Abuse in Bankruptcy Cases

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RECOGNITION AND PREVENTION OF ABUSE IN CONSUMER BANKRUPTCY CASES

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I. Abusive Practices by Lenders and Mortgage Rescue Scammers

A. Common Schemes

According to the Federal Trade Commission ("FTC"), many unscrupulous companies use half-truths and even outright lies to sell "mortgage rescue" services. These companies promise relief, but don't deliver. In fact, many of these companies leave their homeowner customers in worse financial shape.

In 2010, the FTC enacted "The Mortgage Assistance Relief Services (MARS) Rule," which makes it illegal for companies to collect any fees until a homeowner has actually received an offer of relief from his or her lender and accepted it. That means even if a consumer agrees to hire a mortgage assistance company, the consumer owes nothing until he or she obtains a written offer from the lender or servicer that's acceptable to the consumer. Unfortunately, many companies ignore this rule, and prey upon desperate homeowners.

Since 2008, the FTC has brought more than 40 cases against companies peddling fraudulent mortgage relief schemes, which caused hundreds of millions of dollars in consumer damages. These enforcement actions have helped tens of thousands of consumers who were victims of the scams, and have prevented tens of thousands more from becoming victims.

The FTC's website outlines the following common schemes:

1. *Phony Counseling or Phantom Help*

The scam artists tell you that if you pay them a fee, they'll negotiate a deal with your lender to reduce your mortgage payments or to save your home. They may claim to be attorneys or represent a law firm. They may tell you not to contact your lender, lawyer, or credit counselor. They promise to handle all the details once you pay them a fee. Then they stop returning your calls and take off with your money.

Sometimes, phony counselors insist you make your mortgage payments directly to them while they negotiate with the lender. They may collect a few months of payments – and then disappear.

2. *The "Forensic Audit"*

In exchange for an upfront fee, so-called forensic loan "auditors," mortgage loan "auditors," or foreclosure prevention "auditors" offer to have an attorney or other expert review your mortgage documents to determine if your lender complied with the law. The "auditors" say you can use their report to avoid foreclosure, speed the loan modification process, reduce what you owe, or even cancel your loan. In fact, there's no evidence that forensic loan audits will help you get a loan modification or any other mortgage relief.

3. *Rent-to-Buy Schemes*

Con artists who use the rent-to-buy scheme tell you to surrender the title to your house as part of a deal that allows you to stay there as a renter and buy it back later. They say that surrendering the title will let a borrower with a better credit rating get new financing and prevent the loss of the home. But the terms of these deals usually are so expensive that buying back your home becomes impossible. You lose the house and the scam artist walks off with the money you put into it. Worse, when the new borrower defaults on the loan, you're the one who's evicted.

In a variation, the scam artist raises the rent over time so you can't afford it. After missing several rent payments, you're evicted, leaving the "rescuer" free to sell the house.

In a similar equity-skimming scam, fraudsters offer to find a buyer for your home, but only if you sign over the deed and move out. They promise to pay you a portion of the profit when the home sells. Once you transfer the deed, they simply rent out the home and pocket the proceeds while your lender goes ahead with the foreclosure. The result: You lose your home – and you're still responsible for the unpaid mortgage because transferring the deed does nothing to transfer what you owe on the mortgage.

4. *Bait-and-Switch*

In a bait-and-switch scam, con artists give you papers they claim you need to sign to get another loan to make your mortgage current. But buried in the stack is a document that surrenders the title to your house to the scammers in exchange for a "rescue" loan.

5. *Forensic Loan Audits*

One of the latest foreclosure rescue scams to exploit financially strapped homeowners is the “forensic mortgage loan audit” sales-pitch. In exchange for an upfront fee of several hundred dollars, so-called forensic loan auditors, mortgage loan auditors, or foreclosure prevention auditors backed by forensic attorneys offer to review your mortgage loan documents to determine whether your lender complied with state and federal mortgage lending laws. The “auditors” say you can use the audit report to avoid foreclosure,

accelerate the loan modification process, reduce your loan principal, or even cancel your loan.

4. *Mass Joinder Lawsuits*

So-called specialized law firms are sending invitations to homeowners, urging them to participate in "mass joinder" lawsuits against their mortgage lenders as a way to get favorable loan modifications and stop foreclosure. The FTC cautions that the firms involved in this scam promise relief, but generally don't deliver. In fact, many of the firms fail to use qualified attorneys or pursue homeowners's cases, and often leave their clients in worse financial shape than before. The firms market their services through direct mail solicitations to homeowners who are behind in their mortgages, or who are in default or foreclosure. The firms charge fees in advance that range from a few thousand dollars to more than $10,000; they falsely lead homeowners to believe that by joining with other people in similar circumstances to sue their mortgage lender, they can stop their foreclosures, reduce their loan balances or interest rates, get them money damages, and even get them title to their homes, free and clear of their existing mortgages. Mass joinder lawsuits are not class action lawsuits. What's the difference? In a class action, most class members don't have to pay legal fees in advance.

Mass joinder scam artists often tout that they have an attorney on staff, but that attorney likely isn't reviewing each homeowner's file, and likely is not even licensed to practice in the homeowner's state.

B. Examples of Agency Civil Actions and Criminal Prosecutions

1. Last year, the United States Department of Justice (DOJ), with the assistance of HUD's Office of the Inspector General (OIG), negotiated a $25 billion settlement against five of the largest mortgage servicers for foreclosure abuses. The OIG's investigation revealed that Bank of America, JP Morgan Chase, CitiMortgage, Wells Fargo and Ally Financial, Inc., did not establish proper policies or procedures to ensure compliance with laws and regulations. Questionable practices included employing "foreclosure mills" and "robosigning" sworn documents in thousands of foreclosures across the United States.

