BANKRUPTCY FRAUD: CRIME WITHOUT PUNISHMENT II

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Realistically, commerce has always found debtors who, whether through improvidence, mismanagement or ill fortune, have reached a depth of insolvency from which they have no hope of extricating themselves. The oldest bankruptcy laws emerged as weapons for creditors to prevent the flight of such debtors and to recover what assets might remain. More recently, legislatures have crafted bankruptcy statutes favoring cooperative action whereby debtors may work with creditors to realize the best return possible under the circumstances. In return for their cooperation, debtors receive a discharge of their debts and a “fresh start.” Those who do not

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3. For example, in the current Bankruptcy Code, see “A Philosophical Basis for a Federal Bankruptcy Act,” ch. 3, Commission Report. Note that the Bankruptcy Code has not, however, abandoned the interests of the creditor in providing for rehabilitation of the debtor: “This is not primarily a debtor’s bill, however.” Report of the Committee on the Judiciary, House of Representatives, to Accompany H.R. 8200, H.R. REP. No. 95-959, 95th Cong., 1st Sess. 4 (1977), reprinted in Appendix 2, COLLIER ON BANKRUPTCY (Lawrence P. King et al. eds., 15th ed. 1984).

4. See, e.g., In re May, 12 B.R. 618, 621 (N.D. Fla. 1980) (The primary purpose of bankruptcy statutes is “collection and distribution of the debtor’s estate to his creditors. The discharge of the bankrupt is a secondary purpose designed to give the honest debtor the opportunity to reestablish himself in the business world; it is not intended to be available to a dishonest debtor.”). See also Jennen v. Hunter (In re) Hunter, 771 F.2d 1126 (8th Cir. 1985) (indicating that the discharge is available only to honest debtors; in case of dishonesty, debtor “is no longer entitled to the benefit of debtor rehabilitation considerations,”) (quoting In re Wilson, 12 B.R. 363, 370 (Bankr. M.D. Tenn. 1981)). For
cooperate may forfeit discharge.\textsuperscript{5} Unfortunately, as a practical matter, this poses an empty threat to many debtors, whose lack of assets takes the sting out of civil remedies.\textsuperscript{6} For this reason, and because the deliberate misuse of the bankruptcy system is a fraud on the court and on creditors, the bankruptcy laws are incomplete without the statutes which criminalize bankruptcy fraud.\textsuperscript{7}

Use of the bankruptcy system, however, has reached unparalleled proportions. A series of economic setbacks, coupled with a seemingly new tolerance for bankrupts, has placed the burden on bankruptcy trustees to police fraud by actively seeking hidden assets. Trustees and courts could attempt to provide remedies for creditors after such frauds occur, but equally important is prevention through the deterring effect of enforcement of criminal penalties. Fortunately, legislation to control such fraud is already in place. As a result, all that is needed is more vigorous prosecution.

Section 152 of the Federal Criminal Code is Congress's answer to bankruptcy fraud. It occupies, however, the curious position of a statute which is often invoked, but seldom enforced. Courts refer frequently to § 152 fraud in determining whether discharge should be available.\textsuperscript{8} Creditors also point to § 152 violations as predicate acts creating civil RICO claims which they may assert directly. Yet prosecutions under § 152 itself are comparatively infrequent.\textsuperscript{9} Gen-

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6. Because bankruptcy, particularly under Chapter 7, protects little more property than is already protected under many state claims and delivery statutes, many debtors are so insolvent that the bankruptcy does little more than provide a psychological "fresh start," rather than a practical one. For these persons, the threat of denying a discharge is idle at best. Additionally, the fraud these persons perpetrate on the bankruptcy court and their creditors goes largely undetected, primarily because the payoff for catching them is minor.
8. In Local Loan Co. v. Hunt, 292 U.S. 234 (1934), the Court held that discharge is relief only available to the "honest" debtor, thus providing the rationale for denial of discharge in cases of fraud.

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erally, when criminal charges are brought, they are against defendants who are also subject to prosecution for mail fraud, wire fraud, tax evasion, racketeering, or other crimes not directly related to bankruptcy.\textsuperscript{10}

The general reluctance to prosecute bankruptcy crimes is paradoxical. Frequently, criminal law and tort law overlap, each providing penalties to discourage unwanted conduct. It makes sense for criminal law to step aside when civil punitive damages can achieve the same deterrent effect, while at the same time, damages paid by the intentional tortfeasor may accrue directly to the benefit of the injured party. However, in the case of bankruptcy crimes, the civil penalties available—such as recovery of concealed assets and denial of discharge—neither compensate creditors fully for their loss nor impose on the debtor a penalty greater than his original debt.\textsuperscript{11}

\textit{the U.S. Attorney Offices, Fiscal Year 1995; Statistical Report of the Administrative Offices of the U.S. Courts, Fiscal Year 1995}. While the more than 100% increase in complaints would suggest a heightened awareness of bankruptcy fraud on the part of federal prosecutors, the increase in awareness is tempered by the 27% increase in bankruptcy filings.

10. Curiously, the treatment of § 152 has been precisely the converse of that of the RICO statutes. Designed to pinpoint organized crime, RICO has been adopted in the plaintiffs’ arsenal for use against the broadest range of defendants. See, e.g., Banker’s Trust Co. v. Feldesman, 566 F. Supp. 1235, 1236 (S.D.N.Y. 1983) (RICO claims brought by victim of bankruptcy fraud: “Perhaps enticed by the lure of a treble damage recovery, private litigants have attempted increasingly to utilize the civil remedies of . . . RICO . . . in a variety of factual settings ostensibly within the broadly-worded provisions of the statute but arguably far beyond the original contemplation of the framers.”), aff’d, 741 F.2d 511 (2d Cir. 1984), vacated, 473 U.S. 922 (1985). In contrast, the anti-fraud provisions of § 152 appear to be aimed against all who controvert the bankruptcy system, but have been asserted mainly against defendants who have organized crime connections or who bring other systematic criminal behavior into the bankruptcy system, and who are already exposed to a variety of other criminal counts. See, e.g., United States v. Dioguardi, 428 F.2d 1033 (2d Cir.) (defendant convicted of bankruptcy fraud and conspiracy, unsuccessfully claimed jury prejudice because of his known connections with Mafia), cert. denied, 400 U.S. 825 (1970); United States v. Ianniello, 808 F.2d 184 (2d Cir. 1986) (bankruptcy fraud claim against racketeers also charged with mail fraud, RICO conspiracy, and tax evasion resulting from ongoing skimming from various bars, night clubs, and restaurants); overruled by United States v. Indelicato, 865 F.2d 1370 (2d Cir. 1989) (holding that two acts of racketeering activity, without more, fails to establish a RICO pattern); United States v. Tashjian, 660 F.2d 829 (1st Cir.) (fifteen defendants, indicted for receiving stolen property, mail fraud, use of fictitious name in furtherance of mail fraud, RICO conspiracy, extortion and so on, as well as bankruptcy fraud in connection with five year bust-out scheme; allegations of Mafia membership and threats to witnesses made during trial; ironically conviction on one count of bankruptcy fraud reversed because property ordered under fictitious name was received in scheme separate from that relating to bankruptcy), cert. denied, 454 U.S. 1102 (1981); United States v. DeFazio, 899 F.2d 626 (7th Cir. 1990) (tax evasion).

11. See Luther Zeigler, Note, \textit{The Fraud Exception to Discharge in Bankruptcy: A Reappraisal}, 38 STAN. L. REV. 891 (1986) (arguing that denial of discharge on the basis of fraud is generally ineffective, and that full discharge should be available except when fraud occurs in contemplation of bankruptcy, while other bankruptcy fraud is best punished and deterred by the criminal law). The Note observes, although with limited
Occasionally, courts have imposed punitive damages on bankrupt debtors for common-law fraud.\textsuperscript{12} Obviously, in most cases, creditors would stand little chance of recovering such damages.\textsuperscript{13} Therefore, a debtor has little incentive not to attempt some form of bankruptcy fraud. If caught, the debtor is in the exact same position had he or she been genuine; if successful, the debtor reaps the benefits of a windfall in the form of assets that should have been liquidated or used to pay creditors. Even if one were capable of catching one hundred percent of the persons guilty of bankruptcy fraud, without criminal sanctions for such actions, the current system would create no incentives to enter bankruptcy with clean hands. Compounding this point is the obvious fact that nowhere close to one hundred percent of the persons committing bankruptcy fraud are caught. Thus, unless Criminal Code § 152 is used to an extent sufficient to threaten a potential violator, the bankruptcy laws will continue to encourage fraudulent behavior.

