

Helping Debtors on the Fringe

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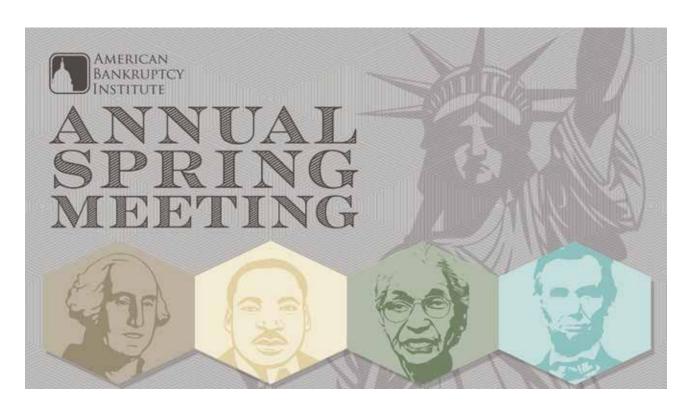
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Helping Debtors on the Fringe

Judge Bruce Harwood January Bailey Stephen Relyea Moderator: Jeffrey Fraser



Infant or Incompetent Persons

INFANT OR INCOMPETENT

- Not defined in Bankruptcy Code
- Refer to state statutes and state courts
- Infant: generally accepted to be someone under 18 years old
- Incompetent: incapacity



Infant or Incompetent Persons

Section 109(h)(4):

INCAPACITY: The debtor is impaired by reason of mental illness or mental deficiency so that he is incapable of realizing and making rational decisions with respect to his financial responsibilities

DISABILITY: the debtor is so physically impaired as to be unable, after reasonable effort, to participate in an in person, telephone, or Internet briefing



Infant or Incompetent Persons

Fed. R. Bankr. P. 1004.1. Voluntary Petition on Behalf of an Infant or Incompetent Person.

- Representative (guardian, conservator) may file petition
- Next friend or guardian ad litem may file for unrepresented person

Fed. R. Bankr. P. 7017. Parties Plaintiff and Defendant; Capacity – similar representatives in adversary proceedings.



Infant or Incompetent Persons

Fed. R. Bankr. P. 1016
Death or Incompetency of a Debtor.

- Chapter 7: case continues
- Chapter 11, 12, or 13: case may be dismissed or continue



Infant or Incompetent Persons

Model Rule of Professional Conduct 1.14: Client with Diminished Capacity

- As far as reasonably possible, maintain a normal client-lawyer relationship with the client.
- If at risk of harm, lawyer may take protective action: seeking appointment of guardian ad litem, conservator, or guardian



Infant or Incompetent Persons

Cases

- In re Maes
- In re Sapp
- In re Brown
- Whitmore v. Arkansas
- In re Corson



Infant or Incompetent Persons

Practice Pointers

- Issue spotting during consultation
- Incompetency during case



Powers of Attorney

Local Rules and Practice Pointers

- POA should be filed at same time as Petition
- POA should specifically identify filing a bankruptcy petition as one of the powers



Scams

Types of Scams

- Romance
- Government
- Investment
- Compromised Email
- Debt Relief
- "Bankruptcy Fraud Watchdog Group"
- Post-Discharge



Scams

Implications & Practice Pointers

- Tax
- §523 and §727 Actions
- Identify and Document

American Bankruptcy Institute (ABI) 2025 Annual Spring Meeting (ASM) "Helping Debtors on the Fringe"

> Friday April 25, 2025 9:45am – 10:45am

Panelists:
The Honorable Bruce Harwood
January Bailey
Jeffrey S. Fraser
Stephen Relyea

I. Overview/Session Objective.

As bankruptcy practitioners, the goal of a "fresh-start" for the honest debtor is a unified objective for all constituents in a consumer bankruptcy case (be it the debtor attorney, chapter 13 trustee, the court, and even creditor attorneys). As a collaborative environment (as opposed to an adversarial one), the consumer bankruptcy court has been a forum that provides debtors space to address financial affairs, save property, and to recapture a once-lost financial profile. This already important objective is elevated to an even higher standard when confronted with "debtors on the fringe" – vulnerable individuals that have fallen victim to scams (inadvertently incurring significant debt assisting a bad actor), or infant/incompetent debtors that require assistance from another in dealing with a fractured financial situation. This panel will explore how these vulnerable populations are sometimes taken advantage of, focusing on a review of the types of debts they may incur, and provide practical tips for best assisting them.

II. Infant or Incompetent Persons.

Determining whether a debtor is "Incompetent"

- The term "incompetent" is not defined in the Bankruptcy Code. Therefore, bankruptcy courts typically refer to state statutes and state courts for guidance.¹
- The Bankruptcy Code does define the related term "incapacity" in Section 109(h)(4):

The requirements of paragraph (1) [regarding credit counseling requirements] shall not apply with respect to a debtor whom the court determines, after notice and hearing, is unable to complete those requirements because of incapacity, disability, or active military duty in a military combat zone. For the purposes of this paragraph, incapacity means that the debtor is impaired by reason of mental illness or mental deficiency so that he is

¹ In re Maes, 616 B.R. 784 (Bankr. Colo. 2020); In re Brown 645 B.R. 524 (S.C. 2022); see also In re Whitehead, No. 05-50136, 2005 WL 1819399, at *4 (Bankr. M.D.N.C. July 22, 2005) (citing Matchem v. Frank , 998 F.2d 1009, 1010 (4th Cir. 1993); Siers v. Greiner , 983 F.2d 1057, 1058 (4th Cir.1993) all in the context of Fed. Rule of Civ. Pro. 17(c).

incapable of realizing and making rational decisions with respect to his financial responsibilities; and "disability" means that the debtor is so physically impaired as to be unable, after reasonable effort, to participate in an in person, telephone, or Internet briefing required under paragraph (1).²

- The Alzheimer's Association has also identified several symptoms of dementia that may signal some level of incompetence or incapacity.³ These are signs to consider in determining whether a debtor or potential debtor may be incompetent to make financial decisions or file bankruptcy.
 - o Memory loss that disrupts daily life
 - Challenges in planning or solving problems
 - o Difficulty completing familiar tasks
 - o Confusion with time or place
 - o Trouble understanding visual images and spatial relationships
 - New problems with words in speaking or writing
 - o Misplacing things and losing the ability to retrace steps
 - o Decreased or poor judgment
 - Withdrawal from work or social activities
 - o Changes in mood and personality.

Relevant Rules related to representing incompetent/incapacitated debtors

Practitioners should be aware of the bankruptcy rules governing the representation of incompetent or incapacitated debtors, which are set forth herein. Practitioners should also be aware of any applicable state statutes and ethical rules in their state pertaining to the representation of incompetent individuals as well as any applicable local bankruptcy rules and procedures in their jurisdiction.

Fed. R. Bankr. P. 1004.1. Voluntary Petition on Behalf of an Infant or Incompetent Person.

- **Represented Infant or Incompetent Person.** If an infant or an incompetent person has a representative--such as a general guardian, committee, conservator, or similar fiduciary--the representative may file a voluntary petition on behalf of the infant or incompetent person.
- Unrepresented Infant or Incompetent Person. If an infant or an incompetent person does not have a representative:
 - o a next friend or guardian ad litem may file the petition; and
 - o the court must appoint a guardian ad litem or issue any other order needed to protect the interests of the infant debtor or incompetent debtor.

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² 11 USC §109(h)(4)

³ https://www.alz.org/alzheimers-dementia/10_signs.

Fed. R. Bankr. P. 1016. Death or Incompetency of a Debtor.

- Chapter 7 Case. In a Chapter 7 case, the debtor's death or incompetency does not abate the case. The case continues, as far as possible, as though the death or incompetency had not occurred.
- Chapter 11, 12, or 13 Case. Upon the debtor's death or incompetency in a Chapter 11, 12, or 13 case, the court may dismiss the case or may permit it to continue if further administration is possible and is in the parties' best interests. If the case continues, it must proceed and be concluded in the same manner as though the death or incompetency had not occurred.

Fed. R. Bankr. P. 7017. Parties Plaintiff and Defendant; Capacity.

Rule 7017 incorporates Fed. R. Civ. P. 17 in adversary proceedings. Fed. R. Civ. P. 17(c) provides for minors or incompetent persons to sue or be sued in adversary proceedings as follows:

- (1) With a Representative. The following representatives may sue or defend on behalf of a minor or an incompetent person:
 - (A) a general guardian;
 - (B) a committee;
 - (C) a conservator; or
 - (D) a like fiduciary.
- (2) Without a Representative. A minor or an incompetent person who does not have a duly appointed representative may sue by a next friend or by a guardian ad litem. The court must appoint a guardian ad litem—or issue another appropriate order—to protect a minor or incompetent person who is unrepresented in an action.

Model Rule of Professional Conduct 1.14: Client with Diminished Capacity

- MRPC 1.14 sets forth a lawyer's responsibilities when representing a client with diminished capacity. Several states have either incorporated the model rule or have adopted a similar rule in their rules of professional responsibility.
- MRPC 1.14 states as follows:
 - When a client's capacity to make adequately considered decisions in connection with a representation is diminished, whether because of minority, mental impairment or for some other reason, the lawyer shall, as far as reasonably possible, maintain a normal client-lawyer relationship with the client.
 - o When the lawyer reasonably believes that the client has diminished capacity, is at risk of substantial physical, financial or other harm unless action is taken and cannot adequately act in the client's own interest, the lawyer may take reasonably necessary protective action, including consulting with individuals or entities that have the ability to take action

to protect the client and, in appropriate cases, seeking the appointment of a guardian ad litem, conservator or guardian.

- o Information relating to the representation of a client with diminished capacity is protected by Rule 1.6. When taking protective action pursuant to paragraph (b), the lawyer is impliedly authorized under Rule 1.6(a) to reveal information about the client, but only to the extent reasonably necessary to protect the client's interests.
- Relevant comments to the MRPC 1.14 are as follows:
 - [1] The normal client-lawyer relationship is based on the assumption that the client, when properly advised and assisted, is capable of making decisions about important matters. When the client is a minor or suffers from a diminished mental capacity, however, maintaining the ordinary client-lawyer relationship may not be possible in all respects. In particular, a severely incapacitated person may have no power to make legally binding decisions. Nevertheless, a client with diminished capacity often has the ability to understand, deliberate upon, and reach conclusions about matters affecting the client's own well-being. For example, children as young as five or six years of age, and certainly those of ten or twelve, are regarded as having opinions that are entitled to weight in legal proceedings concerning their custody. So also, it is recognized that some persons of advanced age can be quite capable of handling routine financial matters while needing special legal protection concerning major transactions.
 - [2] The fact that a client suffers a disability does not diminish the lawyer's obligation to treat the client with attention and respect. Even if the person has a legal representative, the lawyer should, as far as possible, accord the represented person the status of client, particularly in maintaining communication.
 - [3] The client may wish to have family members or other persons participate in discussions with the lawyer. When necessary to assist in the representation, the presence of such persons generally does not affect the applicability of the attorney-client evidentiary privilege. Nevertheless, the lawyer must keep the client's interests foremost and, except for protective action authorized under paragraph (b), must look to the client, and not family members, to make decisions on the client's behalf.
 - [4] If a legal representative has already been appointed for the client, the lawyer should ordinarily look to the representative for decisions on behalf of the client. In matters involving a minor, whether the lawyer should look to the parents as natural guardians may depend on the type of proceeding or matter in which the lawyer is representing the minor. If the lawyer represents the guardian as distinct from the ward and is aware that the guardian is acting adversely to the ward's interest, the lawyer may have an obligation to prevent or rectify the guardian's misconduct. See Rule 1.2(d).
 - [5] If a lawyer reasonably believes that a client is at risk of substantial physical, financial or other harm unless action is taken, and that a normal client-lawyer relationship cannot be maintained as provided in paragraph (a) because the client lacks sufficient capacity to

communicate or to make adequately considered decisions in connection with the representation, then paragraph (b) permits the lawyer to take protective measures deemed necessary. Such measures could include: consulting with family members, using a reconsideration period to permit clarification or improvement of circumstances, using voluntary surrogate decision-making tools such as durable powers of attorney or consulting with support groups, professional services, adult-protective agencies or other individuals or entities that have the ability to protect the client. In taking any protective action, the lawyer should be guided by such factors as the wishes and values of the client to the extent known, the client's best interests and the goals of intruding into the client's decision-making autonomy to the least extent feasible, maximizing client capacities and respecting the client's family and social connections.

- [6] In determining the extent of the client's diminished capacity, the lawyer should consider and balance such factors as: the client's ability to articulate reasoning leading to a decision, variability of state of mind and ability to appreciate consequences of a decision; the substantive fairness of a decision; and the consistency of a decision with the known long-term commitments and values of the client. In appropriate circumstances, the lawyer may seek guidance from an appropriate diagnostician.
- [7] If a legal representative has not been appointed, the lawyer should consider whether appointment of a guardian ad litem, conservator or guardian is necessary to protect the client's interests. Thus, if a client with diminished capacity has substantial property that should be sold for the client's benefit, effective completion of the transaction may require appointment of a legal representative. In addition, rules of procedure in litigation sometimes provide that minors or persons with diminished capacity must be represented by a guardian or next friend if they do not have a general guardian. In many circumstances, however, appointment of a legal representative may be more expensive or traumatic for the client than circumstances in fact require. Evaluation of such circumstances is a matter entrusted to the professional judgment of the lawyer. In considering alternatives, however, the lawyer should be aware of any law that requires the lawyer to advocate the least restrictive action on behalf of the client.

Acting on Behalf of Incompetent Debtors

The following cases discuss the process for representation of incompetent debtors, the obstacles that may materialize during that process, and the important distinction between a "next friend" and "guardian ad litem," as it relates to applicability to Fed. Bankr. Rule 1004.1. Full opinions are included in the materials, and summaries are directly below.

• In re Maes, 616 B.R. 784 (Bankr. D. Colo. 2020). To aid in articulating the process, procedures, and sometimes frustrations of filing a petition on behalf of an incompetent person, consider the case of In re Maes, 616 B.R. 784 (Bankr. D. Colo. 2020), where the court thoroughly addressed the requirements under Fed. Bankr. Rule 1004.1. In Maes, the bankruptcy court was confronted with the delicate scenario of a clearly incompetent elderly debtor with dementia. Prior to the petition, the debtor's daughter attempted to execute a

power of attorney (POA) to act on her mother's behalf. Unfortunately, she incorrectly executed the document, rendering the POA ineffective. Thus, notwithstanding worthy intentions by the daughter, the debtor did not have a formal representative at the time of filing. The debtor, through counsel, conceded that that the POAs were ineffective; and the court took the matter under advisement in deciding whether it was appropriate to appoint the daughter as guardian ad litem in order for the case to proceed. Thereafter, the court explained the important distinction between the status of a "next friend" vs. "guardian ad litem" as it relates to a bankruptcy case. If a guardian ad litem initiated and signed the bankruptcy petition, the inquiry is complete and the case may proceed. However, if only a "next friend" started the bankruptcy proceedings, then the Court must appoint a guardian ad litem or take other action to protect the incompetent debtor; the Court cannot just let the "next friend" continue along in prosecuting the bankruptcy case. Id. at 797. Emphasis added. The court first confirmed that the POAs executed by her daughter were indeed ineffective, and that debtor was incompetent at the time of filing. As such, the debtor did not have a valid "representative" when her bankruptcy petition was signed. However, while the daughter did not qualify as guardian ad litem to her mother (as no court ever appointed her as such), the court determined that the daughter did, however, meet the burden as "next friend" because of her "significant relationship" with her mother (the debtor) and her demonstrated dedication to the interests of the debtor. Because a "next friend" is not a fiduciary, the court appointed the debtor's daughter as guardian ad litem for the limited purpose of prosecuting and administering her mother's bankruptcy, allowing her to exercise the rights of a chapter 13 debtor-in-possession.

In re Sapp, Case No. 10-20580-659 (Bankr. E.D. Mo. Jul. 20, 2011). The bankruptcy court confirmed that incompetent persons are not barred from filing a bankruptcy via an appointed representative. Here, the debtor wife was incapacitated and disabled and the debtor husband had been appointed as guardian and conservative by the state court prior to the filing of the bankruptcy petition. The debtor husband signed the petition on behalf of himself and on behalf of his wife as her guardian, and he submitted to the bankruptcy court copies of the letters of guardianship and conservatorship from the state court demonstrating he was "authorized and empowered to perform the duties of a guardian." The bankruptcy court determined that the debtor husband was acting within his capacity as guardian of the debtor wife. The court further concluded that an incapacitated person—in this case, the debtor wife—may be a debtor in bankruptcy, citing Fed. Bankr. Rule 1004.1 and several cases from jurisdictions around the country supporting that conclusion. See In re Kjellsen, 155 B.R. 1013, 1018 (Bankr. D.S.D. 1993), rev'd on other grounds (Congress did not intend to bar incompetent persons from filing a voluntary bankruptcy petition; to so do would likely raise constitutional issues of due process and equal protection); In re Kirschner, 46 B.R. 583, 584 (Bankr. E.D. N.Y. 1985), abrogated on other grounds by In re Colish, 289 B.R. 523 (Bankr. E.D. N.Y. 2002)(wife who was appointed guardian ad litem of her husband by the Supreme Court of the State of New York to file a petition in Bankruptcy was permitted to do the same); see also In re Zawisza, 73 B.R. 929, 932 (Bankr. E.D. Pa. 1987)(an incompetent debtor is not barred from seeking relief in bankruptcy via a court appointed guardian); In re Smith, 115 B.R. 84 (Bankr. E.D. Va. 1990)(an incapacitated or disabled person may file bankruptcy through a guardian or next friend, but not a mere power of attorney unless the power of attorney is expanded to include the power to file bankruptcy

petition on debtor's behalf); <u>In re Myers</u>, 350 B.R. 760, 76263 (Bankr. N.D. Ohio 2006)(an incompetent person may be a debtor in a Chapter 7 case, and the Court may appoint a next friend to act on the debtor's behalf pursuant to Bankruptcy Rule 1004.1 and Section 105); <u>In re Clinton</u>, 41 F.2d 749 (S.D. Cal. 1930)(a person adjudged incompetent may on petition of guardian, as authorized by probate court, be a debtor in bankruptcy); *cf.* <u>In re Raymond</u>, 12 B.R. 906 (Bankr. E.D. Va. 1981)(where wife who only held power of attorney over her Sailor husband, who was serving in the U.S. Navy, could not file a joint petition on her and her husband's behalf); *contra* <u>In re Eisenberg</u>, 117 F. 786 (S.D. N.Y. 1902)(where a state court-appointed committee of debtor-lunatic was restrained from filing a bankruptcy petition on his behalf).

- In re Brown, 645 B.R. 524 (Bankr. D.S.C. 2022). The debtor in Brown was purportedly incompetent and unable to manage financial affairs due to a pre-petition stroke. Upon a Motion to Approve Representative for Debtor, the court was tasked to determine (1) whether the debtor was incompetent at the time of filing and remains so, (2) whether the debtor had a duly appointed represented at the time of filing the petition; (3) if the debtor did not have a duly appointed representative at the time of filing the petition, whether the Intended Representative (the debtor's son) qualifies as a next friend for purposes of filing the petition, and (4) whether the Intended Representative should be appointed as guardian ad litem. In this case, although the Intended Representative properly filed the petition on the debtor's behalf as a "next friend," the Intended Representative cannot continue prosecuting the case in that capacity, as the plain terms of Fed. Bankr. Rule 1004.1 do not provide for the appointment of a "next friend," but instead provides that the court must determine whether to appoint the intended person as guardian ad litem or make another order to protect the debtor. Based on the evidence presented, the Court appointed the debtor's son as guardian ad litem pursuant to Fed Bankr. Rule 1004.1 for the limited purpose of pursuing the case on behalf of the debtor.
- Whitmore v. Arkansas, 495 U.S. 149, 110 S.Ct. 1717, 109 L.Ed.2d 135 (1990). The Supreme Court held that a third-party petitioner does not have standing to challenge the validity of a death sentence imposed on a capital defendant. In so doing, the Court examined the concept of "next friend" standing and made clear that it is not granted automatically to whoever seeks to pursue an action on behalf of another person. Instead, the Court determined that to qualify as a "next friend," a person must first provide an adequate explanation—such as inaccessibility, mental incompetence, or other disability—why the real party in interest cannot appear on his own behalf to prosecute the action. Second, the "next friend" must be truly dedicated to the best interests of the person on whose behalf he seeks to litigate. Finally, the "next friend" should have some significant relationship with the real party in interest. Some bankruptcy courts have adopted these factors in determining whether a person qualifies as a "next friend" under Rule 1004.1. See Maes, 616 B.R. at 800; Brown, 645 B.R. at 529.

Pre-Petition Guardian Ad Litem Fees

The following case displays a slight twist regarding "fringe" debtors and involves how to deal with guardian ad litem fees incurred by the debtor pre-petition.

In re Corson, Case No. 18-10191-PGC (Bankr. D.NH May 21, 2021). Prior to the petition, the debtor and his ex-wife divorced, resulting in a state court order that appointed ex-wife as a guardian ad litem for the debtor's minor children. During his bankruptcy, the debtor filed a proof of claim on his ex-wife's behalf in the amount of \$4,076.26 and asserted that the claim was entitled to priority treatment as a domestic support obligation ("DSO") under §507(a)(1)(A) or (a)(1)(B). Approximately a year later, the chapter 13 trustee objected to the claim; not on the grounds of its validation, but instead arguing that it should be treated as a general unsecured claim (instead of having priority as a DSO). Reviewing multiple interpretations for §101(14A) of the Bankrutpcy Code, the court believed that the "plain meaning" approach hewed most closely to the congressional intent and statutory construction. According to the court, the claim's status as a priority was dependent upon (1) whether the debt is in the nature of support for the debtor's children under §101(14A)(B) and (2) whether the ex-wife was an enumerated person under §101(14A)(A)(i). First, the court determined that it was clear that the guardian ad litem fees owed by the debtor to the ex-wife were in the nature of support (as her services as guardian ad litem supported the debtor's children during the custody and divorce proceeding, and she acted in the "best interests" of the children). However, her status as a payee under §101(14A)(A)(i), was the crucial question in determining whether her claim would be allotted priority status. In concluding that the ex-wife did *not* meet the requirements for §101(14A)(A)(i), the court explained that the ex-wife, in her capacity as guardian ad litem, was not a (i) "spouse, former spouse, or child of the debtor or such child's parent, legal guardian, or responsible relative" or (ii) "governmental unit." Because a "legal guardian" or "guardian" is different than a guardian ad litem, and because New Hampshire law expressly underscored the difference between the terms, providing that a guardian ad litem shall have none of the rights of the general guardian; the court sustained the trustee's objection and allowed the claim as a general unsecured nonpriority claim.

Practice Pointers/Factors to Consider

- Try to identify any competency/capacity issues during consultation(s):
 - o Does the potential client have an understanding of his finances, budget, assets, and debts?
 - Does the client know basic information about himself (address, phone number, social security number)?
 - O Does the potential client need extensive assistance from another person answering basic questions about himself?
 - o Is the potential client sharing bank accounts or other property with others?
 - Has the potential client recently transferred his interest in property to others?
 - Has the potential client recently co-signed on loans for others?

- If there is a question of competency, determine if the potential client has any personal representatives (court-appointed representative or power-of-attorney)
 - O Determine the details of the representation (i.e. the name and contact information of the representative, the date that representative was appointed, and the nature of representation)
 - o Obtain and review any documentation related to the representation
- If the debtor becomes incompetent during representation, determine if the case can continue. If so, a guardian ad lietem or other representative may need to be appointed.

III. Powers of Attorney (POA)

Bankruptcy courts around the country generally have different rules and procedures relating to the use of a power attorney to file bankruptcy petitions on behalf of a debtor. The Federal Rules of Bankruptcy Procedure authorize the use of a power of attorney for specific filings on behalf of creditors (proofs of claims and acceptance or rejection of a plan), but do not offer any guidance with respect to the use of a power of attorney to file a petition on behalf of another person.⁴

Several jurisdictions have promulgated local rules that address the use of a power of attorney to act on behalf of a debtor. Typically, there will be some requirement to provide a copy of the power of attorney or other legal document that allows the representative to act on behalf of the debtor, a signature on all filed documents (petition, schedules, statements, etc.) that reflects the representative capacity of the of the representative, and in some cases, a declaration that provides additional information regarding the representation. Some examples of such local rules are as follows:

- District of New Hampshire Local Rule 9010-2. Power of Attorney; Guardians; Conservators.
 - (a) Commencement of a Bankruptcy Case. If a bankruptcy case is commenced on behalf of a debtor by a representative, i.e., an agent, attorney in fact, proxy, guardian, or conservator, the following procedural requirements shall be met to ensure that the petition has been properly filed.
 - (1) A copy of the legal document under which the representative is acting must be filed with the petition so that the court may determine whether the representative's actions fall within the scope of the representative's authority. In the case of an agent, attorney in fact, or proxy, a power of attorney shall be filed with the court. In the case of a guardian or conservator, the court order appointing the guardian or conservator shall

⁴ Fed. Bankr. Rule 9010(c). Power of Attorney. The authority of any agent, attorney in fact, or proxy to represent a creditor for any purpose other than the execution and filing of a proof of claim or the acceptance or rejection of a plan shall be evidenced by a power of attorney conforming substantially to the appropriate Official Form.

- be filed with the court, along with any other orders describing or limiting the guardian's or conservator's authority to so act.
- (2) The petition, schedules, statements, and other documents in the case shall be properly executed by the representative in a manner which reflects the representative capacity of such person. Both the debtor's and the representative's mailing addresses shall be filed with the court.
- (3) The representative shall appear at the meeting of creditors so that the representative can state on the record the reasons for commencing the case in this manner and answer any questions of the trustee.
- (b) Commencement of an Adversary Proceeding or Contested Matter or Filing of Pleadings. If subsequent to the commencement of a bankruptcy case, any party commences a contested matter or an adversary proceeding, or files any pleadings by a representative, i.e., an agent, attorney in fact, proxy, guardian, or conservator, the procedural requirements set forth above in paragraphs (a)(1)-(2) shall be met to ensure that the contested matter or adversary proceeding has been properly commenced or the pleading has been properly filed.
- District of Maryland Local Rule 1007-3. Power of Attorney and Declaration Required.
 - A petition filed by the holder of a power of attorney (the "Filing Party") must be accompanied by a copy of the power of attorney and the Filing Party's declaration under penalty of perjury ("Declaration"). The Declaration must include (a) the Filing Party's name, address, and relationship to the debtor; (b) whether a guardian or other representative was appointed for the debtor under nonbankruptcy law before the petition was filed; (c) whether the debtor has been adjudicated an incompetent person; (d) whether the power of attorney expressly authorizes the filing of a bankruptcy petition; (e) whether the debtor consents to the bankruptcy filing; (f) the reason for filing the bankruptcy case; (g) whether any of the debtor's debts were incurred for the benefit of the Filing Party and whether the Filing Party is a party in interest in the bankruptcy case; (h) why the debtor is unable to file the petition himself or herself or is otherwise unable to manage his or her financial affairs; and (i) the names and addresses of all immediate family members. The signature on the petition, Declaration, and any other documents signed by the Filing Party must reflect that the Filing Party signed as attorney in fact for the debtor (i.e., "/s/ John Smith, Attorney in fact on behalf of Debtor"). The Filing Party must serve a copy of the petition, the power of attorney, and the Declaration on the debtor, the debtor's immediate family members (if known), any other party required to be served by the instrument which authorized the Filing Party to file the petition, and all parties in interest.
- Southern District of Florida Local Rule 1004.1-1(B) Filing of a Petition by the Holder of a Power of Attorney or Next Friend.
 - (1) Power of Attorney and Declaration Required. A petition filed by the holder of a power of attorney or next friend (the "Filing Party") under Bankruptcy Rule 1004.1 must be accompanied by a copy of the power of attorney, if any, and the Filing Party's declaration under penalty of perjury ("Declaration"). The Filing Party shall serve a copy of the

petition and the Declaration on the debtor, any other party required to be served by the instrument which authorized the Filing Party to file the petition, all creditors, the U.S. Trustee, any governmental entity from which the debtor is receiving funds, and the debtor's closest relative, if known. The Declaration and any attachments must be filed as non-public "restricted documents."

- (2) Contents of Declaration. The Declaration must include the following information:
 - (a) the Filing Party's name, address, and relationship to the debtor;
 - (b) whether a representative was appointed for the debtor under non-bankruptcy law before the petition was filed;
 - (c) if applicable, whether the power of attorney expressly authorizes the filing of a bankruptcy petition, and whether the debtor was a minor or has been adjudicated an incompetent person prior to the date of the power of attorney;
 - (d) whether the debtor consents to the filing of the petition;
 - (e) the reason for filing the bankruptcy petition;
 - (f) if applicable, why the debtor is unable to file the petition himself or herself or otherwise unable to manage his or her financial affairs;
 - (g) whether any of the debtor's debts were incurred for the benefit of the Filing Party; and
 - (h) the names and addresses of any persons known to the Filing Party who may object to the filing of the petition on debtor's behalf.

Practice Pointers/Factors to Consider

- If relying on a power of attorney, review the document to make sure it specifically identifies filing a bankruptcy petition as one of the powers of the attorney-in-fact.
- Review any applicable local bankruptcy rules and procedures as they relate to representing incompetent/incapacitated persons.

IV. Victims of Scams

Vulnerable individuals are often targeted by online romance, sweepstakes, petition preparers, and other scams, leading such individuals to lose significant amounts of money and fall into financial distress. These scams prey on emotions and trust, exploiting people's loneliness or desire for connection. For those affected, bankruptcy can offer a way to regain control by discharging debts and providing a fresh start. While it doesn't reverse the emotional toll, it can help victims of fraud rebuild their financial stability and move forward without the overwhelming burden of scam-related debt. Included in these materials is a report from the U.S. Government Accountable Office ("GAO") detailing examples of the various types of scams and how they are carried out by the perpetrators.⁵

⁵ New York Times Article highlighting personal examples of individuals that have been scammed out of significant sums of money https://www.nytimes.com/2025/03/08/your-money/taxes-retirement-withdrawal-

"Pig butchering" scams resemble the practice of fattening a hog before slaughter. Victims invest in supposedly legitimate virtual currency investment opportunities before they are conned out of their money. Scammers refer to victims as "pigs," and may leverage fictitious identities, the guise of potential relationships, and elaborate storylines to "fatten up" the victim into believing they are in trusted partnerships before they defraud the victims of their assets—the "butchering." These scams are largely perpetrated by criminal enterprises based in Southeast Asia who use victims of labor trafficking to conduct outreach to millions of unsuspecting individuals around the world. For a satirical but informative take on "pig butchering" scams, see Last Week Tonight with John Oliver episode from February 29, 2024.