2. John M. Desenberg of Westlake Village, California pleaded guilty to two counts of mail fraud, and agreed to a money judgment of $300,000. Mr. Desenberg devised a scheme targeted at distressed homeowners. Radio, internet and mail advertisements marketed a "fresh start program" that was, in fact, a ploy to convince homeowners to sell their home to an investor, who promised an opportunity to re-purchase. Most homes, however, ended up in foreclosure, and homeowners lost more than $300,000.

3. Gregory Flahive and Cynthia Flahive, the owners of the Flahive Law Corp., and Mike Johnson, the firm's managing attorney, were arrested on 19 felony counts, including grand theft by false pretenses, conspiracy, and false advertising. According to the indictment, the firm took up-front fees of up to $2,500 from homeowners for loan modification services that were never performed. Although the Flahives averred that, as a law firm, they had "extra leverage" with the banks, the client's lender frequently had no record of contact with the Flahive Law Corporation.

4. Andrew Bartok, the former owner of a foreclosure rescue operation called "Revelations Consulting," located in New Jersey and Connecticut, was found guilty of charges related to a csheme to defraud distressed homeowners, commit witness tampering, and obstruct federal court proceedings. Bartok and his co-conspirators filed fraudulent bankruptcy petitions and forged the names of his clients on bankruptcy petitions. Bartok routinely instructed clients not to attend court proceedings, and not to mention Revelations if contacted by court personnel. Throughout the fraud, Bartok collected millions of dollars in fees from his victims, and lived a lavish lifestyle.

5. The FTC charged an Ohio-based company, United Debt Associates, and its owner, with making fraudulent claims on 17 websites that the company could quickly eliminate debts through debt-settlement services. The company owner, Ryan Golembiewski, agreed to a settlement with the FTC barring future deceptive claims, and to a judgment requiring him to pay more than $390,000.

6. Three separate federal lawsuits were filed by the FTC in federal court to halt the allegedly deceptive tactics of three operations that, according to the lawsuit, violated the MARS Rule by preying on distressed homeowners. The lawsuits allege that "Prime Legal Plans/Reaching U Network," "American Mortgage Consulting Group," and "Expense Management America" falsely claimed that they could save consumers' homes from foreclosure, and then charged thousands of dollars up-front, while delivering little or no help, often leaving consumers deeper in debt.

7. The FTC filed a complaint against Villa Park, California-based Varang K. Thacker, American Credit Crunchers, LLC, and Ebeeze, LLC, alleging that the defendants would contact consumers who previously had or received payday loans. Often pretending to be law enforcement or other government authorities, the callers would falsely threaten to immediately arrest and jail consumers if they didn't make immediate payment. Consumers received millions of collection calls from India, and in a two-year period, the operation took in more than $5 million from the victims.

8. A federal court in Jacksonville, Florida, has found a credit repair operation in

contempt for violating a previous court order that required the defendants to stop promoting bogus credit repair products and services to consumers. The court ordered the defendants – Kevin Hargrave , Latrese Hargrave, BFS Empowerment Financial Services, Inc., Help My Credit Now Credit Services, Inc., and Kevtrese Enterprises, Inc. – to pay $6.4 million to the FTC within 30-days and to shut-down their credit repair business.

9. The FTC settled charges against "The Freedom Companies," after charging the defendant with running a nationwide scam in violation of the FTC Act and the MARS Rule. The defendant, operating out of the Dominican Republic, peddled fake mortgage assistance relief to financially distressed homeowners in the United States. Telemarketers claimed to be affiliated with the federal government, and charged homeowners an advance fee of $995 to $1,500. Homeowners were advised to stop paying their mortgages, then received a batch of forms requiring them to provide extensive personal and financial information. Afterwards, the homeowners couldn't reach a live representative, or if they could, they were told that the modification was underway, but they needed to pay several thousand dollars in additional fees to finalize the process. The FTC settlement bans the defendants from ongoing mortgage relief services, and imposes a $2.39 million judgment.

10. Under an agreement with the FTC, American Tax Relief LLC, and its manager, Alexander Hahn, are banned from telemarketing and prohibited from selling debt relief services. The defendants operated a scheme that allegedly bilked consumers out of more than $100 million by falsely claiming they could reduce their tax debts.

11. The FTC settled a complaint against California-based Consumer Advocates Group Experts, LLC, its owner, Ryan Zimmerman, and two other related companies, halting an operation that violated the MARS rule by deceptively telling consumers that they could renegotiate mortgages through "forensic audits." The settlement imposes a $3.5 million judgment. According to the complaint, the defendants falsely claimed on their website that "up to 95% of mortgages may be legally unenforceable due to defects like lost documents, improper notices, appraisals and/or predatory lending."

C. NACBA Warning About Debt Settlement Agencies

The National Association of Consumer Bankruptcy Attorneys (NACBA) has issued a consumer alert that as few as 1 in 10 consumers who participate in "debt settlement" programs actually end up debt-free in the promised period of time.

"Based on what bankruptcy attorneys are seeing across the nation, we believe that debt settlement schemes are the number one problem facing America's most deeply indebted

consumers today. Bombarded with slick radio and Web advertisements falsely promising a smooth road to being debt free in a short period of time, these companies prey on the most desperate victims of the economic downturn. These particularly vulnerable consumers usually end up getting sued, stuck with outrageous fees, more deeply in debt, and far worse off in terms of their credit score," said Durham, N.C. bankruptcy attorney Ed Boltz, a NACBA Board member and the association's incoming president.

