

# Bankruptcy Crimes

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**Crimes in Bankruptcy**

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## Crimes in Bankruptcy

I.	Introduction	1
II.	Prosecution of Bankruptcy Crimes	2
III.	Concealment of Assets and False Statements	3
A.	Sixth Circuit Cases	5
B.	Cases from Other Circuits	8
IV.	Bankruptcy Fraud	10
A.	Sixth Circuit Cases	11
B.	Cases from Other Circuits	12
V.	Embezzlement	13
A.	Sixth Circuit Cases	13
B.	Cases from Other Circuits	14
VI.	Improper Fee Agreement	15
VII.	Effect of Bankruptcy Crimes on Bankruptcy Case	15
A.	Discharge	15
B.	Creation of Private Right of Action	16
VIII.	Attorneys and Bankruptcy Crimes	17
IX.	Bankruptcy Crime Referral	18

### I. Introduction

Although the purpose of bankruptcy is to provide debtors with a fresh start, some debtors, through bankruptcy crimes, attempt to obtain a head start. For some debtors, the possibility of civil suits brought against them by their creditors is an insufficient deterrent. Therefore, the criminalization of bankruptcy misconduct is necessary to dissuade debtors from bad behavior.<sup>1</sup> Crimes in bankruptcy include concealment of assets, false oaths and claims, embezzlement against estates, adverse interest and conduct of officers, fee agreements in cases under title 11 and receiverships, knowing disregard of a bankruptcy law or rule, and bankruptcy fraud.<sup>2</sup>

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1. See Ralph C. McCullough, II, *Bankruptcy Fraud: Crime Without Punishment*, 96 COM. L.J. 257, 258 (1991).

2. 18 U.S.C. §§ 151-57 (West 2014).

## II. Prosecution of Bankruptcy Crimes

Bankruptcy crimes are investigated and prosecuted by the United States Attorney.<sup>3</sup> Cases are referred to the United States Attorney by the United States Trustees, Bankruptcy Judges, and the Federal Bureau of Investigation.<sup>4</sup> Over the past seven years, on average, 1,500 cases were referred by the U.S. Trustee Program to the U.S. Attorney for bankruptcy fraud. However, on average, less than 100 of the referred cases were prosecuted.<sup>5</sup> This low prosecution rate may stem from a belief that civil claims by creditors are a sufficient deterrent to debtors and a remedy for creditors.<sup>6</sup>

	2012	2011	2010	2009	2008	2007	2006
18 U.S.C. § 152 Cases Filed	45	32	42	42	42	58	52
18 U.S.C. § 153 Cases Filed	0	2	3	3	2	2	2
18 U.S.C. § 156 Cases Filed	1	0	0	0	0	0	0
18 U.S.C. § 157 Cases Filed	23	24	19	18	13	20	33
Total	69	58	64	63	57	80	87
U.S. Trustee Referrals <sup>7</sup>	1,910	1,741	1,708	1,549	1,513	1,456	1,299
<b>% of Referrals Prosecuted</b>	<b>3.6126%</b>	<b>3.3314%</b>	<b>3.7471%</b>	<b>4.0671%</b>	<b>3.7673%</b>	<b>5.4945%</b>	<b>6.6975%</b>

3. 18 U.S.C. § 158 (West 2014)

4. See William I. Kampf & Jay M. Quam, *The Intersection of Bankruptcy and White Collar Crime*, 97 COM. L.J. 70, 72 (1992).

5. See Ed Flynn & Charles Bowles, *Bankruptcy Crime and Punishment*, AM. BANKR. INST. J., January 2015, 24, 25 (presenting tables that break down the number of U.S. Trustee referrals per year by type of bankruptcy crime).

6. See Ralph C. McCullough, II, *Bankruptcy Fraud: Crime Without Punishment*, 96 COM. L.J. 257, 259 (1991).

7. *Id.*; United States Department of Justice Bureau of Justice Statistics, *Defendants Charged in Criminal Cases*, <http://www.bjs.gov/fjsrc/> (last visited March 12, 2015) (providing the number of federal crimes prosecuted each year by statute defendant was charged with violating).

### III. Concealment of Assets and False Statements

Most crimes in bankruptcy are violations of 18 U.S.C. § 152.<sup>8</sup> This broad section contains several provisions, each requiring an individual to knowingly and fraudulently commit an act in relation to a case under title 11 of the U.S. Code.<sup>9</sup> The elements required to be found guilty of concealment of assets and false statements overlap significantly and are intentionally broad to criminalize all methods of fraudulently circumventing bankruptcy proceedings. These crimes require that the perpetrator knowingly defraud the Court, the trustee, or creditors. These fraudulent acts may include affirmative actions of fraud, such as hindering a trustee's ability to dispose of estate property, or a failure to act, such as failing to disclose assets of the estate.<sup>10</sup>

A crime of concealment may include concealment of assets in the bankruptcy case, concealment or transfer of assets in contemplation of a bankruptcy case, or concealment of an equitable interest in an asset.<sup>11</sup> An individual has violated § 152(1) if they “knowingly and fraudulently conceal [...] from creditors or the United States Trustee any property belonging to the estate of a debtor.”<sup>12</sup> Equitable interest in a trust must also be disclosed in bankruptcy

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8. *Id.*

9. 18 U.S.C. § 152 (West 2014).

10. *See U.S. v. Wagner*, 382 F.3d 598, 607 (6th Cir. 2004) (holding that a debtor who hinders the trustee's ability to dispose of estate assets has concealed those assets); *U.S. v. Marston*, 694 F.3d 131, 137 (1st Cir. 2012) (holding that a debtor's failure to disclose other names under which she acquired debt constituted a violation of 18 U.S.C. § 152(2)).

