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GREEN — REGS AND SCAMS: COMMENTS ON THE REPORT OF THE BANKRUPTCY FORECLOSURE SCAM TASK FORCE OF THE CENTRAL DISTRICT OF CALIFORNIA

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In May of 1998, the Bankruptcy Foreclosure Scam Task Force (the "Task Force") for the Central District of California issued its Final Report (the "Report").¹ The Report addressed several significant issues and suggested specific solutions;² however, care should be taken not to read the Report too broadly so as to prohibit actions which can be legitimately undertaken pursuant to the Bankruptcy Code as currently written.

It should be noted that the Task Force consisted of judges, U. S. Trustee personnel, representatives from the United States Attorney's office, the Federal Bureau of Investigation, the Internal Revenue Service, the Federal Trade Commission, the California State Department of Real Estate and the Los Angeles County District Attorney's Office.³ Listed as "Other Task Force Participants" were the Executive Director of the Legal Aid Foundation of Los Angeles, the Executive Director of the Los Angeles Housing Law Project, representatives of Public Counsel, Bank of America, two savings and loan associations and Experian, the credit reporting agency.⁴ Although an "open mic" forum was held in December of 1996 it does not appear that non-governmental debtor's counsel were members of the Task Force. In light of the absence of private counsel for debtors, it could be concluded that the tone of the Report was set by the prosecutorial background of the membership of the Task Force.⁵

The Report defines as "abusive" a case filed to delay or defraud creditors, without any intention of complying with the requirements to obtain a discharge or complete a plan.⁶ Since many cases are filed to at least delay creditors,⁷ it would seem that the definition would encompass situations where the debtor intended to compromise with his major creditor, or prevail in his claim objection to the claim of that creditor, and then dismiss the case.⁸ This is often a legitimate tactic when a debtor has one or a handful of disputed or difficult creditors. The filing of a bankruptcy case provides the appropriate incentive for compromise and should not be labeled "abusive."

Another question that should be asked is when does the filing of a bankruptcy case defraud creditors? Although fraud is defined by state law, classic fraud contains the common elements of intent, knowledge, reliance and injury.⁹ The mere filing of a bankruptcy case will rarely involve all of these elements, although subsequent actions, such as failing to disclose assets, can be fraudulent.¹⁰ The Report lumps together actions that may be non-fraudulent, although potentially abusive, uses of the Bankruptcy Code with scams and fraud.¹¹ For example, the Report labels as a "scam" the transfer of a fractional interest in real estate followed by the filing of a bankruptcy petition by the transferee.¹² Although many of the instances cited in the Report were abusive in the classic sense of the word, utilization of the statute should not always be labeled a scam or fraudulent.

As indicated by many of the proposals contained in the Report, Bankruptcy Courts can deal with the abusive use of civil statutes without converting the creative use of loopholes in civil statutes into crimes.¹³

The Report defines "foreclosure scam" to include multiple or fraudulent bankruptcy petitions to delay residential foreclosures without any intent to complete the cases.¹⁴ Multiple or sequential filings that comply with the law, even if they delay creditors, are neither scams nor fraudulent. The Report notes with approval

that abusive filings involving the transfer of fractional interests are being prosecuted by the United States Attorney but laments that the criminal process is too slow to solve the problems identified by the Task Force.¹⁵ Again, the discussion does not distinguish between abuse and fraud. It can be questioned whether taking advantage of a loophole in the statute by utilizing multiple or serial filings should result in criminal prosecution. Perhaps many of the foreclosure problems could be alleviated if the bankruptcy judges entered the foreclosure orders rather than lifting the stay or dismissing the case.¹⁶

One of the recommendations of the Task Force is "Operation Identification" which provides for a series of procedures to determine the identity of debtors.¹⁷ Identification is important to the Prosecutorial. They want to know who you are, what you have in your pocket and how you can prove to them that the money in your pocket didn't come from selling drugs. Possession in interstate commerce of false identification appears to be a federal crime.¹⁸ In addition, pretending to be a member of a 4-H club can result in six months in a federal penitentiary.¹⁹ Thus, it is not surprising that the Social Security number has become a universal identification number and that the Task Force recommends mug shots and fingerprints and multiple forms of identification for debtors.²⁰ Of course, any slip up by the debtor²¹ could result in federal prosecution. What will be even more fun is if the debtor is represented by an attorney, that attorney must inspect the appropriate identification and file a declaration or certificate that the attorney has inspected the appropriate documents.²² To assist in the implementation of Operation Identification, the Task Force recommends that the clerk be allowed to reject petitions presented without the proper identification.²³ This will provide more opportunities for error by debtors and their counsel, and more opportunities for malpractice.²⁴ In addition, what redress will be available if the clerk makes a mistake and rejects a petition that is subsequently determined to comply with the rules? If the foreclosure has already taken place, it will be difficult to remedy the situation.