Ellen Harnick, senior policy counsel for the Center for Responsible Lending, warned that debt settlement companies require clients to default on their debts before they will negotiate. *"This adds late fees, penalties and interest to their debt, and frequently results in the client being sued by creditors. Since only a tiny portion of debts are actually settled by these companies, clients are typically left worse off than they were when they started."*

According to NACBA, more than 500,000 consumers with approximately $15 billion of debt are currently enrolled in debt settlement programs.

II. Abuse Prevention Provisions Title 11 and Title 18 of the United States Code

A. Title 11 of the United States Code & Recent Consumer Abuse Decisions

11 U.S.C. § 105(a). Equitable and Inherent Power of the Bankruptcy Court to Carry Out the Provisions of the Bankruptcy Code. *"The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process."*

Widely considered the "catch-all" provision in the Bankruptcy Code, 11 U.S.C. § 105 concerns general abuses of the judicial system by debtors, as compared with the more focused and specific kind of debtor abuse under 11 U.S.C. § 707. Section 105 may be invoked to deny a motion to convert a case from Chapter 7 to Chapter 13 if the conversion is merely to postpone the debtor's duties and to aggravate creditors. *Marrama v. Citizens Bank of Mass.*, 549 U.S. 365 (2006); *see also In re Nordin*, Nos. CO-12-0141, BR10-35841, 2013 WL 936370 (B.A.P. 10th Cir. Mar. 12, 2013) (unpublished); *In re Levesque*, 473 B.R. 331 (B.A.P. 9th Cir. 2012); *Malley v. Agin*, 693 F.3d 28 (1st Cir. 2012); *In re Kelly*, 392 B.R. 750 (W.D. Wis. 2007) (addresses the debtor's abuse of the bankruptcy judicial system); *Byrd v. Johnson*, 467 B.R. 832 (D. Md. 2012) (court had discretionary authority to appoint a Chapter 11 trustee where debtor abused the process).

11 U.S.C. § 110. Penalties for Persons who Negligently or Fraudulently Prepare

Bankruptcy Petitions. Title 11 U.S.C. § 110 is not a debtor abuse statute. It contains disclosure requirements directed at non-attorney bankruptcy petition preparers ("BPP") and is intended to protect debtors from petition preparers who fail to comply with the regulations. The BAPCPA amended this section, adding new disclosure requirements and allowing the Supreme Court to promulgate rules to set a maximum fee for bankruptcy petition preparers. *In re Spence*, 411 B.R. 230 (Bankr. D. Md. 2009); *see also In re Wicker*, 707 F.3d 874 (6th Cir. 2012) (court levied fines of $11,500 against BPP); *In re Reynoso*, 477 F.3d 1117 (9th Cir. 2007) (BPP found to have engaged in deceptive acts and in the unauthorized practice of law); *In re Avitia*, No. 11-35964 HRT, 2013 WL 1332500 (Bankr. D. Colo. Mar. 29, 2013) (BPP fined treble damages for violations of statute).

11 U.S.C. § 523(a). Exceptions to Discharge. Although many exceptions exist, common examples of nondischargeable debts include the following: tax debts incurred within the past 3-years, debts connected to the debtor's fraudulent activity, child support, alimony, student loans, financial loss attributable to an intoxicated debtor, criminal restitution, post-petition HOA dues, and 401(k) loans. Nondischargeability under § 523(a) concerns a debtor's prepetition circumstances and conduct, not a debtor's abuses of the bankruptcy proceeding, which is the focus of § 707(a) and (b).

11 U.S.C. §§ 526(a), 527 and 528. Restrictions, Disclosures and Requirements Applicable to "Debt Relief Agencies" and "Debt Relief Agents" (i.e., Consumer Bankruptcy Attorneys). Title 11 U.S.C. § 526 was created under the BAPCPA. The statute was intended to regulate the activities of debt relief agencies and agents; it imposes penalties for violations of §§ 526, 527, and 528. For example, a Debt Relief Agent *MUST NOT*: fail to perform any required service, make any misrepresentations, or advise any debtor to incur more debt in contemplation of filing bankruptcy. Furthermore, a Debt Relief Agent *MUST*: provide the debtor with a detailed written contract of employment, provide the debtor with certain other written disclosures, and maintain copies of those disclosures for at least 2 years. Section 528 of the Bankruptcy Code now limits the scope of attorney advertising, and requires consumer bankruptcy attorneys to include the following disclaimer on all advertisements: *"We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code."*

In *Milavetz, Gallop & Milavetz, P.A. v. United States*, 130 S. Ct. 1324 (2010), the U.S. Supreme Court held that § 526(a)(4), which prohibits covered persons from giving advice to engage in fraudulent practices or advice on how to defeat the means test, does not violate the First Amendment. *See also Hersh v. United States ex rel Mukasey*, 553 F.3d 743 (5th Cir. 2008); *In re Smith*, Nos. 12-11603, 12-11857, 2013 WL 1092059 (Bankr. E.D. Tenn. Jan. 30, 2013).

11 U.S.C. § 707(a). Title 11 U.S.C. § 707(a) allows a court to dismiss any Chapter 7 case "for cause," where it is shown after notice and a hearing that the debtor engaged in unreasonable delay, failed to pay certain fees, or, under certain circumstances, failed to timely

file certain required information required under Section 521(a). The court's ability to dismiss a Chapter 7 case for cause under § 707(a) is not limited to individual Chapter 7 debtors or to debtors with primarily consumer debts.

Section 707(a) was not extensively amended by the BAPCPA. It is distinguishable from § 707(b), which was rewritten under the BAPCPA and which applies only to individual debtors with consumer debts. *See In re Krawczyk*, No. 11-09596-8-JRL, 2012 WL 3069437 (Bankr. E.D.N.C. July 27, 2012).