Types of Common Financial Scams

- i) Romance/relationship scam. Scammer adopts a fake online identity to gain a victim's affection (romantic or platonic) and trust and then uses the illusion of a romantic or close relationship.⁷
- ii) Government impersonation scam. Scammer fraudulently identifies as a government official to manipulate or steal from the victim.⁸
- iii) *Investment scam.* Scammer offers low or no risk investments, guaranteed returns, overly consistent returns, complex strategies, or unregistered securities to manipulate or steal from the victim. ⁹ Cryptocurrency scams would be included in this category.
- iv) Business email compromise scam. Scammer targets a business or individual and takes over an official account or uses email spoofing to attempt to redirect payments to an illicit account controlled by the fraudster to steal from the victim.¹⁰
- v) Debt Relief Scams. Scammers falsely claim they will help eliminate a victim's debt and convince the victim to pay significant fees for this service.
- vi) "Bankruptcy Fraud Watchdog Group" letters. Scammers may threaten debtors with legal consequences or make false claims related to bankruptcy to extort money. Here, scammers identifying themselves as the "Bankruptcy Fraud Watchdog Group" send letters to debtors

<u>scam.html?unlocked_article_code=1.4U4.leUj.lLv3Dk18UXjE&smid=nytcore-ios-share&referringSource=articleShare</u>

⁶ FinCEN Issues Alert on Prevalent Virtual Currency Investment Scam Commonly Known as "Pig Butchering", September 8, 2023, available at https://www.fincen.gov/news/news-releases/fincen-issues-alert-prevalent-virtual-currency-investment-scam-commonly-known

⁷ GAO-24-107107 Payment Scams

⁸ *Id*.

⁹ *Id*.

¹⁰ *Id*.

falsely accusing them of failing to disclose assets in their bankruptcy cases. The debtors are then instructed to pay an "amnesty fee" of \$450 in Bitcoin via a QR code.¹¹

vii) *Post-discharge scams*. Scammer, often impersonating the debtor's attorney or trustee contacts a debtor who has received a discharge, falsely claiming that certain debts were not discharged in the bankruptcy and tries to collect on them.

Key Takeaways¹²

- Fraudulently induced payment scams can take many forms, including the use of generative artificial intelligence (AI) technology that can create text, images, audio, or video, making these scams harder for victims to detect.
- Financial institutions are generally <u>not</u> required under federal law to reimburse consumers for losses stemming from a fraudulently induced payment because such a payment is authorized by a person with payment authority on the account (i.e., the owner of the account or other authorized person).

Tax Implications of Scams

Victims of scams often use funds from a pre-tax retirement account to pay scammers. As a result, these victims may incur a tax liability for these withdrawals and, in some cases, they may also incur early withdrawal penalties if funds are withdrawn prior to the victim reaching the designated age of eligibility.

To prevent such taxation on funds lost as a result of fraud, the tax code provided for a casualty and theft loss deduction, which allowed an individual to take a tax deduction for "losses actually sustained during the year, incurred in his business or in trade, or arising from fires, storms, shipwreck, or other casualty, and from theft, when such losses are not compensated for by insurance or otherwise." The theft loss provision had protected scam victims from having to pay income taxes on stolen funds. ¹³

The casualty and theft loss deduction was amended several times over the years to limit its use, but it continued to offer those taxpayers who were eligible to use it a critical tool to limit their tax liability on lost income.¹⁴

https://govtrackus.s3.amazonaws.com/legislink/pdf/stat/39/STATUTE-39-Pg756.pdf#page=4.

¹¹ US Trustee Program Fraud Alert, November 15, 2024. https://www.justice.gov/ust/notice/us-trustee-program-warns-consumers-bankruptcy-fraud-alert-scam.

¹² *Id*

¹³ The Revenue Act of 1916, P.L. No 64-271, 39 Stat. 759,

^{14 &}quot;Scammed then taxed: How the Republican Tax Bill Hiked Taxes on Fraud Victims", available at https://www.aging.senate.gov/imo/media/doc/scammed then taxed how the republican tax bill hiked taxes on fraud-victims.pdf

The Tax Cuts and Jobs Act (TCJA) passed in 2017 modified the casualty and theft loss deduction that had been a part of the tax code for over a century in a way that essentially restricted its use solely to losses related to federally declared disasters. ¹⁵ As a result, victims of scams are not able to deduct those losses on their taxes and are often obligated to pay taxes on money that has been stolen from them. The provision in the TCJA limiting the effectiveness of the casualty and theft loss deduction is set to expire in 2025.¹⁶

Adversary Proceedings

The case of In re Hunt, 439 B.R. 690 (Bankr. N.D. Ind. 2010) displays the, at times, unfortunate consequences felt by family members as a result of a debtor's vulnerability, negligence, and bad choices. In Hunt, the debtor fell victim to two internet "advance fees" scams - one involving trunks that were smuggled out of the Middle East containing cash and securities, and the other involving an inheritance in Ghana. In both instances, the debtor was asked to pay taxes and other fees associated with the scams, ultimately resulting in a loss of several hundreds of thousand dollars. Unfortunately, half of those dollars (\$149,709 to be precise) came from the trust that he established for his son. The aggrieved son initiated an adversary proceeding against the debtor, his father asserting that his father's decision to use the trust's funds for such "investments" violated Indiana's Prudent Investor Act and constituted defalcation in a fiduciary capacity, resulting in an obligation that should be nondischargeable under §523(a)(4). The court explained the elements for defalcation and analyzed whether the debtor's conduct fit the parameters. Willfulness requires an intentional injury, not just an intentional act that leads to injury. Recklessness does not require intent; in this context it involves a complete indifference to the consequences of one's actions. The court determined that the father's actions were not willful, knowing, or reckless. The debtor did not know these were bad investments or intend on losing substantial amounts of both his own money and the trust's money. Based on the foregoing, the court found that the debtor was undoubtedly negligent in his own choice of investments for both himself and the trust, however, his actions did not constitute defalcation under §523(a)(4), and any obligation he may have had to the plaintiff/son was dischargeable.

In Landmark Credit Union v. Ammons (In re Ammons), 2015 Bankr. LEXIS 2842 *; 2015 WL 5063935, Landmark filed a nondischargeability proceeding against the Debtor under §523(a)(2)(A), for incurring a debt to the credit union by depositing a check which later turned out to be dishonored. The proceeding was dismissed after the credit union failed to show that the Debtor intended to deceive the creditor.

In Neary v. McCarthy (In re McCarthy), 418 B.R. 745 (E.D. Wis. 2009), The debtors' real estate investments involved a scam orchestrated by a third party. The debtors contended that they were innocent investors who were victimized by the third party, while the UST contended that they were in cahoots with him. The UST failed to establish by a preponderance of the evidence all of the elements necessary for denial of a discharge under $\int 727(a)(4)(A)$. Although the debtors were educated and had business experience, the court concluded that they were credible and had no

¹⁵ *Id*.

¹⁶ Congressional Research Service, The 2017 Tax Revision (P.L. 115-97); Comparison to 2017 Tax Law (February 6, 2018), at 1 and 15-16, https://crsreports.congress.gov/product/pdf/R/R45092

fraudulent intent. The court noted that an investigator for the state concluded that the debtors were only passive investors and were victims of a scam. With respect to $\S727(a)(5)$, the UST did not make the initial prerequisite showing that substantial and identifiable assets were no longer available to the debtors' creditors. The purchase prices paid by the debtors for various parcels of real estate were well in excess of their fair market values, and the inflated prices were part of the scam perpetrated on them. In making pre-bankruptcy transfers, the debtors reasonably relied on the advice of their bankruptcy counsel, which negated the element of fraudulent intent required in $\S727(a)(2)$.

Practice Pointers/Factors to Consider

- Identify Red Flags. Many victims are embarrassed or otherwise hesitant to share the circumstances of their situation. Look out for inconsistencies, blind spots, retirement account disbursements, significant tax debt, or other signs that indicate the potential debtor may have incurred debt as a result of fraudulent inducement.
- Discuss red flags with potential clients and develop a plan on how best to proceed with bankruptcy.
 - Ask potential clients questions about inconsistencies you have identified and get them to elaborate on their answers until you have a clear understanding of the situation.
 - o Explain to them the importance of full disclosure to the court and the ramifications of their failure to do so.
 - o If there is a tax liability that resulted from a scam, determine whether all necessary tax returns have been filed and whether the tax liability would be treated as a priority claim and/or whether it would be dischargeable in bankruptcy.
- Documentation. If you are aware that a potential client has been a victim of a scam, obtain as much documentation as possible regarding the scam (for example letter of explanation, police report, or any other evidence to help explain the situation to court/trustee or even combat an avoidance and/or exception to discharge action).
- Prepare for potential inquiries from the bankruptcy court, the US Trustee and the standing trustee. Advise your potential client that they may be subject to additional questioning at a 341 meeting of creditors or a Rule 2004 examination. They may also need to provide additional documentation not collected prior to the filing of the case.

616 B.R. 784 United States Bankruptcy Court, D. Colorado.

IN RE: Jennie Adelle MAES, Debtor.

Bankruptcy Case No. 19-17160 TBM | Signed 05/20/2020

Synopsis

Background: After daughter of debtor with severe dementia and memory loss, as debtor's purported attorney-in-fact, filed petition for bankruptcy relief using power of attorney (POA) that later was found to be invalid, debtor, through daughter and counsel, sought confirmation of proposed Chapter 13 plan. Trustee objected to confirmation on the basis of incapacity and requested that case be dismissed or converted. Debtor filed motion to determine authority to proceed, to which trustee objected.

Holdings: The Bankruptcy Court, Thomas B. McNamara, J., held that:

- [1] under Colorado law, neither of the two POAs signed by debtor was effective;
- [2] debtor was **incompetent** when her daughter signed and filed the bankruptcy petition;
- [3] debtor did not have a "representative" when her daughter signed and filed the petition;
- [4] debtor's daughter qualified as debtor's "next friend" when she signed and filed the petition; and
- [5] the court would appoint daughter as debtor's **guardian** ad **litem** and fiduciary solely for purposes of the bankruptcy proceedings.

Ordered accordingly.

Procedural Posture(s): Objection to Confirmation of Plan; Motion to Convert or Dismiss Case; Other.

West Headnotes (24)

[1] Bankruptcy 🕪 Petition

Although neither the Bankruptcy Code nor rules expressly mandates that a bankruptcy debtor sign the petition and most other bankruptcy documents, the Official Forms prescribed by the Judicial Conference of the United States require the signature of the debtor or someone otherwise properly authorized to sign for the debtor. 11 U.S.C.A. §§ 301, 302; Fed. R. Bankr. P. 1002, 1007, 1008, 9009.

[2] Bankruptcy 🕪 Petition

Bankruptcy Schedules and Statement of Affairs

Debtors must sign the bankruptcy petition, schedules, and Statement of Financial Affairs (SOFA) as a means of not only authorizing the filing of these documents, but of verifying, under penalty of perjury, that they have reviewed the information contained therein and that it is true and correct to the best of their knowledge, information, and belief. Fed. R. Bankr. P. 9009.

[3] Bankruptcy 🕪 Who May Institute Case

Under the Colorado Uniform Power of Attorney Act (CUPOA), Chapter 13 debtor's daughter was not an "attorney-in-fact" for debtor and was not properly authorized to direct that her bankruptcy petition be filed, where none of the conditions required for the first power of attorney (POA) to become effective occurred and it was questionable whether debtor, who had severe dementia and memory loss, had the capacity to execute that document, and second POA was executed after the petition date and after debtor had been diagnosed with severe dementia. Colo. Rev. Stat. Ann. § 15-14-701 et seq.

[4] Bankruptcy 🕪 Who May Be a Debtor

Bankruptcy rule governing petitions for infants or **incompetent** persons was added to the Federal Rules of Bankruptcy Procedure to address, among other things, recurring issues found in bankruptcy filings made on behalf of **incompetent** persons and whether bankruptcy courts are authorized to appoint **guardians ad litem**. Fed. R. Bankr. P. 1004.1.

[5] Bankruptcy ← Who May Be a Debtor
Bankruptcy ← Cause in general
Bankruptcy ← Determination of Issues;
Dismissal

Bankruptcy rule governing petitions for infants or **incompetent** persons generally applies when a debtor is **incompetent** at the time of the commencement of the bankruptcy case, while a companion procedural rule governing death or **incompetency** of debtor applies if a debtor becomes **incompetent** during the pendency of the bankruptcy case. Fed. R. Bankr. P. 1004.1, 1016.

[6] Bankruptcy → Who May Institute Case Mental Health → Necessity of appointment

Bankruptcy rules addressing competency require bankruptcy court to engage in a decision tree of determinations when **incompetency** issues are raised: first, to decide which rule applies, court must decide whether debtor was incompetent when petition was filed or whether she became incompetent after commencement of case; second, court must determine if debtor had formal "representative" at time of petition, such as a general guardian, committee, conservator, or similar fiduciary, and whether that person filed petition; third, if debtor had no formal "representative," court must decide whether petition was filed by a "next friend" or guardian ad litem, and if guardian ad litem initiated and signed petition, inquiry is complete and case may proceed; but fourth, if only a next friend started the bankruptcy proceedings, court must appoint a guardian ad litem or take other action to protect the incompetent debtor, and cannot just let the

next friend continue along in prosecuting case. Fed. R. Bankr. P. 1004.1, 1016.

1 Case that cites this headnote

[7] Bankruptcy Particular proceedings or issues

Although **incompetency** determinations are not the common province of bankruptcy courts, and neither the Bankruptcy Code nor the Federal Rules of Bankruptcy Procedure defines the term "**incompetency**," the bankruptcy rule governing petitions for infants or **incompetent** persons provides full authorization for bankruptcy courts to make **incompetency** determinations for bankruptcy purposes in appropriate circumstances. Fed. R. Bankr. P. 1004.1.

[8] Mental Health Persons subject to control or treatment

Under Colorado law, the central consideration making an "**incompetency**" determination is whether the individual is incapable of participating effectively in communication and decision-making.

1 Case that cites this headnote

[9] Bankruptcy 🕪 Who May Be a Debtor

Under the bankruptcy rule governing petitions for infants or incompetent persons, Chapter 13 debtor was "incompetent," with respect to her financial affairs and for purposes of her bankruptcy case, when her daughter, as her purported attorney-in-fact, signed and filed her bankruptcy petition; debtor had severe dementia and memory loss, debtor's condition was confirmed by her physician and three close relatives, debtor's physician also opined that debtor was incapable of handling her financial affairs, both on the petition date and thereafter, and there was no contrary evidence, such that debtor was unable to participate effectively in communication and decision-making about her financial condition when her daughter filed for bankruptcy protection. Fed. R. Bankr. P. 1004.1.

1 Case that cites this headnote

[10] Bankruptcy 🕪 Who May Be a Debtor

For purposes of the bankruptcy rule governing petitions for infants or **incompetent** persons, severe dementia and memory loss are archetypical examples of "**incompetency**." Fed. R. Bankr. P. 1004.1.

[11] Bankruptcy 🕪 Who May Institute Case

Although neither the Bankruptcy Code nor the Federal Rules of Bankruptcy Procedure defines the word "representative," the bankruptcy rule governing petitions for infants or **incompetent** persons gives illustrative examples: a general guardian, committee, conservator, or similar fiduciary. Fed. R. Bankr. P. 1004.1.

[12] Bankruptcy P Who May Institute Case

Under the bankruptcy rule governing petitions for infants or **incompetent** persons, which provides that the representative of an infant or **incompetent** person may file a voluntary petition on such person's behalf, the holder of a valid durable power of attorney may qualify as a "representative" without a separate appointment by the bankruptcy court. Fed. R. Bankr. P. 1004.1.

[13] Bankruptcy 🕪 Who May Institute Case

Chapter 13 debtor did not have a "representative" within the meaning of the bankruptcy rule governing petitions for infants or **incompetent** persons when her daughter, as her purported attorney-in-fact, signed and filed her bankruptcy petition; debtor did not have a general guardian, committee, or conservator upon commencement of the bankruptcy case, because neither power of attorney (POA) executed by debtor and her daughter was effective, debtor did not have an agent under an effective and valid durable POA, and there was no evidence that anyone else acted in a fiduciary capacity vis-à-vis debtor. Fed. R. Bankr. P. 1004.1.

[14] Bankruptcy 🕪 Who May Institute Case

If a debtor is **incompetent** but does not have a representative, the bankruptcy rule governing petitions for infants or **incompetent** persons allows a "next friend or **guardian ad litem**" to file for bankruptcy on behalf of such debtor. Fed. R. Bankr. P. 1004.1.

[15] Bankruptcy P Who May Institute Case

For purposes of the bankruptcy rule governing petitions for infants or **incompetent** persons, which allows a next friend or **guardian ad litem** to file for bankruptcy on behalf of an **incompetent** debtor who does not have a representative, the term "**guardian ad litem**" means guardian "for the lawsuit" or "for the litigation." Fed. R. Bankr. P. 1004.1.

[16] Mental Health • Guardian Ad Litem or Next Friend

Colorado state law ties the appointment of a "guardian ad litem" to a specific proceeding or lawsuit.

[17] Bankruptcy • Who May Institute Case

In the bankruptcy context, the term "next friend" is broad enough to include anyone who has an interest in the welfare of an infant or **incompetent** person who may have a grievance or a cause of action. Fed. R. Bankr. P. 1004.1.

2 Cases that cite this headnote

[18] Bankruptcy 🕪 Who May Institute Case

For purposes of the bankruptcy rule governing petitions for infants or **incompetent** persons, which allows a next friend or **guardian ad litem** to file for bankruptcy on behalf of an **incompetent** debtor who does not have a representative, a "next friend" is different than a "**guardian ad litem**"; the main difference is that a "next friend" is not appointed by a court and

In re Maes, 616 B.R. 784 (2020)

does not have any fiduciary obligations. Fed. R. Bankr. P. 1004.1.

1 Case that cites this headnote

[19] Bankruptcy 🕪 Who May Institute Case

For purposes of the bankruptcy rule governing petitions for infants or **incompetent** persons, which allows a next friend or **guardian ad litem** to file for bankruptcy on behalf of an **incompetent** debtor who does not have a representative, a "next friend" must provide an adequate explanation as to why the real party in interest cannot appear on his own behalf to prosecute the action, and the "next friend" must be truly dedicated to the best interests of the person on whose behalf he seeks to litigate. Fed. R. Bankr. P. 1004.1.

3 Cases that cite this headnote

[20] Bankruptcy > Who May Institute Case

For purposes of the bankruptcy rule governing petitions for infants or **incompetent** persons, which allows a next friend or **guardian ad litem** to file for bankruptcy on behalf of an **incompetent** debtor who does not have a representative, the burden is on the "next friend" clearly to establish the propriety of his status. Fed. R. Bankr. P. 1004.1.

1 Case that cites this headnote

[21] Bankruptcy 🧼 Who May Institute Case

Under the bankruptcy rule governing petitions for infants or **incompetent** persons, which allows a next friend or **guardian ad litem** to file for bankruptcy on behalf of an **incompetent** debtor who does not have a representative, Chapter 13 debtor's daughter qualified as debtor's "next friend" when she signed and filed the bankruptcy petition for debtor; debtor, who had severe dementia and memory loss and, according to her treating physician, was incapable of making financial decisions, could not appear on her own behalf to sign the petition and other bankruptcy documents, daughter, as debtor's caregiver, demonstrated that she had

a "significant relationship" with debtor and was dedicated to her interests, and the parties stipulated that daughter was "next friend" of debtor, Fed. R. Bankr. P. 1004.1.

1 Case that cites this headnote

[22] Bankruptcy Who May Institute Case Mental Health Authority to appoint

Although most **guardian ad litem** appointments are made in the context of state-court proceedings, bankruptcy courts are authorized to appoint **guardians ad litem** in main bankruptcy cases pursuant to the bankruptcy rule governing petitions for infants or **incompetent** persons. Fed. R. Bankr. P. 1004.1.

[23] Bankruptcy → Who May Institute Case Mental Health → Necessity of appointment

Bankruptcy rule governing petitions for infants or **incompetent** persons explicitly requires the appointment of **guardians ad litem**, not next friends, when an **incompetent** person is a debtor and is not otherwise represented. Fed. R. Bankr. P. 1004.1.

[24] Bankruptcy → Who May Institute Case Mental Health → Necessity of appointment

Under unique circumstances of case, bankruptcy court would appoint Chapter 13 debtor's daughter as her guardian ad litem and fiduciary, solely for purposes of bankruptcy proceedings, pursuant to the bankruptcy rule governing petitions for infants or **incompetent** persons, where debtor, who had severe dementia and memory loss, was **incompetent** when petition was filed and remained so, debtor did not have a "representative," debtor had special relationship with daughter, who had filed petition as debtor's purported attorney-in-fact pursuant to power of attorney (POA) that was later found to be invalid, daughter had acted only in capacity of "next friend" in the proceedings, there were no funds to pay a third-party guardian ad litem, and, though debtor through counsel apparently

preferred daughter's appointment as next friend, having proceedings administered by next friend lacking specific duties or obligations would have been unclear and problematic, and contrary to plain reading of rule. 11 U.S.C.A. § 1303; Fed. R. Bankr. P. 1004.1.

Attorneys and Law Firms

*788 Robert S. Sutton, Golden, CO, for Debtor.

MEMORANDUM OPINION AND ORDER ON DEBTOR'S MOTION TO DETERMINE AUTHORITY TO PROCEED

Thomas B. McNamara, United States Bankruptcy Judge

I. Introduction.

Suffering from severe dementia and memory loss, Jennie Adelle Maes (the "Debtor") — a poor, elderly widow living primarily off of Social Security benefits - forgot to make some of her monthly mortgage payments. So, her secured lender started foreclosure proceedings against her sole significant asset: her home. The Debtor's only daughter, Juanita Maes, caught wind of the circumstances and began to assist the Debtor in managing her financial affairs. She had the Debtor sign a power of attorney. Then, in order to stop the foreclosure proceedings and save the Debtor's only shelter, the Debtor's daughter filed a petition for relief under Chapter 13 of the Bankruptcy Code ¹ for her mother. *789 The Debtor's daughter signed the bankruptcy petition and other related bankruptcy documents this way: "Juanita Maes, as attorney-in-fact for Jennie Adelle Maes." Next, the Debtor, through her daughter, filed a Chapter 13 Plan proposing to continue payments to the Debtor's lender as well as make up the missed mortgage payments over time. On its face, it appeared to be a solid effort to "reorganize" and save the Debtor's home while paying off the only secured creditor.

But, there was a problem. The power of attorney, upon which Juanita Maes relied, was not effective. The Chapter 13 Trustee, to his credit, identified the issue. All the parties now agree (in retrospect) that the Debtor's daughter lacked valid written authorization to file bankruptcy for her mother. It turns

out that Juanita Maes was not an "attorney-in-fact" for the Debtor. So, the Chapter 13 Trustee requested that the Court deny confirmation of the Debtor's proposed Chapter 13 Plan and dismiss the bankruptcy case or convert it to a liquidation under Chapter 7.

No longer able to rely upon any alleged "attorney-in-fact" status under the ineffective power of attorney, Debtor's counsel shifted to another potential legal basis to justify Juanita Maes' actions and maintain the bankruptcy case. The Debtor, through her daughter and counsel, contends that the insolvency proceedings are still valid and may proceed in Chapter 13 pursuant to Fed. R. Bankr. P. 1004.1 because the Debtor was "incompetent" when the bankruptcy petition was filed by her daughter, who qualifies as her "next friend."

To resolve this thorny and technical legal dilemma, the Court must assess the Debtor's competency and her daughter's role in filing the bankruptcy petition. In the end, the Court concludes that the Debtor was (and is) **incompetent** to make her own financial decisions by virtue of her severe dementia and memory loss. In these circumstances, even though the Debtor's daughter had no effective authorization as an "attorney-in-fact" under a power of attorney, she still was permitted to act as her mother's "next friend" to protect her mother's best interests. That is what she did. Thus, the bankruptcy petition was valid and the bankruptcy case may continue. However, going forward, Juanita Maes' role must be formalized. The Court appoints the Debtor's daughter as her "guardian ad litem" and fiduciary solely for purposes of this bankruptcy case.

II. Jurisdiction and Venue.

This Court has jurisdiction to enter final judgment on the issues presented in this bankruptcy case pursuant to 28 U.S.C. § 1334. The dispute is a core proceeding under 28 U.S.C. §§ 157(b)(2)(A) (matters concerning administration of the estate), (b)(2)(L) (confirmation of plans), and (b)(2)(O) (other proceedings affecting the liquidation of the assets of the estate). Venue is proper in this Court pursuant to 28 U.S.C. §§ 1408 and 1409.

III. Procedural Background.

In re Maes, 616 B.R. 784 (2020)

This bankruptcy case was commenced by the filing of a Petition for relief under Chapter 13 of the Bankruptcy Code on August 19, 2019. The Debtor did not sign *790 the Petition. Instead, the Petition was signed and filed by "Juanita Maes, as attorney-in-fact for Jennie Adelle Maes." The Debtor's Statement of Financial Affairs and Schedules also were signed and filed by "Juanita Maes, as attorney-in-fact for Jennie Adelle Maes," not by the Debtor. 4

The same day the Petition was filed, the Debtor proposed a Chapter 13 Plan. ⁵ As with the other Court filings, "Juanita Maes, as attorney-in-fact for Jennie Adelle Maes," not the Debtor, signed and verified the Chapter 13 Plan. ⁶ All payments proposed under the Chapter 13 Plan have been made on time so far. ⁷ In bankruptcy vernacular, the Debtor is "current with plan payments."

The Chapter 13 Trustee objected to the Chapter 13 Plan. ⁹ In the Plan Objection, the Chapter 13 Trustee stated:

The petition was signed by a power of attorney, however, based upon the information provided at the meeting of creditors, the power of attorney provided to the Trustee may not be valid. Debtor was not in attendance at the meeting of creditors and upon information provided it is possible that the Debtor did not have the requisite capacity to sign the power of attorney and there has not been a court determination to determine the Debtor's capacity.

Based upon the foregoing, the Chapter 13 Trustee requested that the Court deny confirmation of the Chapter 13 Plan and dismiss or convert the bankruptcy case. ¹⁰ The Chapter 13 Trustee presented no objections to confirmation of the Chapter 13 Plan other than the capacity objection.

Subsequently, the Debtor (through counsel) filed a "Motion to Determine Authority to Proceed." ¹¹ In the Motion to Determine Authority, the Debtor's counsel recited that the Debtor's daughter, Juanita Maes, had initiated contact

concerning a possible bankruptcy filing. Debtor's counsel advised Juanita Maes that she needed to have a valid power of attorney to file a case on the Debtor's behalf. According to Debtor's counsel, Juanita Maes provided two powers of attorney: one power of attorney was not executed; the other power of attorney was not effective. However, the Debtor's counsel filed the bankruptcy Petition anyway. After the bankruptcy, the Debtor apparently signed yet another power *791 of attorney. In any event, the Debtor, through the Debtor's counsel, requested that the Court "allow the case to proceed by and through her power of attorney agent Juanita Maes, Jennie Maes' daughter." ¹²

Thereafter, the Chapter 13 Trustee objected to the Motion to Determine Authority. The Chapter 13 Trustee argued that all three of the Powers of Attorney were invalid for various reasons. Citing Fed. R. Bankr. Pro. 1004.1, the Chapter 13 Trustee suggested that "it may be appropriate for the Court to consider appointing a guardian ad litem for the Debtor in order for the case to proceed." ¹³

The Court conducted a non-evidentiary hearing on the Motion to Determine Authority. ¹⁴ At the hearing, Debtor's counsel conceded that Juanita Maes did not have a valid power of attorney at the time the bankruptcy case was filed. Further, Debtor's counsel and the Chapter 13 Trustee agreed that an evidentiary hearing would be required to determine: (1) whether the Debtor was **incompetent** at the time her daughter filed the Petition in this case; (2) if the Debtor was in fact **incompetent**, whether Juanita Maes properly may be considered a "next friend" of the Debtor; and (3) whether the Court should appoint a **guardian ad litem** or issue any other protective order for the benefit of the Debtor. Accordingly, the Court set an evidentiary hearing on the capacity issues.

Thereafter, both the Debtor's counsel and the Chapter 13 Trustee submitted simultaneous legal briefs addressing the legal and factual issues. ¹⁵ At the Parties' request, the Court set a trial on March 20, 2020. However, the Parties later agreed to forego an evidentiary hearing and instead submit the issues for consideration by the Court based only upon: (1) a Statement of Stipulated Facts ¹⁶; (2) an Affidavit of Dr. William Bauer ¹⁷; (3) an Affidavit of Juanita Maes ¹⁸; (4) the Debtor's Exhibits A-L; and (5) the Chapter 13 Trustee's Exhibits 1-6. ¹⁹

The Court took the matter under advisement. Subsequently, the Court reviewed all the foregoing evidence and written

legal arguments submitted by the Parties. The Court concurs that it has a sufficient factual record upon which to reach legal conclusions on the various legal issues presented by the Parties.

IV. Findings of Fact

Based upon the evidentiary record presented by the Parties, the Court makes the following findings of fact under Fed. R. Civ. P. 52(a)(1), as incorporated by Fed. R. Bankr. P. 7052.

A. The Debtor and Her Family, Income, Assets, and Debts.

The Debtor is an 84-year old widow whose parents are deceased. ²⁰ She has one *792 surviving sister and four adult children. ²¹ Her eldest son is William Maes. He is 55 years old, suffers from schizoaffective disorder, and lives with the Debtor. ²² The Debtor's second son is Daniel Maes. He is 52 years old, suffers from schizophrenia and resides in an assisted living facility: Alpine Living Center. ²³ The Debtor's third son is Chris Maes. He is 51 years old and resides with the Debtor. ²⁴ Finally, the Debtor's youngest child is her only daughter: Juanita Maes. She is 46 years old and lives in Westminster, Colorado. ²⁵

The Debtor is unemployed. ²⁶ Her sole source of income is Social Security benefits and family financial support. ²⁷ She receives monthly social security benefits of \$986 and a monthly contribution of about \$900 from one of her sons. ²⁸ After subtracting her expenses, the Debtor has about \$286 in monthly net income. ²⁹ It is not much.

The Debtor has very few assets. She owns some household goods, clothes, a coin collection, and a bank account all of fairly nominal value. ³⁰ Her only significant asset is her three-bedroom home located at located at 745 S. 4th Ave., Brighton, Colorado (the "Real Property.") ³¹ She owns the Real Property and lives there along with her sons William and Chris Maes. ³² According to the Debtor's Schedules, the Real Property is worth \$226,039. ³³ However, the Real Property is encumbered by a mortgage held by J.P. Morgan Chase Bank, N.A. (the "Bank"). ³⁴ When the bankruptcy case was filed, the Debtor asserted that she owed about

\$131,800 on the secured debt.³⁵ The Bank filed a slightly larger proof of claim for \$132,381, including \$6,967 in prepetition arrearages.³⁶ The Debtor's other debts are nominal. Only two parties filed unsecured claims which, together, total \$4,911.³⁷ And, the claims bar date has passed.³⁸

The Debtor, through her daughter, filed for Chapter 13 bankruptcy protection to save the Debtor's home from imminent foreclosure by the Bank. As set forth below, the Debtor suffered (and continues to suffer) from severe dementia and memory loss such that she forgot or failed to timely pay her home mortgage of about \$719 per month. She got behind and was about to lose the only shelter she had for herself and her two sons.

B. The Debtor's Medical Condition.

The Debtor suffers from poor health. She has chronic kidney disease, hypertension, and hypothyroidism. ³⁹ More recently (but before her bankruptcy filing), she developed severe dementia and memory *793 loss. ⁴⁰ Just a few months before the Petition, the Debtor visited one of her primary physicians: Dr. William Joseph Bauer. He reaffirmed a diagnosis of severe dementia and opined that she "would not be able to complete her routine financial affairs." ⁴¹ Later, Dr. Bauer provided an Affidavit stating:

It is my opinion that Jennie Maes was incapable of handling her financial affairs on August 19, 2019 and that she remains incapable of handling her financial affairs. 42

Although not medical professionals, the Debtor's family also concurs that the Debtor suffers from severe dementia and memory loss. The Debtor's daughter, Juanita Maes testified that "my mother suffers from severe dementia" and "my mother ... has been having difficulty for some time now due to dementia. She has become increasingly forgetful" ⁴³ The Debtor's son, Chris Maes, stated that "my mother ... has been suffering with Dementia and has had difficulty with handling finances" ⁴⁴ The Debtor's sister agreed too. ⁴⁵

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The Court has received no contrary evidence about the Debtor's severe dementia. Indeed, the Parties stipulated:

Debtor currently suffers from severe dementia and was suffering from severe dementia at the time of filing of her bankruptcy petition. 46

Thus, the Court finds that the Debtor had severe dementia when she filed for bankruptcy protection (through her daughter) and the Debtor was not able to manage her financial affairs. Further, those conditions have continued to the present.