Another suggestion of the Task Force is that section 362 of the Bankruptcy Code be amended to provide that it does not apply to unscheduled real estate in consumer cases unless the debtor establishes good cause for the omission or post petition acquisition.²⁵ This could leave creditors out in the cold if the debtor, Rehab Ronnie, forgets to list the one quarter interest in the family farm he inherited from his uncle Mort that is now on the outskirts of suburban Seattle. Ronnie had his brains fried from ingesting too many chemical substances and has trouble remembering where he is, much less where his assets are. The Report does not seem to provide a mechanism to protect the creditors from Ronnie's forgetfulness.

The Report addresses many significant problems and proposes many useful solutions. However, any implementation of the Report should carefully consider whether a given solution will be cost and hassle justified. Keep in mind that the Prosecutorial tend to think that everyone is a liar and that fraud is a word that should be used in every other sentence. Use, even abuse, of the system is not fraud and every abuse should not be criminalized. The terms should not be used interchangeably and the term "fraud" should not be used lightly. We should not build into the system traps for panicked debtors trying to save their homes. Incarcerating such individuals indiscriminately would be counterproductive. They are often the victims of true defrauders. However, the bankruptcy crime statutes are so vague²⁶ that any mistake by a debtor could lead to prison. The Report should be carefully studied and many of its procedural recommendations implemented, but we must be careful to heed one of the principal credos of the medical profession, "first do no harm."

FOOTNOTES:

* Actually, they are only sort of green. I was really thinking of green as in new.[Back To Text](#)

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¹ See

² The report focuses on such issues as serial filing by related debtors, chapter 13 serial filings and amending bankruptcy petitions to include phony alias names. *Final Report*, *supra* note 1. The Task Force recommends such counter-measures as "flexible and immediate" responses to fraudulent filing, depriving serial filers of relief from the automatic stay and preference to using administrative and procedural solutions instead of the slower criminal remedies. *Id.*[Back To Text](#)

³ See *Final Report*, *supra* note 1.[Back To Text](#)

⁴ See *id.*[Back To Text](#)

⁵ Hereinafter referred to as the "Prosecutorials."[Back To Text](#)

⁶ *Final Report*

, *supra* note 1.[Back To Text](#)

⁷ And often to reduce or eliminate the claims of creditors entirely. See Keiter v. Stracka, 192 B.R. 150, 155 (S.D. Tex. 1996) (finding debtor's bankruptcy petition was filed in bad faith in order to prevent foreclosure); In re Island Helicopters, Inc., 211 B.R. 453, 468 (Bankr. E.D.N.Y. 1997) (dismissing debtor's bankruptcy petition because it was merely "device to serve some sinister . . . purpose"); Simmons v. Simmons (In re Simmons), 149 B.R. 586, 590 (Bankr. W.D. Mo. 1993) (dismissing debtor's bankruptcy petition after debtor had filed three previous petitions in order to prevent foreclosure on property).[Back To Text](#)

⁸ See

In re Ortiz, 200 B.R. 485, 489 (D. P.R. 1996) (stating court may dismiss or convert case, whatever is in best interest of creditor, where debtor "abuses" bankruptcy system); In re Weaver, 222 B.R. 521, 523 (Bankr. E.D. Va. 1998) (noting recent spate of abusive filings that result in dismissals of bankruptcy petitions); In re Tim Wargo & Sons, Inc., 99 B.R. 922, 924 (Bankr. E.D. Ark. 1989) (asserting creditor's claim of "abusive filing" in instance where creditor believed debtor's filing was fraudulent attempt to manipulate bankruptcy system).[Back To Text](#)

⁹ See, e.g.

