The Bankruptcy Fraud Reporter

Critical Information for the Credit Industry and Insolvency Professionals

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Inside

Inaugural Issue

WELCOME to the inaugural issue of **The Bankruptcy Fraud Reporter**, the only monthly publication covering news and developments on all matters of bankruptcy fraud and insolvency crimes. In each issue you will find feature articles on developments in the civil and criminal law of bankruptcy fraud, receive news of indictments, dispositions and sentences, read about current trends and emerging areas of bankruptcy fraud and receive analysis of recent cases in the bankruptcy, district and circuit courts.

In addition, each month you will receive new feature articles discussing cutting edge issues of importance to you from an experienced legal professional who literally wrote the book on the subject of bankruptcy crimes. Offering critical information you need to be successful, **The Bankruptcy Fraud Reporter** serves the informational needs of bankruptcy attorneys, trustees, examiners, judges, creditors, committees, debtors, lenders, factors, debt traders, government agencies, criminal prosecutors and defense counsel.‡

Eighth Circuit: materiality not an element of false declaration offense

When materiality is included as an element of a criminal statute it limits the range of conduct that is subject to prosecution. Some statutes expressly contain a materiality element while other statutes are less clear, leaving the courts to discern Congress' intent by examining the history and purpose of the statute in question. The bankruptcy criminal statute prohibiting false declarations in bankruptcy proceedings is one of the latter variety.

18 U.S.C. § 152(3) prohibits "knowingly and fraudulently mak[ing] a false declaration, certificate, verification or statement under penalty of perjury . . . in or in relation to any" bankruptcy case. Section 152(3) does not contain an express element of materiality. Yet despite the statutory silence, courts for years have "implied" an element of materiality in the statute (or assumed the element

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The Bankruptcy Fraud Reporter

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false declarations

(continued from page 1)

(pertained). This lead to the traditional view that a false declaration in a bankruptcy case must "relate to some material matter" in order to be criminal. The Eighth Circuit decision in *United States v. Mitchell*, No. 07-3136 (8th Cir. June 10, 2008), has now challenged that long-standing view and made easier the task of prosecuting false statements in bankruptcy.

Facts and Investigation

Upset at the way he was being treated in his divorce, Daniel P. Mitchell contacted an Assistant United States Trustee to accuse his wife of bankruptcy fraud. The move backfired when the evidence Mitchell provided lead to his own indictment, prosecution and conviction for making false statements in the bankruptcy case he filed two years earlier.

Mitchell filed a voluntary chapter 7 bankruptcy petition in July 2000. In the statement of financial affairs filed with the petition, he stated that in the two years immediately preceding the filing he did not own any business nor was an officer, director or executive of any business. He also declared that his only income was $1,000 per month as a laborer for Wood Floors Import (WFI).

Mitchell founded WFI in January 1998 to import bamboo flooring from China and distribute it throughout the United States. In March 2000 he directed his wife Kathy to prepare meeting minutes reflecting that he gave his interest in WFI to her in November 1998. Mitchell explained that the transfer was necessary to protect WFI from the personal bankruptcy case he was contemplating. Minutes were prepared stating that Mitchell would remain as president of the company and Kathy would hold all other titles. New certificates of ownership were signed and delivered on March 30, 2002. Thereafter, operations remained the same as Mitchell continued to run the business and Kathy's responsibilities were not expanded beyond data entry.

In late October 2002 Kathy filed for divorce. Concerned that because she was the owner of the company "on paper" she would be liable for its actions, she consulted an attorney. On counsel's advice, she fired Mitchell from WFI, denied him access to its assets and later filed a chapter 7 bankruptcy petition for the company in December. Mitchell in turn contacted the United States Trustee to accuse Kathy of bankruptcy fraud and request permission to liquidate WFI's inventory. During the meeting, Mitchell provided the UST with volumes of WFI documents and later testified in a hearing on his own motion to compel the chapter 7 trustee to hire him to liquidate WFI. Among the documents and testimony provided was evidence that Mitchell was President and CFO of WFI in July 2000; that he directed WFI to pay more than $44,000 in personal loan debt that was income to Mitchell; and that WFI paid Mitchell approximately $425 per week.

Indictment and Conviction

Following a referral by the U.S. Trustee's Office, Mitchell was indicted on charges that he made a false declaration in his bankruptcy case. The government's three theories were that he (i) failed to disclose his ownership interest in WFI; (ii) failed to disclose his total income; and (iii) failed to disclose debt payments made on his behalf by WFI. A jury convicted Mitchell but the district court granted a new trial because the jury did not unanimously find that any one of the false statements was material. A second jury found Mitchell guilty on all three theories – a verdict Mitchell appealed arguing there was insufficient evidence that his false statements were material.

Bankruptcy Fraud Like Bank Fraud

The Eighth Circuit began its analysis by observing that the word "material" does not appear in the bankruptcy criminal statute but acknowledging that courts nonetheless have assumed that a false statement must relate to some material matter. The court refused to equate that assumption with a legal holding however.

