Identifying Bankruptcy Fraud

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The bankruptcy system is designed to give an individual or a company a chance to reorganize their affairs, or if reorganization is not possible, to equitably distribute the non-exempt assets of the debtor among the creditors. This is often referred to as "a fresh start". The amount of money a creditor will receive in a case will range from nothing in many cases to 100 percent in a few cases. In every case there will be significant delays from the time a bankruptcy petition is filed until the case is closed and all creditors receive final payment.

The bankruptcy system is based on the theory that a debtor will make full disclosure of all assets and liabilities so that the final disposition is in accordance with the requirements of the law. Unfortunately, at times both debtors and creditors try to obtain more than they are entitled to under the Bankruptcy Code. There are a number of criminal statutes that prohibit this type conduct.

Although concealing assets or making false statements in a bankruptcy proceeding make up the majority of bankruptcy frauds, there are a number of fraud schemes that are more complicated or are primarily designed for reasons other than maximizing the retention of assets in bankruptcy. Such schemes often use the automatic stay provided by the Bankruptcy Code to conceal an earlier crime, maximize profit from an ongoing fraud scheme or buy time while the perpetrator finds a way to avoid victims or leave town.

A comprehensive list of fraud schemes will be presented in two articles. Within each fraud category examples of schemes will be presented, with red flags to look for, and courses of action to be pursued if a scheme is encountered. Again, keep in mind that this is a list of common warning signs in a fraud scheme. Many of these factors may be present in situations where there is no fraud, so do not jump to conclusions simply based on these warning signs.

Identifying Bankruptcy Fraud–Part 1 covers common fraud schemes involving bankruptcies and debtor fraud. Identifying Bankruptcy Fraud–Part 2 will focus on creditor fraud and professional fraud. Included in both articles is a list of warning signs of banruptcy fraud.

Common Fraud Schemes Involving Bankruptcies

Bustouts

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

Examples Of Bustouts

Distributors of Consumer Products (including cigarettes, diapers, etc.): Company operates for a short period of time and establishes good credit ratings with large consumer goods manufacturers. Orders increase suddenly, and payments are not made. Lulling techniques are used to forestall creditors. Goods are sold to retailers at below cost for cash. Afterwards, a bankruptcy petition is filed. Schedules filed by the debtor after the bankruptcy filing report trade debt owed to consumer products manufacturers with inventory unusually low compared to the date the debt was incurred.

Retail Bustouts: The merchant rents retail space and does not pay rent or suppliers. He files bankruptcy to stop eviction and to gain additional time to run the illegal operation. Oftentimes, retail stores are part of the distributor bustouts because they provide outlets for the consumable goods. (Examples include retail jewelry stores, oriental rug stores and discount stores.)

Tax Bustouts: An individual operates a series of businesses in the same industry and never pays taxes. He usually files Chapter 11 bankruptcy for the company just prior to or at the time the IRS files a lien on the debtor's assets. He operates the business for a brief period of time while in Chapter 11 before the case is converted or dismissed. He starts a new business with the debtor's assets. (Examples include restaurants and employee leasing services.)

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

Travel Agency Bustouts: Travel agency opens and secures authorization plates from the airline cooperative agency to write tickets. After paying the first few bills, a tremendous number of tickets, often overseas tickets, are written and not paid for. These tickets are sold for cash in bargain sales. Travel agency may also report the authorization plates stolen and then continue the scheme. Authorization plates and blank ticket stocks are often missing when the trustee or airline tries to recover.

