

USTP Participates in Nationwide Sweep Targeting Investment Fraud Schemes

Written by:

Sandra R. Klein
Executive Office for U.S. Trustees
Los Angeles

Sandra Taliani Rasnak
U.S. Trustee Program; Chicago

Operation Broken Trust (OBT), a nationwide law enforcement sweep targeting investment fraud, was announced by Attorney General Eric Holder on Dec. 6, 2010, and was designed to highlight the impact that investment fraud schemes have on individuals. It featured both civil and criminal cases, including several cases in which the U.S. Trustee Program (USTP) played a role.



Sandra R. Klein

“Operation Broken Trust is the first national operation in history to target the many different types of investment fraud schemes that prey directly on the investing public,” Holder said.¹ Covering the period from Aug. 16 to Nov. 29, 2010, OBT involved 231 criminal cases against 343 defendants and 60 civil enforcement actions against 189 civil defendants. OBT’s criminal cases involved more than \$8.3 billion in estimated losses and its civil cases involved estimated losses of more than \$2.1 billion. In total, the fraud schemes targeted by OBT harmed more than 120,000 victims throughout the country.²

Enforcement actions taken as a result of OBT involved a range of different investment fraud schemes, all of which prey directly on the investing public. The operators of these schemes often promised high returns to investors, but engaged in little or no legitimate investment activity. Such schemes include Ponzi schemes, affinity fraud, prime-bank/high-yield investment scams, foreign-exchange fraud, business-opportunity fraud and other similar schemes. In some instances, operators of these schemes filed for bankruptcy in an attempt to avoid claims by victim investors.³

¹ “Attorney General Eric Holder Speaks at the Operation Broken Trust Announcement,” www.justice.gov/iso/opa/ag/speeches/2010/ag-speech-101206.html.

² “Financial Fraud Enforcement Task Force Announces Results of Largest-Ever Nationwide Operation Targeting Investment Fraud,” www.justice.gov/opa/pr/2010/December/10-ag-1390.html.

³ *Id.*

About the Authors

Sandra Klein is the acting assistant director of Criminal Enforcement for the Executive Office for U.S. Trustees in Los Angeles, and Sandra Taliani Rasnak is an assistant U.S. Trustee in the USTP’s Chicago office.

OBT was organized by President Obama’s Financial Fraud Enforcement Task Force (FFETF), a multi-agency group that includes the Department of Justice and components such as the USTP. During the sweep, the USTP worked closely with other agencies, including the Federal Bureau of Investigation, Securities and Exchange Commission (SEC), Postal Inspection Service, Internal Revenue Service and Commodity Futures Trading Commission. The USTP participated in the sweep by filing or resolving objections to discharge in bankruptcy cases

million. One defendant ultimately filed for bankruptcy, but the U.S. Trustee’s Manchester office obtained a waiver of his chapter 7 discharge. The debtor operated a mortgage-brokering firm that was involved in obtaining private lending for residential and commercial borrowers. The other defendant owned and operated a mortgage-servicing entity, created to provide services to private-lending customers. The debtor admitted to soliciting individual consumers as private lenders and falsely representing that their money would be or had been used exclusively to fund one or more specific private-mortgage loans. He failed to disclose his intent to use all or part of the private lenders’ money to fund mortgages in which they had not agreed to invest, to make interest payments to other lenders and themselves, to defray the mortgage-brokering firm’s operating expenses and to fund his personal expenditures. In August 2010, the Bankruptcy Court for

On Our Watch

involving alleged participants in investment fraud and by referring to law enforcement a number of the criminal cases that were charged or resolved during OBT. This article discusses several bankruptcy-related investment fraud cases included in the sweep, and the USTP’s role in those cases.

Ponzi Schemes

In several OBT cases, Ponzi scheme operators were subject to civil enforcement activity by the USTP. Ponzi scheme organizers often solicit investors by promising to invest in opportunities claimed to generate high returns with little or no risk. In many Ponzi schemes, the fraudsters solicit new investors in order to make promised payments to earlier-stage investors and use for personal expenses instead of engaging in legitimate investment activity.⁴

One case involved two defendants in the District of New Hampshire who pleaded guilty to charges relating to their participation in a Ponzi scheme that defrauded private lenders out of \$33

million. The District of New Hampshire approved his waiver of discharge. The following month, he pleaded guilty to mail fraud and wire fraud charges.

In another case, a debtor who was an investment manager was convicted by a jury in the Eastern District of New York for operating a long-running, large-scale Ponzi scheme. The U.S. Trustee’s Brooklyn office referred the criminal matter to the U.S. Attorney’s office after the debtor filed for bankruptcy. The U.S. Trustee also objected to the debtor’s discharge, which resulted in his waiver of discharge. The debtor’s scheme began in the late 1970s when he began accepting money from individual investors for purported stock option investments. To induce investments and discourage withdrawals, the debtor guaranteed specific rates of return, issued account statements that showed growing account balances, represented that investing in his business was safe and promised that withdrawals could be made easily. Evidence presented at the criminal trial established

⁴ See SEC, “Ponzi Schemes—Frequently Asked Questions,” www.sec.gov/answers/ponzi.htm.

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that the debtor operated a Ponzi scheme, paying returns from existing investors' deposits and from money paid by new investors. He never produced or earned the rates of return he advertised, and he lied to investors about his company's investments and falsely assured investors about their risk of loss. Approximately 800 individuals invested a total of more than \$40 million in his business. The debtor testified during his 11 U.S.C. § 341 meeting of creditors that he owed \$60 million to investors.

In a case from the Middle District of Tennessee, the U.S. Trustee's Nashville office obtained the stipulated denial of a debtor's discharge in a civil action prior to the sweep and made a criminal referral to the U.S. Attorney's Office. During the sweep, the debtor was sentenced to 96 months in prison and ordered to pay more than \$7 million in restitution after pleading guilty to mail and wire fraud related to his involvement in a Ponzi scheme. The debtor promised investors that they would receive between 10 to 28 percent in annual returns, and persuaded individuals to invest more than \$7 million in investment accounts. Instead of investing on the clients' behalf, the debtor used the funds to subsidize a lavish lifestyle that included expensive homes, cars, a country club membership and shopping trips during which he spent thousands on hotels and clothing. The debtor filed for bankruptcy in an attempt to discharge his debts to the defrauded investors.

In another OBT matter, the U.S. Trustee's Seattle office obtained a debtor's waiver of the chapter 11 discharge of more than \$100 million in unsecured debt arising from his Ponzi scheme and embezzlement activities. The debtor created and operated investment funds purportedly for the purpose of investing in seller-financed real estate contracts,

hard-money loans, real estate and mortgage-backed securities. Approximately 1,000 investors invested \$350 million in four funds, which are currently the subjects of jointly administered chapter 11 cases. In November 2010, the debtor was indicted in the Western District of Washington on charges of wire fraud, money laundering and bankruptcy fraud resulting from his alleged use of more than \$100 million in investor funds for unrelated business activities and personal expenses for private jets, yachts and a waterfront mansion.

