9.16 **RACKETEER INFLUENCED AND CORRUPT ORGANIZATIONS (RICO), 18 U.S.C. §§ 1961 AND 1962**

Application of this statute requires the approval of the Criminal Division of the Department of Justice before indictments or civil complaints can be filed. Because of the complex nature of this statute and the severe penalties involved, it is only used in cases involving significant criminal activity.

The statute lists as a "racketeering activity" any fraud under title 11, except 18 U.S.C. § 157. A "pattern of racketeering activity" means two acts of racketeering activity committed within ten years of each other.

18 U.S.C. § 1962 prohibits anyone from using the income from a pattern of racketeering activity in any way that affects interstate

commerce, or from using a pattern of racketeering to control any business engaged in interstate commerce, or conducting the affairs of a business through a pattern of racketeering activities.

The statute also provides severe criminal and civil forfeiture penalties.

5-9.17 INTERSTATE TRANSPORTATION OF STOLEN PROPERTY, 18 U.S.C. § 2314

This statute prohibits the interstate transportation of property, securities, or money of a value of $5,000 or more if they are known to be stolen, converted, or obtained by fraud. The transportation may be by the defendant or he/she may cause the transportation to take place.

5-9.18 SALE OR RECEIPT OF STOLEN PROPERTY, 18 U.S.C. § 2315

This section prohibits a defendant from receiving, possessing, concealing, storing, selling, or disposing of property, securities, or money of a value of $5,000 or more which has crossed a state line after being stolen, converted, or taken, where the defendant knows the property has been stolen. There is no requirement that the defendant know the property crossed state lines, only that the property was stolen, converted, or taken.

5-9.19 FRAUDULENT USE OF CREDIT CARDS, 15 U.S.C. § 1644

The knowing use in a transaction affecting interstate commerce of a stolen, altered, or fraudulently obtained credit card to obtain anything of value of $1,000 or greater in a one year period is a violation of this section.

This statute would be appropriate where it appears a debtor obtained a credit card by fraud through use of false information and then ran up debts in excess of $1,000 in a year. Debtors who run up large credit card debts may try to discharge them through bankruptcy. Excessive credit card debt should be examined for the possibility of fraud. The Secret Service has investigative jurisdiction over this statute.

5-9.20 EQUITY SKIMMING, 12 U.S.C. § 1709-2

This statute prohibits anyone, with the intent to defraud, from willfully engaging in a pattern or practice of purchasing one- to four-family dwellings (including condominiums and cooperatives) that are subject to loans in default at the time or which go into default within one year from failing to make payments on the debt where the rents are collected and diverted to the defendant's use. The debt on the dwellings must be made, insured, or held by Housing and Urban Development (HUD) or the Veteran's Administration (VA).

Individuals involved in equity skimming may steal money and then, when HUD or the VA start foreclosure proceedings, file bankruptcy. Even if they stop stealing at the point of filing, this statute has been violated. If they continue to steal while acting as a debtor in possession, 18 U.S.C. § 152 will also be violated. Violations of this statute are investigated by the Federal Bureau of Investigation and the Inspector General of HUD.

5-9.21 TAX OFFENSES

The tax offenses identified in the following sub sections are investigated by agents of the Criminal Investigation Division (CID) of the Internal Revenue Service (IRS). Because of disclosure limitations, CID agents are not able to discuss tax investigations with anyone outside the IRS, except in very limited circumstances, until the matter has been formally referred to the Department of Justice. Prosecution of these violations also must be approved by the Tax Division of the Department of Justice before the local United States Attorney may prosecute.

Suspected violation of tax laws should be reported to the IRS either through their District Counsel or the CID.

5-9.21.1 Tax Evasion, 26 U.S.C. § 7201

This section prohibits anyone from willfully attempting to evade or defeat any tax imposed under title 26. This is a felony violation.

The IRS will not recommend prosecution unless there is a substantial tax due and owing and the proof of willfulness is strong.

5-9.21.2 Failure to Pay Withholding Taxes, 26 U.S.C. § 7202

This felony statute prohibits a defendant from willfully failing to collect, account, or pay over taxes he/she is required to collect, account for, or pay over. The normal use of this statute is the willful failure to pay taxes withheld from employee wages.

To establish willfulness under this section it must be shown that the defendant withheld taxes from the employee and then failed to pay when the defendant had the ability to pay. In many bankruptcy cases, the IRS is unable to establish the ability to pay. Accordingly, this section is seldom used despite the serious loss of revenue in many cases.

5-9.21.3 Failure to File, 26 U.S.C. § 7203

This section allows a misdemeanor prosecution of a defendant who willfully fails to file a return, keep required records, supply required records, or pay estimated or other taxes.

The IRS will not, as a rule, recommend prosecution under this section unless there are taxes due and owing and proof of willfulness is strong. For failure to file income tax returns, they normally require the failure to involve more than one year.

5-9.21.4 Fraud And False Statements, 26 U.S.C. § 7206

This section, in many ways, parallels 18 U.S.C. § 152 because it punishes submitting statements, returns, or other documents made under the penalties of perjury. It forbids the removal or concealment of property subject to taxes with the intent to evade payment, and the withholding, falsifying, or destroying of any documents relating to the estate of the taxpayer.

5-9.22 REPORTING MONETARY TRANSACTIONS, 31 U.S.C. §§ 5311-28

These statutes collectively set up requirements for the reporting of movements of cash and other monetary transactions within the United States and to and from the United States. Under regulation issued by the Secretary of the Treasury, cash transactions over $10,000 must be reported to the Department of Treasury.

"Financial Institution" is defined very broadly in 31 U.S.C. § 5312(a)(2). It covers travel agencies, real estate brokers, etc. Form 4789, Cash Transaction Report, is used to report these transactions. It requires a description of the transaction and the identification of the parties to the transaction. The financial institution must file this report on each covered transaction. A Form 8300, Report of Cash, (including many monetary instruments) is also used to report payments of over $10,000 received in a trade or business. This covers lawyers, doctors, car dealers, retail stores, etc. There are similar reports required for anyone taking money or monetary instruments in or out of the country.

Attempting to break covered transactions into several small transactions or providing false information is prohibited by 31 U.S.C. § 5324 and 18 U.S.C. § 1956.

These reports are collected in the Internal Revenue Service's Data Center in Detroit, Michigan. In some cases, the United States Trustee may want to secure information on these reports where it appears a debtor has engaged in covered transactions. Under the provisions of 31 U.S.C. § 5319, this information may be secured by a request of the Director through the Financial Crimes Enforcement Network (FinCEN) of the Department of Treasury.

5-9.23 USE OF FALSE SOCIAL SECURITY NUMBER, 42 U.S.C. § 408(a)(7)(B)

This section prohibits anyone, with an intent to deceive, from falsely representing a social security number to be assigned to the defendant or another person when in fact the social security number is not assigned to the defendant or such other person.

This section is very useful in prosecuting individuals who use false social security numbers in any way in the bankruptcy system. The intent to deceive is clear in cases where the debtor is using the false number to avoid detection of earlier bankruptcy cases, to hide assets, or avoid alerting creditors that the defendant has filed bankruptcy.

Violations of this section are investigated by the Inspector General of the Social Security Administration.

CHAPTER 5-10: COMMON FRAUD SCHEMES INVOLVING BANKRUPTCY

5-10.1 GENERALLY

While simply concealing assets or making false statements in a bankruptcy proceeding make up the majority of bankruptcy frauds, there are a number of fraud schemes that are more complicated and are primarily designed to use the automatic stay provided by the bankruptcy laws to conceal an earlier crime, maximize profit from an ongoing fraud scheme, or buy time while the perpetrator finds a way to avoid victims or leave town.

The following sections detail some of the more common schemes. They are merely illustrative lists of common warning signs identified for each fraud scheme; many of the factors listed may be present in situations where there is no fraud. It is important to analyze all the factors in determining whether a fraud has been perpetrated.

5-10.2 BUSTOUTS

A bustout is conducted by a company that is set up to fail from the outset. The operator obtains merchandise from creditors, disposes of the goods (usually for cash), and does not pay suppliers. A bustout can also be conducted using an existing company's credit to obtain goods available on credit, without the intent to pay, and then disposing of the goods immediately for cash.

5-10.2.1 Examples of Bustouts

5-10.2.1.1 Consumer Products Distributors

A company operates for short period of time and establishes good credit ratings with large consumer goods manufacturers. Orders increase suddenly and payments are not made. Lulling techniques are used to forestall creditors. Goods are sold to retailers at below cost for cash. Bankruptcy is filed. Schedules show large trade debt owed to consumer products manufacturers with inventory unusually low compared to the date the debt was incurred.

5-10.2.1.2 Retail Bustouts

A company rents retail space and does not pay rent or suppliers. Bankruptcy is filed to stop eviction and to gain additional time to continue its illegal operation. Often times, these retail stores are part of distributor bustouts because they provide retail outlets for the consumable goods.

5-10.2.1.3 Tax Bustouts

An individual operates a series of businesses in the same industry and fails to pay taxes. He/she then usually files chapter 11 bankruptcy for the company just prior to or at the time the Internal Revenue Service files a lien on the debtor's assets. The company operates for a brief period of time in chapter 11 before the case is converted or dismissed. A new business is then started with the debtor's assets.

5-10.2.1.4 Credit Card Bustouts

Individuals in contemplation of bankruptcy run up large consumer credit card debt and then file bankruptcy. Purchases and cash advances occur within a short period of time. Frequently, the same individual files bankruptcy several times using false social security numbers or aliases, or assumes another person's name or social security number. False statements are usually made on credit applications and the assets acquired from the fraud are concealed when the bankruptcy is filed.

5-10.2.1.5 Travel Agency Bustouts

A travel agency opens and secures plates from an airline cooperative agency to write tickets. After paying the first few bills, a tremendous number of tickets, often overseas tickets, are written and not paid for. They are sold for cash in bargain sales. The travel agency may report the authorization plates stolen to continue the scheme. Plates and blank ticket stocks are often missing when the trustee or airline attempts to recover them.

5-10.2.2 **Red Flags/Common Characteristics of a Bustout**

1. Company with a short life.
2. Well-established company with good credit recently taken over by a new group who attempts to hide the change in ownership.
3. Fraudulent financial statements.
4. False credit references.
5. No receivables listed on schedules (cash basis operation).
6. Scheduled inventory is very low.
7. Warehouse full of high volume, low cost items.
8. Disproportionate liabilities to assets.
9. Mainly temporary employees.
10. Fake social security/tax payer identification (EIN) numbers used to obtain credit.
11. Leased equipment.
12. Few local creditors; unsecured debt is primarily comprised of trade creditors.

13. Lulling letters to creditors (mail/wire fraud).

14. No corporate bank account or existing account has no funds.

15. Cash paid up front to rent location.

16. Same individuals involved in previous "failed companies."

17. Unusual banking activities (check kiting, bank fraud, money laundering, structured transactions).

18. Schedules and statement of financial affairs incomplete or not filed.

19. Person unfamiliar with debtor's operations testifies at section 341 meeting.

20. Taxes not paid.

21. The same attorney repeatedly represents these types of debtors.

5-10.3 BLEEDOUTS

A bleedout is similar to a bustout, only it usually involves an existing company and a depletion of assets over a relatively long period of time by insiders. There are often concealed assets or false statements in this situation. Long-standing owners or corporate raiders can be perpetrators of the crime.

5-10.3.1 Examples of Bleedouts

5-10.3.1.1 Corporate Raider Bleedouts

A stable company with very liquid assets, such as a large pension and/or profit sharing fund, is acquired in a leveraged buyout. The company is operated for the sole purpose of allowing the insiders to loot the company. A chapter 11 is filed to allow the insiders to complete their scheme. Business transactions are complex and purposefully confusing, which makes fraudulent conveyance actions

expensive and difficult to prove. Scheme is used in all types of industries.