11. 18 U.S.C. § 152(1); *Id.* § 152(7). *See* Tamara Ogier & Jack F. Williams, *Bankruptcy Crimes and Bankruptcy Practice*, 6 AM. BANKR. INST. L. REV. 317, 336 (1998).

12. 18 U.S.C. § 152(1).

schedules.<sup>13</sup> Failure to disclose such interest results in violation of § 152(1).<sup>14</sup> Criminal concealment of assets may also occur prior to the filing of a bankruptcy case if an individual knowingly and fraudulently transferred or concealed assets in contemplation of a bankruptcy case.<sup>15</sup> Furthermore, if an individual knowingly and fraudulently receives a transfer from the debtor of property of the estate after the filing of bankruptcy, said individual has also violated 18 U.S.C. § 152.<sup>16</sup>

An individual has also violated 18 U.S.C. § 152 if they knowingly and fraudulently make false statements, oral or recorded, in relation to any case under title 11.<sup>17</sup> These false statements include presenting false claims to the bankruptcy court or making false entries in recorded information relating to assets of the estate.<sup>18</sup>

Courts have routinely defined fraudulent behavior as acting with an intent to deceive.<sup>19</sup> In determining whether a debtor acted fraudulently, courts may look for “badges of fraud.”<sup>20</sup> These “badges” include: (1) lack or inadequacy of consideration, (2) close relationship between parties, (3) retention of beneficial use of property, (4) financial condition of party before and after

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13. See 11 U.S.C. § 541 (West 2014) (“[The] estate is comprised of all of the following property[:] . . . all legal or equitable interests of the debtor in property as of the commencement of the case.”).

14. Tamara Ogier & Jack F. Williams, *Bankruptcy Crimes and Bankruptcy Practice*, 6 AM. BANKR. INST. L. REV. 317, 336 (1998). See *U.S. v. Schireson*, 116 F.2d 881 (3rd Cir. 1940) (holding that the trustee succeeds to legal and equitable title in property of the debtor).

15. 18 U.S.C. § 152(7).

16. *Id.* § 152(5).

17. *Id.* § 152(2); *Id.* § 152(3); *Id.* § 152(4); *Id.* § 152(8).

18. *Id.*

19. See Maureen A. Tighe, *A Guide to Making A Criminal Bankruptcy Fraud Referral*, 6 AM. BANKR. INST. L. REV. 409, 411 (1998) (citing *United States v. Zehrbach*, 47 F.3d 1252, 1258-59 (3d Cir. 1995)).

20. See Ralph C. McCullough, II, *Bankruptcy Fraud: Crime Without Punishment*, 96 COM. L.J. 257, 259 (1991).

transaction, (5) pattern of transactions or conduct after incurring debt, financial difficulties, or threat of suit by creditors, and (6) general chronology of events and transactions.<sup>21</sup> In addition to these “badges,” courts may consider the materiality of the offense committed in relation to the estate and bankruptcy proceedings.<sup>22</sup>

Although these statutes seem straight forward, on appeal those convicted of these crimes have argued about the very meaning of “conceal” and the requisite evidence of fraud necessary for conviction.

*A. Sixth Circuit Cases*

In *U.S. v. Wagner*, the Sixth Circuit held that hindering the trustee’s ability to dispose of estate property qualified as a fraudulent concealment.<sup>23</sup> Harry Wagner was a real-estate developer.<sup>24</sup> In the mid-1970s, Wagner developed a large subdivision of rental units.<sup>25</sup> In the late 1990s, Wagner faced significant financial distress and filed Chapter 11 bankruptcy in April 2002.<sup>26</sup> Wagner refused to cooperate with the U.S. Trustee who moved that Wagner’s bankruptcy be converted to Chapter 7.<sup>27</sup> Before the motion could be heard, Wagner recorded a false mortgage with the county record’s office that claimed to loan Wagner \$10.75 million.<sup>28</sup> During a hearing, Wagner admitted

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21. *Id.* (citing *In re May*, 12 Bankr. 618, 621 (N.D. Fla. 1980)).

22. *United States v. Key*, 859 F.2d 1257, 1261 (7th Cir. 1988) (citing *United States v. Jackson*, 836 F.2d 324, 329 (7th Cir. 1987) (quoting *United States v. O’Donnell*, 539 F.2d 1233, 1237 (9th Cir. 1976))) (“Although § 152 does not expressly include ‘materiality’ as an element of the offense, we have construed this section ‘to require that [a] false oath be given in relation to some material matter.’”).

23. *U.S. v. Wagner*, 382 F.3d 598, 607 (6th Cir. 2004).

24. *Id.* at 602.

25. *Id.* at 603.

26. *Id.*

27. *Id.*

28. *Id.*



that he falsely recorded the mortgage, and his case was converted to Chapter 7.<sup>29</sup> When the Chapter 7 trustee hired a real estate agent to attempt to sell homes within Wagner's subdivision, Wagner had the locks to the homes changed.<sup>30</sup>

In November 2002, Wagner was found guilty of concealing assets in violation of 18 U.S.C. § 152(1) and fraudulently filing the mortgage in the bankruptcy proceeding in violation of 18 U.S.C. § 157(2).<sup>31</sup> The Sixth Circuit affirmed the district court's decision, reasoning that by hindering the trustee's ability to dispose of estate assets constituted fraudulent concealment.<sup>32</sup> Furthermore, the court concluded that Wagner's argument that he did not file fraudulent documents in the bankruptcy proceeding was insufficient to persuade a rational fact finder.<sup>33</sup> Accordingly, the court upheld Wagner's conviction.<sup>34</sup>

In *U.S. v. Carver*, the Sixth Circuit held that an affirmative denial of ownership of property that would otherwise be included in the estate constitutes fraudulent concealment of that property.<sup>35</sup> In October 2004, Dr. Joseph Carver consigned his wine collection, valued at \$377,093.17, to a wine auction house.<sup>36</sup> Carver directed the auction house not to store the wine under his name, when to sell the wine, and to whom the proceeds should be paid.<sup>37</sup> One year later,

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29. *Id.* at 605.