Rather, the Eighth Circuit saw the case similar to the Supreme Court's decision in *United States v. Wells*, 519 U.S. 482 (1997), which held that materiality is not an element of the bank fraud statute (18 U.S.C. § 1014). That statute prohibits "knowingly making any false statement or report … for the purpose of influencing in any way the action" of a federally insured bank. According to the *Mitchell* court, the Supreme Court in *Wells* did not believe that reading the criminal statute without a materiality element would pose a "risk of criminalizing so much conduct as to suggest that Congress meant something short of the straightforward reading." In *Wells*, the knowledge element and the requirement to prove the defendant acted "for the purpose of influencing" was enough to

narrow the class of criminal conduct in the same manner as an implied materiality element.

Similarly, the Eighth Circuit reasoned that the terms "knowingly and fraudulently" in the bankruptcy criminal statute are enough to limit the reach of the statute so that a materiality element need not be implied. The court added in *dicta* that Mitchell's false statements were material anyway under the prevailing definition of that term. The false statements were pertinent to the debtor's financial transactions and may have impeded an investigation into his financial history.‡

Bankruptcy Criminal Referrals Increase in Fiscal Year 2007

Bankruptcy criminal referrals are on the rise again. United States Trustees in each judicial district have a statutory duty to refer suspected criminal activity to the United States Attorney and assist in related prosecutions. The duty is not limited to "bankruptcy crimes." For the second straight year the United States Trustee Program (the Program) increased significantly the number of criminal referrals it made from bankruptcy cases. In fiscal year 2007 the Program made 1,163 bankruptcy and bankruptcy-related criminal referrals. That figure represents a 25.7 percent increase over the 925 criminal referrals made during fiscal year 2006 and a 24.3 percent increase over the 744 referrals made in fiscal year 2005. These figures do not include criminal referrals from sources outside of the Program.

False oaths and declarations again top the list of the most commonly referred bankruptcy crime, comprising nearly half of all criminal referrals made. Concealing assets, bankruptcy fraud schemes, perjury and offenses involving identity theft or misuse of social security numbers round out the top five most reported allegations.

Table 1 displays fiscal year 2007 criminal referrals by type of allegation, number and percentage.

Table 1: Criminal Referrals by Type of Allegation – Fiscal Year 2007		
	Referrals	
Type of Allegation	Number	Percent*
False Oath/False Statement (18 U.S.C. § 152(2) and (3))	545	46.9%
Concealment of Assets	483	41.5%
Bankruptcy Fraud Scheme (18 U.S.C. § 157)	275	23.6%
Perjury/False Statement	271	23.3%
Identity Theft/Use of False/Multiple SSNs	195	16.8%
Tax Fraud	147	12.6%
Mortgage/Real Estate Fraud	86	7.4%
Concealment of Documents (18 U.S.C. §152(8) and (9))	67	5.8%
Bank Fraud	60	5.2%
Forged Documents	57	4.9%
Mail/Wire Fraud	57	4.9%
Tampering/Destruction Bankruptcy Records (18 U.S.C. §1519)	35	3.0%
Post-Petition Receipt of Property (18 U.S.C. § 152(5))	33	2.8%
Embezzlement (18 U.S.C. § 153)	28	2.4%
Money Laundering	19	1.6%
Serial Filing	18	1.6%
Criminal Contempt	16	1.4%
False Claim (18 U.S.C. § 152(4))	16	1.4%
Credit Card Fraud/Bust Out	13	1.1%
Corporate Fraud	12	1.0%
Investor Fraud	12	1.0%
Corporate Bust-Out/Bleed Out	8	0.7%
Obstruction of Justice	8	0.7%

State Law Violation	8	0.7%
Conspiracy	6	0.5%
Disregard of Law by Bankruptcy Petition Preparer (18 U.S.C. § 156)	6	0.5%
Federal Program Fraud	5	0.4%
Threat of Violence	5	0.4%
Insurance Fraud	4	0.3%
Bribery (18 U.S.C. § 152(6))	3	0.3%
Professional Fraud	3	0.3%
Abusive Reaffirmation of Debt/Credit Abuse	2	0.2%
Child Pornography	2	0.2%
Health Care Fraud	2	0.2%
RICO Violation	2	0.2%
Antitrust	1	0.1%
Drug Trafficking	1	0.1%
Environmental Crime	1	0.1%
Extortion	1	0.1%
Terrorism	1	0.1%

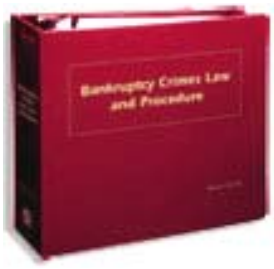
*Percentage based on 1,163 criminal referrals. Each referral may contain more than one allegation, so the total of the percentages exceed 100 percent. Source: U.S. Department of Justice, Executive Office for United States Trustees, Report to Congress: *Criminal Referrals by the United States Trustee Program Fiscal Year 2007* (August 2008).‡

Congressional Activity

In recent testimony before a Senate subcommittee, Clifford J. White III, Director of the Executive Office for United States Trustees described the activities of the United States Trustee Program (USTP) to protect homeowners who file for bankruptcy relief. He observed that debtors are vulnerable to a wide variety of fraudulent schemes and misconduct and described some of the most common patterns of misconduct perpetrated upon debtors facing foreclosure on their homes.