5-10.3.1.2 "White Knight" Bleedouts

A business consultant is hired by a troubled business to assist it in acquiring new financing and streamlining operations. On occasion, the "white knight" is given an ownership interest in the business. The consultant takes control of the financial operations of the business. He/she uses the position to convert company assets, including failure to pay withholding taxes, failure to make pension fund contributions, diverting receivables, paying personal expenses with company funds, taking an excessive salary and bonuses and, in some situations, paying false invoices to entities or individuals related to him/her.

5-10.3.1.3 Parallel Entities

A long-standing company experiences financial problems. Insiders create a new business in the same industry just prior to or soon after the bankruptcy filing. In some cases, a sale of some of the debtor's assets is made to the new entity for a fraction of their value just prior to the bankruptcy. The non-debtor entity is usually not disclosed. The insiders operate the debtor until they have successfully transferred the debtor's inventory, receivables, customers, and good will to the new company. In addition, the insiders may use the debtor to purchase goods and services for the new company with the intent of never repaying the chapter 11 administrative creditors. This is usually a lawyer-assisted fraud.

5-10.3.1.4 Insider Sales

Non-bankruptcy workouts in which misrepresentations are made to creditors (mail fraud) and the assets are sold to undisclosed insiders for inadequate consideration. Secured creditor agrees to the transaction because its security position improves if the new company is debt free. The scheme usually terminates in an involuntary bankruptcy.

5-10.3.2 **Red Flags/Common Characteristics of a Bleedout**

1. Recent changes of ownership/new players.

2. People with no prior involvement in business have money transferred to them, both prepetition and during bankruptcy.

3. Changes in accounting or cash flow practices for no apparent business reason.

4. Payment stream to a certain creditor suddenly balloons.

5. Sudden decrease in inventory; sharp increase in aged receivables.

6. Inventory, equipment, and machinery are sold a short time before the case is filed.

7. Capital infusions of corporate officers are renamed "loans" and are paid back.

8. Excessive salaries and bonuses.

9. Complicated asset transfers with no purpose.

10. Depleted pension funds.

11. Leveraged buyouts.

12. Employee contributions for health care and pension funds are diverted and converted for personal use by the debtor.

13. New company is formed just prior to or immediately after the bankruptcy case is filed.

5-10.4 **PONZI (INVESTOR FRAUD) SCHEMES**

A ponzi scheme (also know as a pyramid scheme) involves soliciting investments by promising interest rates well above the market rate. Early investors recover their investments with the promised rate of

return from funds provided by new investors, and then in turn encourage others to invest. As the pyramid begins to crumble, investors are unable to recover their original investments and interest is no longer paid. Chapter 11 cases are often filed to allow the debtor to continue the scheme. When the scheme collapses before bankruptcy, either a voluntary or involuntary chapter 7 case is filed.

The essence of a ponzi scheme is a promise of a high return on an investment. Once it fails, many investors are reluctant to complain because they realize they have been swindled. It is important to identify the investors; once they are contacted, they are normally cooperative and provide valuable information and assistance in the investigation and prosecution.

5-10.4.1 **Examples of Ponzi (Investor Fraud) Schemes**

5-10.4.1.1 Real Estate Schemes

Limited partnership interests and/or mortgages on residential property are sold to investors. The real estate securing the investment is insufficient to support the shares or interests sold. Funds are removed from the investment properties through large management and general partnership fees paid to insider companies. Investments are commingled. Numerous and complex banking transactions make it difficult to trace funds.

5-10.4.1.2 Church and Ethnic Schemes

An individual solicits funds from members of his/her church or religious faith. Investors believe in the individual because of his/her affiliation with their church and, therefore, trust him/her with their money and to not make appropriate inquiries. Likewise, members of ethnic groups are targeted by members of their community. Shared language and ethnic background allow the perpetrator to win the trust of his/her victims. Recent immigrants are often targets of these schemes. In both situations, the victims are reluctant to believe that their trust has been betrayed and, therefore, may be unwilling to complain about the perpetrator.

5-10.4.1.3 Overseas Funds Needing U.S. Investment

The operators of this scheme promise that they have an overseas investor who needs aid in moving money to this country. They will pay a very high return for the use of the victim's account and aid in transferring the money. The victim has to put up money to help start the transfer. The overseas investment never occurs.

5-10.4.1.4 Advanced Fee Swindle

This is a variation of a ponzi scheme. Either through advertisements or direct contact, individuals or businesses in financial trouble are contacted and offered generous loans. The loans require an advanced fee to guarantee the loan and start the processing. The perspective borrower pays the fee, the loan is not made, and the borrower is in even deeper financial trouble.

5-10.4.2 **Red Flags/Common Characteristics in a Ponzi (Investor Fraud) Scheme**

1. Numerous contacts from investors/creditors about the case.

2. List of creditors, schedules, and statement of financial affairs show mostly unsecured debt owed to numerous individuals.

3. No prospectus or the prospectus provided is untruthful.

4. Numerous complex investment vehicles, such as limited partnerships.

5. Enormous management or general partnership fees to insider controlled companies.

6. Monthly operating reports show income is from individuals with little or no other outside income.

7. Lulling letters to investors explaining that the delay in their interest/loan/deal payment is outside the control of the manager and, if they will be patient or continue to send money, the problems will be resolved.

5-10.5 HEALTH CARE AND WELFARE FRAUD

Health care and welfare fraud is prevalent throughout the country, and there have been an increasing number of bankruptcy cases with these problems. The perpetrators usually file chapter 11 cases to allow their activities to continue and to stall investigations of their actions. The schemes generally involve obtaining funds through the promise of lower cost, greater coverage, or some other inducement to convince either individuals or companies to switch coverage to the new company.

5-10.5.1 Examples of Health Care and Welfare Fraud

5-10.5.1.1 Bogus Health Care Plans

Perpetrator establishes bogus or grossly under-capitalized insurance plans to provide health care to individuals or companies at very favorable rates with no intent to provide services or pay claims. Chapter 11 allows the perpetrator to continue to collect premiums from the victims by paying on a few small claims and stalling on the payment of larger claims.

5-10.5.1.2 Theft of Employee Contributions for Health Insurance

Employer deducts employee's share of insurance premium, but does not remit the funds to the insurance company. This is typical in "bleedout" cases.

5-10.5.1.3 Sham Facilities

Nursing homes, shelters, drug rehabilitation programs, and other health-related homes are set up to secure federal and state funding. They provide little or no services to the clients and convert funds received for their own use. In some instances, the government funding programs require the services to be rendered at no cost to clients. In those

situations, the perpetrators require clients to sign over food stamps and welfare checks to them in order to remain at the shelter.

5-10.5.2 **Red Flags/Common Characteristics in Health Care or Welfare Fraud Scheme**

1. Numerous complaints of poor or non-existent services.

2. Adverse publicity by media about operations.

3. Investigations by state/federal regulators of operations.

4. Lack of normal books and records.

5. Unlicensed shelters, rehabilitation facilities, half-way houses, etc.

6. Deductions from employee paychecks for health care coverage, but funds not remitted to the insurance company.

7. See also red flags from bustout schemes at USTM 5-10.2.2.

5-10.6 **RENT/EQUITY SKIMMING**

Rent or equity skimming involves acquiring the titles to multiple properties with no intention of paying the mortgages. The perpetrator collects the proceeds from the property, and then files a bankruptcy to stall foreclosure and to allow the scheme to continue.

5-10.6.1 **Examples of Rent/Equity Skims**

5-10.6.1.1 Rent/Equity Skim

An individual acquires partnership interest or title to property, but does not assume the mortgage. The perpetrator puts his/her management company in control of the property. He/she collects rent, pays exorbitant management fees, does not maintain the facilities, and makes no payments to the secured lender. The lender is contacted by the perpetrator who attempts to extort a buyout of his/her interest. When

the lender attempts to foreclose, the perpetrator deeds the property to a corporate entity that files bankruptcy. The transfer of title is repeated several times, with bankruptcies filed to cover all the transfers.

5-10.6.1.2 Property Title Skim

This fraud is similar to the one described above. The major difference is that the perpetrator convinces the victim to deed his/her home over to the perpetrator for little or no cash. The victim then pays rent to the perpetrator who does not pay the existing mortgage or seek new financing. Bankruptcies are filed to delay foreclosure. In some instances, the perpetrator will deed fractional interest of the property to other bankruptcy estates, without their knowledge. This complicates and delays foreclosure.

5-10.6.2 **Red Flags/Common Characteristics in a Rent/Equity Skimming Scheme**

1. Failure to make mortgage payments.
2. Transfer of entire or fractional interest to property shortly before foreclosure.
3. Multiple fractional interests in real property listed on the schedules.
4. Frequent quit claim deeds transferring interest in the property.
5. Numerous "doing business as" designations and individuals in the chain of the title.
6. Use of mail drop boxes as company business addresses.
7. Postpetition transfers into a bankruptcy estate.
8. New corporation formed holding a single asset.
9. Schedules amended to dramatically increase number of pieces of real property owned by the debtor.

10. Same individual files claims in large number of unrelated cases. Proofs of claim do not have supporting documentation attached.

11. Debtor complains about the unusual and menacing harassment by a creditor, and counsel takes no court action against the creditor.

12. Unusual provisions in cash collateral orders.

13. Agreements by the debtor to modify the automatic stay to permit foreclosure without any assertion that the lender is under secured.

5-10.7 CONCEALMENT AND FALSE STATEMENTS

The concealment of assets and related false statements constitute over 70 percent of all bankruptcy crimes according to the latest Federal Bureau of Investigation statistics. A debtor who fails to list assets on his/her bankruptcy schedules commits both the crime of concealment and false statement. By concealing assets, the debtor attempts to preserve property for future use and to deprive creditors of their fair share of assets. Concealment may take the form of omission of assets in their entirety or the gross undervaluation of assets.

5-10.7.1 Examples of Concealment

5-10.7.1.1 Failure to Schedule Assets

A debtor fails to schedule assets. Typical examples of assets not disclosed include personal injury lawsuits, real estate, bank and investment accounts, stocks, jewelry, art work, interest in non-debtor entities, etc.

5-10.7.1.2 Undervalued Assets

An asset is listed, but its value is grossly understated or deemed worthless. The intent is to persuade the trustee and creditors not to liquidate the asset.

5-10.7.1.3 Transfer of Assets Prepetition

A debtor transfers assets, with little or no consideration to third parties, with the agreement that after the case is closed the property will be returned to the debtor. The relationship to the debtor or the agreement with the transferee is not disclosed.

5-10.7.1.4 Transfer of Assets Postpetition

A debtor sells or transfers assets without court approval. If the debtor does seek court approval, the debtor does not disclose his/her relationship to or agreements with the purchaser. For example, the debtor sells property below its value to a straw buyer who agrees to convey it back to him/her. A similar situation is where the purchaser agrees to give the debtor part of the purchase price "under" the table and court approval is sought for the purchase at a lower price to allow for the transfer.

5-10.7.2 **Red Flags/Common Characteristics in Cases of Concealment and False Statements**

1. Claims of theft or large gambling losses just before bankruptcy.

2. Inability to account for property listed on insurance policies or personal financial statements in existence before bankruptcy.

3. Incomplete schedules--frequent amendments in response to creditor questions.

4. Unexplained change in financial circumstances.

5. Debtor shows no ownership interest in residence.

6. Tax returns not filed for the relevant years.

7. Debtor "confused" about his/her assets and financial affairs.

8. Unsecured debt does not reconcile with assets listed, e.g., large number of medical bills, but no lawsuit listed.

9. Failure to list prior bankruptcies.

10. Significant amendments to list of creditors after section 341 meeting.

11. Complaints by ex-employees, ex-spouses, or ex-partners about hidden or omitted assets.

12. Fifth Amendment claimed on any issue.

13. Fire or other disaster occurs (of particular importance if arson is suspected).

14. Transfer of property to relatives or friends just before bankruptcy.

15. Sudden appearance of loans or loan repayments to friends or relatives with little or no documentation.

16. Sudden change of attorney for no apparent reason.

5-10.8 COLLUSIVE INVOLUNTARY BANKRUPTCY

There has been an increase in collusive involuntary bankruptcies in which creditors file an involuntary bankruptcy case at the debtor's direction or with his/her approval. The collusive bankruptcy is often part of a larger scheme, frequently involving real estate foreclosures.