Affinity Fraud

Consistent with the focus on protecting consumers, OBT included a number of affinity fraud cases. Affinity fraud refers to investment scams that prey on members of identifiable groups, such as religious or ethnic communities, the elderly or professional groups. The fraudsters who promote affinity scams frequently are, or pretend to be, members of the group. They often enlist respected community or religious leaders from within the group to spread the word about the scheme to convince those persons that an investment is legitimate and worthwhile. The community or religious leaders often become unwitting victims of the fraudster's ruse.⁵

In a bankruptcy-related affinity fraud case included in OBT, a debtor waived his chapter 7 discharge pursuant to an agreed order entered by the Bankruptcy Court for the Northern District of Ohio. The waiver resolved an objection to discharge filed by the U.S. Trustee's Cleveland office alleging that the debtor engaged in a scheme to defraud approximately a dozen investors out of around \$1 million to fund his extravagant lifestyle and gambling habit.

The debtor used his associations with a church to convince members to invest in day-trading software that he claimed to be developing. The U.S. Trustee's investigation revealed that the debtor instead used investors' money to purchase race horses, buy or lease luxury vehicles and maintain a \$450,000 property held in his wife's name, and that he regularly created new corporations and accounts to hinder and delay investors' collection efforts. When he filed for bankruptcy, the debtor initially claimed that he had no financial accounts other than a brokerage account. Among other assets involved in the fraud scheme, the U.S. Trustee discovered eight checking accounts created through corporate shells. Nearly all of these accounts had been used to finance gambling, casino vacations and/or luxury purchases.

Conclusion

The FFETF sent a strong message with Operation Broken Trust. "To the public: be alert for these frauds, take appropriate measures to protect yourself, and report such schemes to proper authorities when they occur," Holder said. "And to anyone operating or attempting to operate an investment scam: Cheating investors out of their earnings and savings is no longer a safe business plan—we will use every tool at our disposal to find you, to stop you and to bring you to justice."

The USTP is pleased to have participated in this significant law enforcement effort. Additional information about investment fraud schemes can be found at the FFETF's website.⁶ The USTP encourages those in the bankruptcy community to report suspected bankruptcy fraud and abuse to the USTP.⁷ ■

⁶ See www.stopfraud.gov.

⁷ Report suspected bankruptcy fraud through either a local field office or the Internet fraud hotline at ustp.bankruptcy.fraud@usdoj.gov.

⁵ See SEC, "Affinity Fraud: How to Avoid Investment Scams that Target Groups," www.sec.gov/investor/pubs/affinity.htm.

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A Fraud Is a Fraud, but Bankruptcy Fraud Is Inherently Bad: Enhanced Sentencing

Written by:

Timothy B. McGrath¹
U.S. Bankruptcy Court; Philadelphia
timothy_mcgrath@paeb.uscourts.gov

Tucked away in the manual and multi-volume appendices of the U.S. Sentencing Guidelines (USSG) is a provision specifically tailored to deter those little Whos in Whoville² who may be contemplating bankruptcy fraud. If the offense of conviction involves “a misrepresentation or other fraudulent action during the course of a bankruptcy proceeding,” USSG §2B1.1(b)(8)(B) provides that an increased penalty is warranted.

¹ The views expressed in this article are the author's and do not necessarily represent the opinions of the federal judiciary or U.S. Sentencing Commission.

² The “Whos in Whoville” is a reference to *The Grinch Who Stole Christmas* by American author Theodore Seuss Geisel (1904-1991), also known as “Dr. Seuss.”

About the Author

Timothy McGrath is the clerk of the U.S. Bankruptcy Court for the Eastern District of Pennsylvania.

As a result, bankruptcy fraud is punished more severely under the federal sentencing guidelines than more pedestrian federal fraud offenses.³ This article addresses the reasons the U.S. Sentencing Commission created the bankruptcy fraud enhancement, the deliberative process used to promulgate the enhancement and its continued viability following two recent Supreme Court rulings.

³ See USSG, Supplement to App. C, Amendment 597 (Nov. 1, 2000), citing *United States v. Saacks*, 131 F.3d 540, 543 (5th Cir. 1997) (noting bankruptcy fraud as being more serious than “the most pedestrian federal fraud offenses”).

Federal Sentencing Guidelines The Amendment Process



Timothy B. McGrath

The federal sentencing guidelines have their genesis in the Sentencing Reform Act (SRA) of 1984.⁴ As part of the SRA, Congress established “an independent commission in the judicial branch” to develop “sentencing policies and practices for the [f]ederal criminal justice system.”⁵

Organized in October 1985, the

⁴ Publ. L. No. 98-473, 98 Stat. 1838 (1984), codified at 18 U.S.C. §§3551-3559; 28 U.S.C. §§991-998.

⁵ 28 U.S.C. §991(a) and (b).

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ABI Event Roundup

More than 1,000 Attend Annual Spring Meeting at Beautiful New Venue on the Potomac River

Insolvency professionals from 45 states, three foreign countries and one U.S. territory attended this year's Annual Spring Meeting at the Gaylord National Resort & Spa, a new venue in National Harbor, Md., situated on the beautiful Potomac River, offering



Prominent economist Mark Zandi addressed the impact of the stimulus package and predicted that the recession will end this December.

the most deluxe meeting and event space in the area. More than 19 hours of CLE credit were available, including an unprecedented 6.75 hours of ethics. An additional program, Nuts & Bolts for Young Practitioners, was held again this year, addressing both consumer and business bankruptcy basics. Conference

attendees heard prominent speakers on current legislative and economic issues of the day, including: a representative for Congressman Steve Cohen (D-Tenn.), Chairman of the House Judiciary Committee's Subcommittee on Commercial and Administrative



Rep. Louis Gohmert (R-Texas) discussed the House Judiciary Committee's agenda for the 111th Congress.

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Bestselling author David Baldacci was the keynote speaker during the luncheon on April 2, 2009. Signed copies of his two most recent novels were available to meeting attendees.

A Fraud Is a Fraud, but Bankruptcy Fraud Is Inherently Bad

from cover

Organized in October 1985, the Sentencing Commission issued its first set of mandatory guidelines in 1987.⁶ After the U.S. Supreme Court rejected constitutional challenges to the SRA and Commission, the guidelines were implemented on a nationwide basis in January 1989,⁷ and federal judges have sentenced more than one million offenders since then under these guidelines.⁸

The Commission is required, by statute, to periodically review and revise the guidelines.⁹ To fulfill its congressional mandate, the Commission established an annual amendment cycle that typically starts each June with a solicitation published in the *Federal Register* to seek input on its policy priorities. The amendment cycle concludes the following May with the proposed amendments to submit to Congress.¹⁰ After a 180-day review period, those proposed amendments that are not rejected by Congress take effect, typically on Nov. 1.¹¹ The Commission has used this deliberative amendment process for two decades.

The Role of Circuit Conflicts

During each annual amendment cycle, the Commission considers proposed guideline changes from a variety of sources.¹² One factor relevant to the guideline enhancement for bankruptcy fraud is the Commission's practice of resolving conflicting interpretations of the guidelines among the appellate courts.