30. *Id.* at 606.

31. *Id.*

32. *Id.* at 607.

33. *Id.* at 614.

34. *Id.* at 617.

35. *U.S. v. Carver*, 494 Fed. Appx. 555, 558 (6th Cir. 2012).

36. *Id.* at 557.

37. *Id.*

Carver filed Chapter 7 bankruptcy.<sup>38</sup> When the trustee inquired about the wine collection, Carver stated, under oath, that “[t]he entire collection was sold.”<sup>39</sup> While his bankruptcy case was pending, almost \$200,000 in wine was sold and the proceeds given to third parties, including his future wife.<sup>40</sup> Carver was found guilty of concealing assets in violation of 18 U.S.C. § 152(1) and making false statements under oath in violation of 18 U.S.C. § 152(3).<sup>41</sup>

On appeal, Carver argued that there was insufficient evidence to support his convictions.<sup>42</sup> The Sixth Circuit determined that a violation of 18 U.S.C. § 152(1) has occurred when “[ (1) ] a bankruptcy proceeding existed under the Bankruptcy Code, [ (2) ] the defendant concealed interest in property from the bankruptcy trustee or creditors, [ (3) ] such interests in property belonged to the bankruptcy estate of the defendant, and [ (4) ] the defendant acted knowingly and fraudulently.”<sup>43</sup> The Sixth Circuit held that a rational trier of fact would be satisfied beyond a reasonable doubt that Carver concealed assets because he failed to disclose ownership, made an affirmative statement denying ownership of the assets, and directed that the proceeds from the sale of the assets go to third parties.<sup>44</sup> The court also held that a rational trier of fact would be satisfied beyond a reasonable doubt that Carver’s affirmative statements denying ownership of the assets

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38. *Id.*

39. *Id.*

40. *Id.*

41. *Id.*

42. *Id.* at 558.

43. *Id.*

44. *Id.*

qualified as making false statements under oath. Accordingly, the Sixth Circuit affirmed Carver's conviction.<sup>45</sup>

*A. Cases from Other Circuits*

The Eighth Circuit broadly interprets 18 U.S.C. § 152 to include “all of the possible methods by which a debtor . . . may attempt to defeat the intent and effect of the bankruptcy law . . . .”<sup>46</sup> In *U.S. v. Novak*, the Eighth Circuit held that evidence of sham transfers was permissible to determine whether a debtor “actually owned assets for the purposes of § 152(1) and § 152(3).”<sup>47</sup> David Novak filed a bankruptcy petition, claiming \$483,719.37 in liabilities and only \$11,380 in assets, despite ownership of pieces of undisclosed real and personal property.<sup>48</sup> Novak made several sham transfers in an attempt to further conceal his assets.<sup>49</sup> Novak was convicted of making false statements and concealing assets.<sup>50</sup> Although Novak argued that evidence of the sham transfers could not be introduced unless he was charged with a violation of 18 U.S.C. § 152(7), the Eighth Circuit disagreed.

In *U.S. v. Marston*, the First Circuit held that a failure to disclose other names under which a debtor incurred debt was a violation of 18 U.S.C. § 152(2).<sup>51</sup> Debtor opened lines of credit and incurred debt under other names. When asked about other used names on her bankruptcy forms, the debtor did not disclose the other names she had used to fraudulently incur debt. Following her

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45. *Id.* at 550.

46. *U.S. v. Novak*, 217 F.3d 566 (8th Cir. 2000) (quoting *United States v. Goodstein*, 88 F.2d 162, 1369 (7th Cir. 1989)).

47. *Id.* at 575–76.

48. *Id.* at 573.

49. *Id.* at 573–74.

50. *Id.*

51. *U.S. v. Marston*, 694 F.3d 131, 137 (1st Cir. 2012).

bankruptcy proceedings, the debtor was charged with bankruptcy fraud for failing to disclose these names and debts in the bankruptcy proceedings.<sup>52</sup> The First Circuit held that a failure to disclose other names used by the debtor to incur debt when asked directly was a false oath.<sup>53</sup> Furthermore, the court concluded that the false oath was given with a “dishonest or fraudulent awareness.”<sup>54</sup> Accordingly, the court held that the failure to disclose the other names was a violation of 18 U.S.C. § 152(2). *Id.*

In *U.S. v. Hale*, the Tenth Circuit held that an individual cannot be convicted of making a false statement under oath, in violation of 18 U.S.C. § 152(2), if the statement was made in response to an ambiguous question.<sup>55</sup> In October 2005, Thomas Hale filed Chapter 13 bankruptcy.<sup>56</sup> In his bankruptcy petition, Hale disclosed that he owned a property (“the Property”) with a value of \$190,000 that was subject to a secured claim of \$198,000.<sup>57</sup> Hale’s case was converted to a Chapter 7 upon his motion in July 2006, and he attended his first meeting of creditors in August 2006.<sup>58</sup> Despite attesting that the information contained in his petition and schedules was true, Hale placed an ad in the local newspaper, advertising the sale of the Property for \$396,075.<sup>59</sup> Less than two weeks later, Hale entered into a contract to sell the property for \$395,000, but did not disclose the contract to the trustee.