In the typical collusive involuntary, the perpetrator has co-conspirators file an involuntary for him/her or his/her corporate entity. The involuntary is used by the debtor if he/she has been prohibited from filing for a period of time. A bustout or bleedout perpetrator uses the involuntary to conceal his/her involvement in the case, where he/she is involved in a number of pending corporate bankruptcies. The bankruptcy system is used to gain the benefit of the automatic stay without information having to be disclosed about the debtor during the involuntary period.

5-10.8.1 Red Flags/Common Characteristics in a Collusive Involuntary Scheme

1. Debtor who is subject to a 180-day bar on refiling has an involuntary filed against him/her.

2. Creditors have recently acquired the claim asserted in the involuntary.

3. "Professional" creditors who reappear regularly in suspicious sounding deals.

4. Same attorney is involved in the voluntary and involuntary bankruptcies.

5. Creditors are "former" long-term business associates of the debtor's insider.

6. Insider has filed several suspicious bankruptcy cases for corporate or partnership entities in a short period of time.

5-10.9 STRAW BUYER/FICTITIOUS BIDDER

The debtor sells assets to a court approved buyer and the assets are secretly resold at a profit pursuant to a previous agreement with the real buyer. Where fictitious bidding is suspected, potential purchasers should be required to state on whose behalf they are bidding.

5-10.9.1 Examples of Straw Buyer/Fictitious Bidder

5-10.9.1.1 Kickbacks

An insider agrees to sell assets to a purchaser who has agreed to pay the insider a kickback. The purchase price disclosed in the motion to sell is less than the price agreed upon by the insider and the purchaser. When the sale is completed, the debtor receives the difference between the court approved price and the undisclosed sale price.

5-10.9.1.2 Straw Sales

An insider wants to conceal his/her purchase of estate assets because he/she wants to orchestrate the sale to allow him/her to buy the assets for a depressed price. A fictitious purchaser or nominee is used to acquire the assets. Once the sale is consummated, the assets are transferred to the insider for a fee. The insider and the purchaser do not disclose the relationship to the court. Often times, both parties will make affirmative statements claiming that there are no connections or agreements between them.

5-10.9.2 **Red Flags/Common Characteristics in a Straw Buyer/Fictitious Bidder Scheme**

1. Pre-existing, undisclosed relationship between the debtor and the straw buyer.

2. Sale terms are structured to prefer one bidder.

3. Inadequate or no effort is made to locate other purchasers. Advertising is not placed in appropriate newspapers or journals to reach potential purchasers.

4. Unusually high bid-protection or break-up fees.

5. High price offered, but broad terms allow the purchasers substantial set-off rights.

6. Purchaser is represented by counsel with close ties to the debtor's counsel.

7. Debtor interferes with potential purchasers due diligence efforts.

8. Short notice requested on sale because of "emergency" situation.

5-10.10 **SERIAL FILERS**

A serial filer is typically an individual. The debtor files numerous cases to take advantage of the automatic stay to prevent foreclosure and

collection on other debts. The petitions usually contain false social security numbers, variations of the debtor's name, or fictitious names. Chapter 7 and chapter 13 cases are filed interchangeably.

5-10.10.1 Red Flags/Common Characteristics in a Serial Filer Scheme

1. Debtor has filed a high number of cases in a short period of time.
2. Debtor does not disclose prior bankruptcy cases.
3. Debtor uses different counsel to file each case.
4. Chapter 13 cases never completed because of failure to fund plan.
5. Debtor had been prohibited from filing a case pursuant to 11 U.S.C. § 109(g).

5-10.11 CREDITOR FRAUD

Creditor fraud exists in the system, but is more difficult to uncover. Typical crimes committed by creditors include filing false proofs of claim, collusive bidding for estate property, and extortion or intimidation in attempts to collect prepetition debt postpetition.

5-10.11.1 Examples of Creditor Fraud

5-10.11.1.1 False Proofs of Claim

A creditor files a false proof of claim in a bankruptcy case. A more complex scheme is where an individual files proofs of claim in numerous unrelated bankruptcy cases. Usually, the claims are filed in large cases where objections to small claims will not be made because of the cost of pursuing claim objections.

5-10.11.1.2 Automatic Stay/Extortion

A creditor threatens, intimidates, and uses force against a debtor to have a prepetition debt paid postpetition, notwithstanding the prohibition of such payment by the automatic stay.

5-10.11.1.3 False Invoices

A creditor, with the debtor's knowledge, submits a false bill for postpetition goods or services which it has not provided to the debtor. The invoice, thus, allows the debtor to pay the creditor its prepetition debt "under" the table.

5-10.11.1.4 Secured Creditor Fraud

A secured creditor and the debtor agree to cure the defect in the lender's lien through use of a cash collateral order. The defect in the lien is not disclosed to the court, creditors, or the United States Trustee. The insiders who have personally guaranteed the debtor's secured obligations are usually willing to engage in this scheme. A similar scheme involves transferring the debtor's assets to a non-debtor entity in which the secured creditor has a properly perfected lien, but may be undersecured.

5-10.12 FRAUDULENT PETITION MILLS

The individual running the mill is a self-styled, unlicensed financial advisor/paralegal/eviction counselor, who solicits clients from foreclosure publications or unlawful detainer filings. The perpetrator's advertisements promise to help solve the financial problems of the victim. On meeting with the victim (debtor), the "advisor" tells the debtor that matters can be resolved--the eviction can be stopped, the mortgage rate can be lowered, interest rates reduced, or car payments and repossession stopped. A large fee is collected up front and the debtor signs papers in blank. The "advisor" then files a bankruptcy petition for the debtor.

Often times, the debtor is not aware that a bankruptcy has been filed and will not show up for the section 341 meeting. When the case is dismissed, the "advisor" may claim to the victim debtor that a mistake

has been made and, for an additional fee, it can easily be corrected. A subsequent bankruptcy is filed, many times with a slight change to the name or social security number. In many cases, the "advisor" directs the debtor to make mortgage/rent/car payments to him/her as part of the agreement and he/she then converts the money to his/her personal use.

5-10.12.1 **Examples of Petition Mills**

5-10.12.1.1 Financial Counseling Skim

Homeowners whose properties are in foreclosure are contacted, usually through the mail, by a financial consultant. The consultant tells the homeowner that he/she will find a new lender to assume the delinquent mortgage. The homeowner is instructed to make mortgage payments directly to the consultant. The perpetrator files bankruptcy, many times without the victim's knowledge, to forestall the foreclosure and to maintain the stream of income being received from the victim.

5-10.12.1.2 Property Title Skim

This fraud is similar to the one described above. The major difference is that the perpetrator convinces the victim to deed the home over to him/her for little or no cash. The victim then pays rent to the perpetrator who does not pay the existing mortgage or seek new financing. A bankruptcy is filed to delay foreclosure. In some instances, the perpetrator will deed fractional interest of the property to other bankruptcy estates, without their knowledge. This complicates and delays foreclosure.

5-10.12.1.3 Petition Mill

The mill will hold itself out as an eviction counseling service, but instead of providing actual eviction defense services, will file a bankruptcy in the tenant's/owner's name to stay eviction. Often the tenant/owner does not know that a bankruptcy has been filed or that he/she will be evicted once the stay is lifted or the bankruptcy dismissed. The landlord/mortgage holder will have a valid eviction repossession order, but must obtain relief from the stay or wait for dismissal of the case to execute it.

5-10.12.1.4 Scrivener Typing Services

An individual sets up a storefront office and advertises a scrivener service that will assist individuals in filing a pro se, simple chapter 7 bankruptcy and will prepare all the paperwork for a low fee. Names like "Attorney Assisted Legal Centers" or "Paralegal Centers" are often used. Attorney approved services are stressed. A debtor may or may not sign bankruptcy papers in blank, and will usually not pick up the bankruptcy document until just before filing.

5-10.12.1.5 Legal Advice Typing Services

Many typing services will prepare petitions and schedules and will advise the debtor of the law. The advertisements will state that the service can perform the same quality of service as attorneys, but for less money. Debtors file petitions and schedules pro se and do not disclose that they were assisted in filing their cases.

5-10.12.2 **Red Flags/Common Characteristics in a Petition Mill Scheme**

1. Pro se petition where debtor says no one assisted him/her, but the debtor is clearly unfamiliar with the bankruptcy system.

2. A pro se petition is filed and the debtor denies filing bankruptcy.

3. Debtor fails to attend section 341 meeting.

4. "Face Sheet" filing with a single creditor listed, usually the mortgagee or the landlord.

5. Debtor facing eviction, foreclosure, or repossession notice.

6. Pattern of pro se debtors with identical paperwork as to form, style, and general content.

7. Pattern of complaints from mortgagees or landlords.

8. Debtors or others have been solicited by petition mills that stress stopping evictions, etc.

9. Complaints by debtor that he/she has been making rent/mortgage/car payments to a third party.

10. Advertising in budget papers and using flyers to advertise bankruptcy and divorce assistance at a low, fixed fee.

11. Imply that attorneys are supervising/approving the service.

12. Request payment of filing fee in installments.

13. Assets or liabilities are not scheduled.

14. Failure to properly fill out or file schedules.

15. Use of chapter 7 when chapter 13 is clearly feasible.

CHAPTER 5-11: GRAND JURY PROCEEDINGS

5-11.1 FUNCTION AND USE OF A GRAND JURY

The federal grand jury is a body consisting of at least 16 and not more than 23 individuals selected from the jury pool by the district court. Once 23 individuals are qualified as grand jurors, the district judge will select a foreperson and a deputy foreperson from the 23. The normal term of a grand jury is 18 months, although the district court may provide it serve a shorter term. Certain special grand juries can have a term of three years.

Grand juries normally meet at a time set by the United States Attorney. In most districts, they will meet monthly for one to four days depending on work load. Most districts have more than one grand jury qualified at one time. When the term of a grand jury expires, any unfinished work is normally transferred to the grand jury that takes its place.

The grand jury will hear evidence of possible crimes committed within the district. It has the authority to issue subpoenas for individuals and records located anywhere in the United States or its territories. The

grand jury's authority to investigate is extensive and only rarely will courts intervene in its investigations. U.S. v. George, 444 F.2d 310, 314 (6th Cir. 1971). The grand jury investigation may consist of hearing a single investigator report on the results of an investigation of a crime or it may involve months of testimony, extensive evidence, and numerous witnesses.

The grand jury may not permit a witness to have an attorney or other individuals with the witness in the grand jury room. A person under investigation has no constitutional right to have the grand jury hear evidence on the subject's behalf. Likewise, the person under investigation has no right to appear before the grand jury. As a matter of Department policy, such evidence will normally be presented and, if a subject desires to testify before the grand jury, he/she will be allowed to do so.

At the conclusion of an investigation, if an indictment is warranted, the United States Attorney will ask the grand jury to return an indictment. This is normally done by presenting the grand jury with a prepared indictment and asking it to vote on it. If at least 12 grand jurors vote in favor on the return of the indictment, it is a "true bill" and it becomes a formal charge once it is signed by the attorney for the government. While the standard for the return of an indictment is probable cause, Department of Justice policy is not to seek an indictment unless there is a reasonable likelihood of a conviction after trial. If less than 12 grand jurors concur in the return of an indictment, it is a "no true bill" and, in the absence of new evidence or the rare case of the matter being presented to a new grand jury, the investigation of that defendant will be ended.