Among the types of misconduct described was the conduct of **bankruptcy petition preparers** who illegally provide poor advice to, or file bankruptcy petitions on behalf of, needy homeowners, **foreclosure rescue operators** who use the bankruptcy system to victimize distressed homeowners; and **mortgage servicers** who file proofs of claim in inflated amounts and file motions for relief from the automatic stay based on inaccurate financial information.

Director White's full testimony before the Senate Committee on the Judiciary Subcommittee on Administrative Oversight and the Courts in a hearing entitled "Policing Lenders and Protecting Homeowners: Is Misconduct in Bankruptcy Fueling the Foreclosure Crisis?" is available online at **The Bankruptcy Fraud Resource Center**: http://bankruptcyfraud.typepad.com/WhiteForeclosureTestimony.pdf ‡



Bankruptcy Crimes Law and Procedure. The only comprehensive treatise on the Law of bankruptcy fraud. 2006 Loose-Leaf binder. 875pp. By Wayne D. Holly. Published by LRP Publishing.

Did You Know?

In an attempt to prevent identity theft in bankruptcy cases, the U.S. Trustee Program requires debtors to provide evidence of their identity by confirming their names and social security numbers at the first meeting of creditors. The Program also utilizes a national multiple filer review of court records to guard against abusive repeat filings.‡

INDICTMENTS

Florida investment adviser charged with false statements, fraudulent transfers and money laundering

Following a two year federal investigation, **Don W. Reinhard**, a former Tallahasee investment advisor, has been charged in a 23 count indictment in the Northern District of Florida with numerous federal charges, including making false declarations in his bankruptcy case, fraudulently concealing or transferring assets, making false statements by submitting false income tax returns to the United States Trustee and money laundering relating to the bankruptcy fraud charges. ‡

Fraudulent transfers among numerous federal charges brought against alleged Ponzi schemer

A federal jury in the Eastern District of Tennessee has indicted **Louis Rivas** on multiple charges of mail fraud, money laundering and fraudulent transfers in contemplation of bankruptcy relating to the collapse of Rivas' alleged foreign currency exchange firm - and its investment endeavor, The Forex Project - which the indictment alleges was nothing but a classic Ponzi scheme.

According to the indictment, Rivas represented himself to be an experienced trader in foreign currency exchange operating through The Forex Project, which invested in "off market foreign currency exchange." In approximately March 2007, Rivas devised a scheme to defraud by raising more than a million dollars in investments through false promises of high rates of return, recruiting investors as "equity agents" for the purpose of recruiting additional investors and paying early investors with income from later investors. Rivas allegedly misapplied investors' funds for his personal use by purchasing numerous lavish assets. As the scheme began to unravel, according to the indictment, several creditors filed an involuntary bankruptcy petition against Rivas on May 15, 2008. Rivas, however, had already allegedly transferred hundreds of thousands of dollars - presumably to a safe place. Those transfers gave rise to the bankruptcy criminal charges. ‡

Dentists charged with transferring assets to defraud creditors

Arjinderpal "AJ" Sekhorn, a doctor, and his wife **Daljit** - a dentist - were indicted in the Eastern District of California each on multiple bankruptcy criminal charges arising from an alleged scheme to transfer more than a million dollars in assets to avoid paying creditors.

According to various news resports,1997 the Sekhorns were sued by a former employee for defamation and sexual harassment. Before trial, and again immediately before the verdict, the Sekhorns transferred more than a million dollars in assets solely to Mrs. Sekhorn's control. Following a reversal of the judgment and entry of a new arbitration award against them, the Sekhorns again transferred additional assets solely to Mrs. Sekhorn allegedly in a scheme to avoid paying creditors. Mr. Sekhorn filed bankruptcy cases in May and October 2003 in which he allegedly falsely denied owning various assets and denied transferring any property in the preceding year.

Last month both Sekhorns were indicted for their alleged roles in the scheme. Mr. Sekhorn is charged with three counts of bankruptcy fraud, two counts of concealment and two counts of making false declarations in his bankruptcy case. Mrs. Sekhorn is charged with three counts of bankruptcy fraud, one count of making a fraudulent transfer and one count of making a false statement. ‡

Disbarred attorney charged with concealing assets and defrauding client of honest services

John A. Allen a disbarred attorney was indicted in the Southern District of Mississippi on charges of concealing nearly $22,000 in a bankruptcy case. Allen is also charged with wire fraud arising from an alleged scheme to defraud his former client of his honest services and to obtain her money through false promises to reduce her debt. According to the indictment, Allen converted the client's funds to his own use and then concealed the conversion. The defendant is also charged with laundering the proceeds of the wire fraud. ‡

DISPOSITIONS

Florida man pleads guilty in massive mortgage fraud scheme

Antony Dehaney of Lauderhill and Coral Springs, Florida pleaded guilty to conspiracy to commit mail and wire fraud, one count of mail fraud and a single count of making a false declaration in a bankruptcy case in what is described as a $10 million mortgage fraud scheme.