In view of this, penalties such as denial of discharge and recovery of fraudulent conveyances serve mainly as remedies available to creditors rather than as deterrents. Appropriately, Congress chose to draft a broad anti-fraud statute that specifically provides for criminal penalties in cases of bankruptcy fraud.\textsuperscript{14} In many cases of bankruptcy fraud, prosecution may be possible for general crimes of perjury, criminal fraud, and the like.\textsuperscript{15} With § 152, however, Congress tailored a statute that ""attempts to cover all the possible


\textsuperscript{13} For example, in a later case against other defendants arising out of the Landmark Equity action, United States v. Butler, 704 F. Supp. 1338 (E.D. Va. 1989), aff'd, 905 F.2d 1532 (4th Cir.), cert. denied, 498 U.S. 900 (1990), it appears that two of the five central figures in the scheme fled the jurisdiction, while a third committed suicide.

\textsuperscript{14} Stuhley v. Hyatt, 667 F.2d 807 (9th Cir. 1982) (noting that although § 152 may be violated by persons other than the bankrupt, the principle objectives of such statute are to prevent and punish efforts by a bankrupt to avoid distribution of any part of a liable bankrupt estate).

\textsuperscript{15} See, e.g., Glickstein v. United States, 222 U.S. 139 (1911) (adjudicated bankruptcy indicated for perjury in bankruptcy proceeding; immunity given to compelled testimony does not serve to protect perjurer); United States v. Klupt, 475 F.2d 1015, 1019 (2d Cir. 1973) (""failure to follow procedures that the bankruptcy court had authorized and prescribed was, in a basic sense, a fraud on the court as well as on the creditor""); United States v. Key, 859 F.2d 1257 (7th Cir. 1988) (no error to give state law jury instruction on forgery because it was relevant to bankruptcy fraud issue relating to falsity of statements, where business records were altered to conceal ownership of debtor's assets); Levy v. Runnells (In re Runnells), 815 F.2d 969 (4th Cir. 1987) (stockholder of debtor corporation held in contempt for violation of injunction against disposing of property, imprisoned pending accounting for funds received); United States v. Goodstein, 883 F.2d 1362 (7th Cir. 1989) (owner of failing corporation who transferred assets was guilty of
METHODS by which a bankruptcy or any other persons may attempt to defeat the Bankruptcy Act through an effort to keep assets from being equitably distributed among creditors.\textsuperscript{16}

Section 152 was basically ignored in the years following its passage. In most cases, § 152 was only invoked to add additional weight to prosecutions for non-bankruptcy crimes. Thus, bankruptcy fraud charges usually appeared only where other crimes preceded the bankruptcy fraud itself. Most debtors, who deliberately use the bankruptcy system to accomplish their fraud, begin their fraud outside of bankruptcy, and similarly, commit crimes beyond the scope of § 152. In both cases, there is usually sufficient prosecutorial ammunition to charge the debtor with crimes involving substantial fines and imprisonment, absent the bankruptcy charges. Such debtors will usually have violated other anti-fraud laws, and as a result, it cannot be said that the additional threat of conviction for bankruptcy crime will act as a real deterrent.

Recently, however, the Justice Department has taken a particular interest in bankruptcy fraud. In early 1996, Attorney General Janet Reno and the nation's United States Attorneys announced "Operation Total Disclosure," designed to be "an extensive nationally coordinated law enforcement effort against those who commit fraud crimes in the context of bankruptcy proceedings." The "operation" was the simultaneous prosecution of 127 defendants for their involvement in 111 bankruptcy crimes between December 1995 and February 28, 1996. The "operation" was advertised as the "department's ongoing effort to deter fraud, protect the integrity of the bankruptcy system, and enhance public confidence in that system.\textsuperscript{17} The question is whether this is the beginning of a long-term goal to correct a severely flawed deterrent system, or whether, after these 127 defendants are convicted or acquitted, the Justice Department will go back to the more familiar prosecutions for securities fraud or drug crimes. More importantly, even if the Justice Department is truly interested in patching the holes in the bankruptcy system, will it be able to do so, and who will shoulder the burden of investigation and reporting? This article incorporates and supplements the previous published article of Bankruptcy Fraud: Crime Without Punishment.\textsuperscript{18} With the new promise of federal attention to this problem, the article attempts to collect and explain this area,


recently referred to as "uncharted waters," and to stress the need for continuing interest and devotion in deterring potential violators and in prosecuting those who commit fraudulent acts in bankruptcy.

I. FRAUDULENT BEHAVIOR

Fraudulent acts that are proscribed as bankruptcy fraud may be related to an actual bankruptcy in various ways, and may either cause or be caused by the bankruptcy. First, a person may create debt by defrauding ordinary creditors. When the debtor later seeks to escape liability through bankruptcy upon insolvency of the vehicle of the fraud, the earlier fraud becomes bankruptcy fraud to the extent that bankruptcy was the inevitable result. Second, such a debtor may deliberately plan to use the bankruptcy system to effectuate his fraud. Thus, he may incur debt in a way that is not intrinsically fraudulent, but becomes fraudulent because he intends to escape liability or payment through bankruptcy. In such cases, the fraud involves the deliberate misuse of the bankruptcy system itself. Finally, and not necessarily any less reprehensible, fraud may effectively result from bankruptcy when a debtor who is already insolvent, possibly for quite legitimate reasons, seeks after the fact to defraud creditors by transferring assets out of the reach of the trustee and creditors or by concealing assets otherwise accessible to them.

19. Id.
20. Many bust-out schemes fall into this category. See, e.g., United States v. Ciampaglia, 628 F.2d 632 (1st Cir. 1980) (unpaid-for merchandise purchased on credit obtained through fictitious credit references), cert. denied, 449 U.S. 956 (1980).
21. In such cases, a plan of funneling off of profits or assets serves to put the proceeds of the fraud beyond the reach of creditors following bankruptcy. See; e.g., the elaborate transactions to siphon off millions of dollars in the Landbank Equity cases. See Levy v. Runnells (In re Landbank Equity Corp.), 83 B.R. 362 (E.D. Va. 1987); In re Landbank Equity Corp., 66 B.R. 949 (Bankr. E.D. Va. 1986).
22. In United States v. McClellan, 868 F.2d 210 (7th Cir. 1989), for example, the defendant gave away assets and charged a European vacation in anticipation of a million dollar judgment against him which would lead to bankruptcy. Incurring a debt without intent to make good on the obligation is ordinarily equitable fraud. When the bankruptcy system is involved to escape the liability, however, bankruptcy fraud may result.
23. This category includes the typical range of fraudulent conveyances and concealment of property. See, e.g., United States v. Turner, 725 F.2d 1154 (8th Cir. 1984) (owner of ailing car dealership sold automobile for cash in unrecorded and unreported transaction); United States v. Lewis, 718 F.2d 883 (8th Cir. 1983) (debtor in personal Chapter VII bankruptcy concealed gifts of cash, receives to installment payments from sale of business, and other property, including a house); United States v. Montilla Ambrosian, 610 F.2d 65 (1st Cir. 1979) (skimming of funds from debtor in possession), cert. denied 445 U.S. 930 (1980). Frequently, of course, such conveyances begin at the time bankruptcy becomes inevitable rather than at the time of filing. See, e.g., United States v. Haymes, 610 F.2d 309 (5th Cir. 1980) (defendant systematically sought to increase cash flow and transfer funds when business began to fail).
These categories are, of course, not mutually exclusive. It is not unusual to find cases where a bust-out artist creates false credit references to defraud creditors directly, and then continues to accrue legitimate debt (but without intention of paying) in anticipation of bankruptcy, thereby hiding his assets from the court once he is actually forced into bankruptcy. Indeed, any classification would be formalistic and unnecessary because bankruptcy frauds have received different treatment according to whether they arose outside of bankruptcy or involved bankruptcy at their inception.