There is currently a split among federal circuit courts and bankruptcy courts as to the correct criteria a court should use for determining cause for dismissal under § 707(a) and, specifically, whether § 707(a) dismissals include the debtor's bad faith. In *In re Lusane*, No. 11-00889, 2012 WL 3018050 (Bankr. D. Colo. July 24, 2012), the court stated:

> The court, without deciding the issue, will assume in favor of the creditor that the court has a reservoir of power to dismiss a case for bad faith under § 707(a).[2]
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> ---
>
> [2] The D.C. Circuit has not weighed-in on whether § 707(a) cause includes a lack of good faith. The Third and Sixth Circuits have held that a lack of good faith is cause for dismissal under ' 707(a). *See Tamecki v. Frank* (*In re Tamecki*), 229 F.3d 205, 207 (3d Cir.2000); *Indus. Ins. Servs., Inc. v. Zick (In re Zick),* 931 F .2d 1124, 1127 (6th Cir.1991). The Eighth and Ninth Circuits have rejected bad faith as a basis for dismissal under § 707(a). *See Neary v. Padilla (In re Padilla),* 222 F.3d 1184, 1193 (9th Cir.2000); *Huckfeldt v. Huckfeldt (In re Huckfeldt),* 39 F.3d 829, 832 (8th Cir.1994) (recognizing that "some conduct constituting cause to dismiss a Chapter 7 petition may readily be characterized as bad faith," but declining to hold that bad faith is cause for § 707(a) dismissal.

Id. at *1 & n.2.

In *In re Perlin*, 497 F.3d 364 (3d Cir. 2007), the court held that a debtor's ability to repay his or her debts out of his or her disposable income is not a reason to dismiss a Chapter 7 bankruptcy for cause under § 707(a). Other courts disagree. *See In re Rahim*, 442 B.R. 578 (Bankr. E.D. Mich. 2010); *In re Adolph*, 441 B.R. 909 (Bankr. N.D. Ill. 2011); *In re Lobera*, 454 B.R. 824 (Bankr. D.N.M. 2011).

Other recent § 707(a)-dismissal-for-cause decisions include *In re McFadden*, 477 B.R. 686 (Bankr. N.D. Ohio 2012); *In re Jack*, 471 B.R. 252 (D. Nev. 2012); *In re Lassiter*, No. 08-31578-KRH, 2011 WL 2039363 (Bankr. E.D. Va. May 24, 2011); *In re Layton*, 480 B.R. 392 (Bankr. M.D. Fla. 2012); and *In re Davis*, No. 12-11122, 2013 WL 1205709 (Bankr. S.D. Ga. Mar. 22, 2013).

11 U.S.C. § 707(b). Title 11 U.S.C. § 707(b) was substantially amended by the BAPCPA and permits the court to dismiss the case of an individual debtor who is primarily holding consumer debts, where granting the debtor bankruptcy relief would be an abuse of Chapter 7. *See In re Mantachie Apt. Homes, LLC*, Nos. 12-12596-JDW, 12-12597-JDW, 12-12598-JDW, 2013 WL 953298 (Bankr. N.D. Miss. Mar. 12, 2013). The BAPCPA changed the standard for debtor abuse for dismissal from "substantial abuse" in the pre-BAPCPA statute to "abuse" in the current statute. *In re Ng*, 477 B.R. 118 (B.A.P. 9th Cir. 2012). To carry out this mission, § 707(b) provides for a complicated "means" test, which was included in the BAPCPA legislation as Congress's principal consumer bankruptcy reform. The means test is intended to establish by looking at the debtor's assets whether there exists a presumption of abuse. Section 707(b) establishes the grounds upon which the presumption of abuse under the means test may be rebutted.

Under § 707(b)(2), special circumstances sufficient to rebut the means test presumption of abuse are those circumstances that are beyond the debtor's reasonable control, such as medical conditions or the call to active duty. *In re Ragos*, 700 F.3d 220 (5th Cir. 2012). Importantly, § 707(b) was amended under the National Guard and Reservists Debt Relief Act of 2008 to preclude a court from dismissing a case based on the means test for disabled veterans under certain conditions and for debtors on and during the 540-day period immediately after a period of active military duty or homeland defense activity of not less than 90 days, provided that the debtor was a member of a reserve component of the Armed Services or a member of the National Guard after September 11, 2001, who was called to active duty or performed homeland defense activity.

In rebutting the means test, courts now generally hold that student loan payments do not qualify as special priority debts under § 707(b)(2). *In re Harmon*, 445 B.R. 721 (Bankr. E.D. Pa. 2011). In *In re Fredman*, 471 B.R. 540 (Bankr. S.D. Ill. 2012), the court held that under the circumstances, debtors could not deduct, as amounts contractually due in the future, mortgage payments on a home that they also proposed to surrender and on which they were making no monthly payments. *See also Bolen v. Adams*, 403 B.R. 396 (N.D. Miss. 2009) (debtor could not deduct alleged obligation to repay loan from employee retirement plan.