Red Flags/Common Characteristics

- Company with a short life
- Well-established company with good credit recently taken over by a new group trying to hide the change in ownership
- Fraudulent financial statements
- False credit references
- No receivables listed on schedules (cash basis operation)
- Inventory scheduled is very low
- Warehouse full of high-volume, low-cost items

- Disproportionate liabilities to assets
- Mainly temporary employees
- Fake social security numbers used to obtain credit
- Leased equipment
- Few local creditors, and unsecured debt is primarily comprised of trade creditors
- Lulling letters to creditors (mail/wire fraud)
- No corporate bank account, or existing account has no funds
- Cash paid up front to rent location
- Same individuals involved in previous "failed companies"
- Unusual banking activities (check kiting, bank fraud, money laundering and structured transactions)
- Schedules and statement of financial affairs are incomplete or not filed
- Person unfamiliar with debtor's operations testifies at 341 meeting of creditors
- Taxes not paid
- The same attorney repeatedly represents these types of debtors

Civil Responses To Consider

- Immediate appointment of a Chapter 11 trustee
- Immediate appointment of a "gap" trustee for involuntary cases
- Motion to compel filing of schedules and statement of financial affairs
- Motions designed to expedite debtor's compliance with 704 duties, i.e., 2004 exams prior to 341 meeting of creditors; motions to compel immediate filing of list of bank accounts, inventory and creditors. Seek contempt if orders are not obeyed
- Adversaries to freeze bank accounts and prevent further disposition of estate assets
- Adversaries against insiders for preferences and fraudulent conveyances
- Objections to discharge in individual bustout cases
- Motion to dismiss and prohibit the re-filing of the case
- Waiver by the trustee of attorney/client privilege of corporate debtor's counsel

Criminal Responses To Consider

Mail Fraud, 18 U.S.C. Section 1341: Misrepresentations to suppliers and the use of U.S. mail.

Wire Fraud, 18 U.S.C. Section 1343: Misrepresentations to suppliers and the use of interstate wires.

Bankruptcy Fraud, **18 U.S.C. Section 152**: Concealed assets or false statements. Classic
"bustout" or planned bankruptcy where goods are moved out the back door with the plan of filing for bankruptcy are usually charged as concealment "in contemplation of bankruptcy."

Bankruptcy Fraud, 18 U.S.C. Section 157: If any act of the fraud occurs after October 22, 1994, this statute may be used. The use of bankruptcy must aid the fraud scheme

in some way. Delaying creditors, allowing the debtor to continue to operate or covering up the scheme are examples. The statute will be easier than the use of 18 U.S.C. 152, "concealment" or "in contemplation", because it allows a fuller statement of the scheme. False statements under oath are the same under either statute, although 157 will allow a broader description of the fraud.

Use of False Social Security Number, 42 U.S.C. Section 408: If used to obtain credit or in bankruptcy filing.

Credit Card Fraud, 18 U.S.C. Section 1029: One thousand dollars or more charged on one unauthorized card in one year, or possesses more than 15 fraudulent cards.

Tax Fraud, 26 U.S.C. Sections 7201-7203: Failure to pay withholding taxes, other taxes, or to file returns. IRS should be notified so they may investigate.

Bleedouts

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

Examples Of Bleedouts

Corporate Raider Bleedouts: A stable company with very liquid assets, such as a large pension and/or profit sharing fund, is acquired in a leveraged buyout. The company is operated for the sole purpose of allowing the insiders to loot the company. A Chapter 11 is filed to allow the insiders to complete their scheme. Business transactions are complex and purposefully confusing, which makes fraudulent conveyance actions expensive and difficult to prove. This type of scheme is used in all types of industries.

"White Knight" Bleedouts: A business consultant is hired by a troubled business to assist it in acquiring new financing and streamlining operations. On occasion, the "white knight" is given an ownership interest in the business. The consultant takes control of the financial operations of the business and uses his position to convert company assets. Often this includes failing to pay withholding taxes, failing to make pension fund contributions, diversion of receivables, paying personal expenses with company funds, taking excessive salary and bonuses and, in some situations, paying false invoices to entities or individuals related to the consultant.

Parallel Entities: A long-standing company experiences financial problems. Insiders of the company create a new business in the same industry just prior to or soon after the bankruptcy filing. In some cases, the debtor sells some of its assets to the new entity for a fraction of their value just prior to the bankruptcy. The non-debtor entity is usually not disclosed. The insiders operate the debtor until they have successfully transferred the debtor's inventory, receivables, customers and goodwill to the new company. In addition, the insiders may use the debtor to purchase goods and

services for the new company with the intent of never repaying the Chapter 11 administrative creditors. This is usually a lawyer-assisted fraud.