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52. *Id.* at 132.

53. *Id.* at 137.

54. *Id.*

55. *U.S. v. Hale*, 762 F.3d 1214 (10th Cir. 2014).

56. *Id.* at 1216.

57. *Id.*

58. *Id.* at 1217.

59. *Id.*

Hale was convicted of making a false oath in violation of 18 U.S.C. § 152(2) and concealing the contract to sell property from the trustee in violation of 18 U.S.C. § 152(1).<sup>60</sup> On appeal, Hale argued that the questions for which he was convicted of falsely answering were too ambiguous to warrant a conviction.<sup>61</sup> The questions were: (1) “To your best knowledge and belief, is the information contained in your petition, statements, schedules, and related bankruptcy documents true, complete and accurate?” and (2) “Are you aware of any changes or amendments that need to be made?”<sup>62</sup> Hale asserted that he understood the questions to be in reference to the accuracy of the information contained in the documents “at the time he listed his assets.”<sup>63</sup> Accordingly, the Tenth Circuit reversed Hale’s conviction of making a false oath, but affirmed his conviction of concealing assets.<sup>64</sup>

#### IV. Bankruptcy Fraud

A person has committed bankruptcy fraud if they, with the intent to defraud, “(1) file a petition under title 11, including a fraudulent involuntary petition under section 303 of such title; (2) file a document in a proceeding under title 11; or (3) make 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.”<sup>65</sup> Section 157 acts as a catchall provision in relation to § 152, criminalizing fraudulent

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60. *Id.* at 1219.

61. *Id.*

62. *Id.*

63. *Id.* at 1220.

64. *Id.* at 1226.

65. 18 U.S.C. § 157 (West 2014).

acts that could not be prosecuted under § 152.<sup>66</sup> Violations of 18 U.S.C. § 157 include transactions made directly before filing bankruptcy with the intention of using the ensuing bankruptcy proceedings to defraud creditors. Such transactions and statements would be outside the scope of 18 U.S.C. § 152 because they are not made subject to the penalty of perjury. Unlike a finding of fraud in bankruptcy proceedings, which only requires fraud be proven by a preponderance of the evidence, to convict of bankruptcy fraud under 18 U.S.C. § 157, the prosecution must prove the debtor's guilt beyond a reasonable doubt.<sup>67</sup>

*A. Sixth Circuit Cases*

To be found guilty of violating § 157, the Sixth Circuit requires: (1) the existence of a scheme to defraud or intent to later formulate a scheme to defraud and (2) the filing of a bankruptcy petition (3) for the purpose of executing or attempting to execute the scheme.<sup>68</sup>

In *U.S. v. Kurlemann*, the Sixth Circuit held that owners of a closely held business are liable for bankruptcy fraud they commit while operating the business.<sup>69</sup> Bernard Kurlemann was the sole owner of KBI.<sup>70</sup> In August 2007, on the verge of filing Chapter 7 bankruptcy on behalf of KBI, Kurlemann sold an undeveloped residential lot owned by KBI.<sup>71</sup> After filing bankruptcy, Kurlemann used another closely held company he owned to buy the lot back from the buyer, a

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66. See Maureen A. Tighe, *A Guide to Making A Criminal Bankruptcy Fraud Referral*, 6 AM. BANKR. INST. L. REV. 409, 431 (1998). But See *U.S. v. West*, 22 F.3d 586, 589-90 (5th Cir. 1994) (holding, prior to the enactment of 18 U.S.C. § 157, that 18 U.S.C. § 152 included fraudulent transfers made in contemplation of bankruptcy).

67. See 11 U.S.C. § 727(a)(4) (West 2014).

68. *U.S. v. Wagner*, 382 F.3d 598, 612 (6th Cir. 2004) (citing *United States v. DeSantis*, 237 F.3d 607, 613 (6th Cir. 2001)).

69. *U.S. v. Kurlemann*, 736 F.3d 439, 452-53 (6th Cir. 2013).

70. *Id.* at 451.

71. *Id.*

premeditated transaction to which the buyer had orally agreed to upon his original purchase.<sup>72</sup> Kurlemann disclosed none of the preceding information to the bankruptcy court.<sup>73</sup> The Sixth Circuit conceded that Kurlemann was only responsible for disclosing legal or equitable interests of KBI, the debtor.<sup>74</sup> However, the Court held that a jury could have reasonably concluded that Kurlemann was acting in his business capacity on behalf of KBI when participating in the transaction.<sup>75</sup>

*B. Cases from Other Circuits*

To find a defendant guilty of a § 157 violation, the Seventh Circuit requires: “(1) that he engaged in a fraudulent scheme; (2) that he made misrepresentations to the bankruptcy court; (3) in order to further the scheme.”<sup>76</sup> In *U.S. v. Persfull*, the Seventh Circuit held that a disclaimer of an inheritance followed by transfers from a sibling equivalent to the inheritance shortly after a Chapter 7 discharge constituted bankruptcy fraud and a violation of 18 U.S.C. § 157 by both the debtor and his sibling.<sup>77</sup> The debtor’s mother passed away two days after the meeting of creditors.<sup>78</sup> Although the debtor disclaimed his inheritance, he did not disclose to the trustee that he was entitled to an inheritance.<sup>79</sup> The debtor’s brother then inconsistently provided the

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72. *Id.*

73. *Id.*

74. *Id.*

75. *Id.* at 451–52.

76. *U.S. v. Holstein*, 618 F.3d 610, 612 (7th Cir. 2010).

77. *U.S. v. Persfull*, 660 F.3d 286, 294 (7th Cir. 2011).

78. *Id.* at 289.