C. <u>Juanita Maes' Role in Assisting the Debtor and Filing for Bankruptcy</u>.

Juanita Maes is the Debtor's only daughter. She is employed as a Resident Medication Assistant at Atria Westminster. ⁴⁷ She appears to have her mother's best interests in mind and at heart. For example, she has accompanied her mother to most of her regular medical appointments. ⁴⁸ After she became aware of her mother's memory loss and dementia, she started to "help take care of [the Debtor's] finances in April 2019." ⁴⁹ She discovered that her mother was forgetting to make her monthly mortgage payments to the Bank and, as a result, the Bank commenced foreclosure proceedings on the Real Property. ⁵⁰ She stepped in to try to assist in the Debtor's finances. She engaged bankruptcy counsel and directed the filing of the bankruptcy Petition for her mother. The Parties stipulated that "Debtor's case was filed at the direction of her daughter. Juanita Maes, as next friend," ⁵¹

Juanita Maes is willing to continue to assist her mother. She testified:

I am aware of all my mother's financial obligations and am able to assist her is making sure all payments are made. I arrange and take my mother to all of her necessary appointments. I am able to continue to care for my mother as care taker for both her medical and

financial needs. I have not gained any *794 financial benefit from assisting my mother with her affairs, not do I seek any compensation. ⁵²

Juanita Maes, her brother, Chris Maes, and her maternal aunt, Frances Hunter, all concur that it would be in the Debtor's best interests for Juanita Maes to continue to manage her mother's affairs and make financial decisions for the Debtor. ⁵³ No party has come forward to argue otherwise. ⁵⁴

D. The Lack of Legal Authorization.

When she directed that the Petition be filed commencing this bankruptcy case for her mother, Juanita Maes believed that she was authorized to do so by virtue of a Power of Attorney. ⁵⁵ Thus, she signed the Petition and other required bankruptcy documents as "Juanita Maes, as attorney-in-fact for Jennie Adelle Maes." She was mistaken.

The Debtor signed a "General Durable Power of Attorney" on June 14, 2019 whereby the Debtor purported to appoint Juanita Maes as her agent for financial affairs and other purposes. ⁵⁶ However, according to the terms of the First POA, it "will only become effective" if: (1) two physicians provide written opinions that the Debtor cannot effectively manage my property or financial; (2) a court of competent jurisdiction declares that the Debtor is disabled, **incompetent**, or legally incapacitated; or (3) the Debtor is incapacitated by virtue of having disappeared for more than thirty days or having been detained under duress. The Court has not received any evidence establishing that any of the conditions for the First POA to become effective occurred. Furthermore, the First POA was executed by the Debtor at a time when she already had been diagnosed with severe dementia. Accordingly, the Court questions the capacity of the Debtor to execute the First POA.

Given the problems with the First POA, the Debtor executed a second "General Durable Power of Attorney" on October 11, 2019. ⁵⁷ The Second POA did not have the conditions for effectiveness like the First POA. Instead, the Second POA purported to become effective "as of the date of this instrument." However, the POA was executed after the Petition date and is quite suspect since the Debtor already had been diagnosed with severe dementia.

In any event, the Debtor has expressly conceded, through counsel, that neither the First POA nor the Second POA were effective to authorize Juanita Maes to file the bankruptcy Petition for the Debtor. Furthermore, as of the Petition date, no guardian, conservator, or other representative had been appointed for the Debtor by any court or otherwise. ⁵⁸

V. Conclusions of Law

A. <u>General Legal Framework Governing Executing a</u> Petition and an <u>Incompetent</u> Debtor.

[1] The Bankruptcy Code does not expressly mandate that a bankruptcy debtor *795 sign the petition and most other bankruptcy documents. *In re Benton*, 2016 WL 721487, at *6-7 (Bankr. E.D. Mich. Feb. 12, 2016). The closest statute is Section 301(a) which merely provides:

A voluntary case under a chapter of this title is commenced by the filing with the bankruptcy court of a petition under such chapter by an entity that may be a debtor under such chapter.

11 U.S.C. § 301(a). Section 302(a) is virtually identical in the context of "joint cases." The statutory text is focused on "filing," not signing the petition. And, the Code does not require that every debtor actually come to Court to "file" a petition. Instead, in most cases the filing exercise is performed, as it was in this case, by counsel through electronic means. "Neither statute [Section 301 or 302] requires or states that the petition must be signed by the debtor" Benton, 2016 WL 721487, at *6.

In the absence of a statutory signature requirement, the Court looks to the governing procedural rules. Fed. R. Bankr. P. 1002 is similar to Section 301 and focuses on filing: "A petition commencing a case under the Code shall be filed with the clerk." Fed. R. Bankr. P. 1007 also requires that a debtor "shall file" various documents including a Statement of Financial Affairs and Schedules. But, again, that mandate does not require that those documents be executed by a debtor. Fed. R. Bankr. P. 1008 requires that "[a]ll petitions, lists, schedules, statements and amendments thereto shall be verified or contain an unsworn declaration as provided in 28 U.S.C. § 1746." So, someone must sign; but Fed. R.

Bankr. P. 1008 does not indicate that it must be a debtor. Fed. R. Bankr. P. 9011(a) deals mainly with attorneys and requires that "[e]very petition, ... schedule, or statement, or amendments thereto, shall be signed by at least one attorney of record in the attorney's individual name." Debtor's counsel did that. Fed. R. Bankr. P. 9011(a) goes on to state: "A party who is not represented by an attorney shall sign all papers." But that provision does not apply in this case since the Debtor is represented by counsel.

[2] There is a debtor signature requirement, but it takes some digging and cross-referencing to find. Fed. R. Bankr. P. 9009 deals with bankruptcy forms and provides: "... the Official Forms prescribed by the Judicial Conference of the United States shall be observed" The Judicial Conference of the United States has prescribed numerous Official Forms including forms of the Petition, SOFA, and Schedules. See Official Form Nos. 101, 106, and 107. Those documents do require a "Signature of Debtor" (or someone otherwise properly authorized to sign for a debtor). See In re Vitagliano, 303 B.R. 292, 293 (Bankr. W.D.N.Y. 2003) (referring to Fed. R. Bankr. P. 9009 and Official Form No. [10]1 as the basis of the requirement for the debtor to sign the petition). Thus, "Debtors must sign the petition, Schedules, and SOFA as a means of not only authorizing the filing of these documents, but of verifying, under penalty of perjury, that they have reviewed the information contained therein and that it is true and correct to the best of their knowledge, information, and

belief." In re Stomberg, 487 B.R. 775, 807 (Bankr. S.D. Tex. 2013); see also In re Veluz, 2015 WL 161002, at *2 (Bankr. D.N.J. Jan. 12, 2015) ("a debtor is required to sign the petition.").

In this case, the Debtor did not herself execute and file the Petition and the other required bankruptcy documents. Instead, her daughter, Juanita Maes, did. She signed with the following notation: "Juanita Maes, as attorney-in-fact for Jennie Adelle Maes." However, Juanita Maes acted based upon a mistaken understanding.

*796 [3] Under the Colorado Uniform Power of Attorney Act, COLO. REV. STAT. § 15-14-701 et seq. (the "CUPOA"):

An attorney-in-fact under a valid power of attorney [covering claims and litigation] ... has the right to file a petition for bankruptcy relief and otherwise participate in a bankruptcy

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proceeding for the principal ... unless the power of attorney provides otherwise.

In re Sniff, 2015 WL 7351477, at *5 (Bankr. D. Colo. Oct. 6, 2015) (citing COLO. REV. STAT. § 15-14-735(1)(g)). However, the First POA never became effective and the Second POA was signed after the bankruptcy filing while the Debtor was **incompetent**. So, Juanita Maes was not an "attorney-in-fact" for the Debtor and was not properly authorized to direct that the Petition be filed under the CUPOA.

[4] [5] In the absence of authority under the First POA, the Second POA, and the CUPOA, the Debtor's counsel argues that a different set of rules governs if the Debtor is "incompetent." Fed. R. Bankr. P. 1004.1 is titled "Petition for an Infant or Incompetent Person" and provides as follows:

If an infant or **incompetent** person has a representative, including a general guardian, committee, conservator, or similar fiduciary, the representative may file a voluntary petition on behalf of the infant or incompetent person. An infant or incompetent person who does not have a duly appointed representative may file a voluntary petition by next friend or guardian ad litem. The court shall appoint a guardian ad litem for an infant or incompetent person who is a debtor and is not otherwise represented or shall make any other order to protect the infant or **incompetent** debtor.

Fed. R. Bankr. P. 1004.1 mirrors Fed. R. Civ. P. 17(c) and was added to the Federal Rules of Bankruptcy Procedure in 2002 to address, among other things, recurring issues governing bankruptcy filings on behalf of **incompetent** persons and whether bankruptcy courts are authorized to appoint **guardians ad litem**. Fed. R. Bankr. P. 1004.1 generally applies when a debtor is **incompetent** at the time of the commencement of the bankruptcy case, while a companion procedural rule, Fed. R. Bankr. P. 1016, applies if a debtor becomes **incompetent** during the pendency of the

bankruptcy case. Fed. R. Bankr. P. 1016 is titled "Death or **Incompetency** of Debtor" and provides the following:

Death or **incompetency** of the debtor shall not abate a liquidation case under chapter 7 of the Code. In such event the estate shall be administered and the case concluded in the same manner, so far as possible, as though the death or incompetency had not occurred. If a reorganization, family farmer's debt adjustment, or individual's debt adjustment case is pending under chapter 11, chapter 12, or chapter 13, the case may be dismissed; or if further administration is possible and in the best interest of the parties, the case may proceed and be concluded in the same manner, so far as possible, as though the death or incompetency had not occurred.

[6] These procedural rules require the Court to engage in a decision tree of determinations when **incompetency** issues are raised. First, the Court must decide whether the Debtor was **incompetent** when the Petition was filed on August 19, 2019, or whether the Debtor became **incompetent** after the commencement of the bankruptcy case. If the former, then Fed. R. Bankr. P. 1004.1 applies; if the later, then Fed. R. Bankr. P. 1016 applies. *Sniff*, 2015 WL 7351477, at *2.

If Fed. R. Bankr. P. 1004.1 is applicable, then the Court must determine if the Debtor had a formal "representative" at *797 the time of the bankruptcy Petition such as a "general guardian, committee, conservator, or similar fiduciary" and whether that person filed the bankruptcy Petition. Sniff, 2015 WL 7351477, at *3 (Fed. R. Bankr. P. 1004.1 "make[s] a threshold distinction between whether the **incompetent** person is represented or not represented.") If the Debtor had no formal "representative," then the Court must decide whether the bankruptcy Petition was filed by a "next friend or guardian ad litem." If a guardian ad litem initiated and signed the bankruptcy petition, the inquiry is complete and the case may proceed. However, if only a "next friend" started the bankruptcy proceedings, then the Court must appoint a guardian ad litem or take other action to protect the **incompetent** debtor; the Court cannot just let the "next

friend" continue along in prosecuting the bankruptcy case. *Sniff*, 2015 WL 7351477, at *3 ("if there is no representative, then the Court may appoint a representative"). So, now, the Court addresses the foregoing issues.

B. The Debtor Was **Incompetent** When Her Daughter Signed and Filed the Petition.

[7] **Incompetency** determinations are not the common province of bankruptcy courts. Indeed, neither the Bankruptcy Code nor the Federal Rules of Bankruptcy Procedure define the term "incompetency." See, e.g., Sniff, 2015 WL 7351477, at *3; In re Petrano, 2013 WL 6503672, at *2 (Bankr. N.D. Fla. Apr. 16, 2013); In re Whitehead, 2005 WL 1819399, at *1 (Bankr. M.D.N.C. July 22, 2005) (citing In re Moss, 239 B.R. 537, 539 (Bankr. W.D. Mis. 1999)). In the absence of express statutory authority to determine **incompetency**, at least some bankruptcy courts have deferred and required such determinations to be made only in state court. Petrano, 2013 WL 6503672, at *4. However, Fed. R. Bankr. P. 1004.1 provides authorization for **incompetency** determinations. Most bankruptcy courts willing to delve into the issue have engaged in an assessment under state law. Sniff, 2015 WL 7351477, at *3; In re Soto, 534 B.R. 460, 464 (Bankr. D.P.R. 2015) (applying Puerto Rico law); In re Douglas, 2006 WL 4449695, at *1 (Bankr. W.D. Mo. Sept. 14, 2006) (applying Missouri law); Whitehead, 2005 WL 1819399, at *2 (citing Moss, 239 B.R. at 539 ("since there is no federal law on the determination of **incompetency**, which has traditionally been left to state law, the **incompetency** laws of the state of the debtor's domicile must be examined for guidance on the matter")). Courts construing analogous Fed. R. Civ. P. 17(c) also generally apply state law governing **incompetency**. Moody v. Smith (In re Moody), 105 B.R. 368, 372 (S.D. Tex. 1989) (applying Texas state law under Fed. R. Civ. P. 17(c)); Moss, 239 B.R. 537 (endorsing use of state law before adoption of Fed. R. Bankr. P. 1004.1). The Court agrees that under Fed. R. Bankr. P. 1004.1 the Court is fully authorized to make a determination of incompetency for bankruptcy purposes in appropriate circumstances.

[8] Colorado law provides for **incompetency** determinations in numerous contexts such as criminal proceedings, commitment proceedings, involuntary medical treatment, and otherwise. Although the definitions vary, the central consideration is whether the individual is incapable of participating effectively in communication and decision-

making. See, e.g., Sniff, 2015 WL 7351477, at *3; People ex Rel. Strodtman, 293 P.3d 123, 132 (Colo. App. 2011) (explaining incompetency determination in involuntary medical treatment case); see also COLO. REV. STAT. §§ 16-8.5-101(11) and 102(2)(a) (defining phrase "incompetent" to proceed" in various criminal contexts); COLO. REV. STAT. § 27-65-101 et seq. (containing *798 various definitions pertaining to mental health). The Colorado approach comports with common understanding of the term "incompetent." See AMERICAN HERITAGE DICTIONARY OF THE ENGLISH LANGUAGE 889 (Houghton Mifflin Harcourt, Fifth Ed. 2011) ("incompetent" means "lacking sufficient mental ability or awareness").

The term "incapacity" is similar. Under Colorado law, an incapacitated person means:

... an individual ... who is unable to effectively receive or evaluate information or both to make or communicate decisions to such an extent that the individual lacks the ability to satisfy essential requirements for physical health, safety, or self-care

COLO. REV. STAT. § 15-14-102(5). Even though the Bankruptcy Code does not define the word "incompetent", it does define the analogous term "incapacity" in a similar way to Colorado law but focusing on financial issues:

... incapacity means that the debtor is impaired by reason of mental illness or mental deficiency so that he is incapable of realizing and making rational decisions with respect to his financial responsibilities

11 U.S.C. § 109(h)(4).

[9] Although the Court might prefer to abstain so that contested and complicated **incompetency** disputes may be adjudicated in state court under state law (for example, by

abstention under 28 U.S.C. § 1334(c)(1)), fortunately, this bankruptcy case presents a very easy factual scenario that makes abstention unnecessary. Every shred of admissible evidence confirms that the Debtor was **incompetent** when her daughter signed and filed the Petition on August 19, 2019. She has (and still has) severe dementia and memory loss. Her physician, Dr. Bauer, and three close relatives confirmed as much. Dr. Bauer also opined that the Debtor "was incapable of handling her financial affairs on August 19, 2019 and that she remains incapable of handling her financial affairs."

There is no contrary evidence. Instead, even the Parties stipulated:

Debtor currently suffers from severe dementia and was suffering from severe dementia at the time of filing of her bankruptcy petition.

[10] Since the Debtor was unable to participate effectively in communication and decision-making about her financial condition when her daughter filed for bankruptcy protection, the Debtor was **incompetent** under Fed. R. Bankr. P. 1004.1. Indeed, the Court concludes that severe dementia and memory loss are archetypical examples of **incompetency**. ⁵⁹

C. The Debtor Did Not Have a Representative When Her Daughter Signed and Filed the Petition.

[12] The next issue in the decision sequence is whether the Debtor had a "representative" when Juanita Maes signed and filed the Petition. Neither the Bankruptcy Code nor the Federal Rules of Bankruptcy Procedure define the word "representative." However, Fed. R. Bankr. P. 1004.1 gives illustrative examples: "a general guardian, committee, conservator, or similar fiduciary." Fed. R. Civ. P. 17(c), the model for Fed. R. Bankr. P. 1004.1, also lists the examples of a "representative." The holder of a valid durable power of attorney also may qualify as a representative *799 under Fed. R. Bankr. P. 1004.1 — without a separate appointment by the bankruptcy court. See Sniff, 2015 WL 7351477, at *4; In re Drenth, 2015 WL 5331797 (Bankr. W.D. Mich. Sept. 10, 2015); In re Matthews, 516 B.R. 99, 102 (Bankr. N.D. Tex. 2014) (citing *United States v. Spurlin*, 664 F.3d 954, 959 (5th Cir. 2011) ("a general power of attorney may be used to file a bankruptcy on another's behalf")); In re James, 2005

WL 6443631 (Bankr. N.D. Tex. Oct. 18, 2005) (confirming that debtor's daughter may act for incapacitated debtor in bankruptcy case under power of attorney granting authority regarding claims and litigation).

[13] The Debtor did not have a general guardian, committee, or conservator at the commencement of the bankruptcy case. Furthermore, because neither the First POA nor Second POA was effective, the Debtor did not have an agent under an effective and valid durable power of attorney. There is no evidence that anyone else acted in a fiduciary capacity *vis-à-vis* the Debtor. Thus, the Debtor did not have a "representative" within the meaning of Fed. R. Bankr. P. 1004.1 when her daughter signed and filed the Petition.

D. Juanita Maes Was the Debtor's Next Friend.

[14] If a debtor is **incompetent** but does not have a representative, Fed. R. Bankr. P. 1004.1 allows a "next friend or **guardian ad litem**" to file for bankruptcy on behalf of such debtor. So, the next question is whether Juanita Maes qualified as a "next friend or **guardian ad litem**" when she signed and filed the Petition for her mother.

[15] The term "guardian ad litem" is not defined in either the Bankruptcy Code or the Federal Rules of Bankruptcy Procedure. However, etymologically the phrase has Latin roots and means guardian "for the lawsuit" or "for the litigation." See, e.g., AMERICAN HERITAGE DICTIONARY OF THE ENGLISH LANGUAGE 780 (Houghton Mifflin Harcourt, Fifth Ed. 2011) ("guardian ad litem" means "a person appointed by the court during litigation to protect the interests of a party who is incompetent."); Bryan A. Garner, BLACK'S LAW DICTIONARY 780 (Thomson Reuters, Tenth Ed. 2014) ("guardian ad litem" means "a guardian, usually a lawyer, appointed by the court to appear in a lawsuit on behalf of an incompetent or minor party.").

[16] Colorado state law similarly ties the appointment of a "guardian ad litem" to a specific proceeding or lawsuit. For example, COLO. REV. STAT. § 13-91-103 defines the term "guardian ad litem" as "a person appointed by a court to act in the best interests [of a child in a dependency or neglect proceeding]" Likewise, COLO. REV. STAT. § 19-1-103(59) provides that a "guardian ad litem" is "a person appointed by a court to act in the best interests of a person"

In this bankruptcy case, Juanita Maes was not her mother's **guardian ad litem** because no court appointed her to be a guardian for purposes of any lawsuit or litigation, including for the filing of a bankruptcy petition. So, the Court must assess whether Juanita Maes qualifies as the Debtor's "next friend" under Fed. R. Bankr. P. 1004.1.

[17] [18] In the bankruptcy context, the term "next friend" is "broad enough to include anyone who has an interest in the welfare of an infant [or incompetent person] who may have a grievance or a cause of action." In re Zawisza, 73 B.R. 929, 936 (Bankr. E.D. Penn. 1987) (quoting **Child v. Beame, 412 F. Supp. 593, 599 (S.D.N.Y. 1976) (construing Fed. R. Civ. P. 17(c))). A "next friend" is different than a "guardian ad litem." The main difference is that a *800 "next friend" is not appointed by a court and does not have any fiduciary obligations.

[19] [20] A few decades ago, the United States Supreme Court construed the term "next friend" in the context of court appearances in *habeas corpus* proceedings on behalf of detained prisoners. Whitmore v. Arkansas, 495 U.S. 149, 110 S.Ct. 1717, 109 L.Ed.2d 135 (1990). Although *habeas corpus* cases obviously are quite different than bankruptcy proceedings, the "next friend" concept is analogous. The Supreme Court stated:

First, a "next friend" must provide an adequate explanation — such as inaccessibility, mental incompetence, or other disability - why the real party in interest cannot appear on his own behalf to prosecute the action. Second, the "next friend" must be truly dedicated to the best interests of the person on whose behalf he seeks to litigate, and it has been further suggested that a "next friend" must have some significant relationship with the real party in interest. The burden is on the "next friend" clearly to establish the propriety of his status

Whitmore, 495 U.S. at 163-64, 110 S.Ct. 1717. This analysis of next friend status also makes abundant good sense as applied in the context of Fed. R. Bankr. P. 1004.1.

[21] Juanita Maes has met her burden to prove her status as next friend vis-à-vis the Debtor. First, there is a very solid reason why the Debtor could not appear on her own behalf to sign the Petition and all the other bankruptcy documents. The Debtor has severe dementia and memory loss. Her treating physician has testified that she is incapable of making financial decisions. Second, Juanita Maes has demonstrated that she is dedicated to the interests of the Debtor. Juanita Maes has a "significant relationship" with the Debtor who is her mother; and she is her only daughter. The mother-daughter relationship is sacrosanct. And, Juanita Maes has proven that she has done her best to take care of her mother. She is her mother's caregiver. She takes her mother to her medical and other appointments. And, after she learned of her mother's failing mental health, she took it upon herself to assist in her mother's financial obligations by making sure that debts were paid so her mother could stay in her house and have shelter. She did what every mother hopes a loyal and caring daughter would do. Furthermore, she did it for no compensation and no expectation of ever being paid anything for her efforts on her mother's behalf. Even the Parties stipulated: "Debtor's case was filed at the direction of her daughter, Juanita Maes, as next friend." Thus, the Court rather easily concludes that Juanita Maes qualifies as the Debtor's next friend under Fed. R. Bankr. P. 1004.1.

E. <u>The Court Appoints Juanita Maes as the Debtor's</u> **Guardian Ad Litem** for Purposes of the Bankruptcy **Proceedings.**

[22] [23] [24] Most guardian ad litem appointments are made in the context of state court proceedings. Until 2002, there was an open legal question whether bankruptcy courts were authorized to appoint guardians ad litem in main bankruptcy cases. That changed with the enactment of Fed. R. Bankr. P. 1004.1. The last sentence of that Rule now provides that authorization. The Rule requires the appointment of guardians ad litem, not next friends, in circumstances like this bankruptcy case:

The court shall appoint a **guardian** ad **litem** for an infant or **incompetent** person who is a debtor and is not

otherwise represented or shall make any other *801 order to protect the infant or incompetent person.

As set forth above, the Court already has determined that the Debtor was **incompetent** when the Petition was filed, and remains so, and that the Debtor did not, and does not, have a "representative." Instead, Juanita Maes has acted only in the capacity of a "next friend." However, a next friend is not a fiduciary. Under these circumstances, Fed. R. Bankr. P. 1004.1 dictates that the Court now appoint a guardian ad litem or make any other order to protect the Debtor. See In re McGlohon, 2016 WL 552332, at *1 (Bankr. E.D.N.C. Feb. 10, 2016) ("While 'unusual and extraordinary," the appointment of a guardian ad litem for an incompetent debtor by a bankruptcy court is available and provided for in Rule 1004.1."); In re Benson, 2010 WL 2016891, at *2-3 (Bankr. N.D. Ga. Apr. 30, 2010) (appointing a guardian ad litem); Whitehead, 2005 WL 1819399, at *4 (appointing a guardian ad litem).

The Debtor, through Debtor's counsel, apparently prefers another course and advocates:

The best procedure [going] forward would be to appoint Juanita Maes (the Debtor's daughter) as next friend as she is qualified to act in the best interest of the debtor. An appointment of **guardian ad litem** is unnecessary as the debtor can be adequately protected through her next friend. ⁶⁰

There is legal authority for the appointment of a next friend. For example, in **In re Myers*, 350 B.R. 760, 764 (Bankr. N.D. Ohio 2006), a bankruptcy court appointed a debtor's wife as the debtor's next friend under Fed. R. Bankr. P. 1004.1. And, in **In re Lane*, 2012 WL 5296122 (Bankr. D. Or. Oct. 25, 2012), a bankruptcy court purported to develop an entire special procedure for the appointment of next friends in Oregon bankruptcy cases.

The Court respectfully disagrees with all decisions in which bankruptcy courts have elected to appoint a "next friend" rather than a "guardian ad litem" under Fed. R. Bankr. P. 1004.1. Such cases contain no real legal analysis or rationale for appointing a next friend. Quite simply, Fed. R. Bankr. P. 1004.1 does not authorize the bankruptcy court to appoint a next friend. It says no such thing. Instead, Fed. R. Bankr. P. 1004.1 explicitly speaks only to the appointment of a guardian ad litem. And, the Court is concerned that having a next friend administer a bankruptcy proceeding would be unclear and problematic. Next friends have no specific duties or obligations. In bankruptcy, it is critical for duties to be identified through the Bankruptcy Code and, in this Court's view, to be performed by a fiduciary if the Debtor is unable to perform the duties. Under a plain reading of Fed. R. Bankr. P. 1004.1, the Court is not permitted to appoint Juanita Maes as the Debtor's next friend.

Instead, the Court determines that it must appoint a guardian ad litem. Juanita Maes fits the bill in the unique circumstances of this case. She has a special relationship with the Debtor as her daughter. She has assisted the Debtor with financial matters for about a year. She is willing to continue to assist her mother and testified: "I am aware of all my mother's financial obligations and am able to assist her is making sure all payments are made I am able to continue to care for my mother as care taker for both her medical and financial needs." She has acted in the Debtor's best interests. In this case, there are no funds to pay for a third-party guardian ad litem. Juanita Maes stated: "I have not gained any financial *802 benefit from assisting my mother with her affairs, not do I seek any compensation." That is important. Also, Juanita Maes' brother and maternal aunt have testified that Juanita Maes has the Debtor's best interests in mind and should continue to assist in making financial decisions for the Debtor. The practical reality is that, acting on her mother's behalf, Juanita Maes has been successful so far in saving the Debtor's Real Property and timely making all payments proposed in the Debtor's Chapter 13 Plan. And, there is no one else to step in as guardian ad litem.

So, the Court appoints Juanita Maes as a **guardian ad litem** for the limited purpose of prosecuting and administering this bankruptcy case on behalf of the Debtor. This appointment shall not extend to other matters such as medical decision-making. If Juanita Maes wishes to expand her authority beyond that provided by this Court for this bankruptcy case, she must obtain such appointment and authority under state law, in state court.

In re Maes, 616 B.R. 784 (2020)

Juanita Maes may exercise all the rights and powers of a debtor and debtor-in-possession in a Chapter 13 case, on behalf of the Debtor, under 11 U.S.C. § 1303. Juanita Maes may execute all required bankruptcy documents as follows: "Jennie Adelle Maes by Juanita Maes as **Guardian ad Litem** by Court Order."

Without limitation to the foregoing, Juanita Maes may, on behalf of the Debtor: retain and instruct legal counsel for the Debtor; file and prosecute any Chapter 13 plan or modification thereto; file, prosecute, or defend any pleading, motion, objection, or response; seek conversion or dismissal of the Debtor's bankruptcy case; make payments under any Chapter 13 plan; file a verification of confirmable plan; request the entry of discharge; and take any other action on behalf of the Debtor in this bankruptcy case.

In the performance of her role as **guardian ad litem**, Juanita Maes shall be obligated to act as a fiduciary for the Debtor. Such fiduciary duties shall include, but are not limited to: the duty to act in accordance with the Debtor's reasonable expectations (to the extent actually known); the duty to act in the Debtor's best interests; the duty to act in good faith; the duty to act loyally for the Debtor's benefit; the duty to act with the care, competence, and diligence ordinarily exercised by agents in similar circumstances. Juanita Maes shall not be entitled to compensation for her role as **guardian ad litem** for the Debtor, unless otherwise permitted by Court Order.

The Debtor shall have the right to request termination of Juanita Maes' limited **guardian ad litem** role if the Debtor establishes that she is no longer **incompetent** and is able to prosecute and administer her own bankruptcy case. However, Juanita Maes' limited **guardian ad litem** role shall terminate only upon Court Order, including an order dismissing this case.

VI. Conclusion and Order

For the foregoing reasons, the Court GRANTS the Motion to Determine Authority, in part. IT IS, THEREFORE, ORDERED:

- 1. The Chapter 13 Trustee's Objection to the capacity of Juanita Maes to act on behalf of the Debtor is OVERRULED;
- 2. The Chapter 13 Trustee's Objection to the Debtor's Chapter 13 Plan (Docket No. 2) is DENIED;
- 3. The Chapter 13 Trustee's request that the bankruptcy case be dismissed or converted to Chapter 7 is DENIED;
- 4. Juanita Maes is appointed as the guardian ad litem for the Debtor for the limited purpose of prosecuting *803 and administering this bankruptcy case on behalf of the Debtor and according to the obligations, terms, and conditions set forth in this Order; and
- The Debtor, by Juanita Maes as Guardian ad Litem by Court Order, shall file an Amended Chapter 13 Plan no later than May 29, 2020, addressing the objection of J.P. Morgan Chase Bank, N.A. (Docket No. 22).
- 6. By separate Order, the Court shall set a schedule for notice, objections, and a plan confirmation hearing.

All Citations

616 B.R. 784

Footnotes

- All references to the "Bankruptcy Code" are to the United States Bankruptcy Code, 11 U.S.C. § 101 et seq.
- Docket No. 1 at 1-7; see also Ex. 1 at 1-7 and Exs. J & K at 1-7 (the "Petition"). When referring to a document filed in the CM/ECF record for this case, the Court will use the convention "Docket No. ____" to identify the document. Docket No. 1 in this case includes the Petition, the Statement of Financial Affairs, and Schedules. The Petition is at pages 1 through 7 as indicated above; the Statement of Financial Affairs is in Docket No. 1 at pages 8 through 14 (the "SOFA"); and the Schedules are in Docket No. 1 at pages 17 through 40 (the

In re Maes, 616 B.R. 784 (2020)

"Schedules"). The Chapter 13 Trustee marked the Petition as Exhibit 1 and the SOFA as Exhibit 2. The Debtor marked the Petition, SOFA and Schedules as Exhibits J and K. The Parties stipulated to the admissibility of all exhibits. Thus, the entirety of Docket No. 1 has been admitted into evidence. For the sake of clarity, when referring to the Petition, the SOFA or Schedules in this Opinion and Order, this Court will cite to Docket No. 1 only and not to the related Exhibit number or letter assigned to it by the Parties.