In *Braxton v. United States*, the Supreme Court affirmed the Commission's role in resolving, through the guideline amendment process, circuit conflicts in the interpretation of guideline provisions.¹³ According to the *Braxton* court's unanimous decision, "in charging the Commission 'periodically [to] review and revise' the [g]uidelines, Congress necessarily contemplated that the Commission would periodically review the work of the courts, and would

make whatever clarifying revisions to the [g]uidelines conflicting judicial decisions might suggest."¹⁴ Relying upon both statutory mandate and Supreme Court precedent, the Commission sought public comment on and subsequently established a process for resolving circuit conflicts as part of its annual guidelines amendment process.¹⁵

The Commission's Office of General Counsel catalogues and publishes conflicts in circuit case law.¹⁶ The Commission solicits public input through notices, published in the *Federal Register*, seeking comment on amendment priorities, including resolution of circuit conflicts.¹⁷ The Commission also holds public hearings to collect testimony and interact with key stakeholders in the criminal justice system.¹⁸ The enhancement for bankruptcy fraud came about as a result of a circuit conflict.

Bankruptcy Fraud Majority and Minority Circuit Views

A conflict arose among the circuits as to how to correctly apply the sentencing guidelines to bankruptcy fraud offenders.¹⁹ Before November 2000, the guidelines required an enhanced penalty for a "violation of any judicial or administrative order, injunction, decree or process not addressed elsewhere in the guidelines."²⁰ The majority of circuits held that this enhancement applied to bankruptcy fraud defendants.²¹ For example, in *United States v. Messner*, the Tenth Circuit found that:

Bankruptcy fraud undermines the whole concept of allowing

a debtor to obtain protection from creditors, pay debts in accord with the debtor's ability, and thereby obtain a fresh start. When a debtor frustrates those objectives by concealing the very property which is to be utilized to achieve that purpose, the debtor works a fraud on the entirety of the proceedings.²²

Five appellate courts found bankruptcy fraud more insidious than a "typical" fraud, since offenders "abused the bankruptcy process and hindered the orderly administration of bankruptcy."²³ The courts determined that "bankruptcy fraud involves a higher level of culpability due to its deception of the court, [and thus] the offense warrants a greater punishment."²⁴

Three appellate courts reached a different conclusion.²⁵ The Third Circuit found that "[n]othing in the guidelines suggests the drafters intended as a general matter to sentence bankruptcy fraud more strictly than other types of fraud."²⁶ Instead, these courts found that if any enhancement applies, it "applies only to those who receive a more specific command from the bankruptcy court and break it."²⁷ The enhancement would not apply "whenever someone fails to follow a general set of instructions in a bankruptcy rule or form."²⁸

The Commission's Resolution

After listing the resolution of circuit conflicts as a priority for the 1999-2000 amendment cycle, the Commission received public comment and heard testimony on the matter.²⁹ The Commission tentatively adopted the majority view on the bankruptcy fraud conflict and released a proposed amendment for public comment.³⁰ The Commission then deliberated on the proposed amendment

⁶ See U.S. Sentencing Commission 2008 Annual Report, Chapter 1, *Commission Overview*, at p. 1, available at www.uscc.gov/ANNRPT/2008/ar08toc.htm.

⁷ *Mistretta v. United States*, 488 U.S. 361 (1989) (Court rejects arguments of improper legislative delegation of authority and violation of separation of powers doctrine).

⁸ See *United States Sentencing Commission 2008 Annual Report*, Chapter 1 at p. 2, 28 U.S.C. § 994(o).

⁹ See 28 U.S.C. § 994(p), which gives the Commission authority to send proposed amendments to Congress on or before May 1.

¹⁰ *Id.* See also "Rule of Practice and Procedure of the United States Sentencing Commission," adopted July 11, 1997, revised Aug. 29, 2007, available at www.uscc.gov.

¹¹ See 28 U.S.C. § 994(o) for a list of authorities, individuals and institutions Congress specifically directed the Commission to consult when considering amendments.

¹² *Braxton v. United States*, 500 U.S. 344 (1991).

¹⁴ *Braxton*, 500 U.S. at 348.

¹⁵ See "Commission Policy Regarding Resolution of Guideline Circuit Conflicts," 65 FR 50034, 50037 (Aug. 16, 2000).

¹⁶ The circuit conflict involving bankruptcy fraud first appeared in a publication issued by the Sentencing Commission's Office of General Counsel in October 1997. See www.uscc.gov/training/court.htm. It reappears in 1998 and 1999 circuit conflict publications issued by the Commission.

¹⁷ In December 1999, the Commission published a notice in the *Federal Register*, indicating that resolving circuit conflicts would be a priority in the coming amendment cycle. See 64 FR 68715-68716 (Dec. 8, 1999). On Feb. 11, 2000, the Commission specifically listed the bankruptcy fraud circuit conflict, cited case law and requested comment as to (1) whether the Commission should resolve the conflict and (2) if so, how said conflict should be resolved. 65 FR 7080-7093 (Feb. 11, 2000).

¹⁸ The Commission provided notice of a public hearing scheduled for March 23, 2000. See 64 FR 72129-72134 (Dec. 23, 1999); 65 FR 2663-2668 (Jan. 18, 2000). At the public hearing, testimony was given on a proposed provision addressing bankruptcy fraud. See www.uscc.gov/agendas/3_23_00/test03_00.htm.

¹⁹ Most guideline applications involving bankruptcy fraud are convictions pursuant to 18 U.S.C. § 152 (knowingly and fraudulently concealing property, making false statements in a bankruptcy proceeding).

²⁰ See § 2F1.1(b)(3)(B) (deleted by consolidation with § 2B1.1, effective Nov. 1, 2001. See USGS Appendix C, Amendment 617).

²¹ The Fifth, Seventh, Eighth, Ninth, Tenth and Eleventh Circuits shared this view. See *United States v. Saccks*, 131 F.3d 540 (5th Cir. 1997); *United States v. Webster*, 125 F.3d 1024 (7th Cir. 1997); *United States v. Messner*, 107 F.3d 1448 (10th Cir. 1997); *United States v. Welch*, 103 F.3d 906 (9th Cir. 1996); *United States v. Michalek*, 54 F.3d 325 (7th Cir. 1995); *United States v. Bellaw*, 35 F.3d 518 (11th Cir. 1994); and *United States v. Lloyd*, 947 F.2d 339 (8th Cir. 1991).

²² *Messner*, 107 F.3d 1448, 1457 (10th Cir. 1997).

²³ See *Lloyd*, 947 F.2d at 340.

²⁴ See *Michalek*, 54 F.3d at 332.

²⁵ Specifically, the First, Second and Third Circuits determined that bankruptcy fraud should not be punished more strictly than other fraud offenses. See *United States v. Rowe*, 202 F.3d 37 (1st Cir. 2000); *United States v. Thayer*, 201 F.3d 214 (3d Cir. 1999); *United States v. Shaddock*, 112 F.3d 523 (1st Cir. 1997); and *United States v. Carozzella*, 105 F.3d 796 (2d Cir. 1997) (involving state probate court but expressing "skepticism" about enhancement).

²⁶ See *Thayer*, 201 F.3d at 228.

²⁷ See *Rowe*, 202 F.3d at 43 (citing *Shaddock*, 112 F.3d at 529-30).

²⁸ See *Rowe*, 202 F.3d at 43 (citing *Shaddock*, 112 F.3d at 529-30).