79. *Id.*

disclaimer to insurance companies with whom the debtor's mother held life insurance policies.<sup>80</sup> Where the debtor's brother did provide the disclaimer, the debtor's brother transferred funds to the debtor following receipt of the proceeds.<sup>81</sup> The court determined that "the creation and use of a sham disclaimer" amounted to the creation of a scheme to defraud the trustee.<sup>82</sup>

## V. Embezzlement

Unlike other bankruptcy crimes, 18 U.S.C. § 153 is often violated by individuals other than the debtor. A violation of § 153 occurs when an individual, "who has access to property or documents belonging to an estate by virtue of the person's participation in the administration of the estate," "knowingly and fraudulently" transfers or destroys any property or document of the estate for their own use.<sup>83</sup>

### A. Sixth Circuit Cases

In *U.S. v. Derryberry*, the Sixth Circuit held that the purpose of bankruptcy laws is protect creditors and the purpose of 18 U.S.C. § 153 is to further protect creditors from the embezzlement by a trustee.<sup>84</sup> Derryberry was appointed trustee for Hartley Trucking Company after the owner filed for bankruptcy.<sup>85</sup> At a creditors meeting, Derryberry told creditors that he needed \$75,000 in a creditors' fund to pursue litigation against Hartley. He also introduced Merle Weber as an

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80. *Id.* at 290–91.

81. *Id.*

82. *Id.* at 294.

83. 18 U.S.C. § 153 (West 2014).

84. *U.S. v. Derryberry*, 856 F.2d 196, \*3 (6th Cir. 1988) (table).

85. *Id.*



investigator in the case.<sup>86</sup> The creditors complied with Derryberry's request and wrote checks payable to Derryberry. These checks were then deposited in Weber's personal checking account.<sup>87</sup>

Derryberry was convicted in district court of violation of 18 U.S.C. § 153. On appeal, Derryberry argued that the money he solicited from the creditors was not property of the estate and, therefore, he had not violated 18 U.S.C. § 153.<sup>88</sup> The Sixth Circuit discredited this argument by asserting that "the estate may acquire an interest in property after the commencement of the case" and any funds given to the estate to fund litigation on behalf of the estate is properly classified as property of the estate.<sup>89</sup> Accordingly, the Sixth Circuit affirmed Derryberry's conviction.<sup>90</sup>

### *B. Cases from Other Circuits*

In *U.S. v. Ivers*, the Tenth Circuit held that the mere closing of a bankruptcy case does not constitute the estate's abandonment of the "unadministered assets."<sup>91</sup> Accordingly, the personal use of such assets by a trustee following the closing of bankruptcy proceedings is a violation of 18 U.S.C. § 153.<sup>92</sup> The appointed trustee in *Ivers* received a check as payment of a dividend to the debtor after the bankruptcy case had been closed.<sup>93</sup> The trustee deposited this check into his

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86. *Id.*

87. *Id.*

88. *Id.* \*3.

89. *Id.*

90. *Id.* at \*4.

91. *U.S. v. Ivers*, 512 F.2d 121, 124 (8th Cir. 1975).

92. *Id.*

93. *Id.* at 122-23.

personal business account.<sup>94</sup> It was not until the bankruptcy case was reopened that the embezzlement came to light.<sup>95</sup> The trustee argued that because the bankruptcy case was closed at the time the deposit was made, the check was not property of the estate and, therefore, he had not violated § 153.<sup>96</sup> The court held that absent any evidence that the assets had been abandoned by the estate, the assets remained property of the estate.<sup>97</sup>

## **VI. Improper Fee Agreement**

Criminal liability may also be imposed when two parties in interest, or their attorneys, “knowingly and fraudulently” enter into a fee agreement for services rendered to be paid from assets of the estate.<sup>98</sup> The agreement may be express or implied.<sup>99</sup>

## **VII. Effect of Bankruptcy Crimes on Bankruptcy Case**

### *A. Discharge*

Any bankruptcy crime committed by the debtor will likely result in a denial of their discharge. The Bankruptcy Code provides an extensive list of reasons why a discharge may not be granted.<sup>100</sup> Included in this list is concealing assets with the intent to defraud a creditor or officer of the estate, concealing or destroying records, and knowingly and fraudulently making a

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94. *Id.* at 123.

95. *Id.*

96. *Id.*

97. *Id.* at 124.

98. 18 U.S.C. § 155 (West 2014).

99. *Id.*

100. 11 U.S.C. § 727 (West 2014).

false oath or claim.<sup>101</sup> The bankruptcy crimes of concealment of assets, false oaths, and bankruptcy fraud would clearly fall within this scope and justify a denial of discharge.

*B. Creation of Private Right of Action*

In *Heavrin v. Nelson*, the Sixth Circuit held that the prosecution of bankruptcy crimes does not create a private right of action.<sup>102</sup> Triple S Restaurants, represented by Donald Heavrin, entered into a loan transaction with Boeing Capital Corporation (“Boeing”).<sup>103</sup> The collateral for the loan was life insurance policies on the lives of the owners, valued at \$2 million.<sup>104</sup> Upon the death of one of the owners, \$250,000 of the insurance proceeds was paid to a trust for which Heavrin was the trustee, and \$1.75 million was paid to Boeing.<sup>105</sup> The trustee in bankruptcy was unable to collect the insurance proceeds in trust and representatives of Boeing denied that the amount had been paid to settle a lender liability claim.<sup>106</sup> Heavrin was prosecuted on bankruptcy fraud, but the trial ended in acquittal.<sup>107</sup> Following his acquittal, Heavrin filed a complaint against Boeing for fraud, perjury, and outrage for the statements made by Boeing during the bankruptcy proceedings.