- 3 Docket No. 1 at 6.
- 4 Docket No. 1 at 14 and 40.
- 5 Docket No. 2 (the "Chapter 13 Plan")
- 6 Id. at 8.
- 7 Statement of Stipulation Facts No. 16 (Docket No. 52, hereinafter, "Stip. Fact No.__").
- 8 *Id.*
- Docket No. 22 (the "Plan Objection"). Secured creditor J.P. Morgan Chase, N.A. also objected to the Chapter 13 Plan. (Docket No. 23.) However, that objection was focused narrowly on the debt owed to J.P. Morgan Chase, N.A., and did not raise the issue of the Juanita Maes' capacity to pursue bankruptcy protection for the Debtor.
- 10 Plan Objection at 1.
- 11 Docket No. 31 (the "Motion to Determine Authority").
- 12 *Id.*
- 13 Docket No. 34.
- 14 Docket No. 38.
- 15 Docket Nos. 42 and 43.
- 16 Docket No. 52.
- 17 Docket No. 50.
- 18 Docket No. 51.
- See Docket No. 53 (Parties stipulated to admissibility into evidence of all their respective exhibits); Docket No. 66 (Debtor contends "any further evidentiary hearing is unnecessary"); and Docket No. 67 (Chapter 13 Trustee states "the record in this case now contains sufficient information and documentation for the Court to decide the contested matter at issue without the need for an evidentiary hearing").
- 20 Stip. Fact Nos. 2 and 8.
- 21 Stip. Fact Nos. 7 and 9.
- 22 Stip. Fact No. 7(d).
- 23 Stip. Fact No. 7(c).
- 24 Stip. Fact No. 7(b).

In re Maes, 616 B.R. 784 (2020)

- 25 Stip. Fact No. 7(a).
- 26 Docket No. 1 at 8 and 36.
- 27 *Id.* at 9 and 37.
- 28 Id. and Stip. Fact No. 15.
- 29 Docket No. 1 at 39.
- 30 *Id.* at 18-19.
- 31 *Id.* at 17 and Stip. Fact. No. 11.
- 32 Id. and Stip. Fact Nos. 7(b) and 7(d).
- 33 Docket No. 1 at 17.
- 34 *Id.* at 24.
- 35 *Id.*
- 36 Stip. Fact No. 12.
- 37 Stip. Fact No. 13.
- 38 Stip. Fact No. 14.
- 39 Stip. Fact No. 3; Exs. A and L.
- 40 Ex. L; see also Stip. Fact No. 4.
- 41 Exs. A and L.
- 42 Docket No. 50.
- 43 Docket No. 51 and Ex. C.
- 44 Ex. D.
- 45 Ex. E.
- 46 Stip. Fact No. 4.
- 47 Docket No. 51 and Exs. F and G.
- 48 Exs. B and L and Docket No. 51.
- 49 Docket No. 51.
- 50 *Id.*
- 51 Stip. Fact No. 5.
- 52 Docket No. 51.

In re Maes, 616 B.R. 784 (2020)

- 53 Exs. C-E.
- The Chapter 13 Trustee and the Debtor has submitted information concerning Juanita Maes' criminal history. (Ex. 6 and Ex. H.) That history shows that Juanita Maes was cited for a single misdemeanor offense in the last ten years; and that she was arrested on other occasions long ago. Neither Party has suggested that such episodes disqualify Juanita Maes from caring for her mother or for making her payments under her Chapter 13 Plan in this Bankruptcy Case. Thus, the Court views that information as irrelevant.
- 55 Ex. C.
- 56 Ex. 3, the "First POA."
- 57 Ex. 4, the "Second POA."
- 58 Stip. Fact No. 10.
- The Court's **incompetency** determination is made only with respect to the Debtor's financial affairs and for purposes of this bankruptcy case. This determination shall have no impact in other areas such as medical treatment decision-making or otherwise.
- 60 Docket No. 42.

End of Document

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UNITED STATES BANKRUPTCY COURT EASTERN DISTRICT OF MISSOURI NORTHERN DIVISION

In Re:)	
ROBERT E. SAPP, SR., and)	Case No. 10-20580-659
LORRAINE M. SAPP,)	Chapter 13
	Debtors.)	PUBLISHED

ORDER

The matter before the Court is the Motion to Dismiss Case as to Lorraine M Sapp Only filed by Creditor Tower Loan of Missouri, Inc., Debtors [sic] Response and Objection to Creditor's Motion to Dismiss Case as to Co-Debtor, Lorraine M. Sapp and Trustee's Objection to Motion to Dismiss Cae [sic] as to Lorraine M Sapp Only. The matter was taken as submitted. Upon consideration of the record as a whole, the Court resolves the matter as follows.

Debtors Robert E. Sapp, Sr. and Lorraine M. Sapp filed a joint petition under Chapter 13 of the Bankruptcy Code on October 15, 2010. On December 14, 2010, Debtor Robert E. Sapp, Sr. filed an Amended Petition stating that he signed the Amended Petition on behalf of Debtor Lorraine M. Sapp, his wife, over whom Debtor Robert E. Sapp, Sr. is Guardian and Conservator. Debtor Robert E. Sapp, Sr. also submitted a copy of the Letters of Guardianship of an Incapacitated Person and Conservatorship of a Disabled Person from the 10th Judicial Circuit Court of Marion County, Missouri, which states that on March 11, 2009, Debtor Robert E. Sapp, Sr. was appointed and has qualified as guardian of the person and conservator of the estate of Debtor Lorraine M. Sapp, an incapacitated and disabled person. Specifically, Debtor Robert E. Sapp, Sr. was "authorized and empowered to perform the duties of guardian and to perform the duties of conservator as provided by law, under the supervision of the court, having the care and custody of the person and estate of Debtor Loraine M. Sapp. Letters of Guardianship of an Incapaciated Person and Conservatorship of a Disabled Person in the Estate of Lorraine Mildred Sapp dated

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March 11, 2009, ¶ 2.

Creditor Tower Loan of Missouri, Inc. (hereinafter "Creditor") filed Motion to Dismiss Case as to Debtor Lorraine M Sapp Only, arguing that Debtor Lorraine M. Sapp may not avail herself to the provisions of the Bankruptcy Code because she is not a Debtor within the meaning of Section 109. Trustee states that he is without sufficient information to admit or deny the allegations of the Motion to Dismiss but states that Section 109(h) of the Bankruptcy Code and Rule 1004.1 of the Federal Rules of Bankruptcy Procedure imply that an incompetent person may be a debtor in a Chapter 13 case.

The Bankruptcy Code provides that a voluntary bankruptcy case may only be commenced when an individual or entity who may be a debtor files a petition. See 11 U.S.C. § 301 (2010). Section 109 states who may be a debtor, and specifically exempts incapacitated or disabled debtors from personally meeting certain requirements imposed on most debtors. See 11 U.S.C. § 109(h)(4) (2010). Incapacity under Section 109(h)(4) means "the debtor is impaired by reason of mental illness or mental deficiency so that he is incapable of realizing and making rational decisions with respect to his financial responsibilities; and 'disability' means that the debtor is so physically impaired as to be unable, after reasonable effort, to participate in person, telephone, or Internet briefing required under [109(h)(1)]." Id. Section 109 does not prohibit an incapacitated, incompetent or disabled person from being a debtor in a Chapter 13 case. Moreover, Section 109 cannot be read in isolation of other relevant law.

Debtor Robert E. Sapp, Sr. has been appointed as guardian and conservator of Debtor Lorraine M. Sapp by the 10th Judicial Circuit Court of Marion County, Missouri. Missouri Statute Section 475.120 states that "[t]he general powers and duties of a guardian of an incapacitated person shall be to take charge of the person of the ward and to provide for the ward's care, treatment, habilitation, education, support and maintenance." Mo. Rev. Stat. § 475.120.3 (2010). Further, Missouri Statute Section 475.130.1 states that the conservator of an estate shall protect,

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preserve and manage the estate. . .[and is] under a duty to use the "degree of care, skill and prudence which an ordinarily prudent man uses in managing property the property of, and conducting transaction on behalf of, others." Mo. Rev. Stat. § 475.130.1 (2010). Rule 17 of the Federal Rules of Civil Procedure, as incorporated by Rule 7017 of the Federal Rules of Bankruptcy Procedure, states that a guardian may sue or defend an action in the name of the real party in interest. Fed. R. Civ. P. 17(c)(1) (2010). And, Rule 1004.1 of the Federal Rules of Bankruptcy Procedure states that "if an infant or incompetent person has a representative, including a general guardian, committee, conservator, or similar fiduciary, the representative may file a voluntary petition on behalf of the infant or incompetent person." Fed. R. Bankr. P. 1004.1 (2010).

The only dispute is whether an incapacitated person may be a debtor under Section 109 of the Bankruptcy Code. Debtor Lorraine M. Sapp is indisputably an incapacitated and disabled person, and, it is not disputed that her husband, Debtor Robert E. Sapp, Sr. has been appointed as guardian and conservator of her person and estate. As such, Debtor Robert E. Sapp, Sr. may act within his capacity to do what is in the best interest of the estate of Debtor Lorraine M. Sapp, to the inclusion of filing a voluntary bankruptcy petition on her behalf. A host of cases support this conclusion. See In re Kjellsen, 155 B.R. 1013, 1018 (Bankr. D.S.D. 1993), rev'd on other grounds (Congress did not intend to bar incompetent persons from filing a voluntary bankruptcy petition; to so do would likely raise constitutional issues of due process and equal protection); In re Kirschner, 46 B.R. 583, 584 (Bankr. E.D. N.Y. 1985), abrogated on other grounds by In re Colish, 289 B.R. 523 (Bankr. E.D. N.Y. 2002)(wife who was appointed guardian ad litem of her husband by the Supreme Court of the State of New York to file a petition in Bankruptcy was permitted to do the same); see also In re Zawisza, 73 B.R. 929, 932 (Bankr. E.D. Pa. 1987)(an incompetent debtor is not barred from seeking relief in bankruptcy via a court appointed quardian); In re Smith, 115 B.R. 84 (Bankr. E.D. Va. 1990)(an incapacitated or disabled person may file bankruptcy through a guardian or next friend, but not a mere power of attorney unless the power of attorney is expanded

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to include the power to file bankruptcy petition on debtor's behalf); *In re Myers*, 350 B.R. 760, 762-63 (Bankr. N.D. Ohio 2006)(an incompetent person may be a debtor in a Chapter 7 case, and the Court may appoint a next friend to act on the debtor's behalf pursuant to Bankruptcy Rule 1004.1 and Section 105); *In re Clinton*, 41 F.2d 749 (S.D. Cal. 1930)(a person adjudged incompetent may on petition of guardian, as authorized by probate court, be a debtor in bankruptcy); *cf. In re Raymond*, 12 B.R. 906 (Bankr. E.D. Va. 1981)(where wife who only held power of attorney over her Sailor husband, who was serving in the U.S. Navy, could not file a joint petition on her and her husband's behalf); *contra In re Eisenberg*, 117 F. 786 (S.D. N.Y. 1902)(where a state courtappointed committee of debtor-lunatic was restrained from filing a bankruptcy petition on his behalf). Therefore,

IT IS ORDERED THAT Motion to Dismiss Case as to Lorraine M. Sapp Only is DENIED.

KATHY A. SURRATT-STATES United States Bankruptcy Judge

DATED: July 20, 2011 St. Louis, Missouri

Copies to:

Office of the United States Trustee Thomas F. Eagleton U.S. Courthouse 111 South 10th Street, Suite 6.353 St. Louis, MO 63102

Robert and Lorraine Sapp 308 S. 10th Street Quincy, IL 62301

Tower Loan of Missouri, Inc. Box 961 Hannibal, MO 63401 Michael Dean Holliday Curl & Hark, L.L.C. 999 Broadway P.O. Box 1013 Hannibal, MO 63401

John V. LaBarge, Jr Chapter 13 Trustee P.O. Box 430908 St. Louis, MO 63143

Norman W Lampton Law Offices of Norman W Lampton 4002 Imperial Ct - Suite B Columbia, MO 65201-9026 645 B.R. 524

United States Bankruptcy Court, D. South Carolina.

IN RE: Lucas Nathaniel BROWN, Sr., Debtor(s).

C/A No. 22-02651-EG

Signed November 14, 2022

Synopsis

Background: Debtor, with assistance of counsel and his son as purported "next friend," filed Chapter 13 petition, and later filed motion requesting that son be appointed as representative due to alleged **incompetence**.

Holdings: The Bankruptcy Court, Elisabetta G.M. Gasparini, J., held that:

- [1] Bankruptcy Rule permitting **incompetent** debtors to file petition through "next friend" was applicable;
- [2] debtor was **incompetent** under South Carolina law at time he filed petition, as required for son to qualify as "next friend";
- [3] debtor's appointment of son as "healthcare power of attorney" was insufficient to qualify son as representative for purposes of filing petition;
- [4] debtor's son qualified as "next friend" authorized to file petition on debtor's behalf; and
- [5] appointment of son as **guardian** ad **litem** was warranted for limited purpose of pursuing case.

Motion granted.

Procedural Posture(s): Motion to Appoint Guardian ad Litem.

West Headnotes (16)

[1] Bankruptcy • Who May Institute Case

Bankruptcy Rule permitting incompetent debtors to file petition through "next friend,"

rather than Rule governing continuation of case following debtor's death or **incompetency** arising after filing of case, applied to Chapter 13 debtor's motion to appoint his son as representative, where debtor was allegedly **incompetent** at time petition was filed. Fed. R. Bankr. P. 1004.1, 1016.

[2] Bankruptcy 🕪 Who May Institute Case

Bankruptcy Rule permitting debtors to file petition by representative, "next friend," or **guardian ad litem** only applies if debtor has first been determined **incompetent**. Fed. R. Bankr. P. 1004.1.

1 Case that cites this headnote

[3] Bankruptcy Parties

Courts interpreting whether person is "incompetent" within meaning of federal rule of civil procedure governing capacity to sue, so as to support appointment of representative to sue on person's behalf, look to law of state in which person is domiciled and follow state's incompetency laws. Fed. R. Civ. P. 17(c).

[4] Mental Health Who Are Mentally Ill or Mentally Deficient

Under South Carolina law, mental **incompetence** is established by credible evidence that subject, because of mental impairment, has become incapable of managing his own affairs.

[5] Mental Health Pature of evidence

Under South Carolina law, it is not necessary to prove mental **incompetence** by an adjudication of **incompetency**.

[6] Mental Health Weight and Sufficiency of Evidence

Mental Health ← Determination of mental disorder in general

In re Brown, 645 B.R. 524 (2022)

Under South Carolina law, adjudication of mental **incompetency** is but prima facie evidence of **incompetency**.

[7] Mental Health Degree of proof

Under South Carolina law, party alleging incompetence bears burden of proving incompetence by preponderance of evidence.

[8] Bankruptcy 🕪 Who May Institute Case

Debtor was **incompetent** under South Carolina law at time he filed Chapter 13 petition with assistance of counsel and his son as purported "next friend," as was required for son to qualify as "next friend" with authority to file petition on behalf of debtor, where debtor had earlier suffered from stroke, experienced continuing decline in ability to understand and remember things, and had hard time understanding and recalling prior events during hearings. Fed. R. Bankr. P. 1004.1.

[9] Bankruptcy 🕪 Who May Institute Case

Chapter 13 debtor's pre-petition appointment of his son as his "healthcare power of attorney" was insufficient to qualify son as debtor's "representative" within meaning of Bankruptcy Rule permitting **incompetent** debtors to file petition through a representative. Fed. R. Bankr. P. 1004.1.

[10] Bankruptcy • Who May Institute Case

"Next friend" who may file bankruptcy petition on behalf of **incompetent** debtor is broad enough to include anyone who has interest in welfare of debtor. Fed. R. Bankr. P. 1004.1.

1 Case that cites this headnote

[11] Bankruptcy 🕪 Who May Institute Case

"Next friend" who may file bankruptcy petition on behalf of **incompetent** debtor must be truly dedicated to best interests of person on whose behalf he seeks to litigate. Fed. R. Bankr. P. 1004.1.

1 Case that cites this headnote

[12] Bankruptcy 🕪 Who May Institute Case

Debtor's son qualified as "next friend" authorized to file Chapter 13 petition on behalf of debtor; son had debtor's best interests at heart, as he currently lived with debtor, had lived with debtor for his entire life, was familiar with debtor's financial situation, and contributed \$1,500 per month to debtor's household. Fed. R. Bankr. P. 1004.1.

[13] Bankruptcy • Who May Institute Case

"Next friend" who may file bankruptcy petition on behalf of **incompetent** debtor is not a fiduciary with specific duties and obligations, and therefore cannot continue prosecuting case after filing of petition. Fed. R. Bankr. P. 1004.1.

[14] Bankruptcy Employment of Professional Persons or Debtor's Officers

Mental Health 🕪 Authority to appoint

While unusual and extraordinary, bankruptcy court may appoint **guardian ad litem** for **incompetent** debtor. Fed. R. Bankr. P. 1004.1.

[15] Bankruptcy ← Employment of Professional Persons or Debtor's Officers

Mental Health Pauthority to appoint

Bankruptcy court has power to appoint **guardian** ad **litem** on behalf of **incompetent** debtor for limited purpose of facilitating bankruptcy case. Fed. R. Bankr. P. 1004.1.

1 Case that cites this headnote

[16] Bankruptcy Administration; debtor's status; appointment of trustee

Mental Health • Necessity of appointment

Bankruptcy Court would appoint Chapter 13 debtor's son as **guardian ad litem** for

limited purpose of pursuing case on behalf of debtor, who was mentally **incompetent**; no representative had been sought or appointed in debtor's three prior Chapter 13 cases, all of which ended in dismissal due to debtor's failure to file documents or make required payments, debtor was not competent to manage his financial affairs, and son was able, willing, and well-positioned to pursue debtor's interests. Fed. R. Bankr. P. 1004.1.

Attorneys and Law Firms

*526 David C. Gaffney, Gaffney Law Firm, P.A., West Columbia, SC, for Debtor.

AMENDED ORDER APPOINTING GUARDIAN AD LITEM PURSUANT TO 1004.1 1

Elisabetta G. M. Gasparini, United States Bankruptcy Judge

THIS MATTER came before the Court for hearing on November 3, 2022, on the *Motion to Appoint Representative for Debtor* ("Motion") filed on behalf of Lucas Nathaniel Brown, Sr. ("Debtor"), requesting that the Debtor's son, Lucas Nathaniel Brown, Jr. ("Intended Representative"), be appointed as the Debtor's representative in this case pursuant to Fed. R. Bankr. P. 1016. ²

FINDINGS OF FACT

Prior to this case, the Debtor filed three other Chapter 13 cases with the assistance of different counsel. On August 2, 2019, the Debtor filed the first Chapter 13 case, ³ which was dismissed on December 12, 2019 for failure to file a confirmable plan. ⁴ On *527 January 31, 2020, the Debtor filed the second Chapter 13 case, ⁵ which was dismissed approximately a year later, on January 8, 2021, for failure to make plan payments. ⁶ On September 28, 2021, the Debtor filed the third Chapter 13 case, ⁷ which was dismissed on August 8, 2022 for failure to make payments pursuant to a settlement agreement with the Chapter 13 Trustee. ⁸ The Motion indicates the Debtor's daughter provided some

assistance to the Debtor in the previous cases, but no representative for the Debtor was sought or appointed in any of those cases. Additionally, the Debtor's present counsel stated the reason a representative was being requested in this case was due to the belief, given the outcome of the prior cases, that a representative would be in the best interest of the Debtor and creditors given the Debtor's inability to manage his affairs.

On September 29, 2022, the Debtor filed his fourth Chapter 13 case with the assistance of his present counsel to begin the above case. The petition is signed on behalf of the Debtor by the Intended Representative as "Next Friend 1004.1 FRBP". Other documents in the case have been signed in the same manner, including the schedules and statements ⁹ and plan. ¹⁰ On October 13, 2022, the Debtor filed and served the Motion on the entire mailing matrix. The Chapter 13 Trustee, James M. Wyman ("Trustee"), filed a Notice of No Objection to the Motion, and no objections were filed. The Motion states the Debtor has cognitive and memory deficiencies due to a stroke he had "several years ago" and requires the Intended Representative to act on his behalf. The Motion also states the Intended Representative contributes \$1,500.00 a month to the Debtor's household, as also reflected on Schedule I.

At the hearing on this matter, the Debtor, his counsel, the Intended Representative, and the Trustee appeared. The Debtor testified under oath that he has impaired understanding and memory likely due to a stroke "a couple years [ago]"; as a result, he needs help managing his financial affairs. He further testified that he desired the Court to allow the Intended Representative to help him in this case. It was apparent that the Debtor had great difficulty understanding the questions being asked and recalling prior events, and his testimony regarding whether he had executed a general power of attorney was inconsistent. The Intended Representative also testified under oath and noted that his father suffered a stroke around 2009 or 2010 and currently has impaired understanding and memory. The Intended Representative further testified he lives with the Debtor, has lived with the Debtor his entire life, and is familiar with the Debtor's financial situation. He further testified he did not assist the Debtor during the prior bankruptcies. The Intended Representative indicated that while the Debtor executed a "healthcare power of attorney", the Debtor has not executed a general power of attorney.

DISCUSSION & CONCLUSIONS

[1] Although the Motion was filed pursuant to Fed. R. Bankr. P. 1016, it appears that that Rule is not applicable in this situation. Rule 1016, in fact, addresses the continuation of a bankruptcy case as a result of the debtor's death or incompetency that occurs after the case has been filed and is pending. Here, the Debtor is alleged *528 to have been incompetent at the time the petition was filed; accordingly, Fed. R. Bankr. P. 1004.1 is the rule that applies in this situation. See In re Maes, 616 B.R. 784, 796 (Bankr. D. Colo. 2020) (noting that if the debtor was incompetent when the petition was filed, Rule 1004.1 applies; if the debtor became incompetent after the commencement of the case, Rule 1016 applies). Fed. R. Bankr. P. 1004.1 provides:

If an infant or **incompetent** person has a representative, including a general guardian, committee, conservator, or similar fiduciary, the representative may file a voluntary petition on behalf of the infant or incompetent person. An infant or incompetent person who does not have a duly appointed representative may file a voluntary petition by next friend or guardian ad litem. The court shall appoint a guardian ad litem for an infant or **incompetent** person who is a debtor and is not otherwise represented or shall make any other order to protect the infant or **incompetent** debtor.

The Court must determine the following issues: (1) whether the Debtor was **incompetent** at the time of filing the petition and remains so; (2) whether the Debtor had a duly appointed representative at the time of filing the petition; (3) if the Debtor did not have a duly appointed representative at the time of filing the petition, whether the Intended Representative qualifies as a next friend for purposes of filing the petition; and (4) whether the Intended Representative should be appointed as **guardian ad litem**. See Maes, 616 B.R. at 796-97 (outlining decision tree in which the Court must engage when representative is sought for **incompetent** debtor).

I. DEBTOR'S COMPETENCE

[2] [3] By its plain terms, Rule 1004.1 only applies if the Debtor has first been determined to be **incompetent**. See also In re McGlohon, Case No. 15-06165-5-JNC, 2016 WL 552332, at *3 (Bankr. E.D.N.C. Feb. 10, 2016) ("[Rule] 1004.1...condition[s] the appointment and use of a **guardian** ad litem on finding a party to be **incompetent**."). Courts interpreting Fed. R. Civ. P. 17(c) ¹¹ "look to the law of the state in which the subject is domiciled and follow the state's **incompetency** laws." In re Whitehead, No. 05-50136, 2005 WL 1819399, at *4 (Bankr. M.D.N.C. July 22, 2005) (citing Matchem v. Frank, 998 F.2d 1009, 1010 (4th Cir. 1993); Siers v. Greiner, 983 F.2d 1057, 1058 (4th Cir. 1993)).

[5] [6] [7] Under South Carolina law, "[m]ental **incompetence** is established by credible evidence that the subject, because of mental impairment, has become incapable of managing his own affairs." Grapner v. Atl. Land Title Co., Inc., 307 S.C. 549, 551, 416 S.E.2d 617, 618 (1992) (citing Thompson v. Moore, 227 S.C. 417, 88 S.E.2d 354, 356 (1955); Rogers v. Nation, 284 S.C. 330, 326 S.E.2d 182, 185 (Ct. App. 1985)). "It is not necessary to prove mental incompetence by an adjudication of incompetency." Id. at 550-51, 416 S.E.2d at 618 (citing *Thompson*, 88 S.E.2d 354). "Conversely, an adjudication of **incompetency** is but *prima* facie evidence of that fact." Id. at 551, 416 S.E.2d at 618 (citing Church v. Trotter, 278 S.C. 504, 299 S.E.2d 332 (1983)). The party alleging **incompetence** bears the burden of proving **incompetence** by a preponderance of the evidence. *Id.* (citations omitted).

[8] The testimony of the parties at the hearing indicated that the Debtor suffered from a stroke some years ago and has had a continuing decline in his ability to understand and remember. At the hearing, it was apparent that the Debtor had significant difficulty understanding the questions *529 that were asked of him and in recalling prior events, and at times appeared extremely confused. Moreover, no party in this case has challenged the assertion that the Debtor is incompetent. Accordingly, the Court concludes that the Debtor was incompetent at the time of filing the petition and remains so.

II. DULY APPOINTED REPRESENTATIVE FOR DEBTOR

[9] The testimony of the Intended Representative indicates the Debtor recently executed a "healthcare power of attorney" appointing him as the Debtor's representative. While neither

the parties nor Debtor's counsel explained what terms were contained in this power of attorney, and such document is not in the record of the Court, ostensibly such a power of attorney empowers the holder thereof only to make healthcare decisions on the Debtor's behalf – not financial or other decisions. It is not sufficient for the holder of a healthcare power of attorney to qualify as a representative for purposes of Rule 1004.1, and there is no other evidence of a duly appointed representative for the Debtor. Accordingly, the Court concludes the Debtor did not have a duly appointed representative at the time of filing the petition or thereafter.

III. INTENDED REPRESENTATIVE AS NEXT FRIEND

[10] [11] "In the bankruptcy context, the term 'next friend' is 'broad enough to include anyone who has an interest in the welfare of an infant [or incompetent person] who may have a grievance or a cause of action.' "Maes, 616 B.R. at 799 (quoting In re Zawisza, 73 B.R. 929, 936 (Bankr. E.D. Pa. 1987)). "[T]he 'next friend' must be truly dedicated to the best interests of the person on whose behalf he seeks to litigate, and it has been further suggested that a 'next friend' must have some significant relationship with the real party in interest. The burden is on the 'next friend' clearly to establish the propriety of his status." Id. at 800 (quoting Whitmore v. Arkansas, 495 U.S. 149, 163-64, 110 S.Ct. 1717, 109 L.Ed.2d 135 (1990)).

[12] The Intended Representative testified he is the Debtor's son, lives with the Debtor, has lived with the Debtor his entire life, and is familiar with the Debtor's financial situation. Additionally, the evidence indicates the Intended Representative contributes \$1,500.00 a month to the Debtor's household. Under these circumstances, the Court finds that the Intended Representative has the best interests of the Debtor at heart and therefore qualifies as a next friend for purposes of filing the petition. Accordingly, his filing of the petition on the Debtor's behalf was proper under Rule 1004.1.

IV. APPOINTMENT OF INTENDED REPRESENTATIVE AS GUARDIAN AD LITEM

[13] Although the Intended Representative properly filed the petition on the Debtor's behalf as a next friend, the Intended Representative cannot continue prosecuting the case in that capacity. *Maes*, 616 B.R. at 797 (citing *In re Sniff*, Case No. 15-18086 TBM, 2015 WL 7351477, at *3 (Bankr. D. Colo. Oct. 6, 2015)) ("[I]f only a 'next friend' started the bankruptcy

proceedings, then the Court must appoint a **guardian ad litem** or take other action to protect the **incompetent** debtor; the Court cannot just let the 'next friend' continue along in prosecuting the bankruptcy case."). This is because a next friend is not a fiduciary with specific duties and obligations. *Maes*, 616 B.R. at 801. Moreover, the plain terms of Rule 1004.1 do not provide for the appointment of a "next friend", but instead provide the Court must determine whether to appoint the Intended Representative as **guardian ad litem** or make another order to protect the Debtor. *See* Fed. R. Bankr. P. 1004.1 *530 ("The court shall appoint a **guardian ad litem** for an ... **incompetent** person who is a debtor and is not otherwise represented or shall make any other order to protect the...**incompetent** debtor."); *Maes*, 616 B.R. at 801.

[14] [15] "While 'unusual and extraordinary,' the appointment of a **guardian ad litem** for an **incompetent** debtor by a bankruptcy court is available and provided for in Rule 1004.1." *McGlohon*, Case No. 15-06165-5-JNC, 2016 WL 552332, at *1 (quoting *Whitehead*, No. 05-50136, 2005 WL 1819399, at *1). "A bankruptcy court has the power to appoint a **guardian ad litem** for the limited purpose of facilitating the bankruptcy case." *Id.* (citations omitted).

[16] The Court finds that the Intended Representative should be appointed as **guardian ad litem** pursuant to Rule 1004.1 for the limited purpose of pursuing this case on behalf of the Debtor. No representative for the Debtor was sought or appointed in the Debtor's prior cases, and each of those cases ended in dismissal due to the Debtor's failure to file documents or make payments. The outcome of the Debtor's prior bankruptcy cases and the testimony at the hearing support the conclusion that the Debtor is not competent to manage his financial affairs and requires the assistance of a representative. As indicated above, the Intended Representative has shown he is willing and able to pursue the Debtor's interests and is well-positioned to do so.

IT IS, THEREFORE, ORDERED:

- Lucas Nathaniel Brown, Jr. is appointed guardian ad litem pursuant to Fed. R. Bankr. P. 1004.1 for the limited purpose of prosecuting and administering this bankruptcy case on behalf of the Debtor;
- Lucas Nathaniel Brown, Jr. shall act as a fiduciary for the Debtor, and shall not be entitled to compensation for his role as guardian ad litem for the Debtor;

In re Brown, 645 B.R. 524 (2022)

- Lucas Nathaniel Brown, Jr. may exercise all the rights and powers of a debtor in a Chapter 13 case, on behalf of the Debtor, under 11 U.S.C. § 1303;
- Lucas Nathaniel Brown, Jr. may execute all required documents in this case as follows: "Lucas Nathaniel Brown, Sr. by Lucas Nathaniel Brown, Jr. as Guardian ad Litem by Court Order"; and
- If Lucas Nathaniel Brown, Jr. wishes to expand his authority beyond that provided by this Court for this bankruptcy case, he must obtain such appointment and authority under state law in state court.

AND IT IS SO ORDERED.

All Citations

645 B.R. 524

Footnotes

- This order is being amended to correct typographical errors in the original order entered on November 7, 2022 (ECF No. 25). The findings of fact and conclusions of law remain the same.
- 2 ECF No. 16.
- 3 C/A No. 19-04099-jw, ECF No. 1.
- 4 C/A No. 19-04099-jw, ECF No. 33.
- 5 C/A No. 20-00556-jw, ECF No. 1.
- 6 C/A No. 20-00556-jw, ECF No. 34.
- 7 C/A No. 21-02510-eg, ECF No. 1.
- 8 C/A No. 21-02510-eg, ECF No. 47.
- 9 ECF No. 13, filed Oct. 12, 2022.
- 10 ECF No. 14, filed Oct. 12, 2022.
- Fed. R. Civ. P. 17(c) is nearly identical to Fed. R. Bankr. P. 1004.1 and is applicable to contested matters and adversary proceedings through Fed. R. Bankr. P. 9014 and 7017.