The kind of fraud in which individuals drive a company into bankruptcy by exploiting its credit presents the pattern of a typical “bust out” scheme. In some cases, such operators may simply bilk creditors for as much as they can without concerning themselves with the consequences. Often, however, such fraud involves a deliberate and purposeful misuse of the bankruptcy system, and debtors plan in advance to use the shield of bankruptcy to complete their fraud. The court in *United States v. Crockett* presents a paradigm of such schemes:

A bust-out begins with the formation by the malefactors of a seemingly legitimate wholesale business. The fledgling business's first goal is to establish a favorable credit rating. This task is accomplished by a number of devices which can include temporarily putting cash into the business in order to create a strong balance sheet, bribing credit rating agencies, and inflating financial statements so as to vastly overstate the business's assets and net worth. Also bills for the company's initial purchases are promptly paid—thus furthering the deception through enhancement of the company's credit standing. As the business becomes more established, its promoters order considerable amounts of additional merchandise although they have no intention of paying for these goods. A huge inventory, most of it not paid for, is built up. The principals then busy themselves disposing of their purchases at substantial discounts or secreting the unsold portion for later below-cost covert sales. In other words, they “bust-out” the business. The company is then petitioned into bankruptcy with the mulcted creditors left to pick over the meatless carcass of an assetless enterprise. The con men, or at least those whose names are legally associated with the bankrupt company, suffer a loss of their credit standing and their “good” name. In return, they and their co-conspirators reap handsome monetary benefits for having arranged in advance the demise of a local wholesale outfit.

24. See infra at note 28 and accompanying text.
25. See, e.g., *Landmark Equity cases*, supra note 20.
26. For a recent case discussing typical “bust-out” schemes, see *United States v. Mohammad*, 53 F.3d 1426 n.1 (7th Cir. 1995).
27. 534 F.2d 589 (5th Cir. 1976).
28. *Id.* at 592 (mail fraud rather than bankruptcy fraud). Although no charges were brought under § 152 in *Crockett*, the testimony suggests that prosecution under that section would have been possible for transfer of assets in anticipation of bankruptcy.
A typical example is found in *Asland Oil, Inc. v. Arnett.* In that case, owners of an oil company in financial difficulties sent out a false financial statement in order to secure greater credit from its suppliers. They then picked up great quantities of oil by running trucks nonstop over the weekend to avoid having their credit cut off, thus, exceeding their credit limit with various suppliers by five and six times. When the company went bankrupt, only $170,000 in assets remained to cover debts of almost $2,000,000. Absolutely no inventory remained. A massive diversion of funds appeared to have occurred and, aside from token payments, the only significant debt reduction had been payments that resulted in limiting the personal exposure of the principals. Business records were also burned. However, although the result of the fraud in *Ashland Oil* ultimately affected creditors in bankruptcy, the actual fraud occurred before that time. Creditors in the case brought a RICO suit, alleging as predicate acts mail and wire fraud, bankruptcy fraud, arson, and common law fraud.

More recently, a “bust-out” scheme was identified in *Harris v. Roberto.* This case is important for two reasons. First, even

Q. [The prosecutor] What do you mean by that?
A. [witness Stanley Cachran] Well, he was told at that meeting that nothing could happen except the ruination of his credit for a period of time.
Q. What did Mr. Segas say about that?
A. He said with the amount of money he was going to get out of it, who would need credit.

Q. Now, what was he told?
A. He was told . . . it would just be ultimately built up to a point and pyramided and then it would be busted out and the only thing he would have or would happen, it would be padlocked and forced into bankruptcy.
Q. Was it discussed at this meeting why or how he would be forced into bankruptcy?
A. Yes, sir. He said his creditors would force him into bankruptcy.
Q. How would they do that?
A. Well, none of the bills would be paid.

*Id.* at 595 n.2 (emphasis added).

29. 875 F.2d 1271 (7th Cir. 1989).
30. 1992 WL 150197 (4th Cir. 1992). That court identified a “bust-out” as generally beginning:

when a person or group of people establish a business concerned with the sale of consumer goods. Front men are used to run the day to day operations of the business. Using start-up funds, modest orders are placed with manufacturers and suppliers, and prompt payment is made for the purposes of establishing credit and obtaining credit references. Additional orders are then placed with the same suppliers using credit. Actual retail trade is minimal and most of the goods ordered are immediately shipped after receipt to warehouses and consumer good outlets controlled by the parties that provide the start-up funds and inventory. After an agreed-upon cut-off date, payments to suppliers are stopped. Shipments of goods by the front men to their backers continue until valuable inventory has been
though it was a state law fraud claim, its holding suggests that several persons are necessary and significant parties in perpetrating a "bust-out" scheme, and all of these persons are jointly and severally liable. Generally, the persons responsible for the crime go beyond the "front man," and these persons should also be investigated. Secondly, the case tells the story of a typical "bust-out" scheme as it appears from outsiders:

In December 1983, Roberto filed Articles of Incorporation with the Maryland Department of Assessments and Taxation, thus establishing Atlantic Bargain Center, Inc., as a Maryland Corporation. In January of 1983, he opened a checking account for Atlantic Bargain Center and made deposits until April 25, 1984, totaling approximately $70,000. In March of 1984, Roberto leased commercial space on behalf of Atlantic Bargain Center in Towson, Maryland, for the purpose of operating a retail and/or wholesale operation to sell health and beauty aids, household goods, small appliances and other nonperishable products. The store, owned by Roberto, opened on April 1, 1984. Roberto was also the president of the Atlantic Bargaining Center. In addition to the commercial space, Atlantic Bargain Center also leased warehouse space in Timonium, Maryland, in property owned by Timonium Commerce Park, Co., and managed by Hill Management Services, Inc. Using start-up funds provided by Anthony Leone, Atlantic Bargain Center purchased goods from manufacturers and suppliers across the country. By doing so, it established credit and obtained credit references. It then ordered goods on credit from over seventy creditors, leaving balances due of $1,555,302.69. In fact, the retail trade of Atlantic Bargain Center was virtually nonexistent. Almost all of the activity at the store took place on the loading dock, where goods were loaded onto trucks and shipped to a warehouse in Florida operated by Defendants Leone and Taunton. On February 1, 1985, one truck load containing goods which were either dated products or items with poor marketability was shipped from Florida to Atlantic Bargain's creditors. On February 14, 1985, Roberto met with the accountants of the law firm of Weinstock, Stevan & Harris, P.A., who then represented four Atlantic Bargain Center's creditors. Plaintiff Sanford A. Harris learned from Roberto that Atlantic Bargain Center was insolvent. At the meeting, the claims of the creditors were discussed as well as the possibility of filing an assignment for the benefit of creditors. Roberto told Harris that all of the employees had been fired and that Atlantic Bargain Center was no longer in business. . . . Harris twice visited Atlantic Bargain Center and found a sign that stated it would "Reopen tomorrow at 9 a.m." . . . They visited the premises of Atlantic Bargain Center and found it locked and empty.

exhausted. As creditors' demands for payment increase, the "bust-out" occurs with the business declaring Federal Bankruptcy or, in this case, the state equivalent: assignment for the benefit of creditors. The creditors are left with a less valuable inventory to satisfy their claims.

Id. at *1.
31. Id. at *3.
Therefore, a "bust-out" is most obvious before the bankruptcy and the tell-tale signs are usually noticed by the general creditors of the business. Trustees, investigators, attorneys, and judges should use the fact pattern to develop a line of questions to ask not just the debtor, who is busy covering up his crime, but his creditors or his neighboring stores who may have witnessed the activities.

Closely related to bust-out schemes are two other predatory tactics: skinning and looting. While bust-out operations use their good credit to defraud future creditors, looters steal from existing creditors by bleeding the assets of failing corporations. Skimmers, on the other hand, steal from the public by drawing off the cash flow of vigorous businesses. In all three cases, such continued parasitic behavior will eventually lead to bankruptcy. Because this behav-

32. Corporate looting almost always operates as a fraud upon creditors in anticipation of an inevitable bankruptcy because it is possible only when a corporation close to insolvency can be acquired for a low price. The purchaser then liquidates the corporate assets for his own benefit and at the expense of creditors. Despite this, prosecutions for such fraud are rare, and usually occur only when other forms of criminal activity are also present. See, e.g., United States v. Dioguardi, 428 F.2d 1033 (2d Cir.) (mobster caused sale of a filing provision company to be aborted, then attempted to transfer assets to his own company), cert. denied, 400 U.S. 825 (1970); cf. DeBaun v. First W. Bank & Trust Co., 46 Cal. App. 3d 686 (1975) (systematic looting of company by person who had history of such activity rendered corporation "hopelessly insolvent," resulted in civil judgment against trustee bank that allowed looting, but apparently no prosecution of looter).