5-11.2 SECRECY REQUIREMENTS OF THE GRAND JURY

Fed. R. Crim. P. 6(e)(2) provides that matters occurring before the grand jury may not be disclosed to anyone, except as provided by the rules. Thus, the Assistant United States Attorney and anyone assisting him/her are prohibited from disclosing matters occurring before the grand jury, except as otherwise provided in that rule. Members of the United States Trustee's office assisting in a criminal prosecution may be put on a "6(e) disclosure list" by the Assistant United States Attorney to

assist in the investigation and prosecution of the case. Once individuals are on this list, they may be shown grand jury information. However, grand jury information or information derived from it may not be used in any other proceeding without district court authorization.

This obligation of secrecy does not apply to a witness called before the grand jury, other than individuals assisting the Assistant United States Attorney, such as case agents. Ordinary witnesses may disclose their testimony to the grand jury and what they were asked if they so desire. Often, witnesses are asked not to disclose their grand jury experience and, in rare cases, the Assistant United States Attorney may seek a court order requiring witnesses to keep the proceedings secret. A knowing violation of Rule 6 is punishable as a contempt of court.

5-11.3 PROCEDURE TO SECURE USE OF GRAND JURY MATERIAL IN CIVIL PROCEEDINGS

Fed. R. Crim. P. 6(e)(3)(C)(i) provides that the disclosure of matters otherwise prohibited by this rule of matter occurring before the grand jury may be made when so directed by a court "preliminary to or in connection with a judicial proceeding." U.S. v. Sells Engineering, Inc., 463 U.S. 418 (1983); U.S. v. Baggot, 463 U.S. 476 (1983). This rule allows disclosure upon a strong showing of "particularized need" in civil cases, including bankruptcy adversary proceedings. In re Shenker, 157 B.R. 21 (E.D. Mo. 1993). It may also extend to certain administrative hearings if they are preliminary to judicial proceedings. Attorney disciplinary hearings are included. Matter of Federal Grand Jury Proceeding, 760 F.2d 436 (2d Cir. 1985).

Due to the sensitive nature of disclosure issues, the United States Trustee may not seek disclosure of grand jury material for civil proceedings without the concurrence of the United States Attorney. The motion for disclosure should be made by the United States Attorney because it may then be made ex parte. Fed. R. Crim. P. 6(e)(3)(D). Otherwise, it will require notice and a hearing. Disclosure before an indictment is returned is very unusual. Disclosure has been authorized in cases where the grand jury investigation discovered that assets of the

estate had been concealed, and the assets were in the process of being transferred to third parties with little chance of recovery by the trustee unless there was timely disclosure.

CHAPTER 5-12: IMMUNITY PROVISIONS

5-12.1 STATUTORY REQUIREMENTS

11 U.S.C. § 344 provides that "immunity for persons required to submit to examination, to testify, or to provide information in a case under this title may be granted under part V of title 18." 18 U.S.C. §§ 6001-05.

Unlike the provision of the former bankruptcy law, there is no automatic immunity for individuals who testify at section 341 meetings.

No testimony or information compelled, or other information derived directly or indirectly from the compelled testimony or information, may be used against a witness in any criminal case, except for perjury or false statement or otherwise failing to comply with an order. 18 U.S.C. § 2002.

5-12.2 PROCEDURE FOR SECURING IMMUNITY

While anyone seeking evidence through the provisions of title 11 can seek immunity, only the United States Attorney for the district where the proceeding is being conducted can make the required request for an order from the district court compelling such testimony. 18 U.S.C. § 2003. Requests for immunity may be started by any Department of Justice attorney. This is normally done using Form OBD-111 and sending it to the Assistant Attorney General for the Criminal Division (Attention: Witness Record Unit). An informational copy also must be sent to the local United States Attorney.

Before any immunity request will be granted, it must be shown: (1) that the testimony or information sought may be in the public interest and (2) that the person the order will be directed to has refused

or is likely to refuse to provide the testimony or information on a valid claim of the privilege against self-incrimination.

Except in emergencies, at least two weeks should be allowed for processing immunity requests. If the Assistant Attorney General approves the request, the local United States Attorney will be authorized to request an immunity order from the district court. The United States Attorney must also be personally satisfied of the need for the immunity order and so certify to the district court.

Except in unusual circumstances, the Department of Justice will not prosecute individuals who have given immunized testimony except for perjury or false statements in the testimony.

Because of the procedural problems inherent in the use of immunity orders, no such requests shall be made by Program employees without permission of the General Counsel. Close coordination with the local United States Attorney is necessary.

5-12.3 HANDLING IMMUNIZED INFORMATION

Immunity requests for proceedings under title 11 are rare. Once the immunity order is signed, great care must be taken to segregate information obtained directly or indirectly by that order. So long as no criminal proceedings are involved, few if any problems will arise.

In most cases, however, there will be indications of criminal activity. It is important to be able to show that any evidence used in the criminal case against the immunized defendant was not derived directly or indirectly from the immunity order.

1. The bankruptcy judge should be requested to enter a protective order covering any testimony or documents produced through use of the immunity order that requires those seeking access to such information to identify themselves and the purpose for which the information is sought and will be used. A record of all access to this information should be maintained.

2. The United States Trustee should advise any person having access to such information that they should not disclose its contents to any criminal investigator, absent consultation with the United States Attorney.

3. In case a criminal referral is made, no part of the compelled testimony or information should be included in the referral.

CHAPTER 5-13: PARALLEL PROCEEDINGS

5-13.1 DEFINITION OF PARALLEL PROCEEDINGS

Parallel proceedings are defined as situations where both criminal and civil investigations/cases are in progress at the same time. An example would be where a trustee is conducting an adversary proceeding to recover property in a chapter 7 case, while, at the same time, there is a criminal investigation of the debtor for bankruptcy fraud involving concealment of the same asset.

5-13.2 NEED FOR PARALLEL PROCEEDINGS

Because both civil and criminal investigations and proceedings may consume a great deal of time, it is usually impractical to hold one in abeyance for any substantial length of time while the other proceeds to conclusion. Thus, it is normal for both criminal and civil cases to proceed at the same time. Due consideration must be given to both proceedings to ensure that one does not improperly impact the other.

5-13.3 PROCEDURAL CONSIDERATIONS THAT MAY ARISE

Before a criminal referral is made, all civil proceedings should be carried out in a normal fashion. Where criminal conduct is suspected, no civil proceeding should be undertaken for the sole purpose of securing criminal evidence. U.S. v. Unruh, 855 F.2d 1363, 1374 (9th Cir. 1987), cert. denied, 488 U.S. 974 (1988). Proceedings that are authorized under the

Bankruptcy Code and which are related to the pending cases do have a proper civil purpose and should be pursued. Information that a trustee or other party develops in civil proceedings may be shared with prosecutors. S.E.C. v. Dresser Indus., 628 F.2d 1368 (D.C. Cir., en banc) (1980), cert. denied, 449 U.S. 993 (1980).

Witnesses and debtors may exercise their right against self incrimination under the Fifth Amendment in any proceeding. A debtor who has sought the protection of the Bankruptcy Code may risk having his/her case dismissed if the debtor fails to provide relevant information about the estate under a claim of Fifth Amendment protection. In re Connelly, 59 B.R. 421, 448 (Bankr. N.D. Ill. 1986).

5-13.3.1 **Stay of Proceedings**

In order to avoid providing evidence in a civil case that might be harmful to a party in criminal proceedings, the civil party may request a stay of civil proceedings pending completion of the criminal case. Alternatively, the United States Attorney may seek a stay of the civil proceedings because they are interfering with the criminal investigation. The following factors have been weighed by courts in deciding this issue.

1. The interest of the plaintiff in the proceeding and any potential prejudice the plaintiff will suffer.

2. The burden that will be placed on the defendant(s).

3. The burden that will be placed on the court in the management of its cases and the efficient use of judicial resources.

4. The interest of persons not party to the civil litigation.

5. The interest of the public in the pending civil and criminal litigation.

Where no indictment has been returned, the case for stay of civil proceedings is much weaker. Federal Sav. and Loan Ins. Corp. v. Molinaro, 889 F.2d 899, 902 (9th Cir. 1989).

5-13.3.2 Protective Orders

A party may also request protective orders to deny criminal investigators, including grand juries, access to evidence developed in the civil case. The United States Trustee must not agree to such orders and should oppose them whenever they are sought. Requests for protective orders should be reported to the General Counsel as soon as possible.

Courts are split on whether protective orders are appropriate in any case. Yes, absent strong showing of need: Minpeco S.A. v. Conticommodity Services, Inc., 832 F.2d 739, 742 (2d Cir. 1987). No: In re Grand Jury Subpoena, 836 F.2d 1468 (4th Cir.), cert. denied, 487 U.S. 1240 (1988); and In re Grand Jury Proceedings, 995 F.2d 1013 (11th Cir. 1993); and In re Grand Jury Subpoena, 62 F.3d 1222 (9th Cir. 1995).

5-13.4 REQUIREMENT TO COORDINATE WITH THE UNITED STATES ATTORNEY

5-13.4.1 Double Jeopardy Issues

Defendants in cases involving both criminal and civil aspects have argued that civil and criminal proceedings involving the same matter violated the double jeopardy clause of the Constitution. The Ninth Circuit held that the double jeopardy clause applied to the civil forfeiture of money after a criminal conviction. U.S. v. $405,089.23 U.S. Currency, 33 F.3d 1210 (9th Cir. 1994). In U.S. v. Ursery, 59 F.3d 568, the Sixth Circuit held that a prior civil forfeiture of a defendant's land used in drug transactions voided a later criminal conviction for the actual manufacturing of the marijuana under the double jeopardy clause.

The Supreme Court granted certiorari in both cases and reversed U.S. v. Ursery, 116 S.Ct. 2135 (1996), holding that civil in rem proceedings are not punishment for purposes of the double jeopardy clause. The Court announced a two part test to determine whether forfeiture is "punishment" for double jeopardy purposes. First, whether Congress intended particular forfeiture to be remedial civil sanctions or criminal penalty, and second whether forfeiture proceedings are so punitive in

fact as to establish that they may not legitimately be viewed as civil in nature, despite any congressional intent to establish a civil remedial mechanism.

This decision should foreclose defendants arguing that they are entitled to dismiss a bankruptcy fraud indictment because the denial of a discharge, recovery of the property concealed, and imposition of administrative costs or civil contempt or sanctions constitutes double jeopardy. Recovery of property concealed by the debtor and denial of a discharge have clear remedial aspects. The debtor is required to do what should have been done in the first place in the recovery of the property. Denial of a discharge is in the nature of the denial of a benefit, rather than forfeiture of property already owned by the debtor.

Likewise, civil fines of bankruptcy petition preparers under 11 U.S.C. § 110 are intended by Congress to be remedial. In view of the two part test announced in Ursery, there should be no problem in combining the remedies with criminal prosecutions under 18 U.S.C. § 156 or other sections.

As a matter of practice, when criminal referrals are made, the United States Attorney should be advised of any civil action taken or contemplated against the subject(s) of the referral.

5-13.4.2 Before a Criminal Referral is Made

Prior to a formal criminal referral, the United States Attorney and/or other investigative agencies may be advised of potential criminal activity and furnished with pleadings and summaries of hearings, etc. Normally, they should not be asked for advice nor should they give advice on the civil aspects of the case that are the function of the United States Trustee.

Under no circumstances should the United States Trustee or a private trustee be asked or agree to use bankruptcy proceedings solely to develop evidence for a criminal case.

5-13.4.3 **After a Criminal Referral is Made**

Once a criminal referral is made, the United States Trustee should keep the United States Attorney advised on all relevant aspects of the civil case and, in situations where it appears the civil case may have an adverse affect on the criminal case, should normally follow the recommendation of the United States Attorney until the criminal case is concluded.