End of Document

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2021 BNH 002

UNITED STATES BANKRUPTCY COURT DISTRICT OF NEW HAMPSHIRE

In re: Bk. No. 18-10191-PGC Chapter 7

Keith Michael Corson, Debtor

MEMORANDUM OPINION AND ORDER SUSTAINING CLAIM OBJECTION

I. INTRODUCTION

This dispute involves the question of whether a claim by a guardian ad litem against a debtor is entitled to priority treatment under 11 U.S.C. § 507(a)(1)(A) or (a)(1)(B). ¹ Here, chapter 7 trustee Olga L. Gordon (the "Trustee") objects to the priority treatment of Ms. Rebecca S. McBeath, Esq.'s unsecured proof of claim in the amount of \$4,076.25 (the "Claim") (Claim No. 10). Ms. McBeath is an attorney who provided guardian ad litem services for the children of debtor Keith Michael Corson (the "Debtor") during his divorce proceeding. After considering the submissions of the parties and the applicable law, I hereby sustain the Trustee's objection to the priority treatment of the Claim for the reasons set forth below.

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¹ Unless otherwise indicated, the terms "Bankruptcy Code," "Code," "chapter," "section" and "§" refer to Title 11 of the United States Code, 11 U.S.C. §§ 101, *et seq.*, as amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub L. No. 109-8, 119 Stat. 37 ("BAPCPA"). References to the "Bankruptcy Rules" or "Rule" shall mean the Federal Rules of Bankruptcy Procedure.

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II. BACKGROUND

Before filing for bankruptcy relief in 2018, the Debtor and his then-wife were involved in a divorce action in the New Hampshire State Court.² In December of 2015, the state court appointed Ms. McBeath as a guardian ad litem for the Debtor's minor children under New Hampshire law and ordered her to investigate and make recommendations about any issues that she deemed relevant to the children's best interests, including the Debtor and his wife's residential responsibilities for them; the Debtor and his wife's physiological conditions; and the influence of any companions of the Debtor and his wife on their children. ³ See Appointment Order, at 31-34. The Appointment Order also required the Debtor to pay 75% of the total guardian ad litem fees accrued during the proceeding. The Debtor owes Ms. McBeath \$4,076.25 for her services.

Initially, the Debtor challenged the Claim, scheduling it as a disputed, unsecured, priority claim. (D.E. 19; D.E. 35-3). However, by May of 2018, he filed a proof of claim on Ms. McBeath's behalf pursuant to Rule 3004, asserting that the Claim was entitled to priority treatment as a domestic support obligation under § 507(a)(1)(A) or (a)(1)(B) because it constituted his share of the guardian ad litem expenses ordered to be paid by the state court. See Fed. R. Bankr. P. 3004; 11 U.S.C. § 507(a)(1)(A) and (a)(1)(b).

Approximately one year later, the Trustee filed a one-page objection to the Claim. (D.E. 139). While the Trustee took no issue with the amount of the Claim, she asserted that it was not

² See In the Matter of Keith Corson and Doreen Corson, 618-2014-DM-00535, 7th Cir. Probate Division, Dover.

³ In response to my request during a hearing on the Trustee's objection on October 21, 2020, Ms. McBeath filed documents on October 21, 2020 in support of her Claim, including a copy of the state court's order appointing her as guardian ad litem (the "Appointment Order"). Although the evidence produced by the parties does not so specify, the Court assumes that Ms. McBeath was appointed as the guardian ad litem pursuant to N.H. Rev. Stat. § 461-A:16.

⁴ Although the Appointment Order initially capped Ms. McBeath's guardian ad litem fees at \$2,000, the state court granted her motion to increase her fees in ¶21(g)(1v-v) of its final orders concerning the divorce between the Debtor and his ex-spouse (the "Divorce Order"). A copy of the Divorce Order is on the docket in this case at pages 12-28 of the papers filed by Ms. McBeath on October 21, 2020.

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entitled to priority treatment and should be treated as a general, unsecured claim. She did not cite any legal authority or provide any evidence supporting her position. Ms. McBeath disagreed, maintaining that her Claim is entitled to priority treatment because it arises from legal services that she provided while serving as the state court-appointed guardian ad litem in the Debtor's divorce proceeding. She further argued that the Appointment Order approved the payment obligation of \$4,076.25. In support, Ms. McBeath cited Kassicieh v. Battisti (In re Kassicieh), 482 B.R. 190 (B.A.P 6th Cir. 2012) for the proposition that guardian ad litem fees constitute domestic support obligations that are entitled to priority treatment under the Code.

See 482 B.R. at 191 (affirming the bankruptcy court's finding that the guardian ad litem fees owed were nondischargeable domestic support obligations).

III. DISCUSSION

Under the Code, a claim filed pursuant to § 501 "is deemed allowed[] unless a party in interest . . . objects." 11 U.S.C. § 502(a). A properly filed proof of claim constitutes "prima facie evidence of the validity and amount of the claim." Fed. R. Bankr. P. 3001(f). The First Circuit has observed that merely objecting to a claim "does not deprive the proof of claim of presumptive validity unless the objection is supported by *substantial evidence*." Juniper Dev. Grp. v. Kahn (In re Hemingway Transp., Inc.), 993 F.2d 915, 925 (1st Cir. 1993).

Here, there is no dispute that the Claim was properly filed and that the Trustee filed an objection to it. Her objection, however, is essentially limited to one conclusory sentence: "As grounds for this objection, the Trustee states that the claim is not entitled to priority and should be allowed as a general unsecured claim." (D.E 139). Though the Trustee did not provide any evidence or substantive law supporting her position and consequently has not done enough to divest the Claim of its presumptive validity, Ms. McBeath, as the party seeking priority treatment of the Claim, carries the ultimate burden of establishing that she is so entitled. See Mason v.

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Official Comm. of Unsecured Creditors (In re FBI Distribution Corp.), 330 F.3d 36, 41-42 (1st Cir. 2003) (stating that the granting of priority status to a claim "is contrary to the fundamental principle of bankruptcy law that the debtor's limited resources are to be distributed equally among similarly situated creditors [T]hus, statutory priorities are narrowly construed, and the burden of proving entitlement rests with the party seeking it.") (citations omitted); Woburn Assocs. v. Kahn (In re Hemingway Transp., Inc.), 954 F.2d 1, 5 (1st Cir. 1992) ("The burden of proving entitlement to priority payment as an administrative expense therefore rests with the party requesting it."); In re Plourde, 418 B.R. 495, 507 (B.A.P. 1st Cir. 2009) ("[E]ach creditor must demonstrate its entitlement to distribution at a particular level Otherwise, a claimant may be provided priority at a higher level than that to which it is entitled, watering down the dividend provided to creditors the legislation prefers. This would be contrary to the predominant goal of the Bankruptcy Code 'to secure equal distribution among [similarly situated] creditors."") (citation omitted); In re Coco Beach Golf & Cty. Club SE, 2020 WL 1503528, at *6 (Bankr. D.P.R. Mar. 27, 2020) (stating that "[a] party seeking priority treatment has the burden of proving entitlement to statutory priority."), reconsideration denied sub nom. In re Coco Beach Golf & Cty. Club, SE, 2020 WL 4728366 (Bankr. D.P.R. July 24, 2020).

Determining whether a claim is a domestic support obligation entitled to priority treatment is a question of federal law. See Smith v. Pritchett (In re Smith), 586 F.3d 69, 73 (1st Cir. 2009).⁵ Since the enactment of BAPCPA, two sections of the Code establish the framework through which courts evaluate these claims. Section 507(a)(1)(A) grants priority treatment to certain allowed unsecured claims for "domestic support obligations" if, "as of the date of the

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⁵ I am also aided by cases construing domestic support obligations under § 523(a)(5). <u>See</u> 11 U.S.C. § 523(a)(5) (excepting from discharge debts for domestic support obligations). "The examination to determine whether the debt is a domestic support obligation [under § 507(a)(1)] is the same as a § 523(a)(5) inquiry as they both seek to determine if the obligation is in the nature of 'alimony, maintenance or support.'" <u>Smith v. Pritchett (In re Smith)</u>, 398 B.R. 715, 721 (B.A.P. 1st Cir. 2008), <u>aff'd</u>, 586 F.3d 69 (1st Cir. 2009). <u>See also</u> 11 U.S.C. § 507(a)(1).

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filing of the petition in a case under [the Code], [they] are owed to or recoverable by a spouse, former spouse, or child of the debtor, or such child's parent, legal guardian, or responsible relative, without regard to whether the claim is filed by such person" 11 U.S.C. § 507(a)(1)(A). Section 101(14A) defines a "domestic support obligation" as a debt:

- (A) owed to or recoverable by (i) a spouse, former spouse, or child of the debtor or such child's parent, legal guardian, or responsible relative; or (ii) a governmental unit;
- (B) in the nature of alimony, maintenance, or support . . . of such spouse, former spouse, or child of the debtor or such child's parent . . . ;
- (C) established . . . [by] a separation agreement, divorce decree, or property settlement agreement; [or] an order of the court of record; . . . and
- (D) not assigned to a nongovernmental entity, unless that obligation is assigned voluntarily by the spouse, former spouse, child of the debtor, or such child's parent, legal guardian, or responsible relative for the purpose of collecting the debt.

11 U.S.C. § 101(14A)(A)-(D) (emphasis added).

Not all courts agree on how to best analyze § 101(14A). As one court observed regarding the related issue of examining the dischargeability of domestic support obligations:

A review of both pre-and post-BAPCPA case law interpreting former and current § 523(a)(5) reveals that three lines of authority have emerged on the question of whether a debt that is in the nature of support and owed directly to a third party not listed among the entities identified in § 101(14A) (or former § 523(a)(5)) is excepted from discharge.

Kassicieh v. Battisti (In re Kassicieh), 425 B.R. 467, 472 (Bankr. S.D. Ohio 2010). The first line of authority follows the "plain meaning" approach. <u>Id.</u> This approach maintains "that the dischargeability of the debt turns on whether it is owed to a person/entity described in § 523(a)(5) (pre-BAPCPA) or payable to or recoverable by a person/entity described § 101(14A) (post-BAPCPA)[.]" <u>Id.</u> The second line of authority reasons that "if a debt is in the nature of

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support, it is nondischargeable even if payable directly to a third party and even if the debtor's spouse, former spouse or parent of his/her child would not be financially harmed if the debtor discharged the obligation[.]" Id. Under this approach, "the nature of the debt rather than the [identity of] the payee is controlling" Kassicieh v. Battisti (In re Kassicieh), 467 B.R. 445, 450 (Bankr. S.D. Ohio), aff'd, 482 B.R. 190 (B.A.P. 6th Cir. 2012). A third line of authority, which is more limited, "requires some ongoing liability of the debtor's spouse, former spouse, or parent of the debtor's child on the support obligation owing to a third party" In re Kassicieh, 425 B.R. at 472. This approach focuses on whether "non-payment [of the ongoing liability] might have a financial impact on th[e] part[y] before [the debt] may be excepted from discharge." Id.

I am uncomfortable with the second approach because it reads subsection (A), the list of people to whom the obligation is payable, out of the statute notwithstanding the conjunctive structure of § 101(14A). See 11 U.S.C. § 101(14A)(A). The third approach is not applicable here because neither the Appointment Order nor the Divorce Order imposed ongoing liability for the Claim on the Debtor's ex-spouse or child. Therefore, I believe that the "plain meaning" approach hews most closely to the intent of Congress and the controlling canons of statutory construction. See O'Brine v. Gove (In re Gove), No. 09-22405-JNF, 2011 WL 111155, at *6 (Bankr. D. Mass. Jan. 13, 2011) (stating that "[c]ourts have employed a four part test to determine whether [guardian ad litem] fees qualify as a domestic support obligation under 11 U.S.C. § 101(14A)") (citing Epstein v. Defilippi (In re Defilippi), 430 B.R. 1, 3 *n.7 (Bankr. D. Me. 2010)).

Section 101(14A) is part of a coherent and consistent statutory scheme which is not unclear or vague. As a result, I am tasked with applying the plain language of § 101(14A) in evaluating whether the Claim is a domestic support obligation entitled to priority treatment. See

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<u>United States v. Ron Pair Enters., Inc.</u>, 489 U.S. 235, 240-41 (1989). <u>See also Robinson v. Shell</u>

<u>Oil Co.</u>, 519 U.S. 337, 340 (1997); <u>Connecticut Nat. Bank v. Germain</u>, 503 U.S. 249, 253-54

(1992) ("We have stated time and again that courts must presume that a legislature says in a statute what it means and means in a statute what it says there When the words of a statute are unambiguous, then, this first canon is also the last: judicial inquiry is complete.") (quotations and citations omitted).

The Claim easily satisfies two of the four requirements. The Trustee does not dispute that the underlying debt arises from fees for services that were established by a court order; nor does she allege that the obligation was assigned to a nongovernmental entity. See 11 U.S.C. § 101(14A)(C) and (D). Further, the uncontroverted evidence submitted by Ms. McBeath establishes these two facts. See Appointment Order, at ¶ 2-4; Divorce Order, at ¶21(g). Therefore, the Claim's priority treatment depends on the two remaining inquiries: whether the debt is in the nature of support for the debtor's children under § 101(14A)(B) and whether Ms. McBeath is an enumerated person under § 101(14A)(A)(i). See 11 U.S.C. § 101(14A)(A)(i) and (B).

A. Is the Claim "in the nature of support"?

Support is "what is given to provide for the upkeep of the recipient spouse and children." In re Gambale, 512 B.R. 117, 123 (Bankr. D.N.H. 2014) (quoting Werthen v. Werthen (In re Werthen), 329 F.3d 269, 273 (1st Cir. 2003)). While "[t]he First Circuit Court of Appeals 'has not adopted a specific multi-factor test'... to discern... whether a particular obligation [was intended to be] in the nature of support[,]" it "has stated that it is a 'fact intensive' inquiry that depends on 'the totality of the circumstances of a particular case."" Id. (quoting Smith, 586 F.3d at 74). "[F]actors considered by other courts may inform [the Court's analysis of] the totality of the circumstances [in this case]...." Id. Other courts consider:

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(1)[the] language and substance of the state court's order and thus the characterization of the payment in the decree and the context in which the disputed provisions appear; (2) the parties' financial circumstances at the time of the order and thus whether the recipient spouse actually needed spousal support at the time of the divorce; (3) whether an assumption of a debt or creation of an obligation has the effect of providing the support necessary to ensure that the daily needs of the former spouse and any children of the marriage are met and to ensure a home for the former spouse and any minor children; (4) whether the parties intended to create an obligation of support; (5) the function served by the obligation at the time of such order; (6) whether the labels given to the payments of the parties may be looked at as evidence of the parties' intent; (7) whether there was an imbalance in the relative income of the parties at the time of the divorce decree and thus whether the payment appears to balance disparate income; (8) whether the obligation terminates on the death or remarriage of either spouse; (9) whether the payments are made directly to the recipient spouse in a lump sum [or] are paid in installments over a substantial period of time; [and] (10) whether the payments are to be made directly to the former spouse or to a third party.

In re Efron, 495 B.R. 166, 176 (Bankr. D.P.R. 2013) (collecting cases).

The uncontroverted facts presented by Ms. McBeath leave no question that the guardian ad litem fees that the Debtor owes to her are in the nature of support. Divorces often put children in the center of a maelstrom, requiring that their treatment and well-being be in the forefront throughout the proceeding. In New Hampshire, a divorce court is authorized to "appoint a guardian ad litem for a minor child when [it] has reason for special concern regarding the welfare of the child." N.H. Rev. Stat. Ann. § 461-A:16. See also Baillargeon v. Stacey (In re Stacey), 164 B.R. 210, 212 (Bankr. D.N.H. 1994) (noting that "[a] guardian ad litem is appointed as a party in a divorce proceeding to represent the best interests of the children throughout the proceeding") (citing N.H. Stat. Ann. § 458:17-a (1992) (repealed 2005 and recodified at N.H. Rev. Stat. Ann. § 461-A:16))). New Hampshire law vests a guardian ad litem with certain powers and obligations that are intended to serve and safeguard the best interests of a child. See N.H. Rev. Stat. Ann. § 461-A:16 (explaining that "[t]he role of the guardian ad litem shall be to

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gather information to assist the court in determining the best interests of the child."); N.H. Rev. Stat. Ann. § 461-A:6 ("In determining parental rights and responsibilities, the court shall be guided by the best interests of the child"); N.H. Rev. Stat. Ann. § 461-A:1IV ("Parental rights and responsibilities' means all rights and responsibilities parents have concerning their child."). Consequently, guardians ad litem are not passive observers. They actively investigate and make conclusions about a wide range of matters that affect the best interest of a child, including relationships, emotional and physical development, present and future needs, and the child's parents. See N.H. Rev. Stat. Ann. § 461-A:6. These observations and conclusions are critical to the state court's ability to determine parental rights and duties that promote the child's best interests.

A review of the Divorce Order in this case cements the conclusion that Ms. McBeath's services supported the Debtor's children during the divorce and custody proceeding. That order incorporates, in detail, Ms. McBeath's observations, concerns and conclusions about what is best for the Debtor's children. See Divorce Order, at 2-6. In addition, the state court underscored its reliance on Ms. McBeath's guardian ad litem work noting:

"[t]he court was asked to meet the [children] . . . in camera, but it respectfully declines to do so. The [guardian ad litem] . . . has interviewed them, and articulated their preferences. An in camera meeting is not necessary, and may make the [children] . . . feel they are more in the middle and they already are."

Divorce Order, at 4. "[P]rotecting [a] child's interests in a custody battle is in the nature of support because of the obvious impact that the outcome will have on the emotional health and overall well-being of the child." In re Rackley, 502 B.R. 615, 626 (Bankr. N.D. Ga. 2013) (citing In re Ramirez, 2000 WL 356314, at *7 (Bankr. N.D. Ill. 2000) (explaining that "support for purposes of § 523(a)(5) is not limited to paying bills of the child, but encompasses many aspects of the child's well-being.")). See also In re Kassicieh, 467 B.R. at 451 ("It is nearly universally

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recognized that when a state domestic relations court appoints a guardian ad litem to protect the interests of a child, the services provided by the guardian ad litem have the effect of providing support."); Kelly v. Burnes (In re Burnes), 405 B.R. 654, 658-59 (Bank. W.D. Mo. 2009) (finding that guardian ad litem fees owed by a debtor were in the nature of support and equating the fees with nondischargeable attorney's fees owed by a debtor to a former spouse's attorney).

B. Is Ms. McBeath an enumerated payee under § 101(14A)(A)(i)?

Turning now to the final question, is Ms. McBeath a person listed under § 101(14A)(A)(i)? See 11 U.S.C. § 101(14A)(i). I conclude that she is not. She is not a "spouse," "former spouse," "child of the debtor or such child's parent," "responsible relative" or "governmental unit." Although the term "legal guardian" might appear to be an umbrella term that could include a guardian ad litem, closer examination reveals otherwise.

The Code does not define the term "legal guardian," nor does § 101(14A) instruct courts to look to state law for guidance. See In re Rackley, 502 B.R. at 628. See also Smith, 586 F.3d at 73 (1st Cir. 2009) (explaining that a claim's characterization as a domestic support obligation is controlled by federal law). However, even though state law is not controlling in this context, bankruptcy courts can look to it "for guidance in determining whether a particular obligation is in the nature of support or a property settlement; since virtually the whole subject matter of familial support is within the domain of state law and there is no federal law of domestic relations." In re Efron, 495 B.R. at 178.

Courts are also guided by rules of statutory construction. "In the absence of an express definition, a term contained in a statute should be given 'its ordinary meaning." <u>Raridon v.</u>

⁶ "Although guardianship is a creature of state law, there is no reference to state law in [§] 101(14A). Congress showed in [§] 522(b)(2) that it knows how to make state law applicable in bankruptcy cases. The absence of any reference to state law in [§] 101(14A) points to the conclusion that the meaning of terms in that statute is a question of federal law." In re Rackley, 502 B.R. at 628 (citing In re Harrell, 754 F.2d 902, 904-05 (11th Cir.1985) (holding that the determination of whether a debt was in the nature of "support" in the pre-BAPCPA version of [§] 523(a)(5) was a question of federal law)).

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Carlson (In re Carlson), 545 B.R. 229, 234 (Bankr. N.D. III. 2016) (quoting Clark v. Rameker, 537 U.S. 122, 127 (2014)). See also 2A Norman Singer & Shambie Singer, Sutherland Statutory Construction §47:30 (7th ed.) available on Westlaw (updated Nov. 2020) (stating "[1]egal terms in a statute have their legal meaning,[] absent legislative intent to the contrary,[] or other evidence of a different meaning, such as context or a statutory definition.[]") (footnotes omitted)); In re Greco, 397 B.R. 102, 110 (Bankr. N.D. III. 2008) (stating that "[i]n § 101(14A)(A), the words associated with 'legal guardian' are 'parents' and 'responsible relatives,' both of whom have custody and general responsibility for the children under their care. 'Legal guardian,' then, should be similarly interpreted.") rev'd sub nom. Levin v. Greco, 415 B.R. 663 (N.D. III. 2009).

A "legal guardian" or "guardian" is different than a guardian ad litem. The term "legal" means "[o]f, relating to, or involving law generally; falling within the province of law[,] [e]tablished, required, or permitted by law; lawful . . . [or o]f, relating to, or involving law as opposed to equity." *Legal*, Black's Law Dictionary (11th ed. 2019). A "guardian" is "someone who has the legal *authority and duty to care for* another's person or property, esp. because of the other's infancy, incapacity, or disability [and may be] *appointed either for all purposes* or for a specific purpose." *Guardian*, Black's Law Dictionary (11th ed. 2019) (emphasis added). A "guardian ad litem" is a "guardian, usu. a lawyer, appointed by the court to appear in a lawsuit on behalf of an incompetent or minor party." Id. Unlike a guardian or legal guardian, a guardian ad litem's role and authority is limited to the legal proceeding necessitating its appointment. See Uniform Guardianship, Conservatorship & Other Protective Arrangement. Act, § 102(9)-(10) (2017) (defining "guardian" as "a person appointed by the court to make decisions with respect to the personal affairs of an individual. The term includes a co-guardian but does not include a guardian ad litem[,]" and a "guardian ad litem" as "a person appointed to inform the court about,

Case: 18-10191-PGC Doc #: 155 Filed: 05/21/21 Desc: Main Document Page 12 of 15

and to represent, the needs and best interest of an individual."). Under New Hampshire law, a "guardian ad litem" is appointed by a court for the limited purpose of protecting the interest of a minor or an incompetent person in a case involving the termination of parental rights or when the court has reason for special concern regarding the welfare of the child. See N.H. Rev. Stat. Ann. § 170-C:2; N.H. Rev. Stat. Ann. § 461-A:16. See also In re Lisa G., 504 A.2d 1, 5 (N.H. 1986) (stating that "[a] guardian ad litem is appointed to advocate a juvenile's best interests in a particular proceeding, and has none of the rights of a general guardian. R. WIEBUSCH, 4 NEW HAMPSHIRE PRACTICE, CIVIL PRACTICE AND PROCEDURE § 756 (1984)."). A guardian's duties and responsibilities are much more extensive. See In re Jack L., 20 A.3d 332, 336 (N.H. 2011) (noting in dicta the differences between a guardian and a guardian ad litem notwithstanding the parties' use of those terms interchangeably.). Moreover, under the Uniform Adult General Guardianship and Protective Proceedings Jurisdiction Act, a guardian is a "person appointed by the court to make decisions regarding the person of an adult, including a person appointed under RSA 464-A, and a guardian of the person as defined in RSA 464-A." N.H. Rev. Stat. Ann. § 464-C:2. In Chapter 464-A of the Revised Statutes of New Hampshire entitled "Guardians and Conservators," a guardian is one "appointed by the court to have care and custody of the incapacitated person as specified by a court order." N.H. Rev. Stat. Ann. § 464-A:2. New Hampshire's legislature underscored the difference between a "guardian ad litem" and

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⁷ At least two New Hampshire statutes note distinctions between guardians ad litem and legal guardians. <u>See</u> N.H. Rev. Stat. Ann. § 318-C:3 ("These babies, through their legal guardians and through court appointed guardians ad litem, should be able to recover damages from those in the community who have entered and participated in the marketing of the types of illegal drugs that have caused their injuries."); N.H. Rev. Stat. Ann. § 498-A:4 ("If the condemnee is a minor, an incompetent person, unknown, or is one whose whereabouts are unknown, the condemnor shall serve such notice upon the legal guardian of the condemnee. If there is no such guardian, the condemnor shall petition the board and request that a guardian ad litem be appointed to represent such condemnee.").

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a guardian by providing that a "guardian ad litem shall have *none* of the rights of the general guardian." N.H. Rev. Stat. Ann. § 464-A:41 (emphasis added).⁸

Thus, based upon the commonly accepted legal meanings of the terms legal guardian/guardian and guardian ad litem, as well as the distinctions between those terms under New Hampshire law, I conclude that Ms. McBeath is not a "legal guardian" as contemplated by § 101(14A)(A)(i). Therefore, her Claim cannot receive priority treatment under the Debtor's plan.

A minority of other courts have reached similar conclusions. See Wischmeyer v. Bobinski (In re Bobinski), 517 B.R. 900, 904 (Bankr. N.D. Ind. 2014) (concluding that a guardian ad litem was a "legal representative/attorney" for a child and "[beyond] the scope of persons/entities defined by § 101(14A)(A) "); In re Greco, 397 B.R. 102, 107-08 (Bankr. N.D. III. 2008) (focusing on the plain meaning of § 101(14A)(A)'s enumerated payees). These two cases interpreted BABCPA's "[re]location of the statutory definition of 'domestic support obligation' to a new, more detailed [sub]section § 101(14A), to indicate an intent to limit the definition to debts owed directly to the specifically enumerated categories of payees found in [§101(14A)(A)]." In re Carlson, 545 B.R. at 233. I am aware that "both Greco and Bobinski were reversed on appeal on that point." Id. (citing In matter of Bobinski, 550 B.R. 417 (N.D. Ind. 2015) (reversing bankruptcy court's decision and noting that "[e]ven if the support inquiry were not emphasized over the payee requirement, [the guardian ad litem] would still be able to satisfy the payee requirement"); Levin v. Greco, 415 B.R. 663, 666 (N.D. III. 2009) (reversing bankruptcy court's finding that a debt owed to a child representative, which was equated to a

⁸ Courts in other states reached similar conclusions. <u>See Orr v. Knowles</u>, 337 N.W.2d 699, 705 (1983) (stating that "[i]n short, the legal guardian is not the same as the guardian ad litem, as provided for in this statute."); <u>Ex parte R.H. (In re Marshall Cnty. Dep't of Hum. Res.)</u>, 311 So. 3d 761, 770 (Ala. Civ. App. 2020) ("A guardian ad litem is not a legal guardian. <u>See</u> Ala. Code 1975, § 26-2A-20(7) (defining 'guardian' to exclude 'one who is merely a guardian ad litem'), and § 12-15-102(17) (defining 'legal guardian' to exclude a guardian ad litem). A guardian ad litem also is not a parent or a person acting as a parent under Ala. Code 1975, § 30-3B-102.[]").

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guardian ad litem, was dischargeable, concluding that nature of guardian ad litem fees should be emphasized over the claimant's treatment as an enumerated payee)). Indeed, most courts favor a broader reading of the statute. However, there is no such controlling authority in the First Circuit. As explained above, § 101(14A) must be applied as it is written, which is in the conjunctive. In order to qualify as a domestic support obligation, a term specifically defined by the Code, a claimant must establish all four subsections. Ms. McBeath's inability to satisfy subsection (A) results in her claim not being entitled to priority treatment as a domestic support obligation. On the conjunctive obligation.

⁹ See In re Rackley, 502 B.R. at 627 (concluding that the term "legal guardian" as used in § 101(14A) included a child's guardian ad litem in custody litigation); In re Kassicieh, 482 B.R. at 191 (affirming bankruptcy court's finding that that the fees owed to the guardian ad litem constitute a "domestic support obligation" under § 101(14A)); In re Gove, 2011 WL 111155 (discussing broader interpretation of § 101(14A)(A)); In re Rose, No. 08-30051, 2008 WL 4205364, at *2-9 (Bankr. E.D. Tenn. Sept. 10, 2008) (allowing a guardian ad litem to recover fees as a nondischargeable domestic support obligation under §§ 101(14A) and 507(a)(1)). See also Miller v. Gentry (In re Miller), 55 F.3d 1487, 1490 (10th Cir.1995) (finding that fees owed directly to guardian ad litem were nondischargeable and noting that "[to] hold a debt dischargeable simply because the money was payable to someone other than the spouse [or child], would be to put form over substance, in contravention of established bankruptcy law.").

¹⁰ Unfortunately, this conclusion may create problems for guardians ad litem in New Hampshire who are involved with people who are in the shadow of an impending bankruptcy. Although when Congress enacted BAPCPA it could have avoided these problems by including guardians ad litem in the list of payees in § 101(14A) or by inserting the phrase "including but not limited to" before that list, it instead chose to emphasize the limited subset of entitled payees. Though I may believe that a more inclusive list would be preferrable, my role at this point is limited: I must apply the law as written. See Hunstein v. Preferred Collection & Mgmt. Servs., Inc., 994 F.3d 1341, 1352 (11th Cir. 2021) ("[O]ur obligation is to interpret the law as written, whether or not we think the resulting consequences are particularly sensible or desirable.").

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IV. CONCLUSION

For the reasons stated herein, the Trustee's objection is sustained. The Claim is allowed in the amount of \$4,076.25 as an unsecured nonpriority claim.

ENTERED at Concord, New Hampshire.

Date: May 21, 2021 /s/ Peter G. Cary

Peter G. Cary

United States Bankruptcy Judge

District of New Hampshire (by designation)

In re Hunt, 439 B.R. 690 (2010)

64 Collier Bankr.Cas.2d 1484

439 B.R. 690
United States Bankruptcy Court,
N.D. Indiana,
Hammond Division.

In re Brian L. HUNT, Alice P. Hunt, Debtors.

Brian Lee Hunt, II, Plaintiff

Brian L. Hunt, Alice P. Hunt, Defendants.

Bankruptcy No. 08–40525.

| Adversary No. 08–4050.
| Oct. 26, 2010.

Synopsis

Background: Son brought adversary proceeding in his father's bankruptcy case, seeking to except from discharge, on a fiduciary defalcation theory, a **debt** arising from father's mismanagement of funds that he held in trust for his son.

[Holding:] The Bankruptcy Court, Robert E. Grant, Chief Judge, held that, while debtor, in investing nearly \$150,000 that he held in trust for his son in what turned out to be bogus advance-fee scams, may have been negligent, gullible and even quintessentially stupid, his conduct, in making these purported "investments" only after traveling to foreign countries where funds and securities were allegedly held and meeting personally with principals in scams, did not rise to level of "willful," "knowing" or "reckless" misconduct, and did not provide basis to except resulting debt from discharge as one for debtor's "defalcation."

Judgment for debtor.

West Headnotes (5)

[1] Bankruptcy Defalcation

Term "defalcation," as used in dischargeability exception for **debts** for debtor's "fraud or defalcation while acting in a fiduciary capacity," should be interpreted narrowly, as requiring more

than mere negligent breach of fiduciary duty.

11 U.S.C.A. § 523(a)(4).

2 Cases that cite this headnote

[2] Bankruptcy Defalcation

"Defalcation," within meaning of dischargeability exception for **debts** for debtor's "fraud or defalcation while acting in a fiduciary capacity," requires a reckless, willful or knowing breach of duty. 11 U.S.C.A. § 523(a)(4).