According to a press release issued by R. Alexander Acosta, U.S. Attorney for the Southern District of Florida, Dehaney acknowledged in his plea to engaging in a scheme to submit fraudulent mortgage applications, with fraudulent supporting documents, to various lenders in the name of straw buyers. The scheme involved more than 25 mortgage transactions, resulting in more than $10,000,000 in loans in Broward County, Florida. As part of the scheme, Dehaney also admitted to filing false bankruptcy petitions under chapter 13 of the bankruptcy code in the name of the borrowers to delay the lenders' foreclosure actions.

Co-defendants Marcia Mestre and Angela Manalaysay earlier pleaded guilty on September 3, 2008 and are awaiting a December 12, 2008 sentencing date. Dehaney is scheduled to be sentenced on December 30, 2008. ‡

Jury trial ends in conviction for concealment, false statements and money laundering

A jury sitting in the Eastern District of California convicted **Thomas M. Klassy** on two separate counts of concealing property and making a false declaration in a bankruptcy case and 26 counts of laundering the proceeds of the bankruptcy crimes.

Evidence at trial showed that Klassy falsely denied owning numerous valuable assets during his bankruptcy case including an airplane, a one-third interest in a 220 acre ranch and $205,000 he received from the sale of his chiropractic business. As for the business sale, further evidence showed that Klassy concealed the real $265,000 sale contract and instead produced to the bankruptcy trustee a forged contract purporting to show that the business sold for only $60,000. The conviction ended a three week trial before U.S. District Judge Morrison C. England, Jr. in Sacramento. According to news reports, Klassy is being detained pending sentencing.‡

California debtor pleads guilty to hiding tax refunds

Stevan Charles Pedroarena a/k/a Esteban Carlos Pedroarena Toomey was convicted in the Southern District of California following his guilty plea to a two count superceding indictment charging him with making a false declaration in a bankruptcy case (18 U.S.C. 152(3)) and tax evasion. The bankruptcy fraud charges stem from Pedroarena's failure to report on his 1999 bankruptcy petition that had filed his state and federal tax returns prior to filing bankruptcy and was expecting to receive refunds in excess of $8,000. ‡

Woman pleads guilty to conspiring to conceal assets; husband still awaiting trial

Margaret Diekemper pleaded guilty in the Southern District of Illinois to conspiring with her husband Joseph to conceal assets in their bankruptcy case. Twenty-two other felony counts will be dismissed as part of a plea bargain. The couple was indicted in June on numerous bankruptcy felony counts, including concealing assets in their multi-million dollar bankruptcy case. Joseph is still incarcerated while awaiting trial on the bankruptcy fraud charges because a judge revoked his bond for weapons violations.

Authorities are also investigating the deaths of two potential witnesses found shot to death on property where Joseph allegedly hid a tractor that he is charged with concealing. According to news reports citing an FBI memo, the killings came only days after one of the victims approached the FBI about the tractor and told investigators he was worried that Joseph would burn down his house. Firefighters found the bodies while responding to a fire at the victims' home.

Margaret is scheduled to be sentenced on February 9. Joseph's trial date is scheduled for January 20.‡

SENTENCES

Woman sentenced for concealing income from escort service

April L. Palmer was sentenced last month in the District of Montana to six months of home confinement and 12 months of probation for failing to disclose in her bankruptcy case income she received from the operation of an escort service. Palmer pleaded guilty in July. According to the charging instrument, Palmer filed a chapter 7 petition in December 2002 in which she declared her only source of income was $600 per month. After Palmer received her discharge in April, 2003, ledgers seized pursuant to a search warrant showed Palmer received nearly $36,000 in 2002 and nearly $62,000 in 2003, which she never disclosed to the trustee.‡

New York man sentenced to three years imprisonment for falsely denying business interests

Tyler J. Halperin was sentenced last month in the Western District of New York to 37 months imprisonment and ordered to pay more than $1 million in restitution following his conviction for bank fraud and making a false statement in his bankruptcy case. Halperin gave a false social security number and false date of birth on a bank loan application and then filed a bankruptcy petition in which he falsely stated that he had no ownership interests in any businesses. In fact, the defendant had ownership interests in numerous undisclosed entities.‡

Boy-band producer receives 25 years on conspiracy, money laundering and false claim convictions

Lou Pearlman, the well-known producer behind several 1990s boy bands including The Backstreet Boys and NSYNC was sentenced in the Middle District of Florida to 25 years in prison and required to forfeit numerous valuable assets including several high-end vehicles, a $200 million money judgment and a $25,000 check following his guilty plea to conspiracy, money laundering and presenting or using a false claim in a bankruptcy proceeding. According to his plea agreement, Pearlman successfully raised millions of dollars based on false representations about two companies with which he was associated - Transcontinental Airlines Travel Services, Inc. and Transcontinental Airlines, Inc. Pearlman falsely represented to thousands of investors and two banks that the companies were successful and that his interest in them was worth millions of dollars when in fact the companies had minimal operations, employees and revenue. When the Ponzi and bank fraud schemes began to collapse, Pearlman fled the country. He was arrested in Indonesia through the cooperation of the Indonesian National Police-Bali with the FBI. Indonesia does not have a formal extradition treaty with the United States, but Indonesia expelled Pearlman as "an undesirable visitor," according to news reports quoting the FBI.‡

Chief executive receives prison term for lying about prepetition transfers

Andrew N. Yao, former Student Finance Corp. chief executive, was sentenced in the District of Delaware to concurrent terms of one year and one day in prison on each of two counts of making a false oath in his bankruptcy case.