²⁹ See "Statement of the Federal Public and Community Defenders," submitted by Jon Sands, assistant federal public defender, March 10, 2000, at p. 104-112; and Letter to Judge Diana Murphy, chair of the U.S. Sentencing Commission, from the U.S. Department of Justice, James K. Robinson, assistant attorney general, and Laird C. Kirkpatrick, counsel to the assistant attorney general, dated March 10, 2000, at p. 10.

³⁰ See www.uscc.gov, under the hyperlink "Meeting Materials, April 3-4, 2000."

and, at a public meeting on April 3, 2000, voted unanimously to adopt it.³¹ Finally, the Commission formally submitted the proposed amendments, including the bankruptcy fraud amendment, to Congress and published notice in the *Federal Register*.³² In explaining the reason for the amendment, the Commission stated that it was prompted by a circuit conflict and that the amendment

creates a separate and distinct... enhancement under the fraud guideline for a misrepresentation or false statement made in the course of a bankruptcy proceeding... The Commission has decided to treat bankruptcy fraud more severely because of its adverse impact on the bankruptcy judicial process and because of the additional harm and seriousness involved in such conduct. *See United States v. Saacks*, 131 F.3d 540, 543 (5th Cir. 1997) (noting that bankruptcy fraud is more serious than "the most pedestrian federal fraud offenses").³³

After the expiration of the 180-day review period, Congress, without comment, allowed the proposed amendments to take effect.³⁴ The newly promulgated bankruptcy fraud amendment was published in the USSG manual and took effect on Nov. 1, 2000.

Prior to fiscal year 2005, the Commission's data collection and reporting process was not specific as to each enhancement listed in the manual. As a result, there is no data confirming how frequently the bankruptcy fraud guideline was applied, but the Commission began to collect and report these statistics in October 2004. For the four-year period beginning in October 2004 through September 2008, 250 offenders received the bankruptcy fraud enhancement.³⁵

Recent Supreme Court Rulings: Booker and Its Progeny

In January 2005, nearly five years after the bankruptcy fraud enhancement was promulgated, the Supreme Court issued its decision in *Booker v. United States*.³⁶ The Court found that the mandatory sentencing guideline system violated

the Sixth Amendment.³⁷ To remedy this constitutional infirmity, the Court severed and excised the provisions of the SRA that rendered the guidelines mandatory, *i.e.*, 18 U.S.C. §§3553(b)(1) and 3742(e). This modification of the "Federal Sentencing Reform Act of 1984...makes the [g]uidelines effectively advisory."³⁸

Since *Booker*, there have been a series of Supreme Court decisions attempting to clarify federal sentencing practice,³⁹ most recently two *per curiam* opinions issued in late January 2009. In *Spears v. United States*, 555 U.S. ____ (2009), the Court held that federal judges are free to categorically reject and vary from the guidelines based on a policy disagreement with the Commission.⁴⁰ In *Nelson v. United States*, 555 U.S. ____ (2009), the Court ruled that "the [g]uidelines are not only *not mandatory* on sentencing courts; they are also not to be *presumed* reasonable."⁴¹ The Court continues to acknowledge the Sentencing Commission's institutional utility⁴² but at the end of the day, its decisions have brought a sea of change to federal sentencing practice.

In light of *Booker* and its progeny, what might now happen to a run-of-the-mill⁴³ fraudster convicted of concealing assets from a federal bankruptcy court? After calculating the sentence for the guidelines, including applying the two-level increase under §2B.1(b)(8)(B), the district judge must turn to 18 U.S.C. §3553(a), which enumerates the statutory purposes of sentencing in order to determine whether the punishment meted out under the guidelines is "greater than necessary" to achieve the stated purposes.⁴⁴

What if that sentencing judge decides to vary from the guidelines not on the particular circumstances of the offender before him, but because he (the sentencing judge) categorically disagrees with the Commission's policy decision that bankruptcy fraud is more

insidious than a pedestrian fraud? It is foreseeable, in light of *Spears* and *Nelson*, that a district judge who agrees with the minority circuits could reject the Commission's enhancement.

When the Commission crafted the bankruptcy fraud enhancement to resolve a circuit conflict, it was exercising its "characteristic institutional role."⁴⁵ In doing so, the Commission promoted uniformity of application while avoiding unwarranted disparity in federal sentencing practice. Is the district judge's decision reasonable, or is it entitled to "less respect"⁴⁶ since it infringes on the Commission's characteristic institutional role?⁴⁷

In a post-*Booker* decision, issued by a three-judge panel and denied an *en banc* rehearing, an appellate court overruled a district judge who disagreed with the Commission's policy decision regarding the bankruptcy fraud enhancement. In *United States v. Ahmad Bey*, an unpublished order of the Seventh Circuit, the appeals court vacated the district judge's ruling after the judge declined to impose the two-level enhancement for bankruptcy fraud.⁴⁸ Judge Wayne Andersen of the District Court for the Northern District of Illinois thought the enhancement was unwarranted "because the fraudulent conduct 'is the essence of' a violation of §152(3)."⁴⁹ The Seventh Circuit, not having the benefit of *Kimbrough*, *Spears* and *Nelson*, vacated and remanded, since the law at that time held that it was inappropriate for a sentencing judge to depart or vary from the guidelines based on a disagreement with a congressional policy as reflected in the guidelines. Time will tell if similar rulings will withstand appellate scrutiny as lower courts begin to apply these new Supreme Court rulings.

Conclusion

From the vantage point of Congress and the Sentencing Commission, the Supreme Court is looking increasingly like the Grinch who stole Christmas, perched high atop Mount Crumpit disguised as Capitol Hill. This story ends where it began but with a slight modification, compliments of the high court: A fraud is a fraud, no matter how sad, but bankruptcy fraud may not be so bad!⁵⁰ ■

⁴⁵ See *Braxton*, *supra*; *Spears*, 555 U.S. ____, slip op. at 3-4; 28 U.S.C. §994(o).

⁴⁶ *Spears*, 555 U.S. ____, slip op. at 3.

⁴⁷ For a full discussion of the post-*Booker* standard of appellate review, see *Gall*, 552 U.S. at 595; *Nelson*, 555 U.S. at ____, slip op. at 2; *United States v. Blue*, ____, F.3d ____, slip op. at 4 (6th Cir. 2009).

⁴⁸ *United States v. Ahmad Bey*, 244 Fed.Appx. 57, 2007 WL 2228982 (CA. 7 (Ill.)).

⁴⁹ *Id.* See also, *supra* at note 19.

⁵⁰ Special thanks to Chief Bankruptcy Judge Stephen Raslavich and the staff of the Clerk's Office of the Eastern District of Pennsylvania for giving me time to write this article. Thanks also to Melissa Reimer, Christine Kitchens, Louis Reedt and Jeanne Doherty of the U.S. Sentencing Commission for their assistance in providing data and access to the Commission's archives.

³⁷ *Id.* at 226-227.

³⁸ *Id.* at 245.