Assignment for the Benefit of Creditor (ABC)/Insider Sales: These cases include non-bankruptcy workouts in which misrepresentations are made to creditors (mail fraud) and the assets are sold to undisclosed insiders for inadequate consideration. The secured creditor agrees to the transaction because its security position improves if the new company is debt free. The scheme usually terminates in an involuntary bankruptcy.

Red Flags/Common Characteristics

- Recent changes of ownership/new players
- People with no prior involvement in the business have money transferred to them, both pre-petition and during the bankruptcy
- Changes in accounting or cash flow practices for no apparent business reason
- Payment stream to a certain creditor suddenly balloons
- Sudden decrease in inventory; sharp increase in aged receivables
- Inventory, equipment and machinery are sold a short time before the case is filed
- Capital infusions of corporate officers suddenly renamed "loans" and paid back
- Excessive salaries and bonuses
- Complicated asset transfers with no apparent purpose
- Depleted pension funds
- Leveraged buyouts
- Employee contributions for health care and pension funds have been deducted and converted by the debtor
- A new company is formed just prior to or immediately after the bankruptcy case is filed

Civil Responses To Consider

- Motion to appoint a Chapter 11 trustee, an examiner or an involuntary "gap" trustee
- Extensive 2004 exams
- Require debtor to provide pension fund documents and bank statements for the pension fund prior to the 341 meeting of creditors
- Convert case to a Chapter 7, rather than dismissal
- Fraudulent conveyance actions

Criminal Responses To Consider

Mail Fraud, 18 U.S.C. Section 1341: Misrepresentations and the use of U.S. mail.

Wire Fraud, 18 U.S.C. Section 1343: Misrepresentations and the use of interstate wires.

Bankruptcy Fraud, 18 U.S.C. Section 152: Pre-petition transfers, concealed assets, or false statements to the court at the 341 meeting of creditors or in court filed

documents such as the schedules and statement of financial affairs.

Bankruptcy Fraud, 18 U.S.C. Section 157: If any act of the fraud occurs after October 22, 1994, this statute may be used. The use of bankruptcy must have aided the fraud scheme in some way. Delaying creditors, allowing the debtor to continue to operate or covering up the scheme is an example under this section. The statute will be easier to use than 18 U.S.C. Section 152, "concealment" or "in contemplation" because the fraud scheme can be explained in greater detail. False statements under oath is the same under either statute, although 157 will allow a broader description of the fraud.

Use of False Social Security Number, 42 U.S.C. Section 408: If used to obtain credit or in the bankruptcy filing.

Credit Card Fraud, 18 U.S.C. Section 1029: One thousand dollars or more charged on one unauthorized card in one year or possesses more than 15 fraudulent cards.

Tax Fraud, 26 U.S.C. Section 7201-7203: If there is a failure to pay withholding taxes and other taxes, or failure to file returns. The IRS should be notified so they may investigate.

Ponzi Schemes (Investor Fraud)
A Ponzi scheme (pyramid) invoices soliciting investments by promising interest rates well above the market rate. Early investors recover their investments with the promised rate of return and encourage others to invest. As the pyramid begins to crumble, investors are unable to recover their original investments and interest is no longer paid. Chapter 11 cases are filed to allow the debtor to continue the scheme. When the scheme collapses before bankruptcy, either a voluntary or involuntary case is filed.

The essence of these schemes is a promise of a very high return on an investment. Once it fails, many investors are reluctant to complain because they realize they have been duped. It is important to identify and contact the investors because they generally are excellent witnesses.

Examples Of Investor Fraud Schemes

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

Church and Ethnic Schemes: An individual solicits funds from members of his church or religious faith. Investors believe in the individual because of his affiliation with their church and, therefore, trust him with their money without making the

appropriate inquiries. Likewise, members of ethnic groups are targeted by members of their community. Shared language and ethnic background allow the perpetrator to win the trust of his victims. Recent immigrants are often targets of these schemes. In both situations, the victims are reluctant to believe that their trust has been betrayed and, therefore, may be unwilling to complain about the perpetrator.