33. See United States v. Antar, 53 F.3d 568 (3d Cir. 1995) (cash skimming involves keeping certain cash receipts off the books so that it can be put to tax free personal use); see, e.g., United States v. Robinson, 8 F.3d 398, 402 (7th Cir. 1993), where Wendy's franchise implemented "calculator sales" for a six hour period each evening. Employees were instructed to turn off the cash registers from 2:00 a.m. until 6:00 a.m. and to use the calculator to add up customer sales. Cash register receipts were properly accounted for and placed in a "drop safe" located on the restaurant premises from which the money was deposited. The receipts were reported for royalty and tax purposes. The money from the calculator sale went into a different safe in the manager's office and was picked up by "Tony," instead of the armored courier. Using this scheme, the perpetrators were able to skim approximately $10,000 per month from August 1985 through April 1988. See also, e.g., United States v. Ianniiolo, supra, in which a group of racketeers skimmed millions of dollars from a group of restaurants and clubs including the Peppermint Lounge and Umberto's Clam House. Charges against defendants included RICO conspiracy, mail fraud including fraud upon the state liquor authority, evasion of sales tax and income tax, and bankruptcy fraud. Only one of the many enterprises, the New Peppermint Lounge, went into bankruptcy, and it is unclear whether the bankruptcy could be attributed directly to the skimming operations. Most of the bankruptcy fraud charges stemmed from continuation of the skimming of cash admission charges after the filing of bankruptcy. Defendants included the accountant who assisted in concealment of the skimming. Despite numerous charges of bankruptcy fraud, however, the main thrust of the case was clearly directed against tax evasions and racketeering, most of which occurred outside of bankruptcy and without resulting in bankruptcy.

34. Even embezzlement has been found to lead to a form of bankruptcy fraud when it foreseeably led to insolvency. See United States v. Brimberry, 779 F.2d 1339 (8th Cir. 1985) (bankruptcy fraud under 15 U.S.C. § 78jjj (1994) in case of embezzlement leading to liquidation of securities firm).
ior is illegal even if it does not progress to the bankruptcy stage, it often leads to prosecution based on racketeering charges, tax evasion, mail fraud, and the like, to which bankruptcy fraud may be added as an additional charge. The result, of course, is that a large percentage of the relatively few prosecutions for bankruptcy fraud are mere by-products of other criminal investigations.

This is not to say that bankruptcy courts need not concern themselves with such forms of fraud. A skillful bust-out artist may succeed in concealing his fraud until the victimized corporation falls into bankruptcy. In such cases, the trustee, the court, and the attorneys involved will be the only persons in a position to detect the pre-bankruptcy fraud. Unfortunately, too often courts concentrate only on the recovery of concealed assets and ignore the fact that the concealment involved criminal fraud.

A.D. Sibarium has provided a good outline of many of the tell-tale signs of bankruptcy crime. Practically any transaction that falls outside ordinary parameters of business activity may suggest criminal fraud. Recent changes of ownership or personnel, poor record keeping, lack of inventory records, sudden changes in position (such as level of debt, inventory, credit, and volume of business), and even apparent disappearance of assets through fire or burglary are but a few of the signs of a possible bust-out operation. Of course, these signs are familiar to most attorneys dealing with bankruptcy, and trustees, in particular, are expected to watch carefully for signs suggesting that assets may have been transferred or concealed.

A consumer debtor's fraud is not quite as complicated, but it is probably more difficult to detect because a paper trail in not likely to follow a consumer as it would a corporation. One may presume, therefore, that consumer bankruptcy fraud occurs much more frequently. Typically, consumer fraud is of the third type, that is, the fraud that follows insolvency. In this case, the concealment of assets occurs in anticipation of bankruptcy, rather than using the bankruptcy to complete the crime:

Consumer debtors frequently attempt to cheat the bankruptcy system by devising ways to hide their property or income from the bankruptcy trustee, thereby keeping it from their creditors. Most schemes require little imagination or cunning. Some debtors give their property to relatives prior to filing a bankruptcy petition. Others lie or fail to make full disclosure about what they own or earn in documents submitted in court. Consumer debtors who are inclined to commit bankruptcy fraud require little advice on how to do it. When a consumer debtor enters a law office for representation in filing a bankruptcy petition, an attorney or paralegal instructs the client to fill out a set of schedules.

36. Id.
One of the schedules asks for a list of all of the debtor's property. The debtor does not need a law degree to figure out that the bankruptcy trustee assigned to the case will not be able to distribute to creditors any property or money that the trustee does not know about and cannot find. Some debtors, as a result, simply lie on their bankruptcy schedules.\footnote{Maggs, \textit{supra} note 9, at 3-4.}

Typically, discovering this type of fraud requires personal, special knowledge of the asset that is hidden. A cursory review of the schedules will not detect the fraud. Unfortunately, less than circumspect review is typically the standard in no asset cases. In these “no asset” cases, the trustee, who represents the unsecured creditors, does not see the ability to recover money for them, and he sends the bankruptcy case through with little questioning; not necessarily because the trustee doesn’t wish to bother with the case, with the tremendous demands on his time, rather it is simply impossible for him to do so. Ironically, these are the very persons who escape the net of the civil remedies and are in great need of other disincentives to keep them from perpetrating the crimes.

II. SCOPE OF SECTION 152

Because Criminal Code § 152 is the Congressional answer to bankruptcy fraud, one must understand its mechanics and the system's implementation of it before one can question its effectiveness. Criminal Code § 152 has as its underlying purpose to discourage bankruptcy fraud that bilks creditors out of their protection and entitlement. The statute must further that goal if it is to be considered an efficient and effective statute.

Section 152, “Concealment of assets—False Oaths and claims — Bribery,” provides that

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[Any] person\footnote{Anyone who has ever had the Environmental Protection Agency knock on their door for a CERCLA violation needs no explanation of the broad range of this language. As a warning to corporate executives and other persons in control of companies who may or intend to file bankruptcy, the author quotes the following passage from the very recent case of United States v. Ross, 77 F.3d 1525, 1548 (7th Cir. 1996):}

Ross was charged and convicted on three counts of bankruptcy fraud, in violation of 18 U.S.C. § 152. One count charged him with fraudulently transferring ISC assets to a company he controlled and to his friend, Lesia Gast. The other two counts charged him with filing false reports in an attempt to make the transfers appear legitimate. Ross argues that since ISC, and not Ross was technically the “bankrupt,” he could not properly be convicted under § 152. Ostensibly as support for the proposition that § 152 applied only to “bankrupts” themselves, Ross cites to several cases from the dawn of this century—namely \textit{Tapack v. United States}, 220 F. 445 (3rd Cir. 1915); \textit{Israel v. United States}, 3 F.2d 743 (6th Cir. 1925); \textit{Carter v. United States}, 19 F.2d 431 (8th Cir. 1927). What Ross does not acknowledge is that
\end{quote}
(1) knowingly and fraudulently conceals from a custodian, trustee, marshal, or other officer of the court charged with the control or custody of property, or, in connection with a case under title 11, from creditors or the United States Trustee, any property belonging to the estate of a debtor;\textsuperscript{39}

(2) knowingly and fraudulently makes a false oath or account in or in relation to any case under title 11;\textsuperscript{40}

(3) knowingly and fraudulently makes a false declaration, certificate, verification, or statement under penalty of perjury as permitted under section 1746 of title 28, in or in relation to any case under title 11;\textsuperscript{41}

(4) knowingly and fraudulently presents any false claim for proof against the estate of a debtor, or uses any such claim in any case under title 11, in a personal capacity or as or through an agent, proxy, or attorney;\textsuperscript{42}

(5) knowingly and fraudulently receives any material amount of property from a debtor after the filing of a case under title 11, with intent to defeat the provisions of title 11;\textsuperscript{43}

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his cited cases were interpreting § 29b(1) of the Bankruptcy Code. The statute under which Ross was convicted contains no such limitation, but instead broadly criminalizes . . . [anyone who] knowingly and fraudulently transfers or conceals any of his property or the property of such other person or corporation . . .

39. In most cases, bankruptcy fraud fits this first blanket characterization of concealment, but even before the nine specific offenses were enumerated, defendants were sometimes charged with this offense together with the other specifically detailed offenses.

40. Each of these paragraphs echoes the first paragraph, requiring the defendant to have acted "knowingly and fraudulently," thus establishing the \textit{mens rea} for criminal acts. \textit{See}, Metheny v. United States, 390 F.2d 559 (9th Cir.) (elements), \textit{cert. denied}, 393 U.S. 824 (1968); United States v. DiCosto, 451 F.2d 21 (2d Cir. 1971), \textit{cert. denied}, 405 U.S. 955 (1972); United States v. Lewis, 718 F.2d 883 (8th Cir. 1983) (jury instruction); United States v. Kyc, 859 F.2d 1257 (7th Cir. 1988) (materiality); United States v. O'Donnell, 559 F.2d 1233 (9th Cir.) (defendant charged with false oath under § 152 and perjury under 18 U.S.C. § 1621), \textit{cert. denied}, 429 U.S. 940 (1976); Glickstein v. United States, 222 U.S. 139 (1911) (false statement in bankruptcy prosecuted as perjury).