³⁹ See *Rita v. United States*, 551 U.S. 338 (2007) (appellate courts may apply presumption of reasonableness when reviewing sentence imposed within guideline sentencing range); *Kimbrough v. United States*, 552 U.S. ____, 128 S.Ct. 558 (2007) (district court judge must include guidelines range in array of factors warranting consideration); *Gall v. United States*, 552 U.S. ____, 128 S.Ct. 586 (2007) (as matter of administration and to secure nationwide consistency, guidelines should be starting point at sentencing); *Irizarry v. United States*, ____, U.S. ____, 128 S.Ct. 2198 (2008) (sentencing court not required to give notice when imposing sentence that varies from guidelines).

⁴⁰ *Spears*, 555 U.S. ____, slip op. at 3-5.

⁴¹ *Nelson*, 555 U.S. ____, slip op. at 3.

⁴² *Spears*, 555 U.S. ____, slip op. at 2-3, citing *Kimbrough*, 552 U.S. ____ (2007) (slip op., at 21), 128 S.Ct. at 574 (2007); *Booker*, 543 U.S. at 224. The Supreme Court, several lower courts and the U.S. Sentencing Commission refer to a common or typical case as being "mine run," "pedestrian" or, in guideline parlance, "inside the heartland." See *Spears* at slip op. 2, (citing *Kimbrough*, 552 U.S. at ____, and *Rita*, 551 U.S. 338, 351 (2007). See also *Saacks*, 131 F.3d 540, 543, (5th Cir. 1997).

⁴³ For a full discussion of the procedural steps a sentencing judge must follow post-*Booker*, see *Gall*, 552 U.S. at ____, 128 S. Ct. 586, 596-97 (2007); *United States v. Wise*, 515 F.3d 207, 215-16 (3d Cir. 2008).

³¹ See www.ussc.gov/minutes/4-3-00.htm.

³² See 65 FR 26879-26902 (May 9, 2000).

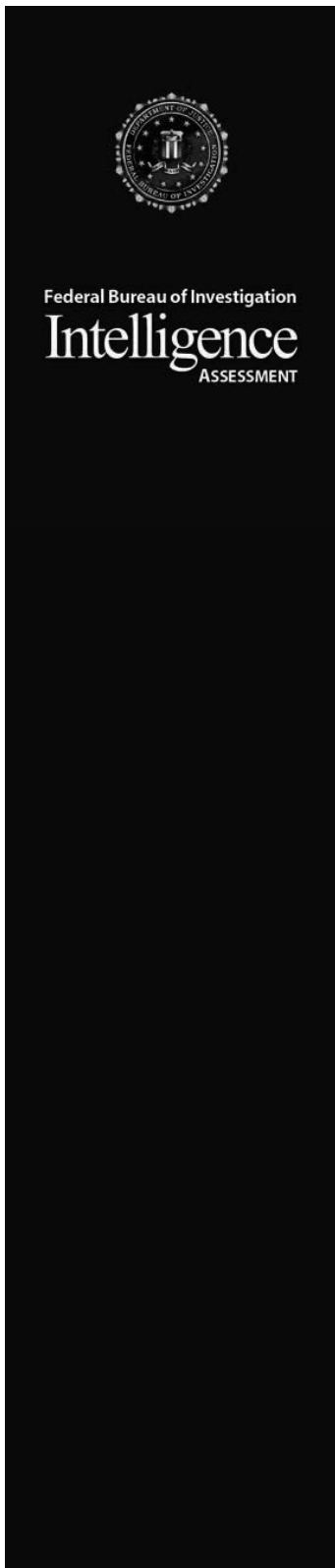
³³ See USSG, Supplement to App. C, Amendment 597 (November 1, 2000).

³⁴ See, generally, Statement of Judge Diana E. Murphy, chair of the U.S. Sentencing Commission, before the Criminal Justice Oversight Subcommittee of the U.S. Senate Committee on the Judiciary, 146 Cong. Rec. D1078-01; 2000 WL 1521168 (Cong. Rec.); www.ussc.gov/hearings/murphyoversight.pdf.

³⁵ See www.ussc.gov/gl_frequencies.htm.

³⁶ *Booker v. United States*, 543 U.S. 220 (2005)

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(U) US Bankruptcy System Exploited to Perpetrate Foreclosure Rescue Schemes

25 May 2010



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(U) US Bankruptcy System Exploited to Perpetrate Foreclosure Rescue Schemes

(U) Scope Note

(U) This assessment was jointly prepared and coordinated with the US Trustee Program (USTP)^a and examines the impact of fraudulent bankruptcy filings on the current mortgage industry crisis. The FBI and the USTP assess that the bankruptcy fraud threat will have significant impact on the US mortgage, banking, and securities industries; consumers; and the overall US economy. This is the first analytic FBI publication on this topic. Data sources incorporated into this assessment are current as of April 2010.

(U) This assessment is not intended to outline US bankruptcy system (USBS) policies, procedures, processes, or specific deficiencies therein.

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(U) Source Summary Statement

(U) Information used to prepare this assessment was derived from FBI investigations, FBI source reporting, and reporting from the USTP, US Treasury Department, mortgage industry, and open sources. Most of the FBI source information was derived from reliable sources. Information provided by the USTP is deemed reliable as it primarily emanated from case referrals that resulted in federal criminal court proceedings. Foreclosure information obtained from RealtyTrac has previously been deemed reliable by the FBI and used in FBI annual mortgage fraud reports since 2004 to compare the number of foreclosure filings per US Housing Units and foreclosure rates throughout the United States. RealtyTrac is the leading real estate marketplace for foreclosure properties and publishes the country's largest most comprehensive foreclosure database, with more than 1.5 million default, auction, and bank-owned homes from across the country covering 90 percent of all US households. Federal Housing Administration information was obtained from the US Department of Housing and Urban Development (HUD). Delinquency rates reported by TransUnion and RealtyTrac in a joint press release are based on statistical data deemed reliable in the past. TransUnion data is derived from TransUnion's national consumer credit database consisting of 27 million records and is one of three major credit reporting agencies relied upon by issuers of credit. Finally, open-source reporting was used in this report reflecting easily corroborated information, such as Department of Justice press releases and federal district court criminal case filings.

^a (U) The US Trustee Program is a component of the US Department of Justice that seeks to promote the efficiency and protect the integrity of the Federal bankruptcy system. To further the public interest in the just, speedy and economical resolution of cases filed under the Bankruptcy Code, the USTP monitors the conduct of bankruptcy parties and private trustees, oversees related administrative functions, and acts to ensure compliance with applicable laws and procedures. It also identifies and helps investigate bankruptcy fraud and abuse in coordination with United States Attorneys, the Federal Bureau of Investigation, and other law enforcement agencies.

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(U) Key Questions

- (U) How prevalent is the use of fraudulent bankruptcy filings in the commission of mortgage fraud?
- (U) Which victim population is most vulnerable to perpetrators exploiting USBS in the commission of mortgage fraud?
- (U) What types of mortgage fraud schemes are being perpetrated by exploiting USBS?
- (U) Are perpetrators repeatedly exploiting USBS to further foreclosure rescue operations?
- (U) What vulnerabilities are contributing factors to the exploitation of USBS in the commission of mortgage fraud?