2 Cases that cite this headnote

[3] Bankruptcy Defalcation

"Willful or knowing" breach of fiduciary duty, such as will provide basis to except **debt** from discharge as one for debtor's "defalcation" while acting in fiduciary capacity, requires action by debtor with intent to injure or with knowledge that what he does is impermissible. 11 U.S.C.A. § 523(a)(6).

1 Case that cites this headnote

[4] Bankruptcy Defalcation

"Reckless" breach of fiduciary duty, such as will provide basis to except **debt** from discharge as **debt** for debtor's "defalcation" while acting in fiduciary capacity, does not require intent, but involves complete indifference to consequences of one's actions, i.e., that one does not care about outcome. 11 U.S.C.A. § 523(a)(4).

[5] Bankruptcy 🕪 Defalcation

While debtor, in investing nearly \$150,000 that he held in trust for his son in what turned out to be bogus advance-fee scams involving alleged Ghana inheritance and cash and securities which were allegedly held in Amsterdam and in which he was promised a share for paying purported fees and taxes necessary to obtain their release, may have been negligent, gullible and even quintessentially stupid, his conduct, in making these purported "investments" only after

1

In re Hunt, 439 B.R. 690 (2010)

64 Collier Bankr.Cas.2d 1484

traveling to Amsterdam and Ghana and meeting personally with principals in **scams**, did not rise to level of "willful," "knowing" or "reckless" misconduct, and did not provide basis to except resulting **debt** from discharge as one for debtor's "defalcation" while acting in fiduciary capacity.

11 U.S.C.A. § 523(a)(4).

Attorneys and Law Firms

*691 C. David Little, Power, Little & Little, Frankfort, IN, for Plaintiff.

Brian L. Hunt, Lafayette, IN, pro se.

DECISION

ROBERT E. GRANT, Chief Judge.

The debtor/defendant, Brian Hunt, Sr., 1 is the plaintiff's father and the trustee of a trust established for the plaintiff's benefit. He is also the victim of two Internet scams, having been taken in by what have come to be called advance-fee scams. The essence of this deception is that a substantial sum of money is tied up somewhere, often due to some bureaucratic or tax complication. The victims are told that the only obstacle to the fund's release is the payment of some tax or other fee; they *692 are promised a share of the fund if they will wire the money needed to make that payment. Of course, the payment turns out to be insufficient, there is a delay and another fee, another tax, or another license that needs to acquired, and the victims are asked to wire more money to cover the new expenses. Delay follows delay, fee follows fee, and the victims keep advancing funds until they are either bled dry or refuse to play along any further.

The defendant succumbed to two such **scams**. The first involved trunks, supposedly smuggled out of the Middle East containing cash and securities, that were stored with a

security company in Amsterdam. He was asked to help pay the storage and other charges needed to obtain their release; in return he would be given a share of the contents and then placed in charge of investing the remainder on behalf of the owner. The second scam involved an inheritance in Ghana, which was to be invested in a gold mine. The defendant was asked to pay taxes and other fees associated with the inheritance, organizing a corporation, and acquiring the mine; in return he was to be given 15% of the inheritance, 15% of the corporation's stock and to become the corporation's CEO and chairman of the board. The defendant investigated both of these opportunities, made several trips to London, Amsterdam and Ghana, met with the perpetrators, including one who represented himself to be an English solicitor, visited the warehouse in Amsterdam and the gold mine in Ghana, and reviewed various documents, certificates and affidavits. Having done so, he concluded that both proposals represented legitimate opportunities. The result was a loss of several hundred thousand dollars. Unfortunately, half of those dollars -\$149,709 to be precise—came from the trust. Plaintiff contends that the debtor's decision to use the trust's funds for such "investments" violates Indiana's Prudent Investor Act and constitutes defalcation in a fiduciary capacity, resulting in an obligation that is nondischargeable under 11 U.S.C. § 523(a)(4). ²

Two different lines of authority have arisen with regard to what constitutes "defalcation" for purposes of \$\frac{1}{2}\$ \$523(a) (4). The first interprets the term broadly, so that "[a]ny failure to maintain the standard of care attributable to a fiduciary is a bad act that is nondischargeable...." In re Storie, 216 B.R. 283, 289 (10th Cir.BAP 1997). See also, In re Johnson, 691 F.2d 249, 256–57 (6th Cir.1982); In re Goodwin, 355 B.R. 337, 345 (Bankr.M.D.Fla.2006); In re Miller, 133 B.R. 405, 408 (Bankr.S.D.Ohio 1991) (" 'defalcation' is quite broad and intended to include innocent or negligent defaults in duty as well as intentional acts."). The second line of authority interprets the term narrowly; the mere breach of a fiduciary duty will not, by itself, constitute defalcation. Instead, nondischargeability requires some degree of culpability or self-interested use of the trust property by the trustee. See, In re Hanson, 432 B.R. 758, 775 (Bankr.N.D.III.2010); In re Ellenbogen, 218 B.R. 709, 714–17 (Bankr.S.D.N.Y.1998); [[] In re Hanes, 214 B.R. 786, 813 (Bankr.E.D.Va.1997); In re Woods,

In re Hunt, 439 B.R. 690 (2010)

64 Collier Bankr.Cas.2d 1484

284 B.R. 282, 290 (D.Colo.2001). Poor judgment is, not enough. *Woods*, 284 B.R. at 291. *See also*, In re Hemmeter, 242 F.3d 1186 (9th Cir.2001) (bad investments do not constitute defalcation); In re Ellenbogen, 218 B.R. 709 (Bankr.S.D.N.Y.1998) (violation of prudent investor rule does not *693 constitute defalcation). *But see*, Miller, 133 B.R. at 409 (investment in "dollar stocks" was imprudent and constituted defalcation).

[2] The Seventh Circuit has never addressed the meaning of defalcation under \$ 523(a)(4). It has, however, addressed the meaning of that term for the purpose of § 523(a)(11), "defalcation while acting in a fiduciary capacity committed with respect to any depository institution or insured credit union." See, Meyer v. Rigdon, 36 F.3d 1375 (7th Cir.1994). After surveying the conflicting authority, it concluded that a narrow interpretation was more appropriate. [1382–85]. The negligent breach of a fiduciary duty is not enough. Defalcation requires recklessness or a willful or knowing breach of duty.

Old Id. at 1385. See also, In re Ward, 425 B.R. 507, 526 (Bankr.E.D.Wis.2010); In re Scarpello, 272 B.R. 691, 703 (Bankr.N.D.III.2002); Hanson, 432 B.R. at 775. Although Meyer dealt with defalcation under \$ 523(a)(11), the same terms used in the same section of the Bankruptcy Code should have the same meaning, and so the circuit's conclusion is equally applicable to the meaning of defalcation under [8] 523(a)(4): it requires a knowing, willful or reckless breach of fiduciary duties.

[3] [4] Willfulness requires an intentional injury, not just an intentional act that leads to injury. **Kawaauhau v. Geiger, 523 U.S. 57, 61–62, 118 S.Ct. 974, 977, 140 L.Ed.2d 90 (1998). To act knowingly requires a similar level of intent: one

acts with the knowledge that what they do is impermissible.

Meyer, 36 F.3d at 1385. Recklessness does not require intent; in this context it involves a complete indifference to

the consequences of one's actions; one does not care about the outcome. *See*, Black's Law Dictionary (9th ed. 2009).

[5] The defendant's actions were not willful, knowing, or reckless. He certainly did not know these were bad investments or intend to lose substantial amounts of both his own and the trust's money. To the contrary, his goal was to increase those funds by investing them in something that would produce a higher rate of return. Neither can we say he was indifferent to the consequences of the investments. To the contrary, he cared very deeply about the outcome. He investigated the proposals, made trips to England, Amsterdam and Ghana, and met with the perpetrators before deciding what to do. The problem is not his attitude toward investing the trust's funds but the conclusions he drew from his investigation. He had an over-inflated opinion of his own abilities and was completely taken in. Rather than recognizing the proposals as scams, he decided they were legitimate opportunities. Even now, years later and despite knowing the outcome, the court is left with the impression that the defendant continues to believe he was dealing with honest people who offered him legitimate opportunities, and anyone who may think otherwise simply does not understand the way things are done in other countries or international monetary transactions.

All Citations

439 B.R. 690, 64 Collier Bankr.Cas.2d 1484

Footnotes

The claims against Alice Hunt were dismissed prior to the conclusion of trial.

In re Hunt, 439 B.R. 690 (2010)

64 Collier Bankr.Cas.2d 1484

For the purpose of this decision, the court assumes that the debtor would be liable to the plaintiff under Indiana law. It does not need to determine that issue because of its conclusion that debtor's conduct does not constitute defalcation; so any debt that might exist is dischargeable.

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Landmark Credit Union v. Ammons (In re Ammons)

United States Bankruptcy Court for the Eastern District of Wisconsin

August 26, 2015, Decided

Chapter 7, Case No. 15-23361-svk, Adversary Case No. 15-2163

Reporter

2015 Bankr. LEXIS 2842 *; 2015 WL 5063935

In re Santresa Ammons, Debtor. Landmark Credit Union, Plaintiff, v. Santresa Ammons, Defendant.

Core Terms

deposited, false representation, sweepstakes, scam, follow instructions, intent to deceive, evidence show, fail to prove, commit fraud, misrepresentation, correspondence, possessed, lottery, opened, funds, won

Counsel: [*1] For Landmark Credit Union, Plaintiff (15-02163-svk): Mark C. Darnieder, Darnieder & Geraghty, Milwaukee, WI.

Santresa Ammons, Defendant (15-02163-svk), Pro se, Milwaukee, WI.

Trustee (2:15bk23361): Bruce A. Lanser, Waukesha, WI.

Judges: Susan V. Kelley, Chief United States Bankruptcy Judge.

Opinion by: Susan V. Kelley

Opinion

DECISION AND ORDER DISMISSING COMPLAINT

Landmark Credit Union ("Landmark") filed this adversary proceeding against Santresa Ammons (the "Debtor") for allegedly committing fraud in the creation of a \$5,582.96 debt to Landmark. The Debtor admitted depositing a check that was later dishonored but denied committing fraud. The Court held a trial on August 25, 2015 at which Paul Peterson testified for Landmark and the Debtor testified on her own behalf.

Landmark's evidence showed that the Debtor opened an account and deposited a check from Drafthouse Media, LLC for \$5,859.82. After waiting four days for the funds to become available, the Debtor withdrew \$5,450.00. The Debtor then made a few small purchases with the debit card tied to the account. Eight days later the check was returned because of insufficient funds. Landmark reversed the transaction and the Debtor's account became negative.

The Debtor [*2] testified that she was the victim of a lottery scam. She often entered the Publisher's Clearing House Sweepstakes online, and when she received a letter stating that she had won, she followed the instructions to claim her prize. According to the instructions in the letter, the Debtor was required to deposit the \$5,859.82 check and then send approximately \$5,400 in cash via UPS to an attorney for legal fees. The Debtor followed the instructions and only later realized she was the victim of a scam. She presented evidence of the correspondence she received and a receipt for her UPS transaction. She offered to have her mother and sister testify to confirm that she had sent the bulk of the money in cash to the alleged attorney for the sweepstakes.

Page 2 of 2

2015 Bankr. LEXIS 2842, *2

In order to except a debt from discharge due to a debtor's fraud under *Bankruptcy Code § 523(a)(2)(A)*, a plaintiff must prove that (1) the debtor obtained property through representations which the debtor either knew to be false or were made with such reckless disregard for the truth as to constitute willful misrepresentation; (2) the debtor possessed an intent to deceive; and (3) the creditor actually and reasonably relied upon the false representations. *In re Trevisan*, 300 B.R. 708 (Bankr. E.D. Wis. 2003) (citing *In re Levitsky*, 137 B.R. 288, 290 (Bankr. E.D. Wis. 1992)).

Landmark [*3] has failed to prove that the Debtor made a false representation or that the Debtor possessed an intent to deceive. A check is not a representation of any kind. *Id.* (citing *Williams v. U.S., 458 U.S. 279, 285-86, 102 S. Ct. 3088, 73 L. Ed. 2d 767 (1982)).* Landmark did not present any evidence that the Debtor did anything more than cash a check. Further, the Debtor testified credibly that she believed she had won the Publisher's Clearing House sweepstakes. While naïve, her belief was not unreasonable given her experience with the contest, the official looking correspondence that she received in the mail and the telephone conversations she had with the scammers.

This case is similar to <u>In re Kucera, 373 B.R. 878, 881-83 (Bankr. C.D. III. 2007)</u>, where a debtor became indebted to a bank after falling for a lottery scam and depositing a check that turned out to be counterfeit. The court in *Kucera* found that the plaintiff-bank failed to prove that the debtor made false representations or that the debtor acted with the requisite fraudulent intent. <u>Id. at 883-84</u>.

The Court makes the same findings here. The evidence shows that the Debtor did not make any misrepresentations to Landmark about the check, and that she did not intend to deceive Landmark when she opened the account and deposited the check. Accordingly, Landmark's claim under 11 U.S.C. § 523 fails. [*4]

IT IS THEREFORE ORDERED: the relief requested in the Complaint is denied, and the Complaint is dismissed.

Dated: August 26, 2015

/s/ Susan V. Kelley

Susan V. Kelley

Chief U.S. Bankruptcy Judge

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Neary v. McCarthy (In re McCarthy)

United States Bankruptcy Court for the Eastern District of Wisconsin

August 5, 2009, Decided

Chapter 7, Case No. 06-27298-jes, Adversary No. 07-2137

Reporter

418 B.R. 745 *; 2009 Bankr. LEXIS 3821 **

In Re: JOHN J. McCARTHY and JENNIFER M. McCARTHY, Debtors. WILLIAM T. NEARY, U. S. TRUSTEE, Plaintiff, -v- JOHN J. McCARTHY and JENNIFER M. McCARTHY, Defendants.

Subsequent History: Dismissed by, Discharge granted by <u>Neary v. McCarthy (In re McCarthy)</u>, <u>2009 Bankr. LEXIS</u> 2136 (Bankr. E.D. Wis., Aug. 5, 2009)

Core Terms

properties, Wisdom, mortgage, townhouse, lines, investors, bankruptcy petition, entities, credibility, transferred, consisted, schedules, parcels, funds, scam, fraudulent intent, reimbursement, exempt, mortgage foreclosure, purchase price, real estate, false oath, fraudulent, omissions, expenses, programs

Case Summary

Procedural Posture

Plaintiff United States Trustee (UST) filed a complaint to deny the Chapter 7 debtors a discharge under <u>11 U.S.C.S.</u> § 727(a)(4)(A), (a)(5), and (a)(2). The Chapter 7 supported the UST's position.

Overview

The debtors' real estate investments involved a scam orchestrated by a third party. The debtors contended that they were innocent investors who were victimized by the third party, while the UST contended that they were in cahoots with him. The UST failed to establish by a preponderance of the evidence all of the elements necessary for denial of a discharge under § 727(a)(4)(A). Although the debtors were educated and had business experience, the court concluded that they were credible and had no fraudulent intent. The court noted that an investigator for the state concluded that the debtors were only passive investors and were victims of a scam. With respect to § 727(a)(5), the UST did not make the initial prerequisite showing that substantial and identifiable assets were no longer available to the debtors' creditors. The purchase prices paid by the debtors for various parcels of real estate were well in excess of their fair market values, and the inflated prices were part of the scam perpetrated on them. In making pre-bankruptcy transfers, the debtors reasonably relied on the advice of their bankruptcy counsel, which negated the element of fraudulent intent required in § 727(a)(2).

Outcome

The adversary complaint was dismissed with prejudice, and the debtors were granted a discharge.

LexisNexis® Headnotes

Page 2 of 10

418 B.R. 745, *745; 2009 Bankr. LEXIS 3821, **3821

Bankruptcy Law > ... > Liquidations > Denial of Discharge > General Overview

Evidence > Burdens of Proof > Preponderance of Evidence

HN1[1] Liquidations, Denial of Discharge

A denial of a debtor's discharge is an extreme remedy and denial of such discharge must be construed liberally in favor of the debtor. However, a discharge is not a right but is a privilege and is available only to honest debtors. The burden of proof for denial of discharge is upon a plaintiff to establish grounds for denial of discharge by a preponderance of the evidence.

Business & Corporate Compliance > ... > Liquidations > Denial of Discharge > False Accounts & Oaths Bankruptcy Law > ... > Liquidations > Denial of Discharge > False Accounts & Oaths

Evidence > Burdens of Proof > Allocation

HN2 Denial of Discharge, False Accounts & Oaths

Under 11 U.S.C.S. § 727(a)(4)(A) (false oath or account), a United States Trustee must prove: (1) a debtor made a statement under oath; (2) which was false; (3) the debtor knew the statement was false; (4) the statement was made with a fraudulent intent; and (5) the statement related materially to the bankruptcy case. Omissions from the bankruptcy schedules and statement of financial affairs constitute a false oath for purposes of § 727(a)(4).

Business & Corporate Compliance > ... > Liquidations > Denial of Discharge > False Accounts & Oaths Bankruptcy Law > ... > Liquidations > Denial of Discharge > False Accounts & Oaths

<u>HN3</u>[基] Denial of Discharge, False Accounts & Oaths

A court may consider a debtor's subsequent voluntary disclosure as evidence of innocent intent.

Business & Corporate Compliance > Bankruptcy > Case Administration > Bankruptcy Court Powers Bankruptcy Law > Case Administration > Bankruptcy Court Powers

<u>HN4</u>[基] Case Administration, Bankruptcy Court Powers

A bankruptcy court is not bound by labels given to a debt in an agreement.

Business & Corporate Compliance > ... > Liquidations > Denial of Discharge > Asset Loss & Insolvency Bankruptcy Law > ... > Liquidations > Denial of Discharge > Asset Loss & Insolvency

Evidence > Burdens of Proof > Burden Shifting

HN5 Denial of Discharge, Asset Loss & Insolvency

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Under 11 U.S.C.S. § 727(a)(5), proof of fraudulent intent is not required. What must be shown is that a debtor failed to satisfactorily explain a loss of assets or a deficiency of assets. Initially, the objecting party must show that the debtor at one time owned substantial and identifiable assets which are no longer available to his or her creditors. Once this showing has been made, the burden then shifts to the debtor or debtors to provide a satisfactory explanation for the unavailability of the assets. Courts are not concerned with the wisdom of a debtor's disposition of assets and income but instead focuses upon the truth of the debtor's explanation.

Business & Corporate Compliance > ... > Liquidations > Denial of Discharge > Concealment & Fraudulent Transfers

Bankruptcy Law > ... > Liquidations > Denial of Discharge > Concealment & Fraudulent Transfers

HN6 Denial of Discharge, Concealment & Fraudulent Transfers

11 U.S.C.S. § 727(a)(2) requires proof of the following elements: (1) an act complained of done within one year before filing of a bankruptcy petition; (2) the act was done with actual intent to defraud; (3) the act was done by a debtor; and (4) the act consists of transferring or concealing property of the debtor.

Business & Corporate Compliance > ... > Liquidations > Denial of Discharge > Concealment & Fraudulent Transfers

Bankruptcy Law > ... > Liquidations > Denial of Discharge > Concealment & Fraudulent Transfers

HN7 Denial of Discharge, Concealment & Fraudulent Transfers

Pre-bankruptcy planning is, in and of itself, not improper. A debtor will be permitted to convert nonexempt property into exempt property before filing a bankruptcy petition. The practice is not fraudulent as to creditors and permits the debtor to make full use of the exemptions to which he is entitled under the law. However, where a conversion is made with the intent to defraud creditors, such conversion is objectionable and may provide a basis for denial of discharge under 1.0.s.\sigma 727(a)(2). Whether 5.0.s.\sigma 727(a)(2) applies depends on the facts and circumstances of each case.

Counsel: [**1] For John J. McCarthy, Debtor: D. Alexander Martin, DeWitt Ross & Stevens, Madison, WI.

For Jennifer M. McCarthy, aka Jennifer M. Suttles, Joint Debtor: D. Alexander Martin, DeWitt Ross & Stevens, Madison, WI.

Judges: JAMES E. SHAPIRO, UNITED STATES BANKRUPTCY JUDGE.

Opinion by: JAMES E. SHAPIRO

Opinion

[*748] DECISION

On December 20, 2006, John J. and Jennifer M. McCarthy ("McCarthys") filed a joint petition in bankruptcy under chapter 7, caused by the failure of their real estate investments in Minnesota.

Some facts in this case are undisputed. The McCarthys' Minnesota real estate investments involved a scam orchestrated by Vu Le a/k/a Vihn Le (hereafter referred to as "Vu Le") and by various entities controlled by him. Vu Le's present whereabouts are unknown. It is believed that he is the subject of a pending criminal investigation in Minnesota. The question before this court is: What role, if any, did the McCarthys have in Vu Le's scam? Were

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they, as they contend, innocent investors who, along with other parties, were victimized by Vu Le or were they, as the U.S. Trustee and chapter 7 trustee contend, in cahoots with Vu Le in his scam?

The U. S. Trustee ("UST") and Virginia E. George ("chapter 7 trustee") assert that the [**2] McCarthys are not deserving of a discharge in this bankruptcy. It is their position that the McCarthys were voluntary and eager participants in non-arm's length transactions and that Vu Le and the entities he controlled were insiders of the McCarthys. The UST and chapter 7 trustee further contend that the McCarthys fully knew their role as straw buyers, when title to each of the various parcels of real estate was placed in their names in exchange for fees. The chapter 7 trustee also asserts that the McCarthys crossed the line with respect to pre-petition bankruptcy planning by being overly aggressive in converting non-exempt assets into exempt assets.

This adversary complaint consists of the following counts:

[***749**] 1. § 727(a)(4)(A) (false oath),

- 2. § 727(a)(5) (failure to explain loss of assets), and
- 3. § 727(a)(2) (fraudulent transfer of property within one year of the filing of the bankruptcy).

This is a core proceeding under 28 U.S.C. § 157(b)(2)(J), and this court has jurisdiction under 28 U.S.C. § 1334.

BACKGROUND

John J. McCarthy ("John") and Jennifer M. McCarthy ("Jennifer") are married and have two minor children. When they filed their bankruptcy petition and before their involvement with [**3] Vu Le, they owned a home in Waukesha, Wisconsin, valued at \$ 275,000 and subject to a mortgage with a balance due of approximately \$ 223,750. They also, at that time, owned an income property consisting of a duplex in Milwaukee, Wisconsin, valued at \$ 90,000 and subject to a mortgage with a balance due of approximately \$ 81,900.

The McCarthys are both in their early thirties. Jennifer currently is a real estate broker who began working at Shorewest Realtors as a real estate agent in approximately 2003 and later obtained a real estate broker's license. She is primarily involved in residential sales, with annual earnings in the range of \$92,000 when this bankruptcy petition was filed. She is a graduate of the University of Wisconsin-Madison holding a bachelors degree in marketing and management. John also graduated from the University of Wisconsin-Madison, where he obtained a bachelors degree in engineering. He also holds a masters degree in engineering, which he received from Portland State University, and is currently employed at General Electric where he has worked since 2003. His annual salary at the time this bankruptcy petition was filed was in the range of \$69,000-75,000.

Before [**4] the McCarthys became involved in the Minnesota real estate investments, their financial condition was stable. That situation drastically changed after they invested in the Minnesota real estate properties.

HOW THE McCARTHYS BECAME INVOLVED WITH VU LE

In late 2005 or early 2006, the McCarthys were approached by Bryce Andrews ("Andrews"), a long-time friend of Jennifer, about an investment opportunity. Andrews and Jennifer had been in the same college business fraternity and remained good friends. Andrews told the McCarthys about an "amazing opportunity" for an investment he had with Wisdom Development Group ("Wisdom"), one of the entities controlled by Vu Le. Andrews showed the McCarthys some testimonial letters from prominent Minnesotans about this business opportunity and also displayed a spreadsheet which Andrews had created reflecting the potential profits which could be obtained from this investment opportunity. Wisdom had several alternative investment programs available for potential investors. While these programs differed with each other to some degree, they all provided for participating investors to become title owners and sign mortgages on these properties. Wisdom would make [**5] all of the financing

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arrangements with mortgage lenders obtained by Wisdom. The properties in these programs consisted of either vacant lots or partially developed lots owned by third parties and available for sale. Under these programs, Wisdom also arranged to have the properties fully developed as residential dwellings. All expenses in connection with these properties, including payment of the mortgages, would initially be paid by the investors who would then be promptly reimbursed by Wisdom. These expenses included not only the mortgage payments but all other [*750] expenses including construction costs, real estate taxes, and insurance. After these properties were fully developed, they would first be leased out by Property and Lease Management, LLC ("PLM"), which is another entity fully controlled by Vu Le. PLM would obtain tenants for these properties and also collect rents and maintain the properties. Approximately five years after the properties were fully completed, they would then be resold with Wisdom or another of the entities controlled by Vu Le handling the resales. The McCarthys testified that, for their part in signing as title owners and obtaining the loans, they would receive [**6] fees ranging from \$ 1,000 per property to \$ 3,500 per property. Later, when the properties were to be resold, they would also share in the profits from such resales. Jennifer testified that the percentage of profits which she and John were to receive upon resale would be "somewhere around 35 percent." (February 4, 2009 Tr. p. 160, line 7) Everything else that would be involved in these programs would be handled by Wisdom or one of Vu Le's other controlled entities. Wisdom drafted all of the agreements it entered into with the McCarthys.

Andrews told the McCarthys that, based on his experience, Wisdom had fully complied with all of its responsibilities, including reimbursement for any expenses including the mortgage payments which he incurred. The McCarthys, in reliance upon what they were told by Andrews, decided to invest with Wisdom and signed all of the agreements prepared by Wisdom without these documents first having been reviewed by legal counsel. During March and April of 2006, the McCarthys purchased four separate parcels of real estate - all located in Minnesota - as follows:

12th Avenue Property

This was the first transaction and involved the purchase of a vacant lot located [**7] at 2500 - 12th Avenue South, Minneapolis, Minnesota. This parcel was purchased solely in the name of John ¹ at a price of \$ 70,000. A \$ 358,500 mortgage loan was obtained from the Bank of Cherokee, which was used, in part, to pay the \$ 70,000 purchase price. The McCarthys understood that other withdrawals from this loan would be needed for anticipated construction costs. \$ 25,000 was paid to Acquisition Services, another Vu Le controlled entity, for construction. However, no construction was ever commenced. The full amount borrowed on this loan, including the purchase price of the lot, totaled \$ 105,950. John received a fee of \$ 2,500 for placing title to this property in his name. When John was asked what was the purpose of this fee, his response was: "for bringing our creditworthiness to the table as investors." (February 5, 2009 Tr. p. 23, lines 8-11)

1606 and 1608 Woodbridge, St. Paul, Minnesota

The next purchases made by the McCarthys consisted of two side-by-side townhouses which were nearly fully developed, except for completion of landscaping and construction of a driveway. Jennifer's friend, Andrews, was the seller of these townhouses. The McCarthys testified that, after the purchases of these properties, they discovered that what had been represented in the plans for these townhouses as containing three bedrooms in each townhouse contained only two bed [*751] rooms in each townhouse. Mortgages of \$ 238,000 were obtained for each townhouse. A portion of each mortgage loan was funded by Countrywide for \$ 190,400 and the balance of each mortgage loan of \$ 47,600 was funded by Homecomings Financial. Title to each townhouse was put in the names of both John and Jennifer who received a fee of \$ 3,500 for each townhouse. None of the remaining construction promised to be completed was ever performed. John also testified that appliances would be put in each townhouse, but no appliances were provided. Neither townhouse was ever leased. The McCarthys testified [**9] that there was a \$ 26,920 withdrawal made to Wisdom. They stated that they did not know why this

¹ When John was asked why he purchased this property only in his name, his response was: "We were looking at getting - you know, purchasing multiple properties. We were under the understanding that in order to - you know, in order to do multiple investments for properties, that if we had everything in both of our names it could limit [**8] our potential for acquiring more properties." (February 5, 2009 Tr. p. 10, lines 20-25)

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withdrawal was made because no further construction was performed on either townhouse after the purchases. Andrews never told the McCarthys how much he made from the sales of these townhouses to the McCarthys. However, at the trial, Andrews stated he received \$ 2,500 in the aggregate from the sales. (February 4, 2009 Tr. p. 184, lines 10-14)

5th Avenue Property

The final transaction involved a purchase of a vacant lot at 26XX - 5th Avenue, St. Paul, Minnesota, bought for \$ 120,000. At the closing, Acquisition Services, another entity controlled by Vu Le, received at least \$ 12,500 which the McCarthys understood would be used for closing costs and anticipated costs of construction for this property. No construction was ever started on this property. Jennifer purchased this property in her name only and received a \$ 1,000 fee. This transaction was funded by a mortgage with FCC Acquisition Corp. ² The total amount obtained from the mortgage loan, including the purchase price of the lot, was approximately \$ 147,000. (February 4, 2009 Tr. p. 73, lines 6-16)

WHAT HAPPENED AFTER THE PURCHASES?

In late June or early July of 2006, these Minnesota investments started to unravel. The McCarthys began receiving only partial reimbursement for mortgage payments which they made. By the end of August of 2006, Wisdom discontinued making all further reimbursements to the McCarthys.

The McCarthys testified that Wisdom paid them a total of \$23,481.30 of which \$10,500 consisted of the fees, with the balance as reimbursement for mortgage payments and miscellaneous other expenses which they made. The total amount which the McCarthys paid was \$28,936.35, leaving them with a deficit of \$5,455.05 (Plaintiff's exhibit 29). But the worst was yet to come.

In late July of 2006, the McCarthys met with Vu Le in Minnesota. This was their first and only meeting with him in person. They inquired why they were not being fully reimbursed for payments which they made and why the properties were not being developed. Jennifer testified that Vu Le failed to provide them with a satisfactory response.

Around the middle of December of [**11] 2006, a mortgage foreclosure proceeding was commenced by The Bank of Cherokee against the McCarthys in connection with the 12th Avenue property. The McCarthys tried to surrender this property to The Bank of Cherokee in lieu of foreclosure. They made this same attempt with the other mortgage lenders with respect to the other Minnesota parcels of real estate. [*752] However, all of these efforts failed. They then considered other alternatives, including selling the properties or developing them on their own. None of their options panned out. The McCarthys finally realized that their only recourse was to file a chapter 7 petition in bankruptcy.

The McCarthys' bankruptcy petition includes a combined unpaid balance due to the various mortgage lenders on these Minnesota properties in the amount of approximately \$ 728,000. In addition to the mortgage foreclosure brought on the 12th Avenue property by The Bank of Cherokee, mortgage foreclosure proceedings were also commenced with respect to the Woodbridge properties. No mortgage foreclosure proceedings have, as yet, been started in connection with the 5th Avenue property. The McCarthys testified that they also lost their investment property in Milwaukee [**12] through mortgage foreclosure.

LAW

² FCC Acquisition Corp. and Acquisition [**10] Services are two separate entities. FCC Acquisition Corp. is not controlled by Vu Le, while Acquisition Services is a Vu Le controlled entity.

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The court recognizes that <code>HN1[]</code> a denial of a debtor's discharge is an extreme remedy and that denial of such discharge must be construed liberally in favor of the debtor. <code>In re Koss, 403 B.R. 191 (Bankr. D. Mass. 2009)</code>. At the same time, however, the court also recognizes that a discharge is not a right but is a privilege and is available only to honest debtors. <code>Id. at 215</code>. The burden of proof for denial of discharge is upon the UST to establish grounds for denial of discharge by a preponderance of the evidence. <code>In re Serafini</code>, <code>938 F.2d 1156 (10th Cir. 1991)</code>.