41. This paragraph was added in a 1978 amendment, Pub. L. No. 95-550, and serves merely to enforce perjury sanctions when an unworn statement has been made under penalty of perjury as provided in § 1746. For use of unworn statements in bankruptcy proceedings see \textit{Long Island Lighting v. Bokum Resources Corp. (In re Bokum Resources Corp.), 26 B.R. 615 (D.N.M. 1982); Zupancic v. Winer (In re Zupancic), 38 B.R. 754 (Bankr. 9th Cir. 1984).}

42. \textit{See United States v. Abraham}, 347 F.2d 395 (7th Cir. 1965) (claim for advertising based on invoice price was false when invoices to bankruptcy retailer had been deliberately inflated to allow company to recover expenses from wholesalers; evidence of course of conduct admissible); United States v. Connery, 867 F.2d 929 (6th Cir. 1989) (lease payments billed although equipment had not been installed). \textit{See also United States v. Murray}, 751 F.2d 1528 (9th Cir. 1985) (false proofs of claim apparently elements in general counts of transfer and concealment).

43. United States v. Gibbs, 594 F.2d 125 (5th Cir.) (president-manager of hotel corporation in bankruptcy presented false invoices for linens and received checks issued against those invoices), \textit{cert. denied}, 444 U.S. 854 (1979); United States v. Cohen, 58 F. Supp. 16 (D. Mass. 1944) (elements). Few reported cases include counts under this.
(6) knowingly and fraudulently gives, offers, receives, or attempts to obtain any money or property, remuneration, compensation, reward, advantage, or promise thereof for acting or forbearing to act in any case under title 11;\(^{44}\)

(7) in a personal capacity or as an agent or officer of any person or corporation, in contemplation of a case under title 11 by or against the person or any other person or corporation, or with intent to defeat the provisions of title 11, knowingly and fraudulently transfers or conceals any of his property or the property of such other person or corporation;\(^{45}\)

(8) after the filing of a case under title 11, or in contemplation thereof, knowingly and fraudulently conceals, destroys, mutilates, falsifies, or makes a false entry in any recorded information (including books, documents, records, and papers) relating to the property or financial affairs of a debtor;\(^{46}\) or

(9) after the filing of a case under title 11, knowingly and fraudulently withholds from a custodian, trustee, marshal, or other officer of the court or a United States Trustee entitled to its possession, any record information (including books, documents, records, and papers) relating to the property or financial affairs of a debtor.\(^{47}\)


\(^{45}\) United States v. Micciche, 525 F.2d 544 (8th Cir. 1975) (bust-out scheme leading to involuntary but foreseeable bankruptcy: “scam” to “establish good credit, order a large inventory, dispose of that inventory for whatever it would bring, and then disappear”), cert. denied, 424 U.S. 985 (1976); United States v. Marton, 408 F.2d 949 (7th Cir.) (looters of failing business made concealed transfer of funds; secret dealings in face of prospective bankruptcy illegal even if funds were not in ultimately property of estate), cert. denied, 396 U.S. 824 (1969); United States v. Dioguardi, 428 F.2d 1033 (2d Cir. 1970) (looting assets of failing business); Stegeman v. United States, 425 F.2d 984 (9th Cir. 1970) (transfer of property out of country in contemplation of bankruptcy); United States v. Moss, 62 F.2d 155 (2d Cir. 1937), cert. denied, 343 U.S. 914 (1957) (concealment in contemplation of bankruptcy merges with offense of concealing assets from trustee); United States v. Pfingst, 477 F.2d 177 (2d Cir.) (lawyer took over dairy he knew was failing, decided “to milk whatever profit could be made before the business went bankrupt”), cert. denied, 412 U.S. 941 (1973). See also In re May, 12 B.R. 618 (N.D. Fla. 1980) (applying this paragraph in discharge proceeding, holding that this section applies to concealment even prior to the twelve-month pre-petition period if they continue into that period).

\(^{46}\) See United States v. Murray, 751 F.2d 1528 (9th Cir.) (corporate records including inventories destroyed to conceal transfer of assets), cert. denied 474 U.S. 979 (1985); United States v. Montilla-Ambrosiani, 610 F.2d 65 (1st Cir. 1979) (debtor in possession made false entries in sales reports); United States v. Center, 853 F.2d 568 (7th Cir. 1988) (inadvertently omitted asset (debt) later assigned via backdated documents in attempt to achieve a setoff; defendant argued that assignment did occur so entry was not false, but court held that entry logging false transaction is itself fraudulent if made with knowledge). See also Stegeman v. United States, 425 F.2d 984 (9th Cir. 1970) (deliberate creation of fictitious title element of concealment count).

\(^{47}\) Charges under this paragraph are seldom made, probably because it overlaps other offenses. See, e.g., United States v. Beery, 678 F.2d 856 (10th Cir. 1982) (defendant asked bank to cash C.D. without disclosing it to trustee; charged with withholding
(10) shall be fined not more than $5,000, imprisoned not more than 5 years, or both.48

Together these prohibitions comprise nine distinct offenses which may be separately charged and separately punished.49 It is clear that Congress allowed a great deal of overlap in attempting to write a comprehensive act that reached all possible forms of bankruptcy fraud. For that reason, single offenses may often fall within the definitions of more than one paragraph.50

While § 152 may attempt to encompass “all possible methods” of defeating the bankruptcy laws, related criminal statutes prohibit other violations that may fall outside the express applicability of that section. Criminal Code §§ 153, 154, and 155 address, respectively, embezzlement and conflict of interest on the part of the trustee and other offices and attorneys’ fee agreements in cases

document from trustee, but trial court instructed jury on offense of concealment; appeals court held crime of withholding may include element of concealment); United States v. Moss, 562 F.2d 155 (2d Cir. 1977), cert. denied, 435 U.S. 914 (1978) (charge of withholding documents from trustee was concealment which merged with general offense of fraudulent concealment, as means by which it was accomplished).


49. See United States v. Gordon, 379 F.2d 788, 790 (2d Cir.) (citing United States v. Schireson, 116 F.2d 881 (3d Cir. 1940), cert. denied, 389 U.S. 927 (1967)). But see United States v. Moss, 562 F.2d 155 (2d Cir. 1977) (separate counts may at times merge, as, for example, concealment in contemplation of bankruptcy merges with concealment of assets in bankruptcy), cert. denied 435 U.S. 914 (1978); United States v. Montilla Ambrosiani, 610 F.2d 65 (1st Cir. 1979) (one set of facts which are essential elements of two crimes cannot support two convictions; rejecting contention in Schireson, at 884, that if a person “kills two birds with one stone he can well be punished for killing each bird, if killing birds is an offense”) (citing Ladner v. United States, 358 U.S. 169 (1958) (single offense to injure two officers with single shotgun blast), cert. denied 445 U.S. 930 (1980)). At any rate, the catalogue of separate offenses facilitates prosecution. See United States v. Haymes, 610 F.2d 309 (5th Cir. 1980) (holding that “a disjunctive statute may be pleaded conjunctively and proved disjunctively”) (citing United States v. Quiroz-Carrasco, 565 F.2d 1328 (5th Cir. 1978)).

When several acts specified in a statute are committed by the same person, they may be coupled in one count as together constituting one offense although a disjunctive word is used in the statute, and proof of any one of the acts joined in the conjunctive is sufficient to support a verdict of guilty.


50. United States v. Moss, 562 F.2d 155, 160 (2d Cir. 1977) (concealment of documents was “part of the means by which the offense of fraudulent concealment was accomplished”), cert. denied 435 U.S. 914 (1978). See also United States v. White, 417 F.2d 89, 93-94 (2d Cir. 1969), cert. denied 397 U.S. 912 (1970) (separate and distinct offense of tax fraud only part of comprehensive statutory scheme, and specific form of fraudulent conduct merges into inclusive fraud as lesser offense included in general prohibition).
under Title 11 and receiverships.51 Transfer of concealment of assets in liquidations are prohibited by § 78jjj of SIPA.52 Finally, bankruptcy fraud often involves acts that violate statutes against forgery, criminal fraud, perjury, and the like.53

Thus, § 152 and the related anti-fraud provisions reach a broad range of possible defendants. While the Bankruptcy Code itself provides no real penalties other than denial of discharge and touches only the bankrupt person or entity, the anti-fraud statutes go further to address all who may abuse the bankruptcy process.54 In the case of deliberate abuse of the bankruptcy system, parties other than the bankrupt himself are likely to be the ones who benefit from fraud. Even assuming that denial of discharge may discourage consumer bankrupts from hiding assets, it poses an empty threat to looters who drain the assets from failing businesses and bust-out artists who rob creditors through shell corporations. The civil remedies of the bankruptcy process are too limited in scope and force to control criminal abuse of the system.