If United States Trustee personnel are assisting in the criminal case and have been given access to grand jury material, they may not use that information in any way for civil purposes without district court permission. See USTM 5-11. Wherever possible, different individuals should be assigned to work the criminal and civil aspects of a case.

CHAPTER 5-14: SENTENCING PROCEDURES AND RECOMMENDATIONS

5-14.1 **SENTENCING GUIDELINES ACT IN BRIEF**

The Sentencing Guidelines Act (the Act), 28 U.S.C. § 994 et seq., applies to all crimes committed by individuals after November, 1987. The U.S Sentencing Commission publishes a Guidelines Manual that sets out the procedure for determining sentences. The Commission amends the Manual each year as needed. The changes take effect each November, unless Congress votes to stop the change. The Manual in effect at the date of sentencing will be used, unless an earlier version of the entire manual in effect on the date of the last offense is more favorable to the defendant. In that case, the earlier version of the Manual will be used. The Manual determines a sentence range by using a matrix comprised on the left side by offense levels from 1 to 43 and on the top by criminal history categories from I to VI. Thus, a defendant with an offense level of 13 and a criminal history category of I would have a sentencing range of from 12 to 18 months imprisonment. Where the offense level is above 12, the defendant is not eligible for probation.

The Act abolished parole in the federal criminal system. Defendants sentenced to prison terms may receive 54 days a year good time after the first year of their sentence, otherwise they serve their full sentence. The Act also provides guidelines for sentencing individuals that limit the discretion of the sentencing court. No longer do "white collar" criminals get probation for their first offense as a matter of course. Most of the defendants who steal over $40,000 will spend at least four months in jail, home detention, or community release.

Moreover, the court also may fine the defendant and/or order the defendant to make restitution for any actual loss occurring in the case pursuant to 18 U.S.C. § 3571 et seq. and 18 U.S.C. §§ 3663-64. The maximum fine is $250,000 per count for felony offenses, with some exceptions. 18 U.S.C. § 3571(d). The sentencing guidelines provide a fine range based on the offense level and the gain to the defendant or loss to the victim(s). Any fines or restitution ordered by the court are generally non-dischargeable pursuant to 11 U.S.C. § 523(a)(7). Kelly v. Robinson, 479 U.S. 36 (1986). Any restitution ordered to be paid by the defendant is now non-dischargeable, even in a chapter 13 case. 11 U.S.C. § 1328(a). The defendant, if able, can be required to pay the cost of any probation, supervised release, or imprisonment.

A restitution order may be enforced by the United States or by any victim named in the order as any other judgment rendered against the defendant in a civil action. 18 U.S.C. § 3663.

5-14.2 APPLICATION OF SENTENCING GUIDELINES ACT TO BANKRUPTCY CASES

The basic plan of the Act is straightforward. After the defendant has been found guilty, either by pleading guilty or by trial, the matter is set for sentencing, normally within two months of the trial or plea hearing. This allows the case to be reviewed by a Probation Officer of the United States Probation Office to determine the background on the defendant, including any prior record, a statement of the offense and facts surrounding the same, the impact of the defendant's conduct, financial, mental, or physical impairments on any victim, and the application of the sentencing guidelines and recommended sentence. Fed. R. Crim. P. 32(c)(2).

The guideline sentence normally will be determined as follows using the United States Sentencing Commission Guideline Manual.

1. Determine the count or counts of conviction and identify the guideline that applies to those offenses to determine the base offense level. For most bankruptcy related crimes, this will be section 2B4.1, Bribery; section 2F1.1, Fraud and Deceit; or section 2J1.3, Perjury or Subornation of Perjury, including false oath.

2. Determine the defendant's conduct in the total criminal activity, not just the count or counts of conviction. A defendant who pleads to one count of bankruptcy fraud will be held accountable for all criminal conduct related to that fraud whether charged or not.

3. Add to the base level determined in section 1 above all applicable "Specific Offense Characteristics" listed for that offense. For fraud and bribery, this includes the total amount of money involved in the scheme and will be the higher of the gain to the defendant or the intended loss to the victim. It will often include an additional two levels for more than minimal planning. Most bankruptcy offenses are not limited to a single act and will involve several acts of concealment and false statements. In the case of 2J1.2, Perjury, this may include a three level addition for substantial interference with the administration of justice. 2J1.2(b)(2).

   The law seems well settled that debtors who conceal assets through false statements on the petition and schedules will have an additional two levels added to their offense level for violation of a judicial order under 2F1.1(b). See U.S. v. Messner, 107 F.3d 1448 (10th Cir. 1997); and U.S. v. Welch, 103 F.3d 906 (9th Cir. 1996), and the cases cited therein.

4. Add to the base level any adjustment for vulnerable victims, e.g., a debtor who sold worthless cancer cures to cancer patients. 3A1.1.

5. Make any adjustments needed to reflect the defendant's role in the offense. This adjustment can range from a four level reduction for a person who is minimally involved in an offense to a four level increase for the leader of more than five individuals. 3B1.1 and 3B1.2.

6. Add two offense levels if the defendant abused a position of trust or used a special skill. A professional, trustee, lawyer, or fiduciary, including a debtor in possession, normally would be included in this adjustment. 3B1.3.

7. Add two levels if the defendant obstructed justice during the course of the investigation or trial. This would include lying to the agents, destroying evidence, presenting false evidence at trial, etc. 3C1.1.

8. Subtract two or three levels if the defendant accepts responsibility for his/her actions and cooperates in the investigation. 3E1.1.

9. If there are multiple counts of convictions, apply the grouping rules to arrive at an overall offense level. 3D1.1.

10. Determine the defendant's criminal history and his/her criminal history category. 4A1.1-.3.

11. The court may depart below any guideline or minimum-mandatory sentence on the motion of the government that the defendant has substantially assisted the government in the prosecution of other defendants. 5K1.1. This section gives the government a powerful tool to encourage defendants to cooperate and provide evidence against other people involved in a criminal scheme.

In unusual cases, the court may depart up or down from a guideline range. The court must state reasons for the departure in some detail and the government and the defendant have the right to appeal a departure or an improper application of the guidelines. The government must

have the approval of the Solicitor General or designated Deputy Solicitor General before it may complete its appeal. 18 U.S.C. § 3742.

5-14.3 FACTORS THAT IMPACT ON SENTENCING

The amount of money involved is the single most important factor impacting sentencing in most bankruptcy offenses. The amount of loss used by the guidelines, as noted above, is the greater of the gain to the defendant or the actual or intended loss to the victim(s). A defendant who gives false information with intent to conceal assets intends to deprive the creditors of the value of that asset. Thus, in a concealment case, the value of the assets sought to be concealed is a proper measure of loss. U.S. v. Beard, 913 F.2d 193, 196 (5th Cir. 1990). In cases of theft or embezzlement, the amount of property or money stolen is used. 2F1.1.

In a case involving the concealment of assets under 18 U.S.C. § 152, the Eleventh Circuit held that under 2F1.1(b)(3)(B) the defendant's offense level can be increased by two for violation of a judicial order. The Bankruptcy Rules and Official Forms direct the debtor to truthfully disclose all assets and liabilities. The fraudulent concealment of assets constitutes a violation of this judicial order and subjects the defendant to the increase. U.S. v. Bellew, 35 F.3d 518 (11th Cir. 1994); USTM 5-14.23.

In cases of false oaths, the amount of money is not considered. The false oath base level is set at 12 regardless of the amount of money involved. 2J1.3.

In cases where there are both false oaths and the theft of property, conviction on both counts will result in the use of the highest of either the fraud or the perjury guideline, plus, normally, one additional level for the additional count. 3D1.4.

5-14.4 ROLE OF THE UNITED STATES TRUSTEE IN SENTENCING

The United States Trustee must cooperate fully with the United States Attorney and the court, including the probation office, at all times. In sentencing, the United States Trustee should provide the United States

Attorney and the probation office all information that is relevant to sentencing. This includes the role of the defendant in the offense; whether he/she occupied a position of trust; whether the defendant used a special skill; the total loss to the system, either actual or intended; and the impact the defendant's conduct had on the administration of justice, including the effect on the bankruptcy system, the administration of estates, and the United States Trustee Program. The United States Trustee, along with any private trustee, will often be in the best position to provide information about the monetary loss to the estate.

In some cases, the Probation Officer may desire to discuss a case directly with the United States Trustee. The appropriate person in the United States Attorney's office should be kept advised of such meetings and the substance of any information provided. Because, in many cases, the United States Trustee Program is a victim of the criminal conduct, the United States Trustee may be asked to make a recommendation concerning an appropriate sentence.

CHAPTER 5-15: CRIMINAL PROCEDURE IN UNITED STATES ATTORNEYS' OFFICES

5-15.1 GENERAL ORGANIZATION OF UNITED STATES ATTORNEYS' OFFICES

Each of the 93 United States Attorney's offices is organized in a slightly different way depending on the size of the office, whether it has branch offices, and its geographical and demographic area. As a general proposition, each United States Attorney's office will have one or more Assistants designated to handle a particular area of the criminal law. Some larger offices may have a duty or intake attorney who screens all incoming cases for an initial determination of whether an investigation will be started. The United States Trustee should become familiar with the organization of the local United States Attorney's office.

5-15.2 GENERAL PROCEDURE FOR HANDLING BANKRUPTCY CASES

Once a case is referred by the United States Trustee, a bankruptcy judge, a creditor's attorney, or any other source, the United States Attorney will initially review the matter for investigation or immediate declination. Factors considered are the amount of loss or intended loss, evidence of actual criminal intent, need to protect the integrity of the bankruptcy system, jury appeal, etc. If the case is not immediately declined, then the case will be assigned to an Assistant United States Attorney and a case file opened. The assigned Assistant United States Attorney will then forward the case to the appropriate agency for investigation, usually the Federal Bureau of Investigation. Bankruptcy fraud referrals may also involve other crimes, such as mail fraud, which would be referred to the United States Postal Inspector; federal tax violations, which would be referred to the Criminal Investigative Division of the Internal Revenue Service; and, in the event that more than one type of offense is involved, any combination of the above. Complex cases are often worked jointly by the various agencies. The investigating agency will also open a file and assign a case agent who will work closely with the Assistant United States Attorney as the case develops.

The investigating agent, in most cases, will meet with the Assistant United States Attorney and a representative of the United States Trustee to discuss strategy and sources of information for building the case. The grand jury will be used to investigate and, where the facts warrant, the United States Attorney will seek an indictment. If felony charges are not involved, the United States Attorney may charge the defendant by way of an information, which has the same effect as an indictment in that it begins formal charges. A defendant may waive indictment and proceed by information. This occurs most often in cases where the defendant is aware of the investigation and wishes to enter a plea of guilty.

5-15.3 PROSECUTION GUIDELINES OF UNITED STATES ATTORNEYS' OFFICES AND INVESTIGATIVE AGENCIES

Many United States Attorneys and investigative agencies, e.g., the Federal Bureau of Investigation, have prosecution guidelines for what they will normally investigate or decline. These guidelines may state that simple fraud cases under a certain dollar amount will normally be declined. Use of this type of guideline allows them to quickly determine which cases justify the expenditure of limited resources. Other districts do not use guidelines, but review each case individually.

The United States Trustee should learn the guidelines and policies of the United States Attorney and investigative agencies within his/her region. Where the guidelines appear too restrictive, the United States Trustee should discuss them with the appropriate individual to see if they can be changed. Where a referral presents unusual facts, the United States Trustee should request an exception to the guidelines. The Attorney General has requested that every bankruptcy case be evaluated "on its own merits rather than . . . a blanket declination policy based solely on dollar amounts." (See Appendix 5-1.)