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

Advanced Fee Swindle: This is a variation of a Ponzi scheme. Either through advertisements or direct contact, individuals or businesses in financial trouble are contacted and offered generous loans. The loans require an advanced fee to guarantee the loan and start the loan processing. The perspective borrower is assured "nothing will go wrong–the loan is done as soon as you send in the advanced fee." Of course, once the fee is sent, something does go wrong and the borrower is in even deeper financial trouble.

Red Flags/Common Characteristics

- Numerous contacts from investors/creditors about the case
- List of creditors, schedules and statement of financial affairs show mostly unsecured debt owed to numerous individuals
- No prospectus or the prospectus provided is untruthful
- Numerous complex investment vehicles, such as limited partnerships
- Enormous management or general partnership fees to insider controlled companies
- Monthly operating reports show receipts from individuals
- Income is from individuals with little or no other outside income shown
- Lulling letters to investors explaining that the delay in their interest/loan/deal payment is outside the control of the manager and, if they will be patient or continue to send money, the problems will be resolved

Civil Responses To Consider

- Immediate appointment of a Chapter 11 trustee or an involuntary "gap" trustee
- Object to an individual debtor's discharge
- If a criminal investigation is pending, request that as part of any plea agreement the debtor agrees to waive his discharge or, if the debtor is convicted after the trial, that the entire bankruptcy debt be imposed as restitution
- Coordinate communication with investor creditors, e.g., establish telephone hot lines, hold investor informational meetings, ensure notices to creditors are complete and understandable, etc

Criminal Responses To Consider

Mail-Fraud, 18 U.S.C. Section 1341: Misrepresentations to investors and the use of U.S.mail.

Wire Fraud, 18 U.S.C. Section 1343: Misrepresentations to investors and the use of interstate wires.

Bankruptcy Fraud, 18 U.S.C. Section 152: Concealed assets or false statements to the court at the 341 meeting of creditors, or in court filed documents including the schedules and statement of financial affairs.

Bankruptcy Fraud, 18 U.S.C. Section 157: Where the bankruptcy system is used in any way to aid the fraud. In many investor fraud cases, the bankruptcy system is used to complete the fraud, delay the investigation of the scheme and/or to confuse the victims.

Health Care and Welfare Fraud

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

Examples of Health Care and Welfare Fraud

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

Theft of Employee Contributions for Health Insurance: The employer deducts the employee's share of insurance premium and does not remit the funds to the insurance company. These situations typically occur in bleedout cases.

Sham Facilities: These schemes include nursing homes, shelters, drug rehabilitation programs and other health-related homes set up to secure federal and state funding. They provide few if any services to the clients and convert the funds received for their own use. In some instances, the government funding programs require the services to be rendered at no cost to clients. In those situations, the perpetrators require clients to sign over their food stamps and welfare checks to them in order to remain at the shelter.

Red Flags/Common Characteristics

- Numerous complaints of poor or non-existent services
- Adverse publicity by media about operations

- Investigations by state/federal regulators concerning operations, etc
- Lack of normal books and records
- Unlicensed shelters, rehabilitation facilities, half-way houses, etc
- Deductions from employee paychecks for health care coverage but funds not remitted to the insurance company
- Red flags from bustout schemes

Civil Responses To Consider

- Appoint a Chapter 11 trustee or examiner
- Convert to Chapter 7 case rather than dismissing the case
- Alter ego and constructive trust action against principals
- Assist social welfare agencies in the relocation of residents or patients of the sham facilities
- Co-ordinate and facilitate communications with the victims of the crime
- Notify appropriate law enforcement agencies

Criminal Responses To Consider

Bankruptcy Fraud, 18 U.S.C. Section 152: Concealment of assets, false statements, or transfer of assets.