Section 707(b)(3) broadly refers to "the totality of the circumstances . . . of the debtor's financial situation. . ." Accordingly, where the presumption of abuse does not arise or where it is rebutted by the debtor, the court may still dismiss a Chapter 7 case under § 707(b)(3) by applying the totality-of-the-circumstances test where the debtor's financial situation demonstrates abuse. *See, Calhoun v. U.S. Tr.*, 650 F.3d 338 (4th Cir. 2011) (holding that the means test is not conclusive and the court may still find abuse by looking at other factors); *In re Witcher*, 702 F.3d 619 (11th Cir. 2012); *In re Baird*, 456 B.R. 112 (Bankr. M.D. Fla. 2010) (holding that abuse warranting dismissal of a Chapter 7 case can be determined under § 707(b), where the debtor filed in bad faith or where under the totality-of-the-circumstances test, the debtor's financial situation demonstrates abuse). Again, the totality-of-the-circumstances test for abuse may be applied even where the debtor passes the means test but where the debtor has the ability to pay

creditors through a Chapter 13 plan. *In re Fletcher*, 463 B.R. 9 (Bankr. E.D. Ky. 2011); *see also Bankr. Adm'r v. Gregory*, 471 B.R. 823 (Bankr. E.D.N.C. 2012) (listing five factors a court should consider when determining whether a Chapter 7 case should be dismissed under the totality-of-the-circumstances test); *In re Suttice*, 487 B.R. 245 (Bankr. C.D. Cal. 2013) (same); *In re Piazza*, 451 B.R. 608 (Bankr. S.D. Fla. 2011) (same); *In re McKay*, 463 B.R. 95 (Bankr. S.D. Ga. 2010) (holding that the most important factor for a court in determining debtor abuse is whether the debtor has the ability to repay a meaningful portion of the debt from future income).

Section 707(b) is not intended to treat debtors as bad people but should focus only on debtors who undermine the integrity of the judicial system. *In re McFadden*, 477 B.R. 686 (Bankr. N.D Ohio 2012); *see also In re Welch*, No. 12-60009, 2013 WL 1192961 (9th Cir. filed Mar. 25, 2013) (in determining the debtor's good faith, courts should not consider the debtor's Social Security income or the debtor's payments to secured creditors with respect to luxury items); *In re Rooney,* 2012 WL 4635545 (Bankr. S.D. Ind. 2012) (although the US Trustee urged the Court to dismiss or convert the debtors' case to a chapter 13 because a monthly child support obligation of $1,492 would expire in two years, the Court was "hesitant to dismiss a case on the assumption that the debtors 'might' have additional income in two years, despite the fact they have *no current ability* to fund in a meaningful way a chapter 13 plan.").

11 U.S.C. § 727. Title 11 U.S.C. § 727 details the exceptions to discharge for individual debtors under Chapter 7. Section 727 is distinguished from § 523, which lists exceptions to specific debts, whereas § 727 precludes the debtor from discharge in general. As under § 707(b), the court will look at the totality of the circumstances before denying discharge under § 727. *In re McFadden*, 477 B.R. 686 (Bankr. N.D. Ohio 2012). Pursuant to 727(a), any one of the following twelve (12) circumstances, if proven, could lead to a denial of discharge:

> **(1)** the debtor is not an individual;
> **(2)** the debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed—
> > **(A)** property of the debtor, within one year before the date of the filing of the petition; or
> > **(B)** property of the estate, after the date of the filing of the petition;
> **(3)** the debtor has concealed, destroyed, mutilated, falsified, or failed to keep or preserve any recorded information, including books, documents, records, and papers, from which the debtor's financial condition or business transactions might be ascertained, unless such act or failure to act was justified under all of the circumstances of the case;
> **(4)** the debtor knowingly and fraudulently, in or in connection with the case—
> > **(A)** made a false oath or account;
> > **(B)** presented or used a false claim;
> > **(C)** gave, offered, received, or attempted to obtain money, property, or

advantage, or a promise of money, property, or advantage, for acting or forbearing to act; or

(D) withheld from an officer of the estate entitled to possession under this title, any recorded information, including books, documents, records, and papers, relating to the debtor's property or financial affairs;

(5) the debtor has failed to explain satisfactorily, before determination of denial of discharge under this paragraph, any loss of assets or deficiency of assets to meet the debtor's liabilities;

(6) the debtor has refused, in the case—

(A) to obey any lawful order of the court, other than an order to respond to a material question or to testify;

(B) on the ground of privilege against self-incrimination, to respond to a material question approved by the court or to testify, after the debtor has been granted immunity with respect to the matter concerning which such privilege was invoked; or

(C) on a ground other than the properly invoked privilege against self-incrimination, to respond to a material question approved by the court or to testify;

(7) the debtor has committed any act specified in paragraph (2), (3), (4), (5), or (6) of this subsection, on or within one year before the date of the filing of the petition, or during the case, in connection with another case, under this title or under the Bankruptcy Act, concerning an insider;

(8) the debtor has been granted a discharge under this section, under section 1141 of this title, or under section 14, 371, or 476 of the Bankruptcy Act, in a case commenced within 8 years before the date of the filing of the petition;

(9) the debtor has been granted a discharge under section 1228 or 1328 of this title, or under section 660 or 661 of the Bankruptcy Act, in a case commenced within six years before the date of the filing of the petition, unless payments under the plan in such case totaled at least—

(A) 100 percent of the allowed unsecured claims in such case; or

(B) (i) 70 percent of such claims; and **(ii)** the plan was proposed by the debtor in good faith, and was the debtor's best effort;

(10) the court approves a written waiver of discharge executed by the debtor after the order for relief under this chapter;

(11) after filing the petition, the debtor failed to complete an instructional course concerning personal financial management described in section 111, except that this paragraph shall not apply with respect to a debtor who is a person described in section 109(h)(4) or who resides in a district for which the United States trustee (or the bankruptcy administrator, if any) determines that the approved instructional courses are not adequate to service the additional individuals who would otherwise be required to complete such instructional courses under this section (The United States trustee (or the bankruptcy administrator, if any) who makes a determination described in this paragraph shall review such determination not later than 1 year after the date of such determination, and not

> less frequently than annually thereafter.); or
> **(12)** the court after notice and a hearing held not more than 10 days before the date of the entry of the order granting the discharge finds that there is reasonable cause to believe that—
>
> **(A)** section 522(q)(1) may be applicable to the debtor; and
> **(B)** there is pending any proceeding in which the debtor may be found guilty of a felony of the kind described in section 522(q)(1)(A) or liable for a debt of the kind described in section 522(q)(1)(B).