, Pearce v. General Am. Life Ins. Co., 525 F. Supp. 140, 141 (E.D. Mo. 1981) (listing elements to prove fraud in Missouri); De La Cruz v. Cohen (In re Cohen), 185 B.R. 180, 186 (Bankr. D.N.J. 1995) (stating debtor's actions satisfied New Jersey's elements to prove "actual fraud"); Sack v. Friedlander (In re Friedlander), 170 B.R. 472, 476 (Bankr. D. Mass. 1994) (listing elements plaintiff must prove for "actual fraud" in Massachusetts); Restatement (Second) of Torts § 525 (1977) (defining fraudulent misrepresentation as "one who fraudulently makes a misrepresentation of fact . . . for the purpose of inducing another to act . . . in reliance upon it, is subject to liability to the other in deceit for pecuniary loss caused to him by his justifiable reliance").[Back To Text](#)

¹⁰ See

18 U.S.C. § 157 (Supp. 1996) (defining bankruptcy fraud as making false representation in relation to filing of petition or other proceeding); United States v. Holland, 160 F.3d 377, 381 (7th Cir. 1998) (upholding conviction of debtor for bankruptcy fraud where debtor concealed assets from creditors); Dwyer v. Peebles (In re Peebles), 224 B.R. 519, 520 (Bankr. D. Mass. 1998) (stating debtor's failure to disclose certain assets of estate were grounds for criminal indictment for bankruptcy fraud); Kinstle v. Kinstle (In re Kinstle), 172 B.R. 869, 871 (Bankr. N.D. Ohio 1994) (denying debtor discharge where debtor fraudulently failed to disclose assets).[Back To Text](#)

Final Report, supra note 1.[Back To Text](#)

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Id.[Back To Text](#)

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Id. (suggesting that bankruptcy courts use tactics such as expedited review and disposition of cases, to prevent abuses within bankruptcy system).[Back To Text](#)

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Id.[Back To Text](#)

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Id. (stating that criminal prosecutions, despite their benefits, should not be used as main process of dealing with bankruptcy fraud because criminal system is too slow and too limited).[Back To Text](#)

¹⁶ Not all serial filing will result in criminal prosecution. *See* Home Sav. of Am. v. Chicago Title & Trust Co., No. 92 C 5510, 1994 WL 323222 *2 n.1 (N.D. Ill. Jun. 30, 1994) (stating that "sequential filings...have been recognized as a viable debtor strategy"); *see also* Elmwood Dev. Co. v. General Elec. Pension Trust (In re Elmwood Dev. Co.), 964 F.2d 508, 511 (5th Cir. 1992) (observing that serial filings will not result in prosecution as long as they are in good faith). *But see* In re Weaver, 222 B.R. 521, 523 (Bankr. E.D. Va. 1998) (noting increase in abusive filings to delay creditor's foreclosure attempts).[Back To Text](#)

¹⁷ *See*

Final Report, supra note 1.[Back To Text](#)

¹⁸ *See*

18 U.S.C. § 1028 (1994) (stating it is crime to knowingly possess false identification in interstate commerce); *see also* United States v. Chandler, 98 F.3d 711, 717 (2d Cir. 1996) (affirming that defendant had intent to use false identification unlawfully). *But see* United States v. Rohn, 964 F.2d 310 (4th Cir. 1992) (determining that possession of false identification is not sufficient to establish that crime would be committed with it).[Back To Text](#)

¹⁹ *See*

18 U.S.C. § 916 (providing that individual who falsely and with intent to defraud holds himself out as member agent, or representative for 4-H clubs can be fined or imprisoned for not more than six months). *See generally* Edwin Meese, III, Big Brother on the Beat: The Expanding Federalization of Crime, 1 Tex. Rev. L. & Pol. 1, 3 (1997) (commenting on inclusion of trivial crimes in statute). *See, e.g.,* 18 U.S.C. § 917 (making it crime to impersonate member of American National Red Cross).[Back To Text](#)

²⁰ *See*

Final Report, supra note 1.[Back To Text](#)

²¹ For example, my wife still has her social security card in her maiden name.[Back To Text](#)

²² *See*

Final Report, supra note 1. I assume that I should practice my photographic and fingerprinting techniques.Back To Text

²³ See

id. The Task Force did recognize, however, that Federal Rule of Bankruptcy Procedure 5005, which prohibits rejection of filings for non-compliance with local rules or procedures, petitions, requires such petitions to be accepted for filing. Therefore, deficiencies in a petition must be resolved later. Id.Back To Text

²⁴ Not to mention longer lines at the clerk's office. Back To Text

²⁵ See

Final Report, supra note 1.Back To Text

²⁶ See

18 U.S.C. § 157 (1994) (providing maximum punishment of five years imprisonment for people who intend to defraud creditors by filing bankruptcy petitions or who make fraudulent representations relating to bankruptcy proceeding); *see also* 3 Norton Bankruptcy Law & Practice § 49:2 (William L. Norton, Jr. et al., eds., 2d ed. 1997 & Supp. 1998) (noting that § 157 prohibits any type of criminal conduct in bankruptcy cases).Back To Text