Boeing filed a motion to dismiss for failure to state a claim upon which relief could be granted.<sup>108</sup> The district court held that a federal statute prohibiting the filing of false bankruptcy

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101. *Id.*

102. *Heavrin v. Nelson*, 384 F.3d 199, 202 (6th Cir. 2004).

103. *Id.* at 200-01.

104. *Id.*

105. *Id.*

106. *Id.*

107. *Id.*

108. *Id.* at 202.

claims does not create a private right of action.<sup>109</sup> In affirming the district court's decision, the Sixth Circuit reasoned that Kentucky's judicial proceeding privilege impeded Heavrin from relying solely upon proof from the bankruptcy proceeding to support his claim of fraud.<sup>110</sup>

### VIII. Attorneys and Bankruptcy Crimes

Attorneys may face criminal charges if they advise their client to perpetrate or assist their client in perpetrating a bankruptcy crime insofar as they violate title 18.<sup>111</sup> Like debtors, attorneys must knowingly and fraudulently commit the bankruptcy crimes. Accordingly, a mere act of negligence, such as signing an inaccurate document without the knowledge that it is inaccurate, would not constitute a bankruptcy crime.<sup>112</sup> However, advising a client to "undervalue assets" and "overvalue claims" may constitute a violation.<sup>113</sup>

In *U.S. v. Dolan*, the Eighth Circuit held that an attorney who aids a client in concealing assets of the estate has violated § 152(1).<sup>114</sup> Gary Dolan represented David Anderson in business litigation and, after an involuntary petition of bankruptcy was filed against Anderson, represented Anderson in his bankruptcy proceedings as well.<sup>115</sup> Dolan affirmatively lied to Anderson's creditors, insisting that Anderson did not have the funds to settle their claims, despite Dolan's knowledge that Anderson did have sufficient funds.<sup>116</sup> Dolan also affirmatively denied that

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109. *Id.* at 202.

110. *Id.* at 202-03.

111. See 18 U.S.C. §§ 151-157 (West 2014); Joel M. Shafferman, *Let Counsel Beware: Overzealous Bankruptcy Practice Can Lead to A Prison Cell*, 36-OCT CHAMPION 58, 58 (2012).

112. §§ 151-157.

113. Shafferman *supra* note 106 at 58.

114. *U.S. v. Dolan*, 120 F.3d 856, 869 (8th Cir. 1997); § 152(1).

115. *Id.* at 860.

116. *Id.* at 862.

Anderson owned a Ferrari which secured another claim against Anderson.<sup>117</sup> The Eighth Circuit found that there was sufficient evidence to convict Dolan of violating § 152(1).<sup>118</sup>

In *U.S. v. Holstein*, the Seventh Circuit held that an attorney with a suspended license is guilty of bankruptcy fraud if he prepares bankruptcy petitions and blacks out his own name on the forms.<sup>119</sup> Thomas Holstein was a bankruptcy attorney in Illinois, but his license was suspended after committing professional misconduct.<sup>120</sup> Holstein attempted to circumvent his suspension by ordering his paralegal to take fees from clients and file the prepared bankruptcy petitions, blacking out Holstein's name on forms as though clients were filing pro se.<sup>121</sup> However, clients' fees were paid with checks from Holstein's law firm.<sup>122</sup> The Seventh Circuit held that such falsification of documents constituted bankruptcy fraud.<sup>123</sup>

### IX. Bankruptcy Crime Referral

Referral of bankruptcy crimes to the United States Attorney is mandatory for judges, receivers, trustees, and bank officers.<sup>124</sup> Title 18 of the United States Code requires that if a judge, receiver, or trustee reasonably believes that a debtor has committed a bankruptcy crime, they must

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117. *Id.* at 868.

118. *Id.* at 869.

119. *U.S. v. Holstein*, 618 F.3d 610, 612 (7th Cir. 2010).

120. *Id.* at 611.

121. *Id.*

122. *Id.*

123. *Id.* at 612.

124. 18 U.S.C. § 3057(a) (West 2014).

report all pertinent information regarding the debtor and case to the appropriate U.S. Attorney.<sup>125</sup> If, after investigation, the U.S. Attorney finds probable cause that the debtor committed a bankruptcy crime, the facts must be presented to a grand jury.<sup>126</sup> Criminal referrals are also to be made when appropriate by United States Trustees pursuant to 28 U.S.C. § 586(a)(3)(F).<sup>127</sup> Additionally, a bank officer must report a “known or suspected violation of Federal law or a suspicious transaction related to a money laundering activity or a violation of the Bank Secrecy Act.”<sup>128</sup>

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125. *Id.* See Maureen A. Tighe, *A Guide to Making A Criminal Bankruptcy Fraud Referral*, 6 AM. BANKR. INST. L. REV. 409, 436-38 (1998) (describing the information that should be included when a bankruptcy crime referral is made).

126. 18 U.S.C. § 3057(b).

127. 28 U.S.C. § 586(a)(3)(F) provides:

(a) Each United States trustee, within the region for which such United States trustee is appointed, shall—

(3) supervise the administration of cases and trustees in cases under chapter 7, 11, 12, 13, or 15 of title 11 by, whenever the United States trustee considers it to be appropriate—

(F) 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.

128. 12 C.F.R. § 21.11 (West 2014). See William I. Kampf & Jay M. Quam, *The Intersection of Bankruptcy and White Collar Crime*, 97 COM. L.J. 70, 71-72 (1992) (explaining the importance of disclosing accurate information to a bank when applying for a loan).