Bankruptcy Fraud, 18 U.S.C. Section 157: A fraud scheme which uses bankruptcy to execute or conceal the scheme. This section may be charged if one act of the fraud occurred after October 22, 1994.

Mail Fraud, 18 U.S.C. Section 1341: Misrepresentations to victims made by the use of U.S. mail.

Wire Fraud, 18 U.S.C. Section 1343: Misrepresentations to victims and the use of interstate wires.

Money Laundering, 18 U.S.C. Sections 1956 and 1957: If there is a transfer of funds from the health care provider's account into the insider's account which is then used to purchase other assets available to the insider.

Tax Fraud, 26 U.S.C. Sections 7202, 7203, 7206 and 7212: A failure to pay taxes on assets removed, failure to file returns, or the filing of a false return in an effort to conceal the scheme.

Rent/Equity Skimming

Rent or equity skimming involves acquiring title to multiple properties with no intention of paying the mortgages. The perpetrator then collects the proceeds from the property. A bankruptcy is filed to stall the foreclosure and to allow the perpetrator to continue his scheme.

Examples of Rent/Equity Skimming

Rent/Equity Skim: The perpetrator acquires partnership interest or title to the property, but does not assume the mortgages. He puts his management company in control of the property. The management company collects rent, receives exorbitant management fees, does not maintain the facilities and makes no payments to the secured lenders. The mortgagee is contacted by the perpetrator who attempts to extort the lender to buy out his interest. When the lender attempts to foreclose, the perpetrator deeds the property to a corporate entity which files bankruptcy. The transfer of title is repeated several times, with bankruptcies filed to cover all the transfers.

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

Red Flags/Common Characteristics

- Failure to make mortgage payments
- Transfer of entire or fractional interest shortly before foreclosure
- Multiple fractional interests in real property listed on the schedules
- Frequent Quit Claim Deeds transferring interest in the property
- Numerous D.B.A.'s and individuals in chain of title
- Use of mail drop boxes as business address
- Post-petition transfers into a bankruptcy estate
- New corporation formed holding a single asset.
- Schedules amended to dramatically increase the number of pieces of real property owned.

Civil Responses To Consider

- Dismiss case pursuant to 11 U.S.C. Sections 109(g), 349, 707(a)
- Seek sanctions against attorneys and refer them to state licensing agency, if appropriate
- Motion to compel perpetrator of fraud to appear in court. Seek contempt if person fails to
- appear
- Provide assistance to debtor victims

Criminal Responses To Consider

Mail Fraud, 18 U.S.C. Section 1341: Misrepresentations to homeowners and the use of U.S. mail.

Wire Fraud, 18 U.S.C. Section 1343: Misrepresentations to homeowners and the use of interstate wires.

Bankruptcy Fraud, 18 U.S.C. Section 152: Concealed assets or false statements to the court or at the 341 meeting of creditors.

Bankruptcy Fraud, 18 U.S.C. Section 157: If the system is used to aid the perpetrator's fraud scheme. Delaying creditors, allowing the debtor to continue to operate, or covering up the scheme are examples.

Bankruptcy Fraud By The Debtor

Debtor fraud is the most common type of bankruptcy fraud. The system is used to allow the debtor to conceal and transfer assets from his creditors/victims and to receive a bankruptcy discharge of his pre-petition debts.

Concealment and False Statements

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

Examples Of Concealment

Failure to Schedule Assets: Typical examples include P.I. lawsuits, real estate, bank and investment accounts, stocks, jewelry, art work and interest in non-debtor entities.

Undervalued Assets: Assets are listed, but their value is grossly understated or deemed worthless. The intent is to persuade the trustee and creditors not to liquidate the assets.

Transfer of Assets Pre-petition: The debtor transfers assets with little or no consideration to third parties with the agreement that after the case is closed the property will be returned to the debtor. The relationship to the debtor or the agreement with the transferee is not disclosed.