Yao lied twice during a 2003 bankruptcy deposition when questioned about two large prepetition wire transfers that Yao claimed were for routine maintenance on aircraft he owned and for a family party for his ailing grandfather. In fact, the payments were made as a gift to his former Playboy Playmate mistress and to satisfy casino gambling debts incurred during a Las Vegas outing with the same woman. Yao admitted during trial that he lied about the wire transfers but defended the bankruptcy fraud charges by arguing that he lied not to defraud creditors but to cover up his marital infidelity. The jury convicted him on both counts.

Yao expressed "deep remorse" for his crimes during sentencing before U.S. District Judge Gregory Sleet. But Judge Sleet concluded that Yao did not adequately accept responsibility for his conduct. Yao has appealed the sentence to the Court of Appeals for the Third Circuit.‡

South Carolina man receives 51 month sentence for understating his income and tax evasion

Charles E. Atwell was convicted by a jury in the District South Carolina on four counts of tax evasion and one count of making false statements in his bankruptcy petition. Evidence at trial established that from 2000 through 2003, Atwell made more than $2 million in commissions by selling various financial products but did not file tax returns or pay income taxes during the years in question. In March 2003 Atwell also filed a bankruptcy petition in which he falsely understated his income by more than $750,000 in 2001 and by approximately $350,000 in 2002. Atwell was sentenced to 51 months in prison, followed by 3 years of supervised release and a fine of $50,000. He must also cooperate with the IRS concerning the assessment, filing and payment of back taxes.‡

B&W Motor Cars owner sentenced in New Jersey for lying about closed bank accounts

Moty Rosenkrantz a/k/a Michael Rosenkrantz, the owner of B&W Motor Cars, pled guilty to structuring banking transactions to avoid reporting requirements and making a false oath in a bankruptcy case. The defendant admitted in his guilty plea that in July 2003 he filed a bankruptcy petition in which he falsely reported that no financial accounts in his name had been closed in the preceding year when in fact he had closed at least seven bank accounts in March 2003. Rosenkrantz was sentenced in the District of New Jersey to 48 months in prison, three years of supervised release and a fine of $10,000.‡

Bankruptcy and tax fraud convictions result in 46 month prison term

Charles Eugene Lancaster, was sentenced in the Eastern District of Virginia to 46 months of imprisonment and ordered to pay restitution in the amount of $444,435.96 following his guilty plea to bankruptcy fraud and tax evasion.

According to the U.S. Attorney's Office, during the period covered in the eight-count indictment, Lancaster was the general manager of Auto Sport and Imperial Motors, two used car dealerships located in Virginia Beach. In 1998 and again in 1999, Lancaster formed two shell corporations, naming his ex-spouse as the owner of the first corporation and his girlfriend the owner of the second. Thereafter, Lancaster received all of his income as general manager of the dealerships through the new entities. Lancaster was thereby able to disguise his earnings from the IRS.

After the end of each year, Lancaster issued himself W-2 forms which vastly under-reported his true income. After 1999, neither of the two corporations filed any tax returns. Lancaster however filed personal tax returns for 1999 through 2002 reflecting only his W-2 earnings rather than his true income. In 2003 and 2004 Lancaster did not file any tax returns, personal or corporate. During this time-period of 1999-2004, he evaded paying $337,407.00 in federal taxes.

In July 2001, the defendant filed a personal bankruptcy case. Through the use of the two shell corporations, he claimed much less income for the period from 1999 through June 2001 than he actually earned. This was the same reduced income he claimed on his tax returns. As a result of his fraudulent bankruptcy filings, Lancaster was able to discharge $107,028.96 in back taxes owed to the Internal Revenue Service.‡

Debtor convicted of sending threatening communication to bankruptcy trustee

Eleventh Circuit dismisses appeal

Terence Richards pleaded guilty in the United States District Court for the Northern District of Illinois to two counts of transmitting a threatening communication in interested commerce in violation of 18 U.S.C. § 875(c).