Recently, in *In re Von Kiel*, Civ. Act. No. 12-972, Bankr. No. 10-21364, 2013 WL 460106 (E.D. Pa. Feb. 6, 2013), the court discussed the different "badges of fraud" that the court will assess in determining whether the debtor is not eligible for discharge. In that case, the court held that discharge was not available under § 727, where the debtor fraudulently transferred all of his assets to a religious organization and purportedly took a vow of poverty, notwithstanding the fact that he continued to enjoy all the benefits of the income from the assets. In *Skavysh v. Katsman*, No. 12-CV-3807, 2013 WL 1339735 (N.D. Ill. Mar. 28, 2013), the court applied the five-part test to determine denying discharge under § 727(a)(4)(A) and held that intent to defraud may be proved by circumstantial evidence. *See also Cantwell & Cantwell v. Vicario*, 464 B.R. 776 (N.D. Ill. 2011) (holding that intent to defraud includes a material misrepresentation that the debtor knows to be false).

11 U.S.C. §1325(a)(3) and (a)(7). Title 11 U.S.C. § 1325(a)(3) and (a)(7) excepts from confirmation those Chapter 13 plans proposed and/or filed in bad faith. Good faith under § 1325(a)(3) and (a)(7) is determined using the totality-of-the-circumstances test and by looking at 11 nonexclusive factors. *In re Cranmer*, 697 F.3d 1314 (10th Cir. 2012); *see also In re Crager*, 691 F.3d 671 (5th Cir. 2012) (the Fifth Circuit applies a totality-of-the-circumstances test to determine whether a Chapter 13 petition and plan is filed in good faith and will look closely at whether the plan shows an attempt to abuse the spirit of the Code). Where the Chapter 13 petition is a so-called "Chapter 20" case, additional factors should be considered by the court to determine abuse under § 1325(a)(3) and (a)(7). *See In re Davis*, 447 B.R. 738 (Bankr. D. Md. 2011).

The filing of a Chapter 13 petition and plan solely for the purpose of lien avoidance is not per se filed in bad faith under § 1325(a)(3) and (a)(7). *In re Scantling*, 465 B.R. 671 (Bankr. M.D. Fla. 2012). A Chapter 13 plan the duration of which is based solely on the payment of attorney's fees is abusive under § 1325(a)(3). *In re Buck*, 432 B.R. 13 (Bankr. D. Mass. 2010).

11 U.S.C. § 1330. According to Section 1330(a), "[o]n request of a party in interest at any time within 180 days after the date of the entry of an order of confirmation under section 1325 of this title, and after notice and a hearing, the court may revoke such order if such order was procured by fraud."

B. Bankruptcy Crimes Under Title 18 of the United States Code

1. Applicable Provisions: Title 18 of the United States Code

Concealment of assets: 18 U.S.C.§ 152 (1)
False oaths, accounts and declarations: 18 U.S.C. § 152(2) and 152(3)
False claims: 18 U.S.C. § 152(4)
Receiving property with the intent to defeat the Bankruptcy Code and bribery: 18 U.S.C. § 152(5) and (6)
Fraudulent pre-bankruptcy transfers: 18 U.S.C. § 152(7)
Concealment or destruction of records: 18 U.S.C. § 152(8) and (9) and § 1519
Embezzlement against estates: 18 U.S.C. § 153
Adverse interest and conduct of officers: 18 U.S.C. § 154
Fee agreements in cases under title 11 and receiverships: 18 U.S.C. § 155
Bankruptcy petition preparer fraud: 18 U.S.C. § 156
Aiding and abetting:18 U.S.C. § 2; principals and accessories: 18 U.S.C. § 3
Conspiracy: 18 U.S.C. § 371
False statements: 18 U.S.C. §§ 1001, 1014, and 1032
Mail, wire or bank fraud: 18 U.S.C. § 1341-1344
Obstruction of justice: 18 U.S.C. § 1503
Perjury: 18 U.S.C. §§ 1621-23
Racketeer Influenced and Corrupt Organizations Act: 18 U.S.C. § 1962
Money laundering: 18 U.S.C. § 1956

2. Recent Notable Criminal Prosecutions

(a) George F. Rayner of Baileyville, Maine, was sentenced to one year and one day in prison for concealing assets in connection with his bankruptcy. Concealed assets included a $150,000 deferred compensation account, and his entitlement accumulated but unpaid salary for sick leave and vacation time.

(b) Michael Mastro and Linda Mastro, of Seattle Washington, are facing extradition from France, after being indicted for 43-counts of bankruptcy fraud. The Mastros hid an account worth $761,000, and lied about the purchase and whereabouts of 2 rings (a 15.93 carat ring and a 27.80 carat ring).

(c) Kennedy J. Hyde was sentenced to 27 months in prison on October 26, 2012, after a jury found him guilty of bankruptcy fraud. The jury found that Hyde concealed a $50,000 bank account, and misrepresented his address by claiming to live in New York when he actually resided in Ohio.

(d) Bryan Young, of Ocean County, N.J., was sentenced in December to 18 months in prison for concealing assets in connection with his 2008 chapter 7

bankruptcy. Young concealed almost $200,000 in assets, including bank account balances, and under-valuing his household items and a vehicle.

(e) David E. Woodside of Tamaroa, Ill., pleaded guilty in December to a charge of fraudulently concealing a class-action settlement in the amount of $10,667.18.

(f) Sally Marie Jones, of Crewe, Va., pleaded guilty last September to bankruptcy fraud by using false social security numbers in repeat filings to stop foreclosures.