FALSE OATH - SEC. 727(a)(4)(A)

HN2 1 Under § 727(a)(4)(A) (false oath or account), the U. S. Trustee must prove:

- 1. debtor made a statement under oath,
- 2. which was false,
- 3. debtor knew statement was false,
- 4. the statement was made with a fraudulent intent, and
- 5. statement related materially to the bankruptcy case.

In re Beaubouef, 966 F.2d 174, 178 (5th Cir. 1992). Omissions from the bankruptcy schedules and Statement of Financial Affairs constitute a false oath for purposes of § 727(a)(4). In re Hamilton, 390 B.R. 618, 625 (Bankr. E.D. Ark. 2008) ("Omissions from schedules qualify as a false oath if they are [**13] made knowingly and with fraudulent intent."); In re Glenn, 335 B.R. 703, 707 (Bankr. W.D. Mo. 2005); In re Bostrom, 286 B.R. 352, 360 (Bankr. N.D. III. 2002).

In this case, the chapter 7 trustee testified that there were numerous omissions from the debtors' schedules and Statement of Financial Affairs ("SOFA"), including the following:

- 1. Schedule G. Although the McCarthys disclosed the various agreements entered into with Wisdom and PLM, the chapter 7 trustee contends that these disclosures were "kind of skiddy on characterization" (February 4, 2009 Tr. p. 227, lines 21-22). In her opinion, the disclosures made were not an accurate or truthful statement of the McCarthys' interest in these properties.
- 2. Questions 1 and 2 of SOFA. Failure to disclose the \$ 10,500 fees which the McCarthys received from Wisdom.
- 3. Question 10 of SOFA. Failure to disclose preferential transfers.
- 4. Question 14 of SOFA. Failure to disclose property held for another person.
- 5. Question 21 of SOFA. Failure to disclose the McCarthys' partnership interest.

[*753] With respect to the chapter 7 trustee's assertions of inaccuracies in Schedule "G," she did acknowledge that the supporting documents she requested from the McCarthys [**14] to more accurately explain the nature of their involvement in the Minnesota properties were voluntarily turned over to her before the adjourned § 341 meeting of creditors held on February 20, 2007. It is well established that <code>HN3[*]</code> the court may consider the debtor's subsequent voluntary disclosure as evidence of innocent intent. <code>In re Kelly, 135 B.R. 459, 461 (Bankr. S.D. N.Y. 1992); In re Giquinto, 388 B.R. 152, 181 (Bankr. E.D. Pa. 2008).</code>

With respect to the lack of disclosure of fees which the McCarthys received, Atty D. Alexander Martin, who prepared the McCarthys' bankruptcy petition and schedules, testified that the reason these fees were not disclosed in either Questions 1 or 2 of SOFA was because he "missed it." (February 5, 2009 Tr. p. 179, line 20) Atty Martin also testified that he did not include any preferences in Question 10 of SOFA because he concluded that the McCarthys' debts, being primarily non-consumer debts, did not include any payments in excess of \$5,000, which was the prerequisite amount to qualify as a preferential payment within the meaning of \$547(c)(9)\$ when this bankruptcy case was filed. Atty Martin further stated that this was a complicated case which required [**15] an emergency filing and added: "At the time I filed, I thought it was my best work. Looking back on it, I could have improved; I could have done better." (February 5, 2009 Tr. p. 180, lines 5-7) Atty Martin also stated that he answered Questions 14 and 21 of SOFA as "none" because he reached the conclusion that the debtors were not partners with Vu Le. The court is aware that one of the exhibits in this adversary proceeding is an agreement in

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connection with the 5th Avenue Property between Property Lease Management LLC and Jennifer labeled a "Partner Agreement," and which also referred to Jennifer as "Partner". However, the record in this case persuades the court that neither Jennifer nor John had any control over any of the parcels of real estate they purchased. It is well established that HN4[] the bankruptcy court is not bound by labels given to a debt in the parties' agreement. 6 Collier on Bankruptcy/P 523.11[6][a] (15th ed. rev.). Mark Dorman, a 25-year veteran investigator for the Wisconsin Department of Revenue assigned to the task of investigating possible security violations involving Vu Le, testified that: "[i]t's very common for investors to be referred to as partners in schemes [**16] involving securities transactions." (February 5, 2009 Tr. p. 94, lines 1-4).

This case turns on the credibility of the McCarthys in deciding if they were innocent investors duped by a con artist, or were more deeply involved with Vu Le in a scheme. The chapter 7 trustee testified that it is simply unbelievable that the McCarthys, in view of their educational background and business expertise: "... would risk incurring a million dollars in debt to get \$ 2,500 on each of the parcels. It never made any sense to me." (February 4, 2009 Tr. p. 250, lines 18-21) Fraudulent intent is a difficult element to establish because, generally, it is the debtor or debtors who are the only persons able to testify as to their true intent. In this case, the court, having had an opportunity to observe and evaluate the demeanor of the McCarthys, was impressed by their credibility and is persuaded that there was no fraudulent intent on their part.

The most compelling testimony which supports this conclusion with respect to credibility was presented by Dorman. He stated that he had interviewed the McCarthys to establish their credibility as well as the credibility of other investors with Vu [*754] Le and concluded that [**17] the McCarthys were only passive investors and victims of the scam perpetrated by Vu Le. (February 5, 2009 Tr. p. 89, line 12) He further testified that the fees paid to the McCarthys were part of a "lulling technique to have them thinking they were actually in a legitimate investment." (February 5, 2009 Tr. p. 95, lines 23-25) Dorman added that people who are "smarter, richer, and more successful" than the McCarthys also lost money in these types of schemes. (February 5, 2009 Tr. p. 100, lines 2 and 3) He concluded by stating that the McCarthys had no control over the promised construction of the various real estate properties which they had purchased in their names, and in his opinion, this was not a straw man scheme because the McCarthys were not conscious of their role in this scheme.

The lesson learned from this case is that even intelligent people, like the McCarthys, can be duped by a clever con artist.

Recently, in *In re Guillet, 398 B.R. 869 (Bankr. E.D. Tex. 2008)*, the court concluded that the debtor, a doctor by occupation who had previously been involved in various business enterprises, was a victim of a scam rather than a perpetrator in the scam. The court, finding that the [**18] debtor was truthful and credible in his testimony and entitled to a bankruptcy discharge, declared: "financial victims, no matter how desperate, foolish, or stupid, should not be financially punished for their ineptitudes." *Id. at 891*.

Any omissions from the McCarthys' schedules resulted from unintentional mistakes and not from any fraudulent intent on their part. Atty Martin has accepted full responsibility for omissions which should have been included in the bankruptcy schedules. This is in sharp contrast to what occurred in *In re Dailey, 405 B.R. 386 (Bankr. S.D. Fla. 2009)*. In <u>Dailey, the debtor attempted to blame his former bankruptcy counsel but failed to call that counsel to testify at the trial. The court in <u>Dailey</u> stated that the debtor's failure to have his former attorney testify caused the court to draw an adverse inference from such failure, and the debtor was denied a discharge. In the case at bar, however, the McCarthys did call Atty Martin, who had prepared the bankruptcy petition and schedules, to provide testimony.</u>

SEC. 727(a)(5)

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HN5 Under [**19] § 727(a)(5), proof of fraudulent intent is not required. What must be shown is that the McCarthys failed to satisfactorily explain a loss of assets or a deficiency of assets. Initially, the UST, as the objecting party, must show that the McCarthys at one time owned substantial and identifiable assets which are no longer available to their creditors. In re Bostrom, 286 B.R. 352, 364 (Bankr. N.D. III. 2002); In re Stamat, 395 B.R. 59, 76 (Bankr. N.D. III. 2008). Once this showing has been made, the burden then shifts to the debtor or debtors to provide a satisfactory explanation for the unavailability of the assets. Stamat, 395 B.R. at 76. Stamat further states that courts are not concerned with the wisdom of a debtor's disposition of assets and income but instead focuses upon the truth of the debtor's explanation. See also In re Maletta, 159 B.R. 108, 116 (Bankr. D. Conn. 1993) ("The test under this subsection relates to the credibility of the proffered explanation, not the propriety of the disposition.")

The UST did not make the initial prerequisite showing that substantial and identifiable assets are no longer available [*755] to the McCarthys' creditors. The court is persuaded that the purchase [**20] prices paid by the McCarthys for the various parcels of real estate were well in excess of their then fair market values. The inflated purchase prices paid for the Minnesota properties were part of the scam perpetrated upon the McCarthys by Vu Le. When John was asked at the trial by his attorney if there were any assets lost or dissipated, he responded:

No. I mean, the question is really the property never had the value - they never had the asset. I mean, they were appraised for more than what actual value there was. There never had a loss of assets; they simply didn't have them. The properties were never finished.

(February 5, 2009 Tr. p. 117, lines 8-13). Even had the UST overcome this hurdle, the court concludes that the McCarthys were truthful in explaining what occurred, to the best of their ability. They fully cooperated with the UST and Chapter 7 Trustee in promptly turning over all documentation in their possession when asked to do so.

The court concludes that denial of discharge under § 727(a)(5) has not been established.

SEC. 727(a)(2) - FRAUDULENT TRANSFER OR CONCEALMENT OF PROPERTY

The UST's third count for denial of discharge is grounded upon its contention that the McCarthys [**21] transferred certain assets from non-exempt funds into exempt funds, consisting of the following:

- 1. \$ 2,500 transferred on October 9, 2006 and
- 2 \$ 7,400 transferred on December 13, 2006. ³

in violation of 11 U.S.C. § 727(a)(2).

The McCarthys have responded by stating that these transfers were made upon advice of their bankruptcy counsel.

HN6 Sec. 727(a)(2) requires proof of the following elements:

- 1. act complained of done within one year before filing of bankruptcy petition,
- 2. act was done with actual intent to defraud,
- 3. act was done by the debtor, and
- 4. act consists of transferring or concealing property of the debtor.

<u>HN7</u> Pre-bankruptcy planning is, in and of itself, not improper. As noted in <u>Collier on Bankruptcy</u>, both the House and Senate Reports validate this approach by stating the following:

As under current law, the debtor will be permitted to convert nonexempt property into exempt property before filing a bankruptcy petition. [**22] The practice is not fraudulent as to creditors and permits the debtor to make full use of the exemptions to which he is entitled under the law.

³ In addition, there was a third transfer of \$ 1,800 on December 21, 2006, which was made one day after the McCarthys filed their bankruptcy petition. This transfer has not been challenged by the chapter 7 trustee, who has since filed a no asset report in this case.

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6 Collier on Bankruptcy P 727.02[3][f] (15th ed. rev.), citing 50 H.R. Rep. 595, 95th Cong. 1st Sess. 361 (1977), reprinted in App. Pt. 4(d)(l) infra; S. Rep. No. 989, 95th Cong., 2d Sess. 76 (1978), reprinted in App. Pt. 4(e)(l) infra. However, where a conversion is made with the intent to defraud creditors, such conversion is objectionable and may provide a basis for denial of discharge under § 727(a)(2). In re Smiley, 864 F.2d 562 (7th Cir. 1989). Smiley also recognizes that conversions of assets [*756] from non-exempt to exempt forms within a year preceding a petition in bankruptcy are not necessarily fraudulent, and whether § 727(a)(2) applies depends on the facts and circumstances of each case.

The record in this case shows that the McCarthys established a pattern over the years of periodically setting aside some of their funds for retirement purposes. Moreover, the total amount in this case (\$ 9,900) is not excessive. This court in *In re Bogue, 240 B.R. 742 (Bankr. E.D. Wis. 1999)*, concluded that where a debtor placed \$ 17,800 into exempt annuity [**23] contracts it was not an exorbitant amount. The court is also persuaded that the McCarthys reasonably relied on the advice of their bankruptcy counsel in making these pre-bankruptcy transfers and that such reliance has negated the element of fraudulent intent required in § 727(a)(2).

Because the transfer of these funds by the McCarthys was not made with actual intent to defraud creditors, denial of discharge under § 727(a)(2) is not warranted.

CONCLUSION

The UST has not established, by a preponderance of the evidence, that the McCarthys should be denied a discharge under \S 727(a)(2), \S 727(a)(4), or \S 727(a)(5). This adversary complaint is dismissed, with prejudice, and the McCarthys shall be granted a discharge.

The foregoing constitutes the court's findings of fact and conclusions of law pursuant to <u>Federal Bankruptcy Rule</u> 7052.

A separate order dismissing this adversary proceeding shall be issued.

Dated at Milwaukee, Wisconsin, this 5 day of August, 2009.

BY THE COURT:

/s/ James E. Shapiro

JAMES E. SHAPIRO

U. S. BANKRUPTCY JUDGE

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Payment Scams: Information on Financial Industry Efforts

GAO-24-107107 (Accessible Version) Q&A Report to Congressional Requesters

July 25, 2024

Why This Matters

Scams are a significant and growing problem for U.S. individuals and businesses. Some scams result in a fraudulently induced payment, which occurs when a person with payment authority is manipulated or deceived into making a payment for the benefit of the scammer. These scams succeed by playing on a victim's emotions and exploiting vulnerabilities, often resulting in significant financial losses.

For example, losses from one type of fraudulently induced payment scam—fake investment opportunities—rose from \$3.31 billion in 2022 to \$4.57 billion in 2023, according to the Federal Bureau of Investigation's (FBI) 2023 Internet Crime Report on reported complaints. The federal government has not reported on total losses associated with fraudulently induced payments, in part due to underreporting by victims. Even when victims do report such scams, it can be challenging to recover the funds.

We were asked to review the characteristics of fraudulently induced payments and how financial institutions and peer-to-peer (P2P) payment companies mitigate the impacts of these scams. This report provides information on fraudulently induced payment scams, including reported efforts by selected financial institutions to mitigate these scams.

Key Takeaways

- Fraudulently induced payment scams can take many forms, but they
 generally involve scammers playing on victims' emotions to manipulate them
 into sending money. Some scammers are using generative artificial
 intelligence (AI)—technology that can create text, images, audio, or video—
 which is making these scams harder for victims to detect, according to select
 industry stakeholders and federal agencies.
- Financial institutions are generally not required under federal law to reimburse consumers for losses stemming from a fraudulently induced payment because such a payment is authorized by a person with payment authority on the account (i.e., the owner of the account or other authorized person).
- Financial institutions and P2P payment companies provide consumer education and staff training in various manners and degrees, to help identify and avoid potential scams. Additionally, select institutions and payment apps

Page 1 GAO-24-107107 Payment Scams

have put in place measures to slow down payments to provide the consumer an opportunity to verify the legitimacy of the payment.

 Industry representatives we interviewed recommend a multisector approach, including telecommunications and social media companies, as well as law enforcement, to address fraudulently induced payments.

What kinds of scams involve fraudulently induced payments and how are they carried out?

Well known examples of scams that result in fraudulently induced payments include romance, government impersonation, investment, and business email compromise scams according to financial industry representatives and relevant federal agencies we spoke with (see fig. 1).¹

Figure 1: Examples of Fraudulently Induced Payment Scams



Sources: GAO Antifraud Resource (information); Icons-StudioIstock.adobe.com, sdecoret/stock.adobe.com, GAO (icons). | GAO-24-107107

Accessible Text for Figure 1: Examples of Fraudulently Induced Payment Scams

Romance/relationship scam	Government impersonation scam	Investment scam	Business email compromise scam
A scammer adopts a fake online identity to gain a victim's affection (romantic or platonic) and trust and then uses the illusion of a romantic or close relationship to manipulate or steal from the victim.	A scammer fraudulently identifies as a government official to manipulate or steal from the victim.	A scammer offers low- or no-risk investments, guaranteed returns, overly consistent returns, complex strategies, or unregistered securities to manipulate or steal from the victim.	A scammer targets a business or individual and takes over an official account or uses email spoofing to attempt to redirect payments to an illicit account controlled by the fraudster to steal from the victim.

Sources: GAO Antifraud Resource (information); Icons-Studio/stock.adobe.com, sdecoret/stock.adobe.com, GAO (icons). I GAO-24-107107

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Individuals continue to fall victim to these scams because scammers use social engineering, a form of deception that uses human psychology to target and manipulate individuals and make them more susceptible to the scams, according to financial industry representatives and federal agencies we interviewed.

Social engineering tactics are becoming increasingly sophisticated. For example, a scammer may obtain a victim's personal information to better convince the victim that the scammer is calling from a federal agency. Additionally, scammers may adopt different roles to gain their victim's trust. For example, a scammer may initiate contact as a technical support person, then contact the victim impersonating a financial institution and finally, contact the victim posing as a government employee. Figure 2 illustrates scenarios of selected scams involving fraudulently induced payments and the text box below describes combined romance/ relationship and investment scams.

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Romance or Government Investment scam **Business email** relationship scam impersonation scam compromise scam The scammer contacts 1 The scammer contacts The scammer posts an the victim via a dating the victim, spoofing the advertisement on social I fraudulently gains media sites for an access to a legitimate application or other authentic phone unrealistically social media site. number, name, and email account or uses credentials of a spoofing to make a promising investment well-known law opportunity. fake account appear enforcement or legitimate. government agency. Spoofing is a mechanism that uses deliberately falsified Initial contact information to contact appear to be from a legitimate source. The scammer's The scammer contacts advertisement tells the the victim using the victim to invest. compromised or spoofed email account. The scammer gains the 1 The scammer tells the victim's trust by victim that they owe establishing an online taxes and must pay relationship and often immediately. The promising to meet. scammer may read the victim their Social Security number and date of birth to make Initial the scam seem more convincing. The victim follows I The scammer asks the the link in the victim to transfer money advertisement. as if it were a legitimate business transaction. The scammer claims The scammer threatens they have had a to arrest or deport the victim if they do not pay medical or other emergency and asks the "taxes." the victim for money they promise to pay back Transfer The victim transfers The victim transfers The victim transfers The victim transfers money to the scammer, money to the scammer. money to a fictitious money to the scammer. then the scammer stops investment controlled communicating with the by the scammer. victim.

Figure 2: Illustrative Scenarios of Fraudulently Induced Payment Scams

Sources: GAO analysis of fraud awareness resources (information); Icons-Studio/stock.adobe.com, sdecoret/stock.adobe.com, GAO (icons). | GAO-24-107107

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Accessible Text for Fig	gure 2: Illustrative Scenarios	of Fraudulenth	v Induced Par	vment Scams
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Category	Phase one	Phase two	Phase three	Phase four
Romance Scam	The scammer contacts the victim via dating applications or other social media site.	The scammer gains the victim's trust by establishing an online relationship and often promising to meet.	The scammer tells the victim they have had a medical emergency and asks the victim for money. They promise to pay the money back.	The victim transfers money to the scammer, once the scammer receives the funds they stop communicating with the victim.
Government Impersonation Scam	The scammer contacts the victim, spoofing the authentic phone number, name, and credentials of a well-known law enforcement or government agency.	The scammer tells the victim that their identity was used in a crime or that they owe taxes. The scammer may read the victim their social security number and date of birth to make the scam seem more convincing.	The scammer threatens to arrest, prosecute, or imprison the victim if they do not pay to remove the charges.	The victim transfers money to the scammer.
Investment Scam	The scammer posts an advertisement on social media sites for an investment opportunity with unrealistically high returns.	The scammer's advertisement tells the victim to invest.	The victim follows the link in the advertisement.	The victim transfers money to invest in the fictious financial product, but is actually transferring money into an account controlled by the scammers.
Business Email Compromise Scam	The scammer either gains access to legitimate email account of a person in authority supervisor or uses spoofing. Spoofing is a tactic involving the forging of email header information to make it look very similar to the legitimate account.	The scammer contacts the victim using the compromised email account or with a spoofed email.	The scammer asks the victim to transfer money as if it were a legitimate business transaction.	The victim transfers money to the scammer.

Sources: GAO analysis of fraud awareness resources (information); Icons-Studio/stock.adobe.com, sdecorel/stock.adobe.com, GAO (icons). I GAO-24-107107

Combined Romance/Relationship and Investment Scams

In some cases, several types of scams may be used in combination. For example, a combined romance/relationship and investment scam, colloquially referred to by scammers as "pig butchering", involves a series of manipulative tactics aimed at defrauding victims through fake

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relationships, and fraudulent investment opportunities through a website or application platform. Scammers gain their victim's trust through a romance/relationship scam using an online platform, such as a dating app or social media site or through a seemingly misdirected text message. Once trust has been established, criminals introduce the topic of cryptocurrency investment and claim to have expertise or know an expert who can help potential investors achieve financial success. Criminals then convince their targets to use fraudulent websites or apps, controlled by the criminals, to invest in cryptocurrency. When the victim attempts to withdraw money, they are told they need to pay a fee or taxes. However, the criminals never release the funds, even if their victims pay the imposed fees or taxes. This can leave the victim financially devastated, sometimes having liquidated assets or mortgaged a home to make the "investments." In our prior work we recommended, among other things, that the Consumer Financial Protection Bureau and other relevant regulators work jointly to adapt an existing formal coordination mechanism for collectively identifying risks posed by blockchain-related products and services, such as cryptocurrencies, and formulate a timely regulatory response.^a The recommendations to these agencies have not yet been addressed.

Source: GAO analysis of fraud awareness resources. | GAO-24-107107

^aSee GAO, Blockchain in Finance: Legislative and Regulatory Actions Are Needed to Ensure Comprehensive Oversight of Crypto Assets, GAO-23-105346 (Washington, D.C.: June 22, 2023).

How are criminals using technology in these scams?

Some scammers are using technology, such as generative artificial intelligence (AI), to conduct fraudulently induced payment scams. Generative AI enables the creation of content, including text, images, audio, or video, when prompted by a user. This technology can be exploited by scammers to alter voices and images, according to our investigative research on scammers.

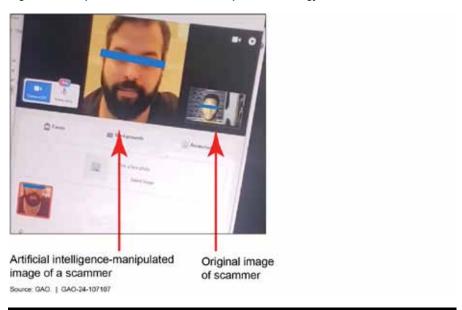
Use of generative AI is making these scams harder for victims to detect, according to industry stakeholders and officials we spoke with from federal agencies including the U.S. Secret Service, the Federal Reserve Board, and the Federal Deposit Insurance Corporation (FDIC).²

Scammers may use various tactics to deceive victims using generative AI, including the following:

- Through voice cloning, impersonating their family or friends, claiming to need money for an emergency;³
- Through voice cloning, impersonating business officials, urgently requesting immediate payment using changed payment instructions (such as a different account and routing number); and
- Through deepfakes (real-seeming but altered video, audio, or images) to gain trust (see fig. 3).⁴ Deepfakes allow scammers to misrepresent themselves as reflecting a variety of backgrounds, languages, statuses, and genders to build rapport with a victim.

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Figure 3: Example of a Scammer's Use of Deepfake Technology



Accessible Text for Figure 3: Example of a Scammer's Use of Deepfake Technology

- Artificial intelligence-manipulated image of a scammer
- Original image of scammer

Source: GAO. I GAO-24-107107

The threat of deepfakes comes from people's natural inclination to believe what they see, and as a result, deepfakes do not need to be particularly advanced or believable to be effective in spreading misinformation, according to a report on deepfake identities published by the U.S. Department of Homeland Security.⁵

Some transnational criminal organizations have also built sophisticated websites and apps to facilitate their scams. These fraudulent platforms, such as cryptocurrency investment websites, often feature legitimate looking interfaces, "log-in" systems, and multifactor authentication to create the illusion of security, according to financial industry representatives we spoke with. In addition, it has been alleged that fake investment apps created by scammers have made their way on to well-known official stores for download to consumers.

Scammers also may use spoofing—deliberate use of false information in a caller ID—to disguise their identity, according to industry stakeholders and the FBI. To build trust, scammers use a local phone number or number of a company or government agency the victim knows. For example, scammers may impersonate a government official and claim the victim owes money to obtain a fraudulently induced payment.

How widespread are fraudulently induced payment scams?

There are no complete measures or estimates of how widespread fraudulently induced payment scams are or the financial losses they have caused. While some federal agencies and financial institutions collect information on fraud, they do not specifically categorize the information as fraudulently induced payments

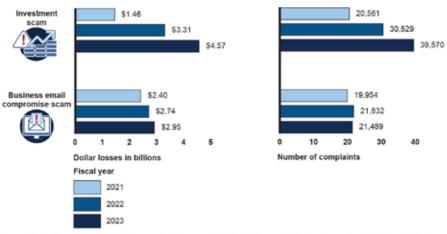
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as compared with other types of fraud. Officials from the Federal Trade Commission (FTC), the federal agency that seeks to protect consumers from deceptive or unfair business practices, told us this is due to the highly varied nature of these scams and the limitations of consumer self-reporting.

However, data from two federal agencies offer insights into the frequency and financial impact of certain scams, which can include fraudulently induced payments.⁸

- FTC. According to the FTC's Consumer Sentinel Network Data Book, consumers reported losing over \$10 billion to fraud in 2023. Impersonation scams accounted for nearly \$2.7 billion of these losses, resulting from 853,935 reports. These scams include people falsely claiming to be a romantic interest, relative in distress, government representative, well-known business, or technical support expert. Additionally, consumers reported losing \$4.6 billion to investment-related fraud in 2023, stemming from 107,699 reports of scammers offering fake investment opportunities. 10
- FBI. According to the FBI's Internet Crime Complaint Center's 2023 Internet Crime Report, individuals reported losing \$4.57 billion to investment scams and \$2.95 billion to business email compromise scams in 2023 (see fig. 4).¹¹ These figures stem from 39,570 complaints and 21,489 complaints, respectively. The number of complaints of scams, and the amounts of losses, reported to the Internet Crime Complaint Center generally grew in the past 3 years, according to data.¹²

Figure 4: Financial Losses and Number of Complaints Related to Investment and Business Email Compromise Scams Reported to the Federal Bureau of Investigations, Fiscal Years 2021 through 2023



Sources: Federal Bureau of Investigation's Internet Crime Reports 2021-2023 (data); Icons-Studio/stock.adobe.com (icons). | GAO-24-107107

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Accessible Data for Figure 4: Financial Losses and Number of Complaints Related to Investment and Business Email Compromise Scams Reported to the Federal Bureau of Investigations, Fiscal Years 2021 through 2023

Investment scam

Dollar losses in billions	Number of complaints
\$1.46	20,561
\$3.31	30,529
\$4.57	39,570

Business email compromise scam

Dollar losses in billions	Number of complaints
\$2.4	19,954
\$4.74	21,832
\$2.95	21,489

Sources: Federal Bureau of Investigation's Internet Crime Reports 2021-2023 (data); Icons-Studio/stock.adobe.com (icons). I GAO-24-107107

These measures have limitations, as they capture some types of scams and rely on victim reporting. Studies have found that a substantial portion of victims of fraudulently induced payment scams never report the scams. For example, the FTC reported that its 2005-2017 mass-market consumer fraud surveys suggest that less than 3 percent of consumers who experienced fraud reported it to a government entity.¹³

Estimates can be used to approximate the extent of scams beyond what can be directly counted through reported complaints. However, available estimates encompass various types of fraud and not just fraudulently induced payment scams. For example, the FTC estimated that consumer losses to fraud in 2022 may have been as high as \$137.4 billion. ¹⁴ This estimate assumes a 2 percent reporting rate for losses of less than \$1,000 and a 6.7 percent reporting rate for losses over \$1,000. The FTC also estimated that if it assumed all individuals who experienced a loss of \$10,000 or more reported it, consumer losses to fraud would have been estimated to have been \$20.5 billion in 2022.

The Global Anti-Scam Alliance, an international knowledge-sharing organization, estimated Americans lost \$159 billion to scams in the period from July 2022 through August 2023. 15 This estimate was calculated by assuming an average \$2,663 loss per scam and that 23 percent of the U.S. adult population had been scam victims that year.

What are examples of enforcement actions involving fraudulently induced payments that have been pursued by the Department of Justice and federal regulators?

The Department of Justice (DOJ) and federal regulators have pursued criminal and civil enforcement actions against entities charged with scams involving fraudulently induced payments. Figure 5 provides examples of adjudicated cases pursued by DOJ. ¹⁶

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Figure 5: Selected Examples of Criminal Cases Brought by DOJ for Scams Involving Fraudulently Induced Payments

Type of scam Description of losses Impacts . In 2023, seven individuals were sentenced Victims lost more than \$11.8 million to between 60 months in prison to probation. in romance scams organized by a coordinated group of scammers. · The individuals were ordered to pay approximately \$11.8 million in restitution. Victims lost at least \$30 million to From 2020 to 2023, 41 individuals were romance scams, business email sentenced to up to 97 months in prison. compromise scams, and other . The individuals were ordered to pay up to scams perpetrated by a large-scale \$9 million in restitution. fraud ring. **Business email** compromise scam . In 2024, an individual was sentenced to Over 2,700 victims lost more than \$2.4 million in a government more than 30 months in prison. impersonation scam. Government . The individual was ordered to pay over \$2. impersonation scam million in restitution.

Accessible Text for Figure 5: Selected Examples of Criminal Cases Brought by DOJ for

Sources: GAO analysis of Department of Justice (DOJ) information, Icons-Studio/stock adobe com, bsd studio/stock adobe com, GAO (icons). | GAO-24-107107

Scams Involving Fraudulently Induced Payments

Type of scam	Description of losses	Impacts
Romance scam	Victims lost more than 11.8 million in romance scams organized by a coordinated group of scammers.	 In 2023, seven individuals were sentenced to between 60 months in prison and probation. The individuals were ordered to pay approximately \$11.8 million in restitution.
Romance scam Business email compromise scam	Victims lost at least \$30 million to romance scams, business email compromise scams, and other scams perpetrated by a large-scale fraud ring.	 From 2020 to2023, 41 individuals were sentenced up to 97 months in prison. The individuals were ordered to pay up to \$9 million in restitution.
Government impersonation scam	Over 2,700 victims lost more than \$2.4 million in a government impersonation scam.	 In 2024, an individual was sentenced to more than 30 months in prison. The individual was ordered

Sources: GAO analysis of Department of Justice (DOJ) information; lcons-Studio/stock.adobe.com, bsd studio/stock.adobe.com, GAO (icons). I GAO-24-107107

to pay over \$2 million in

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restitution.

DOJ has also brought indictments in cases related to combined romance/investment scams. In one case, DOJ alleges victims lost more than \$80 million through at least 284 transactions. In another case, DOJ alleges victims lost at least \$73 million. Both cases are currently pending.

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In addition, the FTC and the Consumer Financial Protection Bureau (CFPB) have taken civil actions related to such scams. For example, the FTC has brought cases against companies using spoofed caller ID information to send robocalls, including one company that impersonated the Social Security Administration.¹⁷ The FTC also has taken action against companies for facilitating consumer harm by allowing scammers to use their payment systems to perpetrate romance and other scams.¹⁸ Similarly, the CFPB brought charges in March 2021 against a company for knowingly processing payments for companies engaged in internet-based technical-support fraud.¹⁹

Are financial institutions required by federal law to reimburse consumers who are victims of fraudulently induced payments?