The charges arose from multiple emails Richards sent to a state prosecutor and to the trustee in his chapter 7 bankruptcy case. Richards was angry that the prosecutor had accepted a misdemeanor rather than felony plea from Richard's friend who refused to return a sizeable sum of money that Richards entrusted him with before filing bankruptcy. Richards was also angry that the trustee re-opened the bankruptcy case when Richards told him - after receiving his discharge - that he and the friend had committed bankruptcy fraud. Richards was sentenced to 30 months imprisonment and three years of supervised release. The Eleventh Circuit dismissed his appeal and authorized counsel to withdraw because he was unable to discern a non-frivolous basis for appeal. *United States v. Richards*, No. 07-1429 (11th Cir. 2008).‡

IN THE NEWS

Lawyer granted immunity to testify against former clients

A Saratoga Springs lawyer whose firm helped its clients Ronald and Esther Persaud file bankruptcy petitions has been granted testimonial immunity as a government witness in the criminal trial of the Persauds on charges including wire fraud, conspiracy and bankruptcy fraud. John M. Hogan, Jr., who requested the immunity grant before testifying last month, must testify truthfully to avoid prosecution.

The Persauds are charged with their son Shawn - an Albany Law School student - in a massive alleged scheme to raise investment money to secure millions of dollars in overseas funding for high-end development projects including theme parks, Caribbean resorts and a Lake George hotel. According to the charges, while the investors believed they were dealing with financiers with access to billions in overseas funding, the Persauds bankruptcy petitions painted a different picture altogether. Shawn Persaud is accused of assisting his parents to make purchases with the proceeds of their alleged crimes.‡

Colorado paralegal charged in state prosecution of bankruptcy petition preparer

Conspiracy, financial elder abuse, grand theft, unauthorized practice of law, false advertising and misleading advertising as a paralegal are among a variety of state criminal charges brought against a Colorado paralegal for allegedly providing illegal bankruptcy petition preparer services in California.

According to Los Angeles City Attorney Rocky Delgadillo, an investigation began in May 2007 after U.S. Bankruptcy Judge Kathleen Thompson and the U.S. Trustee for the Central District of California "observed potentially illicit acts" by the defendant, Emmanuel Assaf. LAPD fraud unit detectives were assigned in September 2007 to investigate Assaf's alleged fraudulent advertising of paralegal services and provision of bankruptcy related serves to a then 85 year old victim, Maximiliano Jimenez.

According to the charges, Assaf advertised a variety of legal services in a Spanish language publication, including paralegal services for bankruptcy filings. Based on the advertisement, the victim's daughter called Assaf who assured her that he could handle the entire case and have someone accompany him to court. Assaf accepted $1,200 in fees to handle the case and received Jimenez's social security number. Jimenez filed for bankruptcy and Assaf declared that he had received only a $200 fee. Assaf did not appear on behalf of the victim nor advise the victim that he needed to complete a pre-petition credit counseling course. Following an investigation into the matter, the case was referred to the L.A. City Attorneys' Identity Theft and Fraud Unit for prosecution. It is not clear whether the Office of the United States Trustee referred the matter to the U.S. Attorney for prosecution under 18 U.S.C. § 156, although the case appears to be the product of a coordinated effort between state and federal officials that will remain in state court.‡

Breaking News -

Crackdown on Bankruptcy Fraud Announced in West Virginia
November 13, 2008

The U.S. Attorney's Office for the Southern District of West Virginia announced a cooperative effort with the Office of the United States Trustee to crackdown on bankruptcy crimes in 23 counties in the district.

U.S. Attorney Charles T. Miller stated, "We are a civilized society. We do not jail people for being in debt. We have a process to help people 'get back on their feet' financially and bankruptcy protection is a critical part of that process. However, when people abuse the bankruptcy process and take affirmative steps to lie and hide assets that could be used to satisfy their creditors, it undermines the process and hurts both creditors and consumers. One can see from the charges filed that bankruptcy fraud is not an isolated problem. It happens in every corner of the Southern District – from Williamstown to Bluefield and from Huntington to Charleston. . . . This is to serve as a warning to those who would abuse the system: If you are caught, you will be prosecuted."

The announcement follows a grand jury's indictment of Victoria A. Caudhill, Clinton L. Smith, Jennifer M. Longwood on various charges related to concealing assets in their bankruptcy cases. A fourth defendant was charged by information for allegedly concealing guns and jewelry from her creditors earlier this year.‡

CASE SUMMARIES

Ninth Circuit

Case: United States v. Sullivan, 522 F.3d 967 (9th Cir. 2008)

Result: Convictions of corporate executives and attorney for mail, wire, and bankruptcy fraud, money laundering and conspiracy in collapse of advertising agency into involuntary bankruptcy affirmed.

Summary: Thomas Rubin (CEO), Thomas Sullivan (CFO) and Geoffrey Mousseau were convicted of various bankruptcy crimes for their roles in the involuntary bankruptcy case of Focus Media, Inc. (Focus). Focus was an advertising agency that placed ads on television and radio for major industry clients, including Sears Roebuck & Co. After commercials aired, media stations invoiced Focus, which in turn invoiced its advertising clients the cost of the air time plus a fee. In late 1999, Focus fell into financial trouble and began failing to pay media stations with the funds collected from its clients. Eventually, three stations, NBC, ABC and Paxon Communications petitioned Focus into involuntary bankruptcy on October 6, 2000. Mousseau, who was Rubin's personal attorney, began to work on the case. Three weeks later, on October 26, Sears filed a motion for the appointment of an interim trustee. That same day, Focus retained a bankruptcy law firm as counsel (Stutman). Stutman, however, insisted that Focus funds not be used to pay its retainer due to a pending preliminary injunction enjoining Focus from spending its funds.