(g) Rockxanna Hawks of San Diego, Ca., pleaded guilty to bankruptcy fraud last December, after she was caught concealing her ownership in a house in France, just outside Monaco.

(h) Ofelia DeAusen of San Diego, Ca., defrauded the bankruptcy court and her creditors by concealing more than $60,000 in jewelry and watches.

(i) Michael Recker, of Arlington, Iowa, pleaded guilty on March 14, 2013, to lying to the bankruptcy court about the proceeds of farm equipment. Recker admitted that he sold a combine at an auction for approximately $50,000 prior to filing bankruptcy. Recker's bankruptcy schedules failed to disclose the proceeds still owed to him by the auction company, and when questioned, Recker claimed he never owned the combine or had an interest in the proceeds.

III. Ethical Implications: Zealous Representation –vs- Consumer Bankruptcy Abuse

Most of the following ethical quandaries are based upon recent court decisions and common situations facing consumer bankruptcy attorneys. How would you, as a zealous advocate for your consumer bankruptcy client, approach each situation?

ABA Model Rules of Professional Responsibility:
PREAMBLE: A LAWYER'S RESPONSIBILITIES

[1] A lawyer, as a member of the legal profession, is a representative of clients, an officer of the legal system and a public citizen having special responsibility for the quality of justice.

[2] As a representative of clients, a lawyer performs various functions. As advisor, a lawyer provides a client with an informed understanding of the client's legal

rights and obligations and explains their practical implications. As advocate, a lawyer zealously asserts the client's position under the rules of the adversary system. As negotiator, a lawyer seeks a result advantageous to the client but consistent with requirements of honest dealings with others. As an evaluator, a lawyer acts by examining a client's legal affairs and reporting about them to the client or to others.

1. Debbie Debtor attended the Memphis School of Beauty and Cosmetology. Halfway through her curriculum, the school lost its accreditation, and after a prolonged period of unemployment, Debbie finally located a job as a clerk at a convenience store. She comes to your office on the verge of losing her house and car. She can afford a chapter 13, but can't afford to fund 100% of unsecured debts, including the $27,000 student loan for beauty school. You want to help her in the most cost-efficient way, and you're of the opinion that Debbie received no "educational benefit" from her $27,000 loan.

   Question: Can you discharge the indebtedness by virtue of a provision in the chapter 13 plan, in lieu of an adversary? Should you try? See, *United Student Aid Funds, Inc. v. Espinosa*, 130 S. Ct. 1367 (March 23, 2010).

2. Your clients tell you that they purchased three rental properties as an investment for their retirement. Over the years, they withdrew approximately $80,000 from their IRAs to cover the negative cash-flow. In the weeks prior to coming to your office to file a chapter 7 bankruptcy, the debtors sold furnishings and used $12,000 of the proceeds to buy two new IRAs. You and the debtors fully-disclose these transactions in the chapter 7 schedules.

   Question: Is the conversion of non-exempt property into exempt property a fraudulent conveyance? See*, Crampton v. Koehler (In re Ronald J Koehler and Susan M. Koehler)*, 2012 WL 719744 (Bankr. E.D.N.C., 2012).

3. Dave and Debbie Debtor come to your office, drowning in debt. You've completed a budget – schedules I & J – and it's obvious that they have insufficient disposable income to propose a feasible chapter 13 plan. The means test, however, shows that Dave and Debbie have $400 per month in "phantom" disposable income. Both of their cars are paid-for, but they're high-mileage and unreliable. They're expecting a $4,000 tax refund in a month or two, which they could exempt. The Debtors ask you if it's okay to borrow $2,000 against each of the 2 paid-for vehicles, with the intention of re-paying the loans once they receive the tax refund, post-petition.

   Question: You know that, if they borrowed even a small amount against the vehicles, the ownership allowance and secured debt deductions from the means test, would allow the Debtors to qualify for chapter 7. What, if anything, should you say? See, *Milavetz, Gallop & Milavetz, P.A. v. United States*, 130 S. Ct. 1324 (2010).

4. David and Debbie Debtor come to your office in dire need of a chapter 13 bankruptcy to prevent a repossession, and to release a bank account garnishment. You quote them an up-front fee of $351 for the combined cost of the filing fee, credit counseling, and a tax transcript. The Debtors, however, have no money – zero dollars – and Debbie has started to cry, hysterically.

   Question: What are the legal and ethical implications of advancing the $351 fee for the Debtors, disclosing it on the 2016(b) statement, and including the fee in the chapter 13 plan as an administrative expense for unreimbursed litigation expenses advanced for the Debtors? *See, e.g., In re Mary A. Marotta*, 2012 WL 4792917 (Bankr. M.D.N.C., 2012).

5. Debbie hires you to file a chapter 7. On Schedule F, she lists her ex-husband, David, as a general unsecured creditor in the amount of $36,340 for a disputed child support overpayment claim. David filed an adversary, seeking a judgment of nondischargeability pursuant to 11 U.S.C. § 523(a)(5) and/or (15). You and Debbie discuss conversion of the chapter 7 to a chapter 13, solely because of chapter 13's more favorable discharge provisions, even though Debbie's income is part-time and unreliable.

   Question: Does Debbie have an absolute right to convert, regardless of good faith? *See, In re Yarborough*, 2012 WL 4434053 (Judge Richard Stair, Jr., Bankr. E.D.Tenn., 2012). *See also*, *Marrama v. Citizens Bank of Mass.,* 549 U.S. 365, 373-74, 127 S.Ct. 1105, 166 L.Ed.2d 956 (2007); *see also Copper v. Copper (In re Copper),* 315 B.R. 628 (B.A.P. 6th Cir. 2004), *aff'd, Copper v. Copper (In re Copper)*, 426 F.3d 810 (6th Cir. 2005).