5-15.4 REQUIREMENTS OF SPEEDY TRIAL ACT, 18 U.S.C. § 3161

Unlike civil cases, in a criminal case, the United States Attorney must theoretically be ready for trial the day an indictment is brought since the defendant has a constitutional right to a speedy trial. The case will be dismissed if the government cannot start the trial within 70 days from the return of the indictment or the initial appearance of the defendant. 18 U.S.C. § 3161. The government must also be prepared to provide the defendant discovery material required under Rule 16 of the Federal Rules of Criminal Procedure. Additionally, the government is required to furnish any information that would be favorable to the defendant and that would tend to show the defendant's innocence or to lessen punishment (Brady material). In many districts, this must be furnished within two weeks of the initial appearance before the Magistrate Judge.

For these reasons, criminal investigations often consume a great deal of time before formal charges are brought. Even in cases where the defendant indicates a willingness to plead guilty, the United States

Attorney will want a solid factual case in case there is a change of plea or the judge rejects a plea of guilty.

CHAPTER 5-16: ASSISTANCE TO THE UNITED STATES ATTORNEY

5-16.1 STATUTORY AUTHORITY TO ASSIST THE UNITED STATES ATTORNEY

Under 28 U.S.C. § 586(a)(3)(F), the United States Trustee can assist in criminal prosecutions and should offer assistance to the United States Attorney whenever criminal referrals are made. The United States Trustee must be careful not to promise more help than can be provided. Care must also be taken to ensure that information derived from the criminal case is not improperly used in any civil proceedings. Within these limitations, the United States Trustee should give the United States Attorney all available assistance having given due consideration to resource implications.

5-16.2 COORDINATION WITH THE EXECUTIVE OFFICE

If the resources of the United States Trustee are inadequate to support the requests of the United States Attorney, the United States Trustee should contact the Deputy Director to determine if additional resources are available from other regions or from the Executive Office. Expert witnesses may be needed in trials to testify about the bankruptcy system or about particular cases. Use of United States Trustee expert witnesses from outside the region must be coordinated with the Deputy Director.

5-16.3 APPOINTMENT OF UNITED STATES TRUSTEE PROGRAM ATTORNEYS AS SPECIAL ASSISTANT UNITED STATES ATTORNEYS

The policy of the Program is to support law enforcement efforts wherever possible in bankruptcy related matters. Thus, it may be advantageous in some cases for a Program attorney to be designated as a Special Assistant United States Attorney (SAUSA). The designation

allows the attorney to fully participate in a criminal trial, subject to the control and supervision of the United States Attorney.

Due to resource limitations within the Program, these appointments must be carefully monitored and controlled. Before committing an attorney as a SAUSA, the United States Trustee must consult with the Deputy Director. Absent special circumstances, all appointments will be on a case-by-case basis.

5-16.3.1 Procedure for Securing Appointment

Where it would be beneficial for a Program attorney to act as a SAUSA in a particular case, both the United States Attorney and the United States Trustee must agree on the appointment. The United States Trustee must provide the Deputy Director with a brief statement of the reasons for the appointment and provide the name of the case, the name of the attorney, and the anticipated duration of the appointment.

The United States Trustee must advise the United States Attorney that approval is for an individual case only (unless an exception has been granted by the Deputy Director) and that, should the needs of the United States Trustee require it, the participation of the Program attorney may be terminated. The United States Attorney will then appoint the Program attorney as a SAUSA for a period not to exceed one year. The appointment may be renewed if the case is not concluded. A copy of the appointment letter should be provided to the Deputy Director.

CHAPTER 5-17: TRAINING RESPONSIBILITIES

5-17.1 REQUIREMENT TO CONDUCT TRAINING FOR PROGRAM PERSONNEL

The importance of an effective criminal referral program dictates that sufficient personnel be trained in the criminal aspects of bankruptcy law to effectively respond to complaints, to discover criminal activity, and to promptly refer criminal matters to the proper authorities.

This training may be accomplished by employees attending appropriate Department of Justice training seminars or by conducting local training within the region. This training also may be combined with training for panel trustees or other individuals having an interest in the criminal aspects of bankruptcy.

5-17.2 REQUIREMENT TO CONDUCT TRAINING FOR PANEL TRUSTEES

The United States Trustee should conduct at least one hour of training on criminal fraud for all panel trustees every three years. This training should cover the basic criminal bankruptcy statutes, how to prepare a criminal referral, and any updates in the criminal area. Each new trustee, upon appointment to the panel, should be given a briefing by the United States Trustee on basic criminal bankruptcy statutes and the local referral procedures. The new trustee should also be given appropriate reference material on criminal matters.

5-17.3 TRAINING AGENDAS AND OUTLINES

The Executive Office maintains sample training agendas for fraud training directed to various audiences, including private trustees, the bankruptcy bar, United States Attorney's office and Program staff. The United States Trustee should utilize this resource in developing programs for his/her region.

CHAPTER 5-18: FORMATION OF WORKING GROUPS FOR CRIMINAL INVESTIGATION

5-18.1 ESTABLISHMENT OF POINTS OF CONTACT

To ensure that criminal referrals receive the attention the law requires, the United States Trustee must ensure that, in each district within the region, there is a working point of contact within the United States Attorney's office, as well as each investigative agency actively involved in bankruptcy related offenses. Investigative agencies include, among others, the Federal Bureau of Investigation; the Internal Revenue

Service; the Postal Service; the Secret Service; and the Inspector Generals of Health and Human Services, Housing and Urban Development, the Social Security Administration, and the Department of Labor.

5-18.2 ESTABLISHMENT OF A WORKING GROUP OR BANKRUPTCY FRAUD TASK FORCE

The United States Attorney is the chief law enforcement officer in each judicial district. The establishment of any task force or working group will require the active support of the United States Attorney. The United States Trustee should explore the formation of these groups wherever possible. The ability of individuals involved in criminal investigations to meet as needed to discuss bankruptcy referrals, both potential and actual, will greatly speed up the process. It will allow unproductive matters to be quickly declined and productive referrals to be brought to resolution in a minimum of time. These meetings will also allow all parties to keep the status of their caseloads current.

5-18.3 PARTICIPATION IN THE LAW ENFORCEMENT COORDINATING COUNCIL

Each United States Attorney has a paid support staff position entitled Law Enforcement Coordinating Council (LECC) Coordinator. This person is responsible for establishing effective law enforcement coordination with local, state, and federal law enforcement officials within the district for the United States Attorney.

The United States Trustee should contact this individual and ensure that he/she is included in the LECC. Participation in LECC activities is highly encouraged, as these activities are an excellent way to build cooperative relationships with other participants in the criminal justice system.

CHAPTER 5-19: CIVIL REMEDIES FOR FRAUD AND ABUSE

5-19.1 INTRODUCTION

Although criminal referrals play a crucial role in combatting bankruptcy fraud and abuse, there are many civil remedies that can be invoked as well, such as appointment of a trustee, denial of a discharge, or a bar from refiling for an extended period of time. Civil remedies can be an effective supplement to a criminal referral, particularly where limited resources make criminal prosecution unlikely.

5-19.2 INITIAL REVIEW OF COMPLAINTS FOR CIVIL REMEDIES

Upon receipt of allegations of fraud or abuse in connection with a bankruptcy, the United States Trustee should make an initial determination as to whether there is a civil remedy available to address the alleged misconduct. If so, the United States Trustee should proceed to conduct an investigation appropriate for implementing a civil enforcement action.

5-19.3 COMMON ABUSES AND CIVIL REMEDIES: CHAPTER 7

5-19.3.1 Abuse: Bad Faith/Improper Purpose

5-19.3.1.1 Remedy: Dismissal Under 11 U.S.C. § 707(a) for "Cause"

1. Lack of good faith constitutes cause. In re Zick, 931 F.2d 1124 (6th Cir. 1991), lack of good faith is valid basis to dismiss chapter 7 case "for cause" under section 707(a).

   But see, In re Huckfeldt, 39 F.3d 829 (8th Cir. 1994), where case sought to be dismissed under section 707(a), court's inquiry must be framed in terms of whether "cause" existed for dismissal, and not in terms of debtor's good or bad faith. However, cause exists where debtor had an improper purpose for filing, i.e., to frustrate state court divorce decree and push ex-wife into bankruptcy.

2. Sufficient income to pay debts insufficient alone, but may be combined with other factors. In re Cappuccetti, 172 B.R. 37 (Bankr. E.D. Ark. 1994), showing of sufficient income to pay debts insufficient alone to warrant dismissal under section 707(a), but when combined with other factors, such as debtor reducing creditors to a single creditor in the months prior to filing, continuing to live an expansive or lavish lifestyle, filing in response to collection effort, etc., federal government could prevail on a motion to dismiss on the grounds that the petition was not filed in good faith.

3. Abuse of procedures. In re Hammonds, 139 B.R. 535 (Bankr. D. Colo. 1992), chapter 7 petition dismissed as not filed in good faith where debtor had some ability to repay debts; had transferred nonexempt, corporate assets to his non-debtor spouse without fair consideration; had continuing comfortable lifestyle; had a deliberate and persistent pattern of evading single major creditor; had provided less than candid, full disclosure; and had engaged in "procedural gymnastics" in earlier bankruptcy case.

4. Non-disclosure of previous filing. In re Burns, 169 B.R. 563 (Bankr. W.D. Pa. 1994), dismissal of chapter 7 petition for cause justified where debtor failed to disclose prior chapter 7 filing which included all debts for which debtor was previously denied discharge.

5-19.3.1.2 Remedy: Dismissal Under 11 U.S.C. § 707(b) for "Substantial Abuse" Other Than Debtor's Ability to Pay Debts

1. Debtor must be honest, as well as non-needy. In re Veenhuis, 143 B.R. 887 (Bankr. D. Minn. 1992), although debtor had negative cash flow and thus could not fund a chapter 13 plan, case could still be dismissed for bad faith where other factors present, such as use of chapter 7 to discharge single debt that debtor doesn't want to pay, failing to make a sincere attempt to repay obligations, desire to repay only certain creditors, tying up significant liquid value in superfluous exempt assets, and financial troubles caused by past excesses rather than any unforeseen calamity, all of which indicate debtor's "relationship

with creditors has [not] been marked by essentially honorable and undeceptive dealings," quoting In re Krohn, 886 F.2d 123, 126 (6th Cir. 1989).

2. Intent to stall or defeat creditors. In re Davidoff, 185 B.R. 631 (Bankr. S.D. Fla. 1995), chapter 7 petition properly dismissed as bad faith filing where court found that debtor did not seek fresh start, but rather sought to retain affluent lifestyle at expense of creditors.

5-19.3.1.3 Remedy: Sanctions

In re Boyd, 143 B.R. 237 (Bankr. C.D. Cal. 1992), Rule 9011 sanctions of $22,500.09 (equal to moving party's costs) against debtor and debtor's attorney, jointly and severally, justified both by fact that chapter 7 petition was filed "in bad faith and for an improper purpose" and under alternative prong that petition was not well-grounded in fact and warranted by law.

See also the sanction power the court has under its inherent powers discussed at USTM 5-9.4, 5-19.4.1.4, and 5-19.4.6.5.

5-19.3.1.4 Remedy: Time Bar on Future Filing

Case law is split on whether the language "unless the court orders otherwise" at the beginning of 11 U.S.C. § 349 modifies a later provision of that same section that dismissal of a case does not prejudice a subsequent petition "except as provided in section 109(g)." If so, the court could use section 105 to order a bar exceeding 180 days.

1. Cases holding the court can impose a bar under section 105 include: In re Driscoll, 1988 WL 117303 (N.D. Ill.); In re Jolly, 143 B.R. 383 (E.D. Va. 1992). See also, In re Strathatos, 163 B.R. 83 (N.D. Tex. 1993); In re Earl, 140 B.R. 728 (Bankr. N.D. Ind. 1992); In re Dilley, 125 B.R. 189 (Bankr. N.D. Ohio 1991); Lerch v. Federal Land Bank of St. Louis, 94 B.R. 998 (Bankr. N.D. Ill. 1989); In re Hundley, 103 B.R. 768 (Bankr. E.D. Va. 1989); In re McKissie, 103 B.R. 189 (Bankr. N.D. Ill. 1989).