(U) Key Assumptions

- (U) The very mechanisms present in the USBS court process intended to protect individuals who file for bankruptcy relief are also used by fraud perpetrators to commit foreclosure rescue schemes.
- (U) Mortgage industry and non-mortgage industry personnel will continue to participate in this scheme as long as the lack of safeguards permits them to be productive and shielded from law enforcement scrutiny.
- (U) The Internet provides instant access to public records that allow perpetrators to easily target victim properties and vulnerable homeowners. Perpetrators will increasingly use this method to identify target victims.

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(U) Executive Summary

(U) The FBI and the USTP assess with high confidence^b that mortgage fraud perpetrators are exploiting the US bankruptcy system (USBS) by filing fraudulent bankruptcy petitions to delay the foreclosure process and extract the maximum profit from victims. This fraud is conducted during the commission of foreclosure rescue schemes and often involves the perpetrator repeatedly filing multiple bankruptcy petitions. This type of fraudulent activity is increasing as perpetrators seize opportunities created by the current housing crisis and the more than 2.1 million properties in foreclosure.¹

(U) The FBI and the USTP assess with high confidence that perpetrators are exploiting the USBS via advance fee/foreclosure rescue schemes. As vulnerabilities in federal legislation aimed at stemming foreclosures become apparent and new loan modification programs emerge, perpetrators will have more opportunities to profit from victim homeowners. These schemes negatively impact distressed homeowners by requiring up-front fees for services not rendered and can result in homeowners losing their homes.

(U) The FBI and the USTP assess with high confidence that perpetrators are engaging in fractional transfer schemes as they convince increasing numbers of homeowners facing foreclosure to deed partial interest in their properties to fictitious companies or individuals and file fraudulent bankruptcy petitions to delay foreclosure and generate additional proceeds. This scheme is allowing perpetrators to collect millions of dollars in monthly fees from financially distressed homeowners.

(U) The FBI and the USTP assess with high confidence that perpetrators are persuading homeowners to deed their homes to the perpetrators in a sale-leaseback-repurchase scheme. By filing fraudulent petitions with the USBS, perpetrators subsequently collect illicit advance fees, rental payments, and false equity proceeds from fraudulent refinances. Sale-leaseback-repurchase schemes negatively impact the mortgage industry and its most vulnerable consumers by contributing to the growing number of foreclosures and significantly impacting a borrower's ability to secure a legitimate loan modification.

(U) The FBI and the USTP assess with high confidence that as mortgage loan defaults and foreclosures increase, delinquent homeowners will become increasingly vulnerable to fraudulent foreclosure rescue and loan modification schemes that exploit the USBS. As this occurs in conjunction with increasing unemployment, decreasing home prices, and increased housing inventory, these schemes will likely continue to impact the overall economic crisis in the US. However, in the near term, should recently enacted legislation reduce the pool of potential foreclosure rescue victims, our confidence in this judgment will be lowered.

^b (U) **High Confidence** generally indicates that judgments are based on high-quality information or that the nature of the issue makes it possible to render a solid judgment.

(U) **Medium Confidence** generally means that the information is interpreted in various ways, that there are alternating views, or that the information, while credible, is of insufficient reliability to warrant a higher level of confidence.

(U) **Low Confidence** generally means that the information is scant, questionable, or very fragmented; that it is difficult to make solid analytic inferences; or that there are significant concerns or problems with the source.

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(U) Introduction

(U) Foreclosures, instant defaults, delinquencies, loan modifications, housing inventory, and slow sales are contributing to a vulnerable pool of potential foreclosure rescue victims. According to RealtyTrac, US foreclosure filings increased 120 percent from 1.3 million in 2007 to 2.8 million in 2009.² The Federal Housing Administration (FHA) mortgage loan market share, which was 3.77 in FY 2006, has increased to 20.18 as of June 2009 and FHA “instant defaults” (borrowers who default before making a single payment) have increased by 320 percent.³ RealtyTrac and TransUnion reported that mortgage delinquency rates were at an all-time high in the second quarter of 2009.⁴ According to the Treasury Department, as of July 2009, less than 10 percent of eligible delinquent borrowers are obtaining federal assistance offered by the Making Home Affordable Plan/Home Affordable Modification Program.⁵ These factors combine to further raise concern that an increasing number of delinquent homeowners will become vulnerable to fraudulent foreclosure rescue and loan modification schemes.

(U) The FBI and the USTP assess with high confidence that mortgage fraud perpetrators are exploiting the USBS during the commission of foreclosure rescue schemes. The current housing market is an attractive environment for mortgage fraud perpetrators employing a variety of methods, such as the filing of fraudulent bankruptcy petitions to circumvent loopholes and gaps in the mortgage lending market. An increase in housing inventory, lack of home sales, and a high foreclosure rate are increasing the desperation among mortgage holders who are searching for alternative solutions. Despite loan modification assistance programs and federal, state, and local legislation, foreclosures are increasing at record levels, providing perpetrators with a plethora of vulnerable targets.⁶

(U) Fraudulent Bankruptcy Filings

(U) The FBI and the USTP assess with high confidence that mortgage fraud perpetrators are exploiting the USBS by filing bankruptcy cases to invoke the automatic stay, an injunction that automatically stops lawsuits, foreclosures, garnishments, and all collection activity against the debtor the moment a bankruptcy petition is filed. This stay postpones the foreclosure and provides additional opportunities to further defraud homeowners and lenders.

(U) In addition to the typical foreclosure rescue scheme, perpetrators may also convince homeowners to cease communicating with their lenders. In some situations, they also convince homeowners to transfer their property to the perpetrators or some person or entity selected by the perpetrators; to make their monthly mortgage payment to the perpetrators in lieu of their lender; and to complete certain paperwork including a bankruptcy petition or Power of Attorney (POA). Sometimes, the victims sign such paperwork without reviewing or understanding the significance of the documents they have executed. There have been several examples of this approach in different regions of the United States.

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- (U) According to the US Department of Justice (USDOJ), on 4 June 2009, a grand jury in the Central District of California returned an indictment against an individual for using the bankruptcy system to defraud distressed homeowners facing foreclosure and tenants facing eviction.⁷
- (U) According to a reliable FBI source with excellent access, in July 2008, an investment company in Oregon, advised a distressed property owner/seller to file for bankruptcy to gain the protection of the automatic stay so that the investment company could arrange for short sales of his 12 properties.⁸
- (U) According to the US District Court for the District of Delaware, from 2003 to 2007, a medical doctor from Dover, Delaware, exploited the bankruptcy system by filing multiple sham bankruptcies for the purpose of thwarting her lender's efforts to foreclose on her home.⁹

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(U) Multiple Bankruptcy Filings

(U) Under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), Pub. L. No. 109-8, 119 Stat. 23, changes were made to the automatic stay provisions to deal with repeat bankruptcy filers. The new law limits the availability and extent of the automatic stay based on the frequency with which an individual filed for bankruptcy within the preceding year. Generally, the stay is only in effect for 30 days if an individual filed a bankruptcy case that had been dismissed within the preceding year. The stay does not go into effect at all if an individual filed two bankruptcy cases that had been dismissed within the preceding year. However, these bankruptcy code provisions can be avoided if perpetrators file under slightly different names, use different social security numbers, or do not list prior bankruptcy cases.

(U) Source: Bankruptcy Abuse Prevention and Consumer Protection Act of 2005; 11 U.S.C. §§ 362(c)(3)(A); (c)(4)(A)(i).