III. PROSECUTION UNDER SECTION 152

Of course, criminal prosecution of bankruptcy fraud requires a higher standard of proof than civil actions and it involves questions

51. 18 U.S.C. §§ 153-55 (1994). These sections have been invoked much less than § 152. See United States v. Ivers, 512 F.2d 121 (8th Cir. 1975) (trustee received check after bankruptcy had been closed and trustee discharged, convicted of misappropriation for failure to promptly credit trust account); United States v. Zipkin, 729 F.2d 384 (6th Cir. 1984) (receiver).

52. 15 U.S.C. § 78jjj (1994) (Securities Investors’ Protection Act of 1970). In 1978, the wording of § 152 was changed by substituting “case under title 11” wherever the statute had previously said “bankruptcy proceeding.” Pub. L. No. 95-598. It is not clear to what extent this changed the applicability of § 152, inasmuch as the first paragraph still prohibits all intentional concealment from a trustee. However, the Securities Investors’ Protection Act of 1970, 15 U.S.C. § 78jjj(c) (1994) (“concealment of assets; false statements or claims”) protects against fraud in liquidations with language parallel to that of § 152, although allowing for a much greater maximum fine ($50,000). Congress explicitly patterned this SIPA statute on existing bankruptcy law. See S. REP. NO. 763, 95th Cong., 2d Sess. 15, reprinted in 1978 U.S.C.C.A.N. 764, 778. For an example of bankruptcy fraud prosecuted under § 78jjj see United States v. Brimberry, 779 F.2d 1339 (8th Cir. 1985) (looting of investment company through manipulation of margin accounts, resulting in embezzlement of $16,000,000; defendant tried for five counts of perjury and two counts of bankruptcy fraud under § 78jjj); court looked to § 152 for interpretation of § 78jjj; for related cases, see United States v. Brimberry, 744 F.2d 580 (7th Cir. 1984); United States v. Bednar, 728 F.2d 1043 (8th Cir. 1984); United States v. Massa, 740 F.2d 629 (8th Cir. 1984); In re Stix & Co., 27 B.R. 252 (Bankr. E.D. Mo. 1983).

53. Supra note 9.

54. Sections 152-55 explicitly apply to any persons, including attorneys and trustees, who conceal or transfer assets or make false statements or claims. See, e.g., United States v. Bartlett, 633 F.2d 1184 (5th Cir. 1981) (attorney for debtor assisted in concealment), reh’g denied, 640 F.2d 385 (5th Cir.), cert. denied, 454 U.S. 820 (1981); United States v. Ianniello, 808 F.2d 184 (2d Cir. 1986) (accountant for debtor guilty of fraud for skimming before and after petition), cert. denied, 483 U.S. 1006 (1987). See also supra note 36.
of evidence and procedure.\textsuperscript{55} A showing of fraud by the preponderance of the evidence will support a civil action for denial of discharge, while a criminal conviction for fraud must rest on a showing beyond a reasonable doubt.\textsuperscript{56} Thus, when fraud has been established in bankruptcy court, the entire issue must be re-tried in a criminal prosecution under § 152.\textsuperscript{57} On the other hand, in some cases where a defendant has already been convicted of fraud, the conviction will serve as a basis for denial of discharge and the fraud issue will not need to be relitigated.\textsuperscript{58}

A. Elements of Offense Under Section 152

Courts have differed in formulating enumerations of the particular elements which must be proven to establish bankruptcy fraud, but agree generally on what these elements must include:

1) The fraudulent act itself, such as concealment, transfer, perjury, and so on.
2) Knowledge and intent; \textit{mens rea}
3) Bankruptcy proceedings, or, in the case of fraud in anticipation of bankruptcy, future bankruptcy.
4) Actual subject matter of the fraud, including assets of the estate and, in the case of information, material misstatement or nondisclosure.\textsuperscript{59}

\textsuperscript{55} See, e.g., United States v. Jackson, 836 F.2d 324 (7th Cir. 1987) (\textit{Miranda} warning not required until time of custodian interrogation in criminal investigation); United States v. White, 879 F.2d 1509 (7th Cir. 1989) (petit jury decision must be unanimous, but jury need not agree on every detail); United States v. Pfingst, 477 F.2d 177 (2d Cir.) (due process question of press conference announcing indictment, duty of prosecutor to reveal relevant matters to court, such as plea bargain agreement, discovery rights of defendant), \textit{cert. denied}, 412 U.S. 941 (1973); United States v. Murray, 751 F.2d 1528 (9th Cir.) (search and seizure, discovery of grand jury transcripts, 6th Amendment right to counsel), \textit{cert. denied}, 474 U.S. 979 (1985).

\textsuperscript{56} 11 U.S.C. § 727(a) (1994); H.R. \textsc{Rep.} No. 595, 95th Cong., 1st Sess. 384 (1977); S. \textsc{Rep.} No. 989, 95th Cong., 2d Sess. 98 (1978) (denial of discharge for bankruptcy crime, but standard of proof preponderance rather than beyond reasonable doubt).

\textsuperscript{57} See, e.g., United States v. Beery, 678 F.2d 856, 868 & n.10 (10th Cir. 1982) (findings of bankruptcy court not controlling in criminal case; defendant not collaterally estopped from raising issues determined against him in civil action) (citing United States v. Konovsky, 202 F.2d 721, 726-27 (7th Cir. 1953)). \textit{See also} United States v. Butler, 704 F. Supp. 1338 (E.D. Va. 1989), \textit{aff'd}, 905 F.2d (4th Cir.), \textit{cert. denied}, 498 U.S. 900 (1990); \textit{In re} Landbank Equity Corp., 83 B.R. 362 (E.D. Va. 1987) (related cases, collateral estoppel not applicable when defendants for fraud were not parties in original bankruptcy action which found no conspiracy).

\textsuperscript{58} Raiford v. Abney (\textit{In re} Raiford), 695 F.2d 521 (11th Cir. 1983) (guilty plea in criminal fraud prosecution conclusive for summary judgment in discharge hearing, because standard of proof and procedural protections are greater in criminal prosecution, even though defendant said he pled guilty to get lighter sentence) (citing United States v. Podell, 572 F.2d 31, 35 (9th Cir. 1978) (criminal conviction conclusive of issue in subsequent civil litigation)).

\textsuperscript{59} \textit{Compare} United States v. Cherek, 734 F.2d 1248 (7th Cir. 1984) (two principal elements of fraudulent failure to disclose asset under § 152 are 1) concealment and 2)
1. Fraudulent Acts

As noted in Stegeman, the intent of the § 152 is to include all possible methods of defrauding the court and creditors in bankruptcy. Thus, the nine paragraphs of this section include forms of fraud that lie beyond the coverage of other criminal law. While perjury would be illegal in any case, bankruptcy fraud also encompasses nondisclosure and related forms of deception. Record keeping that might be acceptable otherwise is criminal if it furthers fraud in the bankruptcy court. Section 152 covers fraudulent acts committed, not just on the officer of the court, but on any creditor of the bankrupt as well. In addition to imposing a high standard of conduct on all who deal with assets of a bankruptcy estate, the criminal fraud statutes also offer a stricter means of enforcement. Damages in civil fraud cases usually lie only where the fraud has caused actual harm. On the other hand, illegal activity can result in prosecution and con-

knowledge and fraudulent intent), cert. denied, 471 U.S. 1014 (1985); United States v. Giuliiano, 644 F.2d 85 (2d Cir. 1981) (to convict for concealment jury must find 1) adjudication of bankruptcy, 2) property was owned by bankrupt business, 3) defendant concealed or aided and abetted concealment from trustee, and 4) defendant did so knowing of appointment of trustee and with intent to defraud); United States v. Arge, 418 F.2d 721 (10th Cir. 1969) (indictment must contain allegations of 1) time and place, 2) action with knowledge and fraudulent intent, 3) description of property, 4) identification of parties from whom property was concealed, and 5) property as part of bankruptcy estate); Metheaney v. United States, 390 F.2d 559 (9th Cir.) (elements for false oath are: 1) bankruptcy proceedings, 2) statement made under oath, 3) oath related to material fact, 4) oath was false, and 5) oath was knowingly and fraudulently false), cert. denied, 392 U.S. 913 (1968).