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

Red Flags/Common Characteristics

- Claims of theft or large gambling loss just before bankruptcy
- Inability to account for property listed on insurance policies or personal financial statements in existence before bankruptcy
- Incomplete schedules–frequent amendments in response to creditor questions
- Unexplained change in financial circumstances

- Debtor shows no ownership interest in residence
- Tax returns not filed for the relevant years
- Debtor "confused" about his assets and financial affairs
- Unsecured debt does not reconcile with assets listed, e.g., large number of medical bills, but no lawsuit listed
- Failure to list prior bankruptcies

Collusive Involuntary Bankruptcy

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

Examples of Collusive Involuntary

Collusive Involuntary: The perpetrator gets his co-conspirators to file an involuntary against him or his corporate entity. The involuntary is used if the debtor has been prohibited from filing for a period of time. A bustout or bleedout perpetrator may use an involuntary to conceal his involvement in a corporation where he is involved in a number of pending corporate bankruptcies. The bankruptcy system is used to gain the benefit of the automatic stay without having to disclose any information about the debtor during the involuntary period.

Red Flags/Common Characteristics

- Debtor subject to a 180-day bar on refiling suddenly has an involuntary filed against him
- Creditors have recently acquired the claim asserted in the involuntary
- Professional" creditors who reappear in suspicious sounding deals
- Same attorney is involved in the voluntary and involuntary bankruptcies
- Creditors are "former" long-term business associates of the debtor's insider
- Insider has filed voluntary bankruptcy cases for at least several corporate or partnership entities in a short period of time, and the cases filed are suspicious

Civil Responses To Consider

- Appointment of an involuntary "gap" trustee
- Sanctions against attorney and referral to disciplinary committee, where appropriate
- Sanctions against petitioning creditors
- Waiver by trustee of attorney/client privilege for the corporate debtor's counsel
- Civil or criminal contempt for failure to comply with court orders, including the production of documents, appearance at court hearings, etc
- Motion to dismiss with prejudice pursuant to 11 U.S.C. Section 707(a) and denying discharge pursuant to 11 U.S.C. Section 349(a), if debtor is an individual
- Objection to discharge pursuant to 11 U.S.C. Section 727

Criminal Responses To Consider

Bankruptcy Fraud, 18 U.S.C. Section 152: False statements in the involuntary petition.

Bankruptcy Fraud, 18 U.S.C. Section 157: If any act of this fraud occurs after October 22,

1994, this statute may be charged. The use of bankruptcy must aid the fraud scheme. Delaying creditors, use of the automatic stay to allow debtor to continue its fraud, or covering up the scheme are a few examples. False statements under oath is the same under 152, although 157 will allow a broader description of the fraud.

Conspiracy to Commit Bankruptcy Fraud, 18 U.S.C. Section 371: If two individuals are involved in the scheme, conspiracy may also be charged.

Tax Fraud, 26 U.S.C. 7202, 7203, 7206 and 7212: A failure to pay taxes on assets removed, failure to file returns, or the filing of a false return in an effort to conceal the scheme.

False Statement, 18 U.S.C. Section 1001: Any false statement or document designed to mislead the court or the United States Trustee, whether or not under oath.

False Statement, 18 U.S.C. Section 152(3): Statement must be under oath or under penalty of perjury.

Forbearance, 18 U.S.C. Section 152(6): Bidder, the debtor and/or a creditor have side deals on a sale. Sale agreement not disclosed and creditors are victimized.

Strawbuyer/Fictitious Bidder

The debtor sells assets to a court-approved buyer and the assets are secretly resold at a profit pursuant to a previous agreement with a third party. Where fictitious bidding is suspected, creditors should require a statement to the effect that the buyer is bidding for himself or have him state the purpose of the purchase. False statement prosecutions have been brought where this statement is false.

Examples Of Straw Buyer/Fictitious Bidder

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

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

Red Flags/Common Characteristics

- Pre-existing, undisclosed relationship between the debtor and the straw buyer.
- Sale terms are structured to prefer one bidder.