(U) Advance-Fee Foreclosure Rescue Scheme

(U) The FBI and the USTP assess with high confidence that perpetrators are exploiting the USBS via advance fee/foreclosure rescue schemes. Lenders are mandated by recent legislation to include the Housing and Economic Recovery Act, the Emergency Economic Stabilization Act and new loan modification programs such as the Home Affordable Modification Program (HAMP) to assist homeowners with keeping their homes out of foreclosure and are using a plethora of media outlets to advertise their loan modification programs.¹⁰ Perpetrators are seizing this opportunity to generate quick profits by soliciting victim homeowners through aforementioned methods and by falsely telling them that their mortgages and delinquent loans will be renegotiated, and their monthly payments will be reduced. Perpetrators typically require an up-front fee ranging from \$200 to \$5,000 from homeowners to participate in a loan modification program and may also require a monthly fee to remain in the program. Perpetrators then use the bankruptcy system to postpone the foreclosure process by filing fraudulent, often serial, bankruptcy petitions for as long as possible to continue to profit from the victim homeowners.

- (U) According to the US District Court for the District of Mississippi, on 21 August 2009, individuals doing business as Yorkshire Financial Services (YFS) plead guilty to conspiracy to commit mail and wire fraud, bankruptcy fraud, and misprision of a felony for failing to report bankruptcy fraud. YFS engaged in an advance

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fee/foreclosure rescue scheme to defraud distressed homeowners and mortgage lenders in the Jackson, Mississippi, area. Perpetrators charged homeowners an advance fee of \$700 to \$900.¹¹

- (U) According to the US District Court for the District of Maryland, from 2004 to 2008, a mortgage broker and other defendants aired television commercials claiming that they could assist individuals who were facing foreclosure or eviction.¹² The Michael K. Lewis Group (MKLG) convinced homeowners facing foreclosure that they could, for a monthly fee, save their homes. In reality, MKLG collected exorbitant rent from the victims and filed fraudulent bankruptcy petitions on their behalf to stop the imminent foreclosure of their homes. Michael K. Lewis and his brother, Earnest Lewis, were convicted of conspiracy and bankruptcy fraud and are currently serving 78 month and 54 month sentences, respectively.
- (U) According to a reliable FBI source with excellent access, since April 2008, several individuals in Illinois, were engaged in advance fee and sale-lease back rescue fraud schemes.¹³ The perpetrators collected at least a \$1,500 fee for assistance in filing fraudulent documents with the bankruptcy court and directed the homeowners to deed their properties to investors and to pay rent to the perpetrators' real estate management company. Very few, if any, mortgage payments were made as promised by the perpetrators and the properties were eventually foreclosed upon.
- (U) According to a press release dated 12 December 2007 from the US Attorney in the Northern District of Ohio, WJW Enterprises, Inc. obtained public information regarding foreclosure actions and mailed flyers to homeowners offering to assist them in saving their homes in exchange for a fee ranging from \$700 to \$900.¹⁴ As part of the scheme, the defendant hired attorneys to prepare and file fraudulent bankruptcy petitions on behalf of homeowners to delay foreclosure proceedings. The Northern District of Ohio returned a nine-count superseding indictment against James Warsing, who owned and controlled WJW Enterprises, Inc. Warsing pleaded guilty to all counts in the superseding indictment.

(U) Fractional Transfer Scheme Using Fictitious Corporations

(U) The FBI and the USTP assess with high confidence that perpetrators are exploiting the USBS via fractional transfer schemes whereby homeowners are convinced to deed partial interests in their properties to fictitious companies. Perpetrators then file fraudulent bankruptcy petitions in the name of the fictitious companies or individuals thereby stopping the foreclosure process and preventing any further collection action by lenders or creditors against the properties. After the bankruptcy court grants relief from the automatic stay, another fractional interest in the property is transferred to a different fictitious company or person and another fraudulent bankruptcy case is filed. This further delays the foreclosure process and generates additional proceeds for the perpetrators.

- (U) According to the US District Court for the District of Kansas, in January 2009 two individuals associated with a Los Angeles, California, company, STOPCO, were

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convicted in the District of Kansas for engaging in a mortgage and bankruptcy fraud scheme perpetrated in California, Kansas, Maryland, and Tennessee. The defendants, through STOPCO, solicited homeowners facing foreclosure and fraudulently represented that they could stop the foreclosure process for a monthly fee. The defendants instructed homeowners to transfer a fractional interest in their homes to a fictitious company. The perpetrators then filed fraudulent bankruptcy petitions in the names of nonexistent individuals, who claimed to be part owners of properties that were in foreclosure. These actions postponed the imminent foreclosures and generated approximately \$2 million in proceeds for the defendants.¹⁵

- (U) According to a reliable FBI source with excellent access, as of April 2008 a California, company, instructed its homeowners that for a program fee of \$2,495, along with a monthly fee as high as \$1,850, they could avoid foreclosure. As part of the scheme, the company required homeowners to transfer a fractional interest in their properties to a fictitious corporation, which filed for bankruptcy in February 2008. This action stopped foreclosure proceedings against all properties in which the fictitious corporation had an interest, which allowed the perpetrators to continue to collect fees from the homeowners.¹⁶
- (U) According to a reliable FBI source with excellent access, from January 2008 to March 2008, Community Home Saver Program (CHSP) offered homeowners a method to avoid current or pending foreclosures and to stop trustee sales. CHSP required its clients to deed fractional interests in their properties to various fictitious corporations. The corporations listed on the deeds then filed serial bankruptcies, delaying foreclosure proceedings for up to two years and collecting monthly payments ranging from \$1,500 to \$2,000.¹⁷ The perpetrators of this scheme were convicted in the US District Court for the Northern District of California, on four counts of bankruptcy fraud.¹⁸ The same perpetrators pleaded no contest in Alameda County, California, for defrauding more than a dozen delinquent homeowners in a similar case in March 2008.¹⁹

(U) Sale-Leaseback-Repurchase Scheme

(U) The FBI and the USTP assess with high confidence that perpetrators are persuading delinquent homeowners to deed their homes to the perpetrators in a sale-leaseback-repurchase scheme that may use the bankruptcy court process to further this scheme. Perpetrators falsely promise to do one or more of the following: assume the homeowners' monthly mortgage payments; find an investor to purchase the victims' homes and rent the property back to the homeowners for less than their mortgage payments; pay off the full value of the victims' delinquent payments; and reestablish the homeowners' credit with a lease-to-buy option. Instead, the perpetrators either file fraudulent bankruptcy petitions in the names of the homeowners or direct the homeowners to file bankruptcy petitions.

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(U) As part of this scheme, the perpetrators convince victim homeowners to enter a sale-lease back agreement, claiming that after discharging their debts in bankruptcy, the homeowners will be able to make their new rent payments and to repurchase their homes at the end of the lease. The victims may or may not be told that they will be selling their homes to investors who will agree to sell it back to them at the end of lease. If the homeowners are given an option to repurchase their homes at the end of the lease agreement, it is at a significantly inflated price and includes conditions—such as no late rental payments—that the homeowner is unable to meet. The homes eventually go into foreclosure because the perpetrators or investors do not make the mortgage payments.²⁰ This type of fraud negatively impacts the mortgage industry by contributing to the growing number of foreclosures and significantly impacts a borrower’s ability to secure a legitimate loan modification.