Unbeknownst to Stutman, after Sears filed its motion, on October 26 and 27, Rubin and Sullivan began transferring monies from Focus accounts to themselves and others, including $500,000 to Mousseau's client trust account. Mousseau later used those funds to pay Stutman's retainer.

At 4:00pm on October 27, the bankruptcy court granted Sears' motion and appointed a trustee. By then, Rubin and Sullivan had disbursed approximately $1.2 million of Focus' funds. When the trustee sought an accounting, Rubin and Sullivan did not disclose the transfers. When Stutman learned of them for the first time in December, the firm terminated its representation,

Five years after these proceedings, on October 27, 2005 a grand jury sitting in the Central District of California indicted Rubin, Sullivan and Mousseau on numerous federal charges, including concealing estate property, making fraudulent transfers, making false declarations, withholding information from a bankruptcy trustee and conspiracy to commit bankruptcy fraud. A jury convicted the defendants and their appealed followed. The primary issue on appeal was whether there was sufficient evidence to sustain the convictions. Viewing the evidence in the light most favorable to the verdicts, the Court of Appeals rejected each of the defendant's arguments and determined that a rational trier of fact could have found the essential elements of each crime beyond a reasonable doubt.

Concealment

The court first rejected the defendants' argument that they did not knowingly conceal funds from the trustee because they identified Focus as the source of the funds transferred to Stutman on October 26 and 27. A rationale jury could have concluded otherwise because trial evidence showed that each of the defendants misrepresented to Stutman the source of the funds when Stutman refused to be retained with Focus' funds and neither Mousseau nor Sullivan disclosed the transfers to the trustee.

Mousseau's additional arguments were equally unavailing. First, his claim that evidence of intent was lacking because funds that pass through an attorney trust account are easily traceable was rejected on the ground that "easily traceable" transactions are not necessarily inconsistent with an intent to conceal. The court likewise rejected Mousseau's argument that his inexperience in bankruptcy vitiated any intent to defraud. According to the court, Mousseau "should have known to report the $500,000 transfers to the interim trustee." He chose to represent the debtor despite having no bankruptcy experience and assisted the concealment of assets. "His lack of experience in bankruptcy law is not a shield from criminal liability."

Lastly, the court rejected Rubin's argument that he lacked intent to conceal because he had no knowledge of the transfers, having resigned from Focus three months earlier. According to the court, evidence that Rubin continued to participate in strategy sessions after resigning, and called Stutman as late as December, 2000 in an effort to persuade the firm to stay on as counsel supported an inference that he could have foreseen the transfers. Under the *Pinkerton* doctrine,

Rubin was therefore liable for the crimes of his coconspirators as they were foreseeable acts

committed in furtherance of the conspiracy. (The court separately affirmed the conspiracy convictions holding that there was sufficient evidence of

meetings from which the jury could infer an agreement among the defendants and ample evidence of acts undertaken in furtherance of the agreement.).

Fraudulent Transfers

Rubin and Sullivan also challenged their convictions for making fraudulent transfers. According to them, the October 27 transfers were made to pay routine business expenses and without intent to defraud. But a rationale jury could have concluded otherwise said the court. Evidence at trial established that the defendants were aware of the pending motion to appoint a trustee and yet caused numerous checks to be drawn on Focus' accounts, disbursing funds to themselves, Rubin's family, corporate credit card, personal physician and others. Sullivan did not disclose to the trustee the location of Focus' bank accounts until after the checks cleared and neither defendant had disclosed all of Focus' banking records as late as December 2000. The circumstantial evidence was sufficient to sustain the conviction.

Withholding Information

The final appellate issue concerned the defendant's fraudulent withholding from the trustee of documents relating to the debtor's financial affairs. Denying any fraudulent intent, the defendants argued that their efforts to provide documents were hampered by an exodus of Focus' employees after the trustee was appointed.

Unpersuaded, the court found sufficient evidence for conviction where Focus employees used a computer program to delete financial information from the debtor's computers on the day after the trustee was appointed and trial testimony established that defendants delivered only incomplete bank and accounting records to the trustee and misrepresented the identity of the party who filed the debtor's tax returns. "A rationale juror," said the court, "could have concluded that the defendants fraudulently withheld information from the trustee."‡

Eleventh Circuit

Case: United States v. Travers, No. 06-14187, slip op. (11th Cir. 2008).

Result: District court judgment revoking supervised release and imposing sentence upon defendant convicted of bankruptcy fraud, equity skimming, mail fraud and money laundering affirmed.

Summary: On May 20, 1999 a jury convicted the defendant of multiple counts of mail fraud,

bankruptcy fraud, equity skimming and money laundering and sentenced him to concurrent prison terms of 78 months on the laundering counts, 60 months on the mail and bankruptcy fraud counts and to a three-year term of supervised release. The defendant was also ordered to pay restitution in the amount of $571,049.