- Inadequate or no effort to locate other purchasers. Advertising not placed in appropriate newspapers or journals to reach potential purchasers.
- Unusually high bid-protection or break-up fees.
- High price offered, but broad terms allow the purchasers substantial setoff rights.
- Purchaser is represented by counsel with close ties to debtor's counsel.
- Debtor interferes with potential purchasers' due diligence efforts.
- Short notice request on sale because of "emergency" situation.

Civil Responses To Consider

- Appointment of a Chapter 11 trustee
- Objection to the sale. Grounds include inadequate disclosure concerning the insider relationship to purchaser; inappropriate advertising, e.g., terms of sales not reasonable and too broad
- Trustee adversaries to avoid sale
- Objection to discharge pursuant to 11 U.S.C. Section 727, if debtor is an individual

Criminal Responses to Consider

Bankruptcy Fraud, 18 U.S.C. Section 152 a(1)-(5): Concealment of assets and false statements to the court or in 2004 depositions. The insider receives property of the estate with the intent to defeat the provisions of Title 11 because the property is not sold at its real value.

Bankruptcy Fraud, 18 U.S.C. Section 157: If the bankruptcy system was used to aid the fraud, concealment and false statement may be charged under this section. Provides a broader description of the crime.

Conspiracy to Commit Bankruptcy Fraud, 18 U.S.C. Section 371: If two individuals are involved in the scheme, conspiracy may also be charged.

Tax Fraud, 26 U.S.C. Sections 7202, 7203, 7206 and 7212: A failure to pay taxes on money received from the sale, failure to file returns, or the filing of a false return in an effort to conceal the scheme.

Serial Filers

The debtor, typically an individual, files numerous cases to take advantage of the automatic stay to prevent eviction, foreclosure and collection on other debts. The petitions usually contain false social security numbers, variations of the debtor's name or fictitious names. Chapter 7 and Chapter 13 cases are filed interchangeable.

Red Flags/Common Characteristics

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

Civil Responses To Consider

- Objection to discharge
- Motion pursuant to 11 U.S.C. Section 707(a) and 349 to dismiss for bad faith and to deny debtor's discharge

Criminal Responses To Consider

Bankruptcy Fraud, 18 U.S.C. Section 152: Concealment of assets and false oaths and statements in bankruptcy petition, schedules and statement of financial affairs.

Bankruptcy Fraud, 18 U.S.C. Section 157: Movement or concealment of assets Pre-petition and post-petition. False statements or oaths.

Use of False Social Security Number, 42 U.S.C. Section 408: If used to obtain creditor in bankruptcy filing.

Bankruptcy Fraud Warning Signs

1. Concealment of assets
2. Serial bankruptcy cases
3. Failure to keep usual business records
4. Incomplete or missing books and records
5. Conduct well outside ordinary business or industry standards and practices
6. Unusual depletion of assets shortly before the bankruptcy filing
7. Recent departure of debtor's officers, directors or general partners
8. Unanswered questions or incomplete information on debtor’s schedules and statement of financial affairs
9. Frequent amendments to schedules, statements of financial affairs and monthly operating reports
10. Inconsistencies among recent financial statements, tax returns and debtor's schedules and statements of financial affairs
11. Absence of knowledgeable officers to testify at the Section 345 meeting
12. Inability to contact principals of debtor at debtor’s stated location
14. Frequent dealings in cash rather than recorded transactions
15. Sudden depletion of inventory post-petition without plausible explanation
16. Inflated salaries, payments of bonuses or cash withdrawals byofficers, directors, shareholders or other insiders
17. Transfer of property to insiders, shareholders and relatives shortly before bankruptcy
18. Payoff of loans to directors, officers, shareholders, relatives or other insiders shortly before filing.
19. Transactions with non-debtor subsidiaries, parent companies or affiliated corporations owned by the same or related persons or entity

20. A history of prior litigation or post-petition litigation involving breech of contracts, fraud misrepresentations, etc
21. Complicated corporate structures and relationships.
22. Creditor confusion concerning corporate structure.
23. Fire, theft or loss prior to or after filing.
24. Failure to pay withholding and sales tax.
25. Startup of a similar business near the time of bankruptcy filing.

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