2. Cases holding the court cannot impose a bar under section 105 include: In re Frieouf, 938 F.2d 1099 (10th Cir. 1991), cert. denied, 502 U.S. 1091 (1992) (court could, however, deny discharge of scheduled debts for a set period or even permanently); In re Cooper, 153 B.R. 898, 899 (D. Colo. 1993).

5-19.3.2 **Abuse: Frivolous/Vexatious Litigation**

5-19.3.2.1 Remedy: Injunction

In re Calder, 973 F.2d 862, 869 (10th Cir. 1992), appeals court held district court justified in enjoining chapter 7 debtor from litigating issues relating to those decided in its order so as to prevent the "misuse of litigation," where district court found that debtor had attempted to frustrate creditors and the trustee's efforts to close estate.

5-19.3.3 **Abuse: Refiling after Previous Petition Dismissed "With Prejudice"**

5-19.3.3.1 Remedy: Dismissal Based on Res Judicata

Colonial Auto Center, Inc. v. Tomlin, 184 B.R. 720 (W.D. Va. 1995), a previous chapter 7 petition dismissed "with prejudice," has res judicata effect of precluding subsequent discharge of debts existing at filing of dismissed case.

5-19.3.4 **Abuse: Assertion of 5th Amendment by Debtor**

5-19.3.4.1 Remedy: Dismissal if Assertion Precludes Administration of Estate

In re Moses, 792 F.Supp. 529 (E.D. Mich. 1992), dismissal appropriate where debtor's refusal to testify, even though based upon validly asserted 5th Amendment privilege, precludes fair and effective administration of estate.

In re Fekos, 148 B.R. 10 (Bankr. W.D. Pa. 1992), debtor's invocation of 5th Amendment as basis for refusal to answer questions at 2004 examination did not warrant dismissal absent showing that refusal made it impossible for trustee to administer the debtor's estates.

5-19.3.5 **Abuse: Fraudulently Incurred Credit Card Debt**

5-19.3.5.1 Remedy: Nondischargeability

In re Lee, 186 B.R. 695 (9th Cir. BAP 1995), BAP declines to follow Manufacturer's Hanover Trust Co. v. Ward, 857 F.2d 1082 (6th Cir. 1988), that, in order to establish that credit card debt was fraudulently incurred and therefore nondischargeable, the credit card company must demonstrate that it had performed a credit check sufficient to demonstrate implied or express reliance on debtor's representations and ability and intent to repay. Relying instead on factors enunciated in In re Dougherty, 84 B.R. 653, 656 (9th Cir. BAP 1988), the BAP stated that "a court may infer a debtor's present intent not to repay future charges when at the time the debtor incurs the charges he is insolvent and has no prospect of repayment." 186 B.R. at 699.

In re Eashai, 87 F.3d 1083 (9th Cir. 1996), Ninth Circuit adopts Dougherty factors in case of credit card kiting, where debtor's intent to deceive can be inferred from fact that cash advances were used to make minimum payments on other credit cards to keep creditors at bay while incurring ever larger debt.

5-19.3.6 **Abuse: Violation of 11 U.S.C. § 110**

5-19.3.6.1 Remedy: Sanctions

In re Cordero, 185 B.R. 882 (Bankr. M.D. Fla. 1995), sanction of $250 warranted for each of nonlawyer's three violations of statute governing bankruptcy petition preparers.

In re Anthony J. Campanella, 207 B.R. 435 (Bankr. E.D. Pa. 1997), the sale of bankruptcy kits alone does not constitute the unauthorized practice of law and section 110 is not applicable because the lay person did not assist in the preparation of the petition. The court held, however, that it had authority to review the lay person's conduct pursuant to 11 U.S.C § 329 and Fed. R. Bankr. P. 2016 and 2017. The court found that the lay person's activities surrounding the sale of the kits constituted the unauthorized practice of law and enjoined him from selling kits in all jurisdictions in which he was doing business.

United States Trustee v. Womack, 201 B.R. 511 (Bankr. E.D. Ark. 1996). Section 110(a) applies even if the debtor intended the money paid to a petition preparer be donated to another entity. The statute does not require that a petition preparer benefit from the compensation received and a petition preparer can not use payment to another entity as a mechanism to avoid the statutory requirements. A petition preparer, however, who causes another to sign the debtor's name to documents does not violate section 110(e)(1) because the section only prohibits petition preparers from executing documents on behalf of debtors.

In re Kassa, 198 B.R. 790 (Bankr. D. Ariz. 1996), court held that petition preparers compensation should be governed by a good legal secretary's salary. Pursuant to section 110(h), the court reduced the petition preparer's fee from $500 to $201.92.

5-19.3.7 **Abuse: Concealed Assets**

5-19.3.7.1 Remedy: Denial of Voluntary Dismissal

In re Churchill, 178 B.R. 478 (Bankr. D. Neb. 1995), chapter 7 debtor not permitted to voluntarily dismiss case in attempt to avoid orderly liquidation of assets and possible denial of discharge where trustee discovered evidence of debtor's alleged concealment of assets.

5-19.4 **COMMON ABUSES AND CIVIL REMEDIES: CHAPTER 11**

5-19.4.1 **Abuse: Bad Faith**

Bad faith is a generic term that covers a wide range of misconduct. It can be applied to acts ranging from prepetition misconduct to misstatements made in connection with a filing to frivolous opposition to motions filed by the United States Trustee or creditors. For this reason, there are numerous remedies available to address it.

5-19.4.1.1 Remedy: Dismissal

1. New debtor syndrome. In re Trident Assoc. Ltd. Partnership, 52 F.3d 127 (6th Cir. 1995), bad faith dismissal affirmed where

petition filed by newly created debtor to which property was transferred on eve of foreclosure; In re Spectee Group, Inc., 185 B.R. 146 (Bankr. S.D.N.Y. 1995), bad faith shown and sanctions ordered against debtor, its president, and attorney where petition filed to frustrate creditor's attempts to foreclose.

2. Serial filing. In re Mableton-Booper Assoc., 127 B.R. 941 (Bankr. N.D. Ga. 1991), serial chapter 11 filings permitted where unanticipated change of circumstances since plan confirmation; however, where changed circumstances were anticipated, later second filing to relieve debtor of obligations under first plan constitutes bad faith; In re McCormick Road Assoc., 127 B.R. 410 (N.D. Ill. 1991), bad faith established where, after confirmation, debtor hired new counsel, made new filing, and then found appraiser to prepare value estimate low enough to suit its purposes.

3. Prior filings in other chapters and non-compliance. In re Smith, 144 B.R. 428 (Bankr. W.D. Ark. 1992), chapter 11 debtors' request for additional time to file schedules denied and case dismissed with a 180-day bar for bad faith where debtors had filed successive chapters 12 and 13 "skeleton" petitions and failed to appear at section 341 meetings or file schedules.

4. Prepetition misconduct. In re Charfoos, 979 F.2d 390 (6th Cir. 1992), prepetition misconduct grounds for dismissal where misconduct included misrepresentations on financial statements filed to obtain loans prepetition, additional misrepresentations and nondisclosures in the bankruptcy filing, a lavish lifestyle, and violation of a state court order by selling some property and spending the $27,373 proceeds in the month preceding bankruptcy.

5-19.4.1.2 Remedy: Bar on Refiling Exceeding 180-days

See USTM 5-19.3.1.4.

5-19.4.1.3 Remedy: Sanctions Under Rule 9011

1. Sanctions mandatory for violation of Rule 9011. In re Gioioso, 979 F.2d 956 (3rd Cir. 1992).

2. New debtor syndrome. In re Coones Ranch, Inc., 7 F.3d 740 (8th Cir. 1993), attorney fees disgorged and $10,000 sanctions imposed on debtor and attorney.

3. Improper purpose. In re Marsch, 36 F.3d 825 (9th Cir. 1994), debtor sanctioned $27,452, the amount of attorneys' fees and costs incurred by judgment creditor in fighting chapter 11 petition filed solely to keep from posting appeal bond out of non-business assets; In re Phoenix Land Corp., 164 B.R. 176 (Bankr. S.D. Fla. 1994), sanctions awarded where chapter 11 case instituted solely to delay state court foreclosure.

5-19.4.1.4 Remedy: Sanctions Under Inherent Power of Bankruptcy Court

In re Rainbow Magazine, Inc., 77 F.3d 278 (9th Cir. 1996), in addition to affirming inherent authority to sanction, the court indicated that its holding in the case of In re Sequoia Auto Brokers, Ltd., 827 F.2d 1281 (9th Cir. 1987), that the bankruptcy court lacked the authority to impose contempt orders was, essentially, superseded by Congressional amendment of Bankruptcy Rule 9020 which gives the bankruptcy court criminal contempt authority; In re Aurora Investments, Inc., 144 B.R. 899 (Bankr. M.D. Fla. 1992); Chambers v. Naxco, Inc., 501 U.S. 32 (1991).

5-19.4.2 **Abuse: Frivolous/Vexatious Litigation**

5-19.4.2.1 Remedy: Sanctions

In re Courtesy Inns, Ltd., Inc., 40 F.3d 1084 (10th Cir. 1994), sanctions against chapter 11 debtor's president upheld on appeal. Although bankruptcy court lacked authority under 28 U.S.C. § 1927 to sanction a vexatious litigant because it is not a "court of the United States," it did have inherent authority to sanction debtor's president and sole

shareholder who made all filings on behalf of a lawyerless, insolvent corporation.

In re French Bourekas, Inc., 175 B.R. 517 (Bankr. S.D.N.Y. 1994), bad faith not shown by mere fact that chapter 11 petition may have been filed to relieve judgment debtor of need to post large supersedeas bond, but sanctions could be assessed under 28 U.S.C. § 1927 against debtor's attorney for "unreasonable and vexatious multiplication of proceedings," and also ordered to pay $500 to court clerk.

In re United Markets Int'l., Inc., 24 F.3d 650 (5th Cir. 1994), upholding district court order striking pleadings filed by debtor's principal, and barring principal, who was also sole shareholder and an attorney, from filing further pleadings until he paid more than $68,000 in sanctions previously entered against him for vexatious litigation.

5-19.4.3 **Abuse: Concealed Assets--Conversion from Chapter 7 to Chapter 11 After Discovery of Undisclosed Assets**

5-19.4.3.1 Remedy: Reconversion/Appointment of Trustee

In re Finney, 992 F.2d 43 (4th Cir. 1994), upon discovery by chapter 7 trustee of debtor's undisclosed postpetition transfers with intent to defraud creditors, debtor moved to dismiss, which was denied, and then moved to convert to chapter 11. Circuit court held that bankruptcy court could immediately reconvert, but only if reorganization found to be "objectively futile." Circuit also noted that bankruptcy court had discretion to determine whether a chapter 11 trustee should be immediately appointed.

5-19.4.4 **Abuse: Unauthorized Practice of Law**

5-19.4.4.1 Remedy: Disgorgement and Injunction

United States Trustee v. Kasuba, 152 B.R. 440 (Bankr. W.D. Pa. 1993), in order to protect the public, bankruptcy court had equitable power to enjoin certified legal technician from engaging in unauthorized practice of law in violation of Pennsylvania statute and, despite disclaimer to the contrary, legal technician could be required to disgorge fees under

section 329 of the Code. Note: In subsequent case, Stone v. Kasuba, 166 B.R. 269 (W.D. Pa. 1994), technician was held to be in contempt of the injunction order and was sanctioned to disgorge all fees received for all bankruptcy petitions he had prepared.

5-19.4.5 **Abuse: Unauthorized Filing**

5-19.4.5.1 Remedy: Dismissal

Chitex Communications, Inc. v. Kramer, 168 B.R. 587 (S.D. Tex. 1994), president of corporation placed in receivership had no authority to file bankruptcy petition on corporation's behalf and, therefore, case dismissed.