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(U) Typical Sale/Lease Back Agreement

(U) In a typical sale and lease back agreement one party sells property to another and agrees to lease the property back from the buyer for a fixed period of time. In essence, the first owner now becomes the tenant making rent or lease payments to the second owner who in effect is now the landlord.

Source: John Downes and Jordan Elliot Goodman, *Barron’s Dictionary of Finance and Investment Terms* (Hauppauge, NY: Barron’s Educational Series, Inc., 2006), p.531.

- (U) According to a reliable FBI source with excellent access, from December 2006 to October 2008, perpetrators doing business as Yorkshire Financial Services orchestrated a scheme requiring homeowners to sign various documents: a contract to rent their home from the firm for two years with an option to repurchase; a quit claim deed; and POAs. YFS filed fraudulent bankruptcy petitions to stop the foreclosure process. When the bankruptcy stay was no longer in place, and because no mortgage payments were made, the victims’ eventually lost their properties through foreclosure. On 21 August 2009, the perpetrators of this scheme plead guilty in US District Court for the Southern District of Mississippi to conspiracy to commit mail and wire fraud, bankruptcy fraud, and misprision of a felony for failure to report bankruptcy fraud.²¹
- (U) According to the US District Court for the Northern District of Illinois, on 23 March, 2010, a grand jury in the Northern District of Illinois returned a fourth superseding indictment against Charles White, who operated Eyes Have Not Seen, Inc. (EHNS); Norton Helton, an attorney who operated Diamond Management of Chicago, Inc.; and Felicia Ford for perpetrating a scheme that offered victim homeowners a “mortgage bailout” program.”²² White and Helton persuaded financially distressed homeowners that they could avoid foreclosure by selling their homes to “investors” for whom White and Helton fraudulently obtained mortgage financing that, in aggregate, exceeded \$1.6 million. The defendants submitted false and fraudulent mortgage applications and closing documents to lenders. They also encouraged and assisted the victim homeowners to file fraudulent bankruptcy petitions to eliminate their debt and repair their credit so they would be able to repurchase their homes after living in them rent and mortgage free for one year.

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(U) Outlook and Implications

(U) From 2007 to 2009, US housing inventory increased from 127 million units to 130 million units;²³ US properties in foreclosure increased more than 120 percent;²⁴ and US home prices declined each consecutive year.²⁵ Based on this information, the FBI assesses with high confidence that should the US economy continue to experience increases in housing inventory, high foreclosure rates, and a lack of home sales, perpetrators will continue to exploit the USBS as part of their rescue schemes. In particular, the ongoing discovery of the lack of due diligence in historical sub-prime loans, loan modification re-defaults,²⁶ increasing prime fixed-rate loan delinquencies,²⁷ and the expected increases over the next three years in the interest rates on Alt-A^c and Option ARM^d loans—raise the chance for future mortgage defaults.²⁸ Borrowers who were teased into these loan products with initially low interest rates, sometimes as low as 1 percent, are experiencing a significant increase in their monthly mortgage payment and are consequently defaulting on these mortgages.²⁹ Increasing mortgage loan defaults and foreclosures will continue to provide opportunities to exploit USBS and thereby continue to contribute to the current economic crisis.

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(U) Alternative Analysis – Legislation May Reduce Pool of Potential Victims

(U) As many indicators— such as mortgage loan delinquencies, defaults, foreclosures, and bank-owned properties—continue to point to an increase in foreclosures (and by correlation, foreclosure rescue schemes), federal, state, and local legislative corrective measures have been taken to offset this crisis. Efforts by the Federal Trade Commission and other organizations to educate consumers on foreclosure rescue schemes, as well as federal measures such as the Hope for Homeowners Program, the Home Affordable Modification Program, and the Home Price Decline Protection Program, will likely assist a great majority of vulnerable homeowners with refinancing and loan modifications needed to remain in their homes, thereby reducing the pool of potential victims of foreclosure rescue schemes. However, the extent to which the more than 2.1 million homeowners in foreclosure will seek or qualify for refinancing or loan modifications is unknown. As such, it is particularly difficult to assess the extent to which loan modifications and refinance will mitigate the potential pool of foreclosure rescue victims.

^c (U) Designed for prime-quality borrowers often requiring no documentation.

^d (U) Designed for slightly better than sub-prime borrowers.

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(U) Intelligence Gaps

- (U) In which US Bankruptcy Court jurisdictions are the use of fraudulent petitions in the commission of mortgage fraud a significant problem?
- (U) Are organized criminal groups involved in exploiting the US Bankruptcy Courts in the commission of mortgage fraud?
- (U) How are foreclosure rescue perpetrators circumventing foreclosure rescue fraud warnings (by lender or others) and otherwise convincing delinquent homeowners to disregard them?
- (U) How many fraudulent bankruptcy-related foreclosure rescue scams have ultimately resulted in homeowners losing their properties to foreclosure?
- (U) In how many instances have fraudulent foreclosure rescue perpetrators repeatedly exploited the USBS?

(U) This assessment was jointly prepared by the Criminal Intelligence Section of the FBI and the US Trustee Program.

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(U) Endnotes

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- ⁸ (U) FBI; Electronic Communication.
- ⁹ (U) U.S. v. Sheila Margaret Hayford, United States District Court for the District of Delaware, Case No. CR A. No. 06-108-JJF.
(U) FBI; Electronic Communication.
- ¹⁰ (U) FBI; Intelligence Note.
(U) FBI; Intelligence Note.
- ¹¹ (U) United States v. Power, United States District Court for the Southern District of Mississippi.
(U) FBI; Electronic Communication, Case No. 09-CR-74.
- ¹² (U) United States v. Michael K. Lewis, et. al., United States District Court for the District of Maryland, Case No. 08-CR-00289-DKC.
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- ¹⁴ (U) U.S. v. James A. Warsing, United States District Court for the Northern District of Ohio.
- ¹⁵ (U) U.S. v. Isaac Yass, Robert Andrew Blechman, United States District Court for the District of Kansas, Case No. 08-40008-01/02-JAR; (U) FBI 4 214 2502 08; 09 February 2008; 26 November 2007; UNCLASSIFIED; UNCLASSIFIED; Source is an officer with another law enforcement agency; (U) FBI; Electronic Communication; (U) Online Article; US Department of Justice, US Attorney's Office for the District of Kansas, Press Release, "Los Angles Man Charged with Filing Fraudulent Bankruptcy Claims in Kansas," 29 February 2008; <http://kansascity.fbi.gov/dojpressrel/pressrel08/yass022908.htm>; accessed on 6 July 2009; (U) Online Article; Mortgage Fraud Blog, "2 Men Convicted of Using Bankruptcy to Stop Foreclosure," 22 January 2009; http://www.mortgagefraudblog.com/index.php/weblog/print_friendly/2_men_convicted_of_using_bankruptcy_to_stop_foreclosure; accessed on 1 April 2009.
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- 3. Neither Agree or Disagree
- 2. Somewhat Disagree
- 1. Strongly Disagree

Comments (if any):

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