6. You represent Debbie in a case filed under chapter 13. The plan provides for a 0% dividend to unsecured creditors. After an investigation, the chapter 13 trustee discovered that Debbie failed to disclose (to you and the court) that she transferred ownership of a paid-for 2012 GMC Yukon to a family member shortly before filing, and that her personal injury claim, which she valued at $10,000, is actually worth considerably more than she claimed or can exempt.

   Question: Does Debbie have an absolute right to voluntarily dismiss her chapter 13 pursuant to 11 U.S.C. § 1307(b)? *See, In re Jacobsen*, 609 F.3d 647 (5th Cir. 2010). *See contra, In re Williams,* 435 B.R. 552 (Bankr. N.D. Ill. 2010).

7. Dr. Debtor wants to file a chapter 7. He went through a mid-life crisis, and financed a collection of 12 luxury automobiles. He now has an $8,000 monthly mortgage payment, along with substantial vehicle debts and credit card debts. He wants to surrender all but 5 vehicles. You draft Dr. Debtor's budget, for purposes of Schedules I & J, and notice the following: (1) Dr. Debtor earns a substantial income as a plastic surgeon, but (2) after paying for his expensive home and vehicles to be reaffirmed, Dr. Debtor has zero

disposable income. You aren't worried about the means test because his secured debt deductions are sufficient to "zero him out." You are concerned, however, about his extraordinary expenses for the mortgage and cars he wants to reaffirm.

> Queston: You read the plain text of 11 U.S.C. § 707(b), and notice the following plain language: " [T]he court . . . may dismiss a case *filed* by an individual debtor *under this chapter*. ." Can you avoid § 707(b), simply by filing Dr. Debtor's petition as a chapter 13, then converting to chapter 7 shortly thereafter? *See, In re Layton,* 2012 WL 5193242 (Bankr. M.D. Fla. 2012); *See also, In re Jeremy M. Pate,* 2012 WL 6737814 (Bankr. S.D. Tx. 2012).

8. David and Debbie Debtor live in Kennesaw, Georgia. Kennesaw is located in Cobb County, and Cobb County is located within the *Atlanta* Division of the Northern District of Georgia. Your office is located in Cartersville, Georgia, which is only about 12 miles from Kennesaw. Cartersville is located in Bartow County, which is located within the *Rome* Division of the Northern District of Georgia. David and Debbie are would prefer to file in the Rome Division, because they don't want their bankruptcy filing to appear in the Kennesaw Daily News. This sounds great to you, because 99% of your other cases are filed in Rome, and you'd prefer not to hire a stand-in attorney for the Debtors' 341 meeting or drive to Atlanta.

> Question: You've noticed that, although the Bankruptcy Code and the Bankruptcy Rules address cases improperly-venued in the wrong *district*, they are silent as to cases filed in the wrong *division* of the proper district. What are the legal and ethical implications of filing the case in Rome? *See, In re Lashunda Stevenson*, 2012 WL 6005755 (Bankr. N.D. Tex. 2012).

9. David Debtor is a self employed "shade-tree mechanic" who regularly incurs business expenses. He has not formed a corporation or LLC for his business. His gross income monthly income averages $9,187 per month, and his business expenses are $6,320. Thus, his *gross* business income is over the median income, but his *net* business income is $2,867 per month, which is below the applicable median income for a household of 3.

> Queston: Can you propose a confirmable chapter 13 plan with a 36-month applicable commitment period? *See, In re Juan C. Romero,* 2013 WL 241742 (Bankr. S.D. Fla. 2013). *See conra, In re Compann,* Case No. 09-82626 (Bankr. N.D.Ga. 2010) .

10. David and Debbie are perfect candidates for a joint chapter 7, except for one small problem. Both vehicles are paid-for, and titled in David's name only. David only has enough exemption available to protect 1 vehicle, but not both.

> Question: What are the legal and ethical implications of advising the Debtors to either jointly title both vehicles, or to transfer one of the vehicles from David to

Debbie prior to filing? By doing so, it appears that the Debtors would be able to fully-exempt both vehicles.

11. About 2-years after receiving their chapter 7 discharge, David and Debbie come to your office with a problem. Again, Debbie is crying hysterically, in fear of going to jail. You realize that Bank of America has not taken any action to foreclose on the house the Debtors surrendered in their chapter 7. The Debtors have received a collection notice for $1,200 owed post-petition to the Homeowners Association, as well as a *criminal* citation for tall grass in violation of a city ordinance.

    Question: (1) Can the Debtors reopen the case and file a motion to compel Bank of America to foreclose? *See, Canning v. Beneficial Maine, Inc., et. al. (In re Canning),* 2013 WL 388060 (1st Cir. 2013). (2) What are the legal and ethical implications of simply executing a quit claim deed, or a deed in lieu of foreclosure, to Bank of America or the HOA?

12. David and Debbie Debtor filed a *pro-se* chapter 7, and hire you a few days later to represent them. You notice that the Debtors didn't comply with their credit counseling requirement, and instruct them to take the course ASAP. You file schedules, and disclose a potential malpractice lawsuit against Debbie's OBGYN. After receiving a discharge, but before the estate was closed, Debbie received a jury verdict against the doctor for $800,000. Now, David and Debbie insist that you dismiss their case, so they can settle the creditor claims themselves, instead of paying statutory fees to the chapter 7 trustee.

    Question: Can the Debtors successfully file a Motion to Vacate Discharge and Dismiss the Chapter 7, based upon their noncompliance with the pre-petition credit counseling mandated by Section 109(h)? *See, In re Osborne,* 2013 WL 979448 (Bankr. S.D.N.Y. 2013).