On November 10, 2005, after the defendant had been released from prison, the probation officer monitoring his supervised release petitioned the district court (S.D. Fla) to revoke his supervised release for failure to abide by the conditions of his release.

Specifically, the defendant (1) filed false monthly reports; (2) responded falsely to his probation officer's inquiries; and (3) failed to make restitution payments. Following a hearing, the district court credited the probation officer's testimony and found the defendant's testimony false "in all material respects." The district court revoked the defendant's supervised release, sentenced him to three months imprisonment and imposed a new thirty-three month term of supervised release. The defendant appealed, arguing that there was no evidence that he intentionally violated the conditions of supervised release.

The Court of Appeals affirmed. Observing that a district court's revocation of supervised release is reviewed for abuse of discretion and its factual findings are binding unless "clearly erroneous," the circuit court found ample evidence supporting the district court's judgment and no basis for reversal.‡

Did You Know?

Bankruptcy trustees qualify as "victims" to whom restitution must be ordered in a criminal bankruptcy fraud case if the trustee's compensation is negatively affected by the defendant's bankruptcy crime.

Trustee's who work uncompensated hours as a result of a defendant's concealment, false statement or other offense covered by the Mandatory Victim Restitution Act (18 U.S.C. § 3663A) are considered restitution victims because the offense effectively reduces the trustee's compensation and increases the trustee' costs.‡

Amending the schedules - a defense to bankruptcy fraud?

One of the most common misconceptions concerning bankruptcy fraud is that amending a petition or schedule to supply missing information (or to correct inaccuracy) in an original filing will protect the debtor from a bankruptcy criminal charge.

In the classic context, a debtor omits an asset from the schedules. A trustee's examination discovers the asset and the debtor is instructed to amend the appropriate schedule, which he does, correcting the original omission or false statement. Does the amendment mean the debtor cannot properly be charged (and convicted) with a concealment or false statement? The answer is no. While amendments are liberally allowed (*see* Fed.R.Bankr.P. 1009(a) and (c)), subsequent remedial measures do not automatically immunize a debtor from criminal prosecution or, for that matter, from a judgment denying the debtor's discharge. The corrective action may, however, be admissible to show the debtor acted in good faith. The debtor's good faith would negate the element of fraudulent intent in a criminal prosecution or civil proceeding to deny the debtor a discharge.

Applying the established rule, the Tenth Circuit easily rejected a debtor's argument that amending his schedules to correct a false social security number (SSN) operated as a defense to a false declaration charge (18 U.S.C. § 152(3)) in *United States v. Beach*, Nos. 05-3362 - 06-3053 (10th Cir. Apr. 9, 2007).

A debtor filed a *pro se* chapter 7 bankruptcy petition in which his SSN was reversed, except for one number. The bankruptcy court clerk published a Notice of Commencement of Case containing the incorrect SSN and mailed it to all creditors. Soon afterwards, the clerk noticed the inaccuracy and alerted the debtor to the deficiency. Within a week of the original filing the debtor filed an amended petition with his correct SSN. The debtor was indicted and convicted for making a false declaration in a bankruptcy case. An appeal followed in which the debtor argued there was insufficient evidence to convict him because the amendment negated the element of fraudulent intent.

The circuit court rejected the argument because despite the amended filing, there was substantial other evidence that the debtor acted with fraudulent intent. The debtor had filed a previous petition omitting his SSN altogether; the debtor's wife's SSN was also incorrect on their joint petition (she pleaded guilty); an FBI special agent testified that the manner in which the numbers were transposed indicated that entry of the incorrect numbers was intentional; the debtor acknowledged discussing the incorrect numbers with his wife; and the debtor admitted that he knew the numbers were incorrect. Accordingly, the court held, a rational juror could have concluded that despite amending the petition to correct the deficiency, the debtor acted with fraudulent intent.

A final note. Interestingly in the *Beach* case, the bankruptcy court clerk noticed the error and called it to the debtor's attention before the amendment, making the case even weaker for an "amendment defense." As a practical and legal matter, a debtor must have corrected the original inaccuracy before it was discovered in order persuasively to show that the corrective measure evinced a lack of fraudulent intent. *See, e.g.*, *Sholdra v. Chilmark Financial LLP (In re Sholdra),* 249 F.3d 380 (5th Cir. 2001) (debtor's amendment to schedule to include previously omitted asset after nondisclosure was discovered was not a defense to objection to discharge).‡

Coming Next Month

Feature: Trustee Home Inspections and the Fourth Amendment.

This feature article discusses the circumstances under which a bankruptcy trustee may inspect a debtor's home for evidence of undisclosed assets in a bankruptcy case and the limitations imposed on that power by the Fourth Amendment.

Article: Draft bankruptcy schedules in bankruptcy criminal investigations: are they discoverable?

Two of the most valuable sources of information in the investigation of a debtor's alleged bankruptcy fraud are the debtor's bankruptcy attorney and drafts of the debtor's schedules (including the completed intake questionnaire). With limited exceptions, a debtor's bankruptcy counsel may properly be interviewed by investigating authorities, and both he and his files may be subpoenaed for use before a grand jury or during trial . . . (continued next month).