60. For example, transfers made in anticipation of bankruptcy evade direct perjury in court. Until § 152 was amended in 1960 to include individuals as well as agents of corporations, "individuals [were] not subject to prosecution for the concealment of assets in contemplation of their own bankruptcy." S. REP. NO. 974, 86th Cong. 2d Sess. (1960). (Noted in In re May, 12 B.R. 618, 623 n.2 (N.D. Fla. 1980)). But compare Bronston v. United States, 409 U.S. 352 (1973) (defendant charged with perjury in testimony before bankruptcy referee, under 18 U.S.C. § 1621 rather than § 152, not guilty because statement was literally true, although unresponsive and misleading) with United States v. Shafrick, 871 F.2d 300 (2d Cir. 1989) (defendant guilty under § 152 for giving literally true but misleading testimony; court distinguished Shafrick on grounds that defendant's offer of additional information beyond simple answer contributed to deception, and contact may render literally true answer perjurious).

61. See, e.g., United States v. Center, 853 F.2d 568 (7th Cir. 1988) (defendant charged, inter alia, of § 152 concealment and violation of 18 U.S.C. § 152 and § 1344 (scheme to defraud federally insured financial institution). Defense in Center cited cases suggesting that recording fraudulent transactions in books may not be itself false or fraudulent; court held that cases were decided under 18 U.S.C. § 1005 dealing with entries in bank's book, and that "[t]he statute involved here, 18 U.S.C. § 152, is broader in scope than § 1005. The purpose of § 152 is to proscribe the concealment of a bankrupt's assets (with false book entries being one of the possible vehicles available to affect [sic] a concealment . . . [defendant's] actions were done to conceal the debt").

viction for criminal bankruptcy fraud even when no monetary harm ultimately results when, for example, a perjuror recants his testimony.\textsuperscript{63} In some cases, bidding agreements may be legal, but when they serve to injure third party creditors, such agreements become criminal.\textsuperscript{64} Concealment has been defined as including secession, falsifying and mutilating property or information.\textsuperscript{65} Preventing discovery or withholding knowledge of the asset is sufficient to find concealment.\textsuperscript{66}

Furthermore, it should be noted that courts have held that no element of materiality of the fraudulent act need be shown in order to constitute a crime.\textsuperscript{67} Therefore, no jury instruction as to materiality need be given.\textsuperscript{68}

\begin{itemize}
\item \textsuperscript{63} See United States v. Norris, 300 U.S. 564 (1936) (recantation does not cure false statement under oath) superseded by 18 U.S.C. § 1623(d), United States v. Roche, 1992 WL 129634 (E.D. Pa. 1992) (permitting recantation to cure false statement if the original declaration has not substantially affected the proceeding and the falsity of testimony has not been exposed); United States v. O'Donnell, 539 F.2d 1233, 1237 (9th Cir. 1976) ("materiality of false oath does not require a showing that creditors are harmed by the false statements"); United States v. Klupt, 475 F.2d 1015, 1017-18 (2d Cir. 1973) (return of money to debtor corporation did not "purge" defendant of criminal responsibility), citing United States v. Diorio, 451 F.2d 21 (2d Cir. 1971) (jury could decide whether recantation of false oath was "prompted by an honest discovery of an earlier mistake" or "by the realization that the jig was up and that the falsity had already been uncovered or was about to be uncovered by others"); Vecchione v. Vecchione (In re Vecchione), 407 F. Supp. 609, 616-17 (E.D.N.Y. 1976) (question is not whether creditors were mislead but whether actual concealment occurred, when transfers of houses were filed publically).
\item \textsuperscript{64} 28 U.S.C. § 152(6) (1994).
\item \textsuperscript{65} United States v. Phillips, 196 F. 574 (S.D.N.Y. 1912).
\item \textsuperscript{66} Burchinal v. United States, 342 F.2d 982 (10th Cir.), cert. denied, 382 U.S. 843 (1965).
\item \textsuperscript{67} See United States v. Grant, 971 F.2d 799, 808-09 (1st Cir. 1992); but see United States v. Lindholm, 24 F.3d 1078, 1082-83 (9th Cir. 1994) (In order to convict a defendant of bankruptcy fraud, the government must prove (1) the existence of the bankruptcy proceedings; (2) that a statement under penalty of perjury was made therein, or in relation thereto; (3) that the statement was made as to a material fact; (4) that the statement was false; and (5) that the statement was knowingly and fraudulent made.).
\item While this case appears to contradict Grant, the two cases can be distinguished on the basis of the subject matter of the fraud. The rule can be summarized as: where the subject matter of the fraud is property, there is no requirement of materiality, where the subject matter of the fraud is a false statement, then there is a requirement of materiality. Stated another way, there is a presumption of materiality where the fraud is dealing with property of the estate. Even if the materiality element is a requirement, it is not a difficult standard to prove. As stated in Lindholm, the scope of materiality includes inquiries related to the bankrupt's assets and business transactions, and the history of its financial transactions: "Materiality does not require a showing that creditors are harmed by the false statement." Id. For earlier cases in accord with this Rule, see infra notes 109, 118-22 and accompanying text.
\item \textsuperscript{68} United States v. Standard, 83 F.3d 430 (9th Cir. 1996), cert. denied, 117 S.Ct. 690 (1997).
\end{itemize}
2. Knowledge and Intent

As with most criminal offenses, bankruptcy fraud requires willful behavior. Footnote 69. "The object of Congress in passing this criminal statute was to punish those debtors who, although wanting relief from their debts, did not want to surrender what property there was to the creditors." Footnote 70. In numerous cases, proof of bankruptcy fraud ultimately depends on whether the bankrupt's conduct indicates a knowing intent to defraud creditors. The line is often a difficult one to draw because intent may exist without malice or "evil motive," yet it cannot be "constructively presumed without any factual basis." Footnote 71. While intent itself must be actual rather than constructive, intentional fraud may be found on the basis of constructive knowledge. Footnote 72.

This is a question of fact that often must be presented to a jury. The jury may have to consider factors such as the debtor's conduct, the extent of concealment, the character of the assets, and the reasons given by the debtor for possibly fraudulent actions. Footnote 73. A good example of a jury instruction on intent and state of mind appears in United States v. Ciampaglia. Footnote 74. That instruction observes that one cannot look inside a person's mind, and that the jury should judge intent "by what a person does or says or fails to do or say," including "willful blindness to the existence of [a] fact" that should have been obvious. When a person "with a lurking suspicion goes on as before and avoids further knowledge, this may support an inference that he has deduced the truth and is simply trying to avoid giving the appearance (and incurring the consequences) of knowledge."Footnote 75. In such instances, courts have approved of "ostrich" instructions, allowing a jury to find guilt on the part of a defendant who deliberately closed his eyes to criminal violations. Footnote 76.

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69. Each of the nine enumerated paragraphs refer to and require an element of knowledge or mens rea. Maggs, supra note 9, at 6. United States v. Lawson, 255 F. Supp. 261, 266 (D. Minn. 1966) ("intent to defect Bankruptcy laws" and "knowledge" prohibit willful rather than inadvertent conduct); United States v. Martin, 408 F.2d 949 (7th Cir.) (knowledge and intent are elements of crime of concealing assets), cert. denied, 396 U.S. 824 (1969).


71. In re May, 12 B.R. at 626.


73. Shapiro, 101 F.2d at 378.

74. 628 F.2d 632, 642 (1st Cir.), cert. denied, 449 U.S. 956 (1980).