5-19.4.5.2 Remedy: Rule 9011 Sanctions

In re Zaragosa Properties, Inc., 156 B.R. 310 (Bankr. M.D. Fla. 1993), Rule 9011 sanctions awarded against attorney who filed unauthorized chapter 11 petition on behalf of corporation. Court noted that, even if retroactively authorized by board, the filing was still unauthorized for purposes of bankruptcy law.

5-19.5 **COMMON ABUSES AND CIVIL REMEDIES: CHAPTER 13**

5-19.5.1 **Abuse: Failure to Attend Creditors' Meeting/Willful Disobedience**

5-19.5.1.1 Remedy: Automatic 180-Day Bar

In re Montgomery, 37 F.3d 413 (8th Cir. 1994), where previous chapter 13 case dismissed for debtor's failure to attend creditors' meeting, dismissal was inherently for "failure to abide by orders of the court," thus barring a subsequent filing for 180 days under 11 U.S.C. § 109(g) and, in motion to dismiss subsequent petition, debtor had burden of establishing that previous conduct was not "willful." [Note: Court observed that some lower courts have placed this burden on the moving creditor.]

5-19.5.2 **Abuse: Bad Faith**

5-19.5.2.1 Remedy: Dismissal Under 11 U.S.C. § 1307(c) and 180-Day Bar Under 11 U.S.C. § 109(g)

1. Bad faith determined on totality of circumstances. In re Eisen, 14 F.3d 469 (9th Cir. 1993), dismissal for bad faith upheld based on totality of circumstances, including that debtor filed two successive chapter 13 petitions containing contradictory and misleading descriptions of property, failed to disclose first filing in second case, and filed second case on eve of state court enforcement action. Court also imposed sanctions for frivolous appeal.

2. Bad faith inferred from proposed plan. In re Love, 957 F.2d 1350 (7th Cir. 1992), bankruptcy court properly concluded that not only plan, but entire chapter 13 case was filed in bad faith where tax protestor proposed several plans that did not indicate serious intent to repay tax debt.

   In re Maurice, 167 B.R. 114 (Bankr. N.D. Ill. 1994), debtor's tactic of mailing plan to incorrect location and neglecting to file plan, together with unrealistic contents of plan, supports conclusion that chapter 13 petition filed in bad faith to stave off enforcement of a state court judgment without having to file a supersedeas bond and dismissal for bad faith and sanctions against debtor and debtor's attorney.

5-19.5.2.2 Remedy: Sanctions

1. Calculating amount when moving party is chapter 13 trustee. In re Armwood, 175 B.R. 779 (Bankr. N.D. Ga. 1994), fifth chapter 13 case filed in bad faith, justifying dismissal with 180-day bar and sanctions payable to court clerk of $500 each against debtor (pursuant to court's inherent authority) and debtor's attorney (pursuant to Rule 9011). In calculating the amount of sanction, court observed that since chapter 13 trustee is "a salaried employee supervised by the United States Trustee and serves a quasi-governmental function," assessment of attorneys fees was

not an appropriate measure of sanction, and instead used "level appropriate to punish the participants and to deter future sanctionable conduct."

In re Peia, 145 B.R. 749 (Bankr. D. Conn. 1992), debtor found to have improper purpose as evidenced by repeated filings without taking appropriate steps towards confirming a plan could be sanctioned under Rule 9011(a). Sanctions included compensation of chapter 13 trustee based on time spent and reasonable rate calculation equalled $1,232, plus additional $1,000 punitive sanction paid to court clerk.

2. Sanctions awarded to moving creditor. In re Mergenthaler, 144 B.R. 632 (Bankr. E.D.N.Y. 1992), debtor sanctioned $8,000 separately and $2,000 jointly and severally with attorney (both under Rule 9011) for filing chapter 13 petitions for purpose of frustrating judgment creditor's execution and for filing false affidavits and a false declaration by attorney.

In re Standfield, 152 B.R. 528 (Bankr. N.D. Ill. 1993), sanction awarded in amount of moving creditor's attorneys fees against debtors' attorney where serial chapter 13 cases filed for sole purpose of delaying pending foreclosure proceeding.

In re Huerta, 137 B.R. 356 (Bankr. C.D. Cal. 1992), court extensively discusses law and policy relating to successive filings, concluding that it is "a misuse of the bankruptcy process to file one case, then, failing to achieve the intended goals, to refile a second case." Sanctions in amount of creditor's attorney's fees awarded.

But see, In re Barker, 129 B.R. 287 (M.D. Fla. 1991), since debtor's third chapter 13 case voluntarily dismissed before relief from stay motion filed, debtor was not barred by Rule 109(g) from making fourth filing and, therefore, debtor's signature on petition did not warrant sanctions. Moreover, even if debtor had neither the ability nor intention to file a feasible plan, this is not a valid basis for the award of sanctions.

3. Sanctions denied where burdensome on debtor's family. In re Jones, 174 B.R. 8 (Bankr. D.N.H. 1994), successive chapter 13 case dismissed as bad faith filing, but no sanctions imposed on impecunious debtor in order to "avoid penalizing debtor's family" and debtor would not be barred from seeking bankruptcy relief for period of one year because the injunction could easily be circumvented by having the debtor's wife file.

5-19.5.2.3 Remedy: Bar on Refiling Exceeding 180 Days
(See also discussion above at USTM 5-19.3.1.4)

In re Gros, Jr., 173 B.R. 774 (Bankr. M.D. Fla. 1994), debtor's five bankruptcy filings over two-year period caused unreasonable delay that prejudiced collection efforts of Internal Revenue Service, justified dismissal with two-year bar on refiling.

In re Stathatos, 163 B.R. 83 (N.D. Tex. 1993), district court affirms bankruptcy court's order dismissing chapter 13 case for bad faith and barring debtor from refiling under chapter 13 for 24 months.

In re Simmons, 149 B.R. 586 (Bankr. W.D. Mo. 1993), court dismissed chapter 13 petition filed by debtor who had filed one previous chapter 12 and two previous chapter 13 petitions in order to defeat secured creditor's rights, and enjoined debtor from further chapter 13 filings. Court also enjoined debtor from refiling for a "reasonable period of time," which happened to be set at 180 days, even though the bar was not imposed pursuant to section 109(g).

But see, In re Frieouf, 938 F.2d 1099, supra; In re Cooper, 139 B.R. 736 (D. Colo. 1992), district court reversed imposition of three year bar, relying on Frieouf.

5-19.5.2.4 Remedy: Conversion

In re Eatman, 182 B.R. 386 (Bankr. 1995), where debtor filed chapter 13 petition in bad faith and creditor moved to dismiss, court instead ordered case converted in order to serve best interests of creditors and the estate.

APPENDIX 5-1

Office of the Attorney General
Washington, D. C. 20530

October 10, 1995

MEMORANDUM

TO: All United States Attorneys
All United States Trustees
Assistant Attorney General, Criminal Division
Assistant Attorney General, Civil Division
Assistant Attorney General, Environment and Natural Resources Division
Assistant Attorney General, Tax Division
Director, Federal Bureau of Investigation
Director, Executive Office for United States Attorneys
Director, Executive Office for United States Trustees

FROM: THE ATTORNEY GENERAL

SUBJECT: Bankruptcy Fraud

In 1992, the Department of Justice made the aggressive prosecution of bankruptcy fraud a high priority of the Department of Justice. It is time to place a renewed emphasis on the Department's efforts in this area.

Several hundred thousand bankruptcy cases are filed each year by individuals and companies in desperate financial straits. As of March 31, 1995, there were over one million active cases pending in bankruptcy courts around the country involving an estimated $7 billion in assets. The potential for fraud and abuse in a system involving such enormous amounts of money and complex financial transactions is great. Only swift, sure enforcement of the bankruptcy fraud statutes can protect the nation's Federal bankruptcy system for the benefit of those who truly need relief and, more importantly, deter those who might be tempted to use bankruptcy as a means to deceive and defraud.

It is imperative that the integrity of the bankruptcy system, an integral component of our national economy, be preserved and enhanced. Debtors who conceal assets, trustees who administer estates to their own improper advantage and "professionals" who run "bankruptcy mills" and other schemes involving the bankruptcy laws all undermine our faith in the integrity of the system. We need to ensure that the message gets out to those who would engage in such conduct that we will not tolerate it and that they will be prosecuted. We also need to ensure that those who find themselves as either willing or

unwilling participants in the bankruptcy system are confident that the system will work as promised.

Accordingly, I want to take this opportunity to announce a bankruptcy fraud program being coordinated jointly by the Attorney General's Advisory Committee of United States Attorneys and the Executive Office for United States Trustees (EOUST). The effort has several components:

- Training: I have asked the Executive Office for United States Attorneys (EOUSA) and EOUST to work with the Office of Legal Education (OLE) to develop joint training programs on bankruptcy fraud detection, investigation and prosecution for Assistant United States Attorneys (AUSAs), Assistant United States Trustees (AUSTs) and Federal Bureau of Investigation agents from the same areas. By training all the participants together, we will be promoting the use of a team approach in combating fraud. In addition, I have asked the OLE to include a segment on bankruptcy fraud in all courses dealing with white collar crime, advanced trial advocacy or bankruptcy. Bankruptcy fraud will also be put on the agendas at meetings of civil and criminal AUSA chiefs to raise awareness of the issue.

- Team Approach: Effective law enforcement in the area of bankruptcy fraud, as in all areas, requires the coordination of all available resources. Accordingly, I am directing the Federal Bureau of Investigation, each United States Attorney and each United States Trustee to work together and develop a coordinated response to this problem including meeting regularly to discuss bankruptcy fraud referrals, investigations and prosecution efforts. In addition, we should work with the Internal Revenue Service, Postal Inspectors, the Secret Service, and the Inspectors General of the various agencies and Departments to enhance government-wide coordination.

- Prosecutions: Often times, individuals involved in bankruptcy fraud are not prosecuted either because the schemes are too complex to warrant the resources needed to unravel them or because the dollar amounts involved do not meet the prosecution guidelines of the particular district. Because bankruptcy fraud directly impacts a governmental process, I ask you to evaluate each case on its own merits rather than follow a blanket declination policy based solely on dollar amounts. It may be warranted in some circumstances to batch cases that individually would not warrant prosecution or to relax the dollar limits for other cases. Furthermore, cases involving violations of public integrity by individuals who have access to bankruptcy funds by virtue of an official position, whether a debtor in possession, a professional appointed or approved by the

court, or a bankruptcy trustee, should be vigorously prosecuted.

- Bankruptcy Fraud Kick-Off Day: I have also directed the EOUSA and EOUST to coordinate a National Bankruptcy Fraud Kick-Off Day on which as many districts as possible would either bring or announce bankruptcy fraud charges. Those U.S. Attorneys who are about to bring indictments up to six-weeks prior to the Kick-Off Day are asked to postpone the indictment, or at least its announcement, until that day. It is understood that all United States Attorneys' offices may not be in a position to participate at that time. For those offices that are able to do so, however, simple coordination of the announcements of bankruptcy fraud indictments and plea agreements will demonstrate the Department's commitment to reducing fraud and ensuring the integrity of the system, and will send a strong message to those who might consider engaging in such activities that they do so at great risk. This will demonstrate that these cases are about real people, and increase bench and bar support for our efforts. It is anticipated that this day will occur in early 1996. You will receive additional information on this effort in the next few weeks.

Bankruptcy is a public process, and we must aggressively pursue those who would use the system to avoid their valid legal obligations, delay or evade their Federal and State tax obligations, and otherwise distort the process which offers deserving debtors the opportunity to seek a fresh start. We must not allow undeserving participants to use the process improperly.

I am counting on each of you to act aggressively in responding to this continuing problem.