## BANKRUPTCY FRAUD PROSECUTIONS

### EXAMPLE #1

Investigation was initiated after receipt of a criminal referral and supporting documentation from the United States Trustee's Office (USTO) alleging that **HUSBAND** and **WIFE** had presented a fraudulent document to **HUSBAND'S** employer. The document bore the seal of the U.S. Bankruptcy Court and the stamped signature of Chief Bankruptcy Judge David S. Kennedy and indicated that **HUSBAND** and **WIFE** were in bankruptcy.

Investigation by the FBI confirmed that document was fraudulent and that there was no bankruptcy case pending. Investigation determined through interviews of witnesses and review of documents that a creditor had obtained a judgment against **HUSBAND** and had filed a garnishment of **HUSBAND'S** wages. The garnishment was served upon **HUSBAND'S** employer. In an effort to stop the garnishment of **HUSBAND'S** wages, defendant **WIFE** sent a handwritten letter to **HUSBAND'S** employer indicating that **HUSBAND** and **WIFE** were in bankruptcy. Enclosed with the letter was the fraudulent document purportedly from the Bankruptcy Court.

**HUSBAND** was indicted for a violation of 18 U.S.C. §157(3) as he had purportedly signed the letter. Post-indictment investigation by **HUSBAND'S** attorney and corroborated through witnesses, determined that **HUSBAND** had given **WIFE** funds to file Bankruptcy Petition and he believed she had filed because she had repeatedly told him she had done so. Ultimately, **WIFE** entered guilty plea to a one-count criminal information charging her with a §157(3) violation. She was sentenced to two months custody. Charges against **HUSBAND** were dismissed. There was no loss because **HUSBAND'S** employer honored the garnishment after learning there was no bankruptcy proceeding pending.

## BANKRUPTCY FRAUD PROSECUTIONS (CONT.)

### EXAMPLE #2

**DEFENDANT**, a former employee of the VA hospital, was receiving disability benefits under the Federal Employee's Compensation Act (FECA) as the result of an on-the-job injury. The benefits were administered through the Department of Labor Office of Workers' Compensation Programs (OWCP). Approximately once every 15 months, in order to continue receiving FECA benefits, **DEFENDANT** had to submit a form to OWCP known as a Form 1032. The form asked a number of questions including a question "were you self-employed or involved in any business enterprise in the past 15 months?"

The U.S. Attorney's Office (USAO) was contacted by investigators with the VA Office of Inspector General and the Department of Labor who indicated that preliminary investigation had determined that **DEFENDANT** was fraudulently receiving FECA benefits because he was self-employed and was receiving income from self-employment but had stated on his FECA Form 1032 that he had not been employed and receiving income. Investigators told the USAO that one of the items of proof was a bankruptcy petition filed by **DEFENDANT** wherein he acknowledged in his petition, schedules, and statement of financial affairs (SOFA) that he was running his own business and had income. However, **DEFENDANT** had omitted the fact that he was receiving FECA benefits on his Schedule I and SOFA.

**DEFENDANT** was indicted on two counts of making false statements on the 1032 Form under 18 U.S.C. §1920 and two counts of making false statements under penalty of perjury on the Schedule I and SOFA he had filed in the bankruptcy case under 18 U.S.C. §152(3).

**DEFENDANT** was convicted on all four counts after a jury trial and was sentenced to 42 months in prison.

**Attorney Client Privilege Issue:** **DEFENDANT'S** bankruptcy attorney was subpoenaed to testify at trial as a government witness. **DEFENDANT** asserted the privilege. Attorney was ordered to testify. He testified that: (1) he prepared the petitions, schedules and SOFA based on the information provided by **DEFENDANT**; (2) he was unaware of **DEFENDANT'S** receipt of FECA benefits; and, (3) had he been aware of **DEFENDANT'S** receipt of FECA benefits, the false answers which were subject of the two Bankruptcy Fraud counts would have been different. The basis for the court's order directing the attorney to testify was that the information provided by **DEFENDANT** to the attorney to use in preparation of the petition was intended to be communicated to a third party and therefore the element of confidentiality was not present.



## BANKRUPTCY FRAUD PROSECUTIONS (CONT.)

### EXAMPLE #3

Investigation was initiated after receipt of a referral from the USTO alleging that **DEFENDANT** had filed a petition in bankruptcy using a Social Security Number (SSN) that belonged to another individual, and that he had failed to list other bankruptcy petitions he had previously filed. In addition it was alleged that **DEFENDANT** had fraudulently used the same SSN to obtain credit from a federally insured financial institution to finance the purchase of a vehicle. Further investigation confirmed the allegations. At the conclusion of the investigation **DEFENDANT** received a target letter advising him that he was about to be indicted on various charges including Aggravated Identity Theft (18 U.S.C. 1028A). The target letter offered **DEFENDANT** the opportunity to resolve the matter prior to indictment. He retained counsel and agreed to plead to a two-count information charging him with one count of Bank Fraud (18 U.S.C. §1344) in connection with the vehicle loan, and one count of Bankruptcy Fraud (18 U.S.C. §152 (3)) because he had falsely represented that the SSN he used on the Bankruptcy Petition was his, and that he had only filed one other bankruptcy case within the preceding eight years. In fact, the SSN was not his and he had filed two other cases which he had not listed.

**DEFENDANT** was sentenced to six months custody and ordered to serve two years supervised release with a condition that he spend nine months in a halfway house.