Generally, no. If a consumer is fraudulently induced to authorize a payment from their account, the consumer may be responsible for the payment under federal law, notwithstanding the circumstances because they authorized the payment. ²⁰ The Electronic Fund Transfer Act, as implemented by Regulation E, is the primary federal law that governs who is liable (i.e., responsible) for a fraudulently induced payment.²¹ Regulation E applies to financial institutions, which covers both depository institutions, such as banks and credit unions, and nondepository institutions, which can include entities such as P2P companies.²²

Generally, under Regulation E, a consumer is responsible for payments from their account that have been authorized.²³ In contrast, when an unauthorized payment is made from their account, the consumer may not be held responsible for that payment in its entirety; rather, the financial institution holding the account may bear some responsibility. Consumers can only be held responsible under Regulation E for an unauthorized payment up to the amounts prescribed in the regulation (e.g., up to \$50, if the consumer notifies the financial institution within 2 business days after learning of the loss or theft of the access device that was used to initiate the unauthorized payment).²⁴

Under Regulation E, a payment is defined to be "unauthorized" when the payment made from the consumer's account is not made by that consumer (or a person who otherwise has authority to initiate the payment) and the consumer receives no benefit from the transaction.²⁵ In the case of a fraudulently induced payment, the scammer induces the consumer victim to make the payment and send it to the scammer for the scammer's benefit. Under Regulation E, this generally would be an authorized payment. Accordingly, the consumer would be responsible for the payment and the financial institution would have no obligation to reimburse the consumer for their loss.²⁶

For example, if Scammer convinces Victim under false pretenses to send Scammer \$1,000 for car repairs and Victim uses their bank account to electronically send \$1,000 to the account of Scammer, this is an authorized payment under Regulation E, because Victim sent the funds themself. In this case, the financial institution holding Victim's account would generally not be required to reimburse Victim, pursuant to Regulation E. (see fig. 6)

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Figure 6: Illustrative Scenarios of Consumer Responsibility for Payment under Regulation E



Accessible Text for Figure 6: Illustrative Scenarios of Consumer Responsibility for Payment under Regulation E

Victim

- Instructs financial institution to pay scammer for "car repairs."
- Victim's financial institution
- · Scammer's financial institution
- Authorized payment (consumer responsible for payment)

Scammer

- · Hacks into victims financial institution account.
- Victim's financial institution
- Scammer's financial institution
- Unauthorized payment (consumer may not be responsible for payment)

Sources: GAO (information); Icons-Studio/stock.adobe.com, GAO (icons). I GAO-24-107107

If a consumer reports a fraudulent payment to a financial institution (i.e., asserts an "error" on the account), a financial institution is required to investigate the transaction to determine whether the consumer or the financial institution is responsible for the payment, pursuant to its error resolution obligations under Regulation E.²⁷ This investigation determines whether the payment was authorized or unauthorized and, accordingly, who is responsible for the payment and in what amount.²⁸ The financial institution has up to 10 business days, or up to 90 days in certain circumstances, to complete its investigation, upon receipt of notice from the consumer that they believe an "error" has occurred. Once the investigation is complete, the institution must report the results to the consumer within 3 business days. If the investigation determines that an error occurred as relevant here, there's a determination that an unauthorized payment occurred — the financial institution must correct the error (e.g., reimburse the consumer).

How does the financial industry mitigate fraudulently induced payments?

According to our interviews with members of the financial industry, including representatives of select financial institutions, the industry seeks to mitigate fraudulently induced payments through consumer education, staff training, and process and technology solutions. Financial institution representatives informed us that these activities are part of financial institutions' programs to combat fraud

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and other illicit financial activity, some of which help meet their obligations under the Bank Secrecy Act.²⁹ Actions include, for example, the following: **Consumer education.** Institutions stated they educate consumers through various channels, including websites and app notifications, mailers, and outreach to specific groups such as older Americans in assisted living facilities or medical facilities. For example, one financial services company we spoke with worked with an online media company to create a website explaining how to spot potential scams and what steps consumers can take to protect themselves.³⁰ While financial institution representatives and federal regulators told us they consider consumer education important, they also noted its limitations. They explained that consumers often ignore education campaigns believing they will not be scammed.³¹ Therefore, focusing on implementing effective fraud prevention methods is imperative.

Staff training. Financial institutions provide training to their front-line staff, including tellers and managers to help them identify potential fraud. This training includes recognizing red flags for transactions that might be fraudulently induced. It also includes learning interdiction techniques to use when fraud is suspected. For example, representatives from one credit union we spoke to said the credit union provides tellers a series of questions to ask consumers if they suspect fraud. Another financial institution uses video calls to explain to consumers that they may be the victim of a scam. Additionally, the Financial Crimes Enforcement Network (FinCEN) issues public and nonpublic advisories to financial institutions concerning threats and vulnerabilities, including fraud. These advisories may provide typologies—categories of fraud—and red flags that aid in monitoring as well as guidance to address these threats. According to FinCEN, financial institutions may use this information to train staff and enhance antifraud monitoring systems.

Slowing down the payments process to combat fraud. Financial institutions and payment apps have reported putting in place additional measures to slow down payment transactions, giving consumers a chance to verify the payment's legitimacy. For example, one institution said it uses popups and warnings before a consumer can make a transaction such as to verify the consumer knows the recipient and wants to move forward with the transaction. Additionally, institutions and payment apps reported limiting the number or dollar amount of transactions allowed per week.

Investments in technology and expertise. Financial institutions have invested in advanced technology and expertise to enhance fraud detection and prevention. Representatives from our selected financial institutions told us they had enhanced their fraud monitoring systems and data analytic tools and hired specialized staff such as data scientists. Institutions also stated they were using All or machine learning to help monitor transactions for fraud and other suspicious activity. They noted the importance of monitoring both outgoing and incoming payments due to the increased use of "money mule" accounts. Such accounts are typically used to transfer fraudulently obtained funds, often out of the country by an unwitting consumer on behalf of a scammer. Institutions and other financial industry representatives told us that technology for fraud monitoring is expensive, especially for real time monitoring. Larger institutions explained to us they already have made such investments, but these technologies may represent significant capital costs, especially for smaller institutions. Financial institutions stated that additional investments in technology and expertise could reduce their ability to offer services to customers, such as

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education for first time homebuyers or other services some of which may specifically benefit low-income consumers.³²

What does the financial industry see as some challenges in mitigating fraudulently induced payments?

Financial institutions and other industry representatives cited the human elements as the greatest challenge in preventing scams that involve fraudulently induced payments.

Convincing consumers that they can fall victim to fraud. Financial institutions face a challenge in effectively conveying to consumers fraud warnings and helping consumers better understand how scams play out. Despite efforts to educate consumers, financial institution representatives told us many consumers believe they will not fall victim to fraud. Institutions reported that consumers often ignore scam warnings until it is too late. As scams have become more sophisticated more people are falling victim. According to an April 2024 FTC report, its Scams Against Older Adults Advisory Group recently reviewed research that showed consumer education can be effective in preventing scams, but that more research is needed to help develop effective campaigns and warnings.³³

Preventing a consumer from sending a fraudulent payment. Financial institutions reported difficulty preventing victims from making payments even once they have been informed of the scam. Sophisticated social engineering tactics manipulate victims, sometimes making them unwilling to believe they are being scammed. Further, financial institutions may hesitate to intervene, such as by refusing to complete the transaction, for fear of losing the customer. For example, officials from one financial institution said that if they refuse to complete the transaction because they suspect fraud, they risk customers closing their accounts and going to another financial institution that will process the transaction. However, according to the FTC, third-party intervention by a financial institution can be effective. A 2019 study from the FINRA (Financial Industry Regulatory Authority) Investor Education Foundation, the Better Business Bureau, and the Stanford Center on Longevity conducted a survey of Americans and Canadians who reported a scam. They found that in cases where a third party intervened, 51 percent of victims were able to avoid losing money.³⁴

What other sectors did select financial industry members indicate could help reduce fraudulently induced payments?

While financial institutions and industry representatives we spoke with acknowledged that they play a role in stopping fraudulently induced payments, they noted that a solution will require a multisector approach. In particular, they cited the key roles of telecommunications and social media companies, and of law enforcement agencies.

Telecommunications and social media companies. Financial institutions and industry representatives we spoke with said they believed telecommunication and social media companies could play a greater role in reducing these scams by making it more difficult for scammers to communicate with potential victims. Other countries have begun addressing fraudulently induced payments with similar strategies. For example, the Australian government is piloting an SMS Sender ID Registry with telecommunication companies that provides message headers for texts from legitimate businesses, which make it difficult for scammers

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to impersonate these companies over text.³⁵ In the United Kingdom, social media companies and online service providers signed the Online Fraud Charter. This voluntary agreement commits them to protect users from fraud through different means including blocking fraudulent material on their platforms, taking down fraudulent advertisements, and having a mechanism for users to report fraudulent content.³⁶

Law enforcement. Financial institutions and industry representatives we interviewed told us that law enforcement could play more of a role in deterring scams involving fraudulently induced payments by increasing the number of investigations and prosecutions of fraudulently induced payments. One industry representative we spoke with said that doing so might decrease instances of fraudulently induced payments because it could demonstrate to other scammers that there are consequences for this behavior.

The FBI uses information contained in reports from consumer to initiate investigations to include fraudulently induced payments. However, according to a study based on FTC surveys, consumers underreport fraud, including fraudulently induced payments.³⁷ Such underreporting could impact the FBI's ability to identify patterns and commonalities among consumer reports, and deconfliction efforts. Additionally, according to FBI officials we spoke with, some cases of fraudulently induced payments may not be investigated because individual scam reports may not provide sufficient information to identify and prosecute suspects and may involve relatively low dollar amounts per individual victim. Therefore, investigating each case individually may not be the most effective use of resources. In addition, fraudulently induced payment scams may involve transnational criminal enterprises located in foreign countries, thereby increasing the complexity in investigating these types of cases, according to the FBI.

A local prosecutor we interviewed who leads a task force specializing in investigating and tracking assets related to combined romance/relationship and investment scams stated that victims who report scams to law enforcement are often told that law enforcement does not have the resources to investigate. ³⁸ The prosecutor, also told us that federal law enforcement rarely gets involved in individual asset recovery because such cases typically involve smaller losses.

Despite these challenges, law enforcement agencies have investigated and prosecuted cases of fraudulently induced payments. Federal agencies, including the FBI's Internet Crime Complaint Center's Recovery Asset Team (RAT) and FinCEN's Rapid Response Program, have been able to freeze and support the recovery of funds stolen through fraudulently induced payments. For example, FinCEN's program works with law enforcement and foreign Financial Intelligence Units (FIUs) to share information about cyber-enabled financial fraud. FinCEN encourages the FIUs to interdict fraudulent transactions, freeze funds, and stop or recall payments under their legal authorities.

Agency Comments

We provided a draft of this report to the CFPB, Department of Homeland Security, DOJ, FDIC, Federal Reserve, FTC, National Credit Union Administration, Office of the Comptroller of the Currency, Department of State, and Treasury for review and comment. The CFPB, DHS, DOJ, FDIC, FTC, and Treasury provided technical comments. In addition, NCUA provided a formal response (reproduced in appendix I).

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How GAO Did This Study

To identify the characteristics of fraudulently induced payments, we reviewed publicly available reports from the FBI and the FTC that summarize data on complaints from consumers and businesses who report being a scam victim. We also conducted a literature review of studies that measure or estimate the extent of fraudulently induced payments published between January 2019 and June 2024. We identified these studies from peer-reviewed journals by searching various databases, such as Scopus and SSRN.com. We also asked stakeholders we interviewed to recommend additional studies. Additionally, we conducted investigative research of scammers to identify techniques and tools that may be used to perpetrate scams resulting in fraudulently induced payments on two online social networking sites.

To identify how financial institutions and federal agencies address fraudulently induced payments, we interviewed officials from 10 federal agencies (CFPB, the FBI. Federal Deposit Insurance Corporation, Federal Reserve, the FTC, National Credit Union Administration. Office of the Comptroller of the Currency. Department of State, Secret Service and Treasury's Office of Terrorist Financing and Financial Crimes and FinCEN). Additionally, we reached out to four financial industry trade groups to solicit their views and also request assistance in identifying member institutions (American Bankers Association, Americas Credit Unions, Bank Policy Institute, and Independent Community Bankers Association). With the assistance of these trade groups, we contacted and interviewed representatives from nine financial institutions including credit unions and banks. We also interviewed two payment application companies that allow for P2P payments and three companies that help the financial industry mitigate fraud. We selected these trade groups and institutions because they represent a mix of financial institution types and sizes. We also met with six knowledgeable stakeholders—people who have experience working to combat fraud, including one local prosecutor, to better understand the types of scams they have seen resulting in fraudulently induced payments and the extent to which these scams are occurring. These stakeholders were identified through our prior work on fraud, other knowledgeable stakeholders, and research on fraudulently induced payment scams.

To describe applicable federal law, we reviewed The Electronic Fund Transfer Act and its implementing regulation, Regulation E, as well as Regulation Z. In addition, we interviewed officials from CFPB, the FTC, and the federal financial regulators to understand the requirements under the law and, where applicable, their process for handling a consumer complaint.

To identify recent federal enforcement activity involving fraudulently induced payment scams, we reviewed DOJ press releases as of June 2024. For identified cases, we obtained relevant court documents by searching Public Access to Court Electronic Records.⁴⁰

We conducted this performance audit from October 2023 to July 2024 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We conducted our related investigative work in accordance

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with standards prescribed by the Council of the Inspectors General on Integrity and Efficiency.

List of Addressees

The Honorable Sherrod Brown Chairman Committee on Banking, Housing, and Urban Affairs United States Senate

The Honorable Robert P. Casey, Jr. Chairman
Special Committee on Aging
United States Senate

We are sending copies of this report to the appropriate congressional committees, the Director of the Consumer Financial Protection Bureau, the Chair of the Federal Deposit Insurance Corporation, the Chair of the Federal Reserve, the Chair of the Federal Trade Commission, the Secretary of the U.S. Department of Homeland Security, the Attorney General of the United States, the Chairman of the National Credit Union Administration, the Comptroller of the Currency, the Secretary of State, and the Secretary of the Treasury. We are also sending informational copies to other interested parties. In addition, the report is available at no charge on the GAO website at https://www.gao.gov.

GAO Contact Information

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Appendix I: Comments from the National Credit Union Administration



National Credit Union Administration
 Office of the Executive Director

July 11, 2024

Rebecca Shea Director, Forensic Audits and Investigative Service U.S. Government Accountability Office 441 G Street NW Washington, DC 20548

Dear Ms. Shea,

We reviewed GAO's draft report (GAO 24-107107) entitled Payment Scams: Information on Financial Industry Efforts. The report highlights valuable information about fraudulently induced payment scams. The NCUA will continue to educate credit unions and consumers about payment scams, including on our consumer facing website www.mycreditunion.gov.

Thank you for the opportunity to review and comment on the draft report.

Sincerely,

Lany Page

Larry Fazio Executive Director

1775 Duke Street - Alexandria, VA 22314-3428 - 703-518-6320

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Accessible Text for Appendix I: Comments from the National Credit Union Administration

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Larry Fazio Executive Director

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Endnotes

¹Other fraudulently induced payment scams mentioned in our interviews with federal agencies, financial institutions, and financial industry representatives included tech/customer support, grandparent/person in need, and bank/financial institution impersonation scams. In addition, these scams can be used for types of fraud other than fraudulently induced payments. For example, victims may be induced to reveal personal information that can be used to commit identity theft.

²Generative AI systems create responses using algorithms that are trained often on open-source information, such as text and images from the internet. See GAO, *Science & Tech Spotlight: Generative AI*, GAO-23-106782 (Washington, D.C., June 13, 2023).

³To promote the development of solutions to protect consumers from the misuse of AI, the FTC held the Voice Cloning Challenge in January 2024. The event was an exploratory competition with the goal of fostering breakthrough ideas on preventing, monitoring, and evaluating malicious voice cloning. According to the FTC, the winning submissions demonstrate the potential for cutting edge technology to help mitigate risks of voice cloning in the marketplace. Federal Trade Commission, Press Release, *FTC Announces Winners of Voice Cloning Challenge* (Apr. 8, 2024).

⁴ See GAO, Science & Tech Spotlight: Deepfakes, GAO-20-379SP (Washington, D.C.: Feb. 20, 2020); and Technology Assessment: Artificial Intelligence: Emerging Opportunities, Challenges, and Implications, GAO-18-142SP (Washington, D.C.: Mar. 18, 2018).

⁵U.S. Department of Homeland Security, *Increasing Threat of Deepfake Identities*, (Sept. 14, 2021).

⁶Multifactor authentication involves using two or more factors to achieve authentication. Factors include something you know (password or personal identification number) and something you have (cryptographic identification device or token), or something that you are (biometric). The combination of identification and authentication provides the basis for establishing accountability and for controlling access to the system. For more information, see GAO, Federal Information Security: Agencies Need to Correct Weaknesses and Fully Implement Security Programs, GAO-15-714 (Washington, D.C., Sept. 29, 2015).

⁷In this report, we refer to measures as counts of detected activities, and to estimates as projections or inferences based on measures, assumptions, or analytical techniques. Estimates are often used when direct measures are unavailable, incomplete, or unreliable.

⁸In addition to estimates from FBI and FTC, the Financial Crimes Enforcement Network (FinCEN) issued a Financial Trend Analysis that reviewed Suspicious Activity Reports from 2021 for identity-related suspicious activity in early 2024. Part of this analysis highlighted data where reports identified impersonation as a concern. FinCEN suggests these reports could indicate potential impersonation scams. For more information see U.S. Treasury Financial Crimes Enforcement Network, *Financial Trend Analysis: Identity-Related Suspicious Activity: 2021 Threats and Trends*, (Jan. 2024).

⁹The FTC's Consumer Sentinel Network collects reports from consumers about fraud, identity theft, and other consumer protection topics in an online database available to law enforcement. Federal Trade Commission, *Consumer Sentinel Network Data Book 2023*, (Feb. 2024). Imposter scams, as reported by the FTC in its Data Book, may include instances of fraud not included in our definition of fraudulently induced payments.

¹⁰Investment-related fraud, as reported by the FTC in its Data Book, may include instances of fraud not included in of our definition of fraudulently induced payments.

¹¹Federal Bureau of Investigation, *Internet Crime Report 2023*, (Mar. 6, 2024).

¹²Federal Bureau of Investigation, *Internet Crime Report 2022*, (Mar. 14, 2023) and *Internet Crime Report 2021*, (Mar. 22, 2022). The scam types and associated losses and complaints reported by the FBI may include instances of fraud outside of our definition of fraudulently induced payments. For example, while these scams often result in a victim making a fraudulently induced payment, the victim may instead provide personal information to the scammer, resulting in the scammer making an unauthorized transaction.

¹³Federal Trade Commission, *Protecting Older Consumers 2022-2023: A Report of the Federal Trade Commission*, (Oct. 18, 2023).

¹⁴Federal Trade Commission, *Protecting Older Consumers 2022-2023: A Report of the Federal Trade Commission*, (Oct. 18, 2023).

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¹⁵Global Anti-Scam Alliance, *The State of Scams in the United States of America*, (2023). The international alliance is composed of entities from government (including law enforcement), private, and nonprofit consumer protection sectors.

¹⁶The federal government may enforce laws through civil or criminal action. According to DOJ officials, such action may be resolved through a trial, a permanent injunction, a civil settlement, a guilty plea, or other disruption. Details of fraud cases and schemes presented in court documents may not be complete. DOJ tracks cases by convictions of specific statutory violations rather than by "fraudulently induced payments". Accordingly, cases involving fraudulently induced payments are not specifically tracked by DOJ but are instead tracked by a variety of potential statutory charges or resolutions, according to these officials.

¹⁷Federal Trade Commission Press Release, FTC Sues to Stop VoIP Services Provider That Assisted and Facilitated Telemarketers in Sending Hundreds of Millions of Illegal Robocalls to Consumers Nationwide (May 12, 2023), available at https://www.ftc.gov/news-events/news/press-releases/2023/05/ftc-sues-stop-voip-service-provider-assisted-facilitated-telemarketers-sending-hundreds-millions.

¹⁸The FTC enforces Section 5 of the FTC Act, 15 U.S.C. § 45, which prohibits unfair and deceptive acts or practices in or affecting commerce. The FTC also enforces several regulations that prohibit or relate to fraud, including in some circumstances those that may involve fraudulently induced payments, such as Regulation E, 12 C.F.R. part 1005, the Telemarketing Sales Rule, 16 C.F.R. part 310, and the Business Opportunity Rule, 16 C.F.R. part 437. See, for example, Federal Trade Commission Press Release, MoneyGram Agrees to Pay \$125 Million to Settle Allegations that the Company Violated the FTC's 2009 Order and Breached a 2012 DOJ Deferred Prosecution Agreement (Nov. 8, 2018), available at https://www.ftc.gov/news-events/news/pressreleases/2018/11/moneygram-agrees-pay-125-million-settle-allegations-company-violated-ftcs-2009-order-breached-2012; Western Union Admits Anti-Money Laundering Violations and Settles Consumer Fraud Charges, Forfeits \$586 Million in Settlement with FTC and Justice Department (Jan. 19, 2017), available at https://www.ftc.gov/news-events/news/pressreleases/2017/01/western-union-admits-anti-money-laundering-violations-settles-consumer-fraudcharges-forfeits-586; and FTC Sues Walmart for Facilitating Money Transfer Fraud That Fleeced Customers Out of Hundreds of Millions (June 28, 2022), available at https://www.ftc.gov/newsevents/news/press-releases/2022/06/ftc-sues-walmart-facilitating-money-transfer-fraud-fleecedcustomers-out-hundreds-millions.

¹⁹ Consumer Financial Protection Bureau Press Release, Consumer Financial Protection Bureau Takes Action Against Payment Processor and Its Former CEO for Supporting Internet-Based Technical-Support Scams (Mar. 3, 2021), available at https://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-takes-action-against-payment-processor-and-its-former-ceo-for-supporting-internet-based-technical-support-scams/.

²⁰There are several types of payments, both electronic and nonelectronic, that can occur because of fraudulent inducement (e.g., electronic transfer via a bank account or P2P payment app, wire transfer, money transfer, or payment via check). Additionally, these types of fraud can be perpetrated on businesses and consumers alike. Our review and analysis focus on fraudulently induced payments, as defined herein for purposes of this report, that are made electronically and perpetrated on individual consumers. Regulation E applies to electronic fund transfers, which means any transfer of funds that is initiated through an electronic terminal, telephone, computer, or magnetic tape for the purpose of ordering, instructing, or authorizing a financial institution to debit or credit a consumer's account. 12 C.F.R. § 1005.3(a), (b). There are also exclusions from the definition of electronic fund transfer. 12 C.F.R. § 1005.3(c). When we use the term "payment" in this section, we mean electronic fund transfer as defined in Regulation E, unless otherwise stated. ²¹See Regulation Z, 12 C.F.R. § 1026.12(g), § 1026.13(i), and Regulation E, 12 C.F.R. § 1005.12(a) regarding whether Regulation Z or Regulation E would apply in the case where a credit card is involved in a fraudulently induced electronic payment. CFPB officials noted that the impact of Regulation Z on P2P transactions may be limited because it is less common for these transactions to be routed using a credit card. Additionally, other laws or regulations could be at issue when resolving disputes between consumers and financial institutions; for example, the Uniform Commercial Code, the Expedited Funds Availability Act, codified as amended at 12 U.S.C. chapter 41, and its implementing Regulation CC, 12 C.F.R. part 229, or contractual or warranty claims made under state law.

²² Regulation E, 12 C.F.R. § 1005.2(i), defines a "financial institution" as a bank, savings association, credit union, or any other person that directly or indirectly holds an account belonging to a consumer, or that issues an access device and agrees with a consumer to provide electronic fund transfer services, other than a person excluded from coverage of this part by section 1029 of the Consumer Financial Protection Act of 2010, title X of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376. An account is further defined as a checking, savings, or other consumer asset account, with some exceptions, that is held directly or

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indirectly by a financial institution and established primarily for personal, family, or household purposes. 12 C.F.R. § 1005.2(b)(1). Consistent with the CFPB's Electronic Fund Transfer FAQs, Regulation E applies to any P2P or mobile payment transactions that meet the definition of an electronic fund transfer. CFPB has described application of Regulation E to P2P payment providers via its Electronic Fund Transfer FAQs, last updated on December 13, 2021 (available at https://www.consumerfinance.gov/compliance/compliance-resources/deposit-accounts-resources/electronic-fund-transfers/electronic-fund-transfers-faqs/).

²³There may be circumstances when a consumer is not responsible (in whole or in part) for an authorized payment because there is an error with the payment (e.g., the payment was processed for an incorrect amount or was misdirected to an unintended recipient). See 12 C.F.R. § 1005.11(a) (defining an "error" for purposes of Regulation E).

²⁴Tiers and conditions of liability are set forth at 12 C.F.R. § 1005.6. Financial institutions may impose less liability on the consumer by contractual agreement. For example, a financial institution can include a provision in its Terms and Conditions of Account that a consumer will have \$0 liability if notice is given to the financial institution within a prescribed period. See 12 C.F.R. § 1005.6(b)(6). Financial institutions can also impose less or no liability as a courtesy to the consumer.

²⁵12 C.F.R. § 1005.2(m) (defining unauthorized electronic fund transfer). The term "unauthorized electronic fund transfer" does not include a payment initiated: (1) by a person who was furnished the access device to the consumer's account by the consumer, unless the consumer has notified the financial institution that transfers by that person are no longer authorized; (2) with fraudulent intent by the consumer or any person acting in concert with the consumer; and (3) by the financial institution or its employee. See also the official interpretation of 12 C.F.R. § 1005.2(m) (among other things, explaining that, in contrast, if an access device (e.g., a debit card) was obtained from the consumer through fraud or robbery and a transfer was then initiated by the person who committed the fraud or robbery, this *would be* an unauthorized transaction. Comment 1005.2(m)-3).

²⁶Whether a payment is considered authorized or unauthorized depends on the facts and circumstances at issue. Additionally, as noted above, there may be circumstances when a consumer is not responsible (in whole or in part) for an authorized payment because there is an error with the payment (e.g., the payment was processed for an incorrect amount or was misdirected to an unintended recipient). See 12 C.F.R. § 1005.11(a) (defining an "error" for purposes of Regulation E). According to CFPB, it has taken supervisory action against institutions that failed to determine that certain authorized transactions were errors – incorrect electronic fund transfers – for which the institution may not hold the consumer liable. See the Bureau's Fall 2021 Supervisory Highlights at page 6 (available at

https://files.consumerfinance.gov/f/documents/cfpb_supervisory-highlights_issue-25_2021-12.pdf). Furthermore, there may be certain circumstances under which financial institutions may impose less or no liability in the case of a fraudulently induced payment (e.g., based on contract, policies, or as a courtesy to the consumer).

²⁷See 12 C.F.R. § 1005.11 for the procedures and timeframes required of financial institutions to resolve errors.

²⁸An error is defined to include an unauthorized payment. 12 C.F.R. § 1005.11(a)(1). In contrast, an authorized payment is not considered an error. However, as noted above, there are other types of errors that may be asserted on an authorized payment (e.g., the payment was processed for an incorrect amount or was misdirected to an unintended recipient). See 12 C.F.R. § 1005.11(a)(1). As relevant here it may be the case that the consumer reports fraud on the account without providing sufficient details for the financial institution to determine whether an error has or has not occurred (that is, whether the payment was authorized or unauthorized). In this case, the financial institution would engage in an investigation consistent with 12 C.F.R. § 1005.11(c) to determine whether an error occurred and, accordingly, whether the financial institution or consumer is responsible for the payment. See also 12 C.F.R. § 1005.11(d).

²⁹Under the Bank Secrecy Act (BSA), as amended, and its implementing regulations, financial institutions are required to maintain an anti-money-laundering and countering the financing of terrorism program (known as a BSA/AML program) that is tailored to the size and risks of the organization. According to financial institutions, these BSA/AML programs include a variety of measures taken to address the risk of fraud. Additionally, as part of their BSA obligations, financial institutions are required to monitor consumer transactions to identify suspicious activity that may indicate money laundering or other criminal activity, and file suspicious activity reports in certain circumstances.

³⁰See Zelle Pay It Safe (voxcreative.com).

³¹We have ongoing work examining federal agency efforts to address fraudulently induced payments, including those related to consumer education.

³²As discussed in GAO, Banking Services: Regulators Have Taken Actions to Increase Access, but Measurement of Actions' Effectiveness Could Be Improved, GAO-22-104468 (Washington, D.C.: Feb. 14, 2022), a study conducted by Federal Reserve economists showed that certain banks raised fees after a federal regulation that increased costs to financial institutions.

³³Federal Trade Commission, A Review of Scam Prevention Messaging Research: Takeaways and Recommendations. (Apr. 2024).

³⁴FINRA Investor Education Foundation, the BBB Institute for Marketplace Trust, and Stanford Center on Longevity; *Exposed to Scams: What Separates Victims from Nonvictims*. (Sept. 2019).

³⁵Scammers will send victims SMS texts imitating trusted brands to trick victims into giving over personal information or money. These scam texts are often difficult to distinguish from legitimate texts from businesses. The SMS Sender ID Registry allows brands to register their sender ID and blocks other messages from other users trying to use the same sender ID.

³⁶The Federal Communications Commission has implemented strategies to reduce robocalls to American consumers including fining telemarketers for illegal caller ID spoofing and robocalling, and caller ID authentication between networks.

³⁷ Keith B. Anderson, "To Whom Do Victims of Mass-Market Consumer Fraud Complain?" *SSRN* (May 24, 2021), http://dx.doi.org/10.2139/ssrn.3852323.

³⁸The Regional Enforcement Allied Computer Team (REACT) Task Force is a partnership of local, state, and federal agencies. REACT's mission is to combat advanced cybercrime, including scams that result in fraudulently induced payments. REACT conducts multijurisdictional investigations, combining resources and expertise, to arrest and prosecute scammers and other sophisticated cyber criminals.

³⁹Federal Bureau of Investigation, Internet Crime Report 2023; Internet Crime Report 2022; Internet Crime Report 2021; and Federal Trade Commission, Consumer Sentinel Network Data Book 2023.

⁴⁰Public Access to Court Electronic Records is a service of the federal judiciary that enables the public to search online for case information from U.S. district, bankruptcy, and appellate courts. Federal court records available through this system include case information (such as names of parties, proceedings, and documents filed), as well as information on case status.

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Faculty

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Hon. Bruce A. Harwood is a retired U.S. Bankruptcy Judge for the District of New Hampshire in Concord, appointed to the bench in March 2013, and currently resides in San Francisco. He also served as Chief Bankruptcy Judge prior to his retirement from the bench, and he served on the First Circuit's Bankruptcy Appellate Panel. Prior to his appointment to the bench, Judge Harwood chaired the Bankruptcy, Insolvency and Creditors' Rights Group at Sheehan Phinney Bass + Green in Manchester, N.H., representing business debtors, asset-purchasers, secured and unsecured creditors, creditors' committees, trustees in bankruptcy, and insurance and banking regulators in connection with the rehabilitation and liquidation of insolvent insurers and trust companies. He was a chapter 7 panel trustee in the District of New Hampshire and mediated insolvency-related disputes. Judge Harwood is ABI's President-Elect. He previously served as ABI's Secretary and Vice President-Communication, Information & Technology, as co-chair of ABI's Commercial Fraud Committee, as program co-chair and judicial chair of ABI's Northeast Bankruptcy Conference, and as Northeast Regional Chair of the ABI Endowment Fund's Development Committee. He also served on ABI's Civility Task Force. Judge Harwood is a Fellow in the American College of Bankruptcy and was consistently recognized in the bankruptcy law section of *The Best Lawyers in America*, in *New England SuperLawyers* and by Chambers USA. He received his B.A. from Northwestern University and his J.D. from Washington University School of Law.

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