## BANKRUPTCY FRAUD PROSECUTIONS (CONT.)

### **EXAMPLE #4 (Note – this prosecution did not result in a Bankruptcy Fraud Charge but arose from a referral from the USTO)**

Investigation was initiated after receipt of a referral from the USTO which alleged that **DEFENDANT** had filed a Chapter 13 Bankruptcy Petition using a SSN ending in 3555, but had later produced a W-2 form and earnings statements showing a SSN ending in 7142. At the first meeting of creditors **DEFENDANT** was questioned under oath about the discrepancy. **DEFENDANT** stated that the 3555 SSN she used to file her Chapter 13 petition was a Taxpayer ID number that had been issued to her by the IRS for the purpose of filing taxes. She stated that the 7142 SSN was a number that she had "just made up." **DEFENDANT** admitted that she had used the 7142 SSN to obtain credit cards, and to purchase a car and a house.

After receiving the allegations from the USTO the matter was referred to the Social Security Administration – Office of Inspector General (SSA-OIG) for further investigation. Investigation determined that the 7142 SSN belonged to an individual ("Victim") residing in Provo, Utah.

Further investigation determined that **DEFENDANT** had used "Victim's" SSN on her employment application, I-9 form, and other documents to obtain employment at Regions Bank. In addition, **DEFENDANT** provided a Social Security Card bearing Victim's SSN to verify that she was authorized to be employed. On the I-9 form, **DEFENDANT** also represented that she was a U.S. citizen. According to information **DEFENDANT** provided on her employment application, she had attended high school in Cuernavaca, Mexico, from 08/22/94 to 05/25/98.

Investigation also determined that **DEFENDANT** had used Victim's SSN to obtain credit from Suntrust Bank and National Bank of Commerce (NBC) (creditors listed on **DEFENDANT'S** Bankruptcy Petition) to obtain a HELOC and to finance the purchase of two vehicles. On the credit applications **DEFENDANT** also falsely represented that she had annual gross income of \$140,000 from employment, whereas on her employment application with Regions Bank she showed that she had earned between \$35,500 and \$40,000 while she was employed at Select Corp.

Records obtained from CitiMortgage reflected that **DEFENDANT** had also used Victim's SSN on a mortgage loan application to finance the purchase of a residential property in Memphis, TN. in the declarations section **DEFENDANT** stated that she was not a U.S. citizen but was a permanent resident alien.

Records obtained from the IRS pursuant to an Ex Parte Disclosure Order confirmed that **DEFENDANT** applied for and been issued the number ending in 3555 as Individual Taxpayer Identification Number (ITIN) in 1997. The application was made under **DEFENDANT'S** maiden name and again reflected that she was born in Cuernavaca, Mexico, and was a Mexican citizen.

## BANKRUPTCY FRAUD PROSECUTIONS (CONT.)

### EXAMPLE #4 (cont.)

In a complaint for absolute divorce filed by **DEFENDANT** in Circuit Court in 2007, **DEFENDANT** represented that she was born in 1981 in Cuervanaza, Mexico, and that her SSN was 3555 (Victim's SSN).

Records maintained by Immigration and Customs Enforcement (ICE) reflected that no record existed to show that **DEFENDANT** entered the United States legally or that she had ever become a U.S. citizen.

**DEFENDANT** was charged in a five count indictment with the following violations:

18 U.S.C. §911 - (False Personation of Citizenship)

18 U.S.C. §1001(a)(2) - (False statements on I-9 Form)

18 U.S.C. §1344 – (Bank Fraud (2 counts – re HELOC and vehicle loan))

42 U.S.C. §408(a)(7)(B) - (Fraudulent Use of a SSN on Regions employment documents)

**DEFENDANT** entered a guilty plea to making false statement on the I-9 Form. She was sentenced to time served (approximately two weeks) and is currently under an order of deportation which she is appealing.

## BANKRUPTCY FRAUD PROSECUTIONS (CONT.)

**EXAMPLE #5** (Note: Example #s 1 thru 4 were all local prosecutions. This example comes from the Central District of Illinois in the 7<sup>th</sup> Cir.)

**DEFENDANT** owed \$200,000 to a federally insured bank (“Bank #1”). In order to continue his credit and secure additional loans, **DEFENDANT** submitted financial statements to Bank #1 and to another Bank (“Bank #2”). On his financial statements **DEFENDANT** valued his assets at over \$6.5 million and claimed a net worth of almost \$6 million. The list of assets included close to \$2 million in “gold monitor certificates” which **DEFENDANT** knew were actually worthless.

The year after **DEFENDANT** obtained the Bank loans, the owners of a motel sued **DEFENDANT** for breaching a contract to buy the motel. While the jury was deliberating in that case, **DEFENDANT** and his wife planned a ski vacation in Europe. On the last day of deliberations, **DEFENDANT** executed an agreement with his father, wherein **DEFENDANT**’s father would pay **DEFENDANT** \$30,000 in exchange for various household goods and two cars, a 1980 Porsche and a 1981 DeLorean. The day after **DEFENDANT**’s father wire transferred the money to **DEFENDANT**, the jury returned a verdict against **DEFENDANT** in the amount of \$1 million. Soon after, **DEFENDANT** and his wife departed on their European vacation, charging all expenses to their American Express account.

A few days after returning from Europe, **DEFENDANT** filed a Chapter 11 petition. Ten months later, no plan of reorganization had been filed, and the petition was converted to Chapter 7. **DEFENDANT**’s creditors filed an adversary suit against him and succeeded in having his debts declared nondischargeable on the basis of fraud. **DEFENDANT** then moved out of state where he purchased a home in his mother-in-law’s name (pursuant to a power of attorney).

**DEFENDANT** was indicted on two counts of fraudulently transferring property (the Porsche and the DeLorean), in contemplation of bankruptcy. He was also charged with one count of mail fraud in connection with his fraud on American Express and two counts of submitting false statements to the Banks.

**DEFENDANT** was convicted after jury trial on all counts and sentenced to five years imprisonment, five years supervised release and was ordered to pay \$658,775.93 in restitution.