76. United States v. DeFazio, 899 F.2d 626, 636 (7th Cir. 1990) (rejecting claim that this imposes negligence standard on specific intent crime)(citing Ramsey).
For example, omissions from a schedule made by an ordinary wage earner may be innocent simply because he is not required to keep books to account for "each dollar" spent.\textsuperscript{77} Even an embezzler who acts without knowledge that a business had been adjudicated bankrupt may be innocent, at least under § 152.\textsuperscript{78} On the other hand, in the case of an experienced businessman, an inference of knowledge "or reckless indifference" may arise more easily when he knows he may "have to meet with his creditors, to be examined under oath regarding the truth of the petition."\textsuperscript{79} Similarly, a debtor who freely charged expenses for a vacation and transferred a Porsche and Delorean to his father just before a million dollar judgment was declared against him obviously "deliberately structured his finances to avoid creditors. [He] consistently attempted to avoid his financial obligations . . . [and] chose to maintain a low income while his father’s corporation paid all of his living expenses."\textsuperscript{80} One court has stated that fraudulent intent could be found where the magnitude of the undisclosed income negated any suggestion that the debtors were mistaken or overlooked the error.\textsuperscript{81}

Some courts have referred to "badges of fraud" as indicators useful in determining the existence of a willful pattern of fraud. When several of these appear in combination, they suggest knowing, intentional behavior. These "badges" include: 1) lack or inadequacy of consideration, 2) close relationship between parties, 3) retention of beneficial use of property, 4) financial condition of party before and after transaction, 5) pattern of transactions or conduct after incurring debt, financial difficulties, or threat of suit by creditors, and 6) general chronology of events and transactions.\textsuperscript{82} This is a partial list, and of course, different indicators will be relevant in particular situations.

The role of advisors, such as attorneys, may affect a finding of intent. A defendant who relied on counsel to arrange a deal may be able to show lack of knowledge.\textsuperscript{83} Most courts now consider this

\textsuperscript{77} Friendly Disc. Corp. v. Humphries (\textit{In re} Humphries), 469 F.2d 643, 644 (5th Cir. 1972) (denial of discharge question).
\textsuperscript{78} United States v. Giuliano, 644 F.2d 85, 87 (2d Cir. 1981).
\textsuperscript{79} United States v. White, 879 F.2d 1509 (7th Cir. 1989) (defendant convicted of fraud for listing phony third mortgage on house and concealing other assets in bankruptcy resulting from personal guarantees of business loans; court found evidence failed to support conviction of wife whose knowledge of business was more limited), \textit{cert. denied}, 494 U.S. 1027 (1990).
\textsuperscript{80} United States v. McClellan, 868 F.2d 210, 213 (7th Cir. 1989).
\textsuperscript{82} \textit{In re} May, 12 B.R. at 627 (citing \textit{In re} Vecchione, 407 F. Supp. 609 (E.D.N.Y. 1976), and \textit{In re} Freudman, 362 F. Supp. 429, 433 (S.D.N.Y. 1973), \textit{aff’d} 495 F.2d 816 (2nd Cir. 1974)).
\textsuperscript{83} \textit{See} \textit{In re} Jartran, 44 B.R. 331, 389 (Bankr. N.D. Ill. 1984). \textit{See also} United States v. White, 879 F.2d 1509, 1514 (7th Cir. 1989) (Will, J., concurring & dissenting) (agreeing
defense to be just one factor in the factual determination of mens rea.\textsuperscript{84} Besides its obvious role in a criminal trial, the advice of counsel defense has been used to avoid charges under § 152 altogether. At least one court has declined to refer a violation to the United States Attorney because potential criminal acts were “done with the advice and knowledge of . . . attorneys, who are among the most respected lawyers appearing in this Court.”\textsuperscript{85} Despite this case, the status of the reliance argument under § 152 of the criminal code is unclear. Because of the paucity of criminal cases brought for bankruptcy fraud, the circuit courts have said almost nothing on the issue. A few rather old cases excused debtors under a prior version of § 152 on the basis of reliance argument. In recent years, however, the few courts that have addressed the provision each have done little more than curiously uphold jury instructions given by trial courts in criminal prosecution.\textsuperscript{86} Additionally, this defense may at times produce unwanted side effects. In one case, for example, a defendant’s attorney was disqualified from representing his client in criminal proceedings under § 152 because he had represented the defendant at the time the latter made false statements in bankruptcy proceedings, and thus, might be called upon to testify to establish an advice of counsel defense.\textsuperscript{87}

Prior bad acts can also be used to show intent to commit a fraud. A good example of this is found in \textit{United States v. Jemal},\textsuperscript{88} wherein the court found that evidence of participation in previous “bust-out” schemes was admissible to show that the defendant knowingly committed a “bust-out” in the particular case. The court concluded that a proper stipulation as to knowledge of the nature of a “bust-out” scheme would have been sufficient to exclude the evidence\textsuperscript{89} to effectively prevent the prior bad act testimony from being introduced. Accordingly, the stipulation must convey the same fact to the same degree as the proposed testimony. The court held that “to succeed, the defendants proffer must be comprehensive and unre-

\textsuperscript{84} See Maggs, \textit{supra} note 9, at 9.

\textsuperscript{85} \textit{In re Featherworks Corp.}, 36 B.R. 460 (E.D.N.Y. 1984), \textit{affg}, 25 B.R. 641 (Bankr. E.D.N.Y. 1982) (citing Thompson v. Eck, 149 F.2d 631, 633 (2d Cir. 1945) (advise of counsel defense in § 152 violations)).

\textsuperscript{86} Maggs, \textit{supra} note 9, at 19.

\textsuperscript{87} United States v. DeFazio, 899 F.2d 626 (7th Cir. 1990) (fact that attorney ultimately was not required to testify irrelevant to court’s decision to disqualify him).

\textsuperscript{88} 26 F.3d 1267 (3d Cir. 1994).

\textsuperscript{89} “[A]s a matter of discretion, it is an abuse of discretion for district courts to admit prior bad acts evidence to prove an issue such as knowledge or intent if the defendant takes sufficient steps to remove that issue from the case.” \textit{Id.} (citing to the 2d, 8th, 5th and 9th Circuits); \textit{but see id.} (discussing 7th Circuit cases stating that in intent crimes, knowledge and intent are always at issue).
served, completely eliminating the government's need to prove the point it would otherwise try to establish using Rule 404(b) evidence." In *Jemal*, the defendant offered to stipulate that if the jury found that he had performed any of the acts alleged, then it should find that he acted with knowledge and intent. The court found this type of stipulation to be inadequate because it left open areas of the government's case where they were still required to prove knowledge and intent as to the particular acts alleged.

In short, while direct evidence seldom demonstrates knowledge and intent conclusively, circumstantial evidence will frequently confirm a pattern of willful fraud. Unrelated incidents of negligence will not subject a debtor to criminal prosecution, but a defendant whose actions suggest a systematic plan to retain assets of an estate for himself will find it harder to convince a jury that his actions were innocent and inadvertent. "Persons whose intention it is to shield their assets from creditor attack while continuing to derive the equitable benefit of those assets rarely announce their purpose. Instead, if their intention is to be known, it must be gleaned from inference drawn from a course of conduct." 

3. Existence of Bankruptcy

Naturally, a critical element in bankruptcy fraud is the actual existence of a bankruptcy. In the past, offenses that occurred prior to the filing of bankruptcy were brought into the reach of the criminal fraud statutes only when the offenses became continuing concealment at the time bankruptcy occurred. Now amendments to § 152 and related statutes expressly include offenses that occur "in contemplation of bankruptcy," and the former analysis is no longer necessary. Theoretically, bankruptcy fraud could occur in contemplation of an apparently inevitable bankruptcy which the debtor

90. *Id.* at 1274.

[W]hether a defendant has removed an issue from the case: "depends not on the form of the words used by counsel but on the consequences that the trial court may properly attach to those words. When the Government offers prior act evidence to prove an issue, counsel must express a decision not to dispute that issue with sufficient clarity that the trial court will be justified (a) in sustaining objection to any subsequent cross-examination or jury argument that seeks to raise the issue and (b) in charging the jury that if they find all the other elements established beyond a reasonable doubt, they can resolve the issue against the defendant because it is not disputed."

*Id.* (quoting United States v. Figueroa, 618 F.2d 934, 942 (2d Cir. 1980)).

91. *Id.* at 1275.

92. *In re Vecchione*, 407 F. Supp. at 615 (discharge question) (citing *In re Saphire*, 139 F.2d 34, 35 (2d Cir. 1943)).

93. See, e.g., United States v. Haymes, 610 F.2d 309 (5th Cir. 1980) (jury allowed to put "two and two together" to decide how far back defendant actually contemplated bankruptcy; jury found contemplation of bankruptcy began at time defendant started trying to generate greater cash flow).
later managed to escape. Section 152 can be used against a person perpetrating a fraud before,\textsuperscript{94} during, or after the bankruptcy proceedings.\textsuperscript{95}

While bankruptcy is an essential element in bankruptcy crimes, it is one that presents relatively few difficulties of interpretation. Because the crime of bankruptcy fraud touches the court, as well as creditors, illegal fraud may occur even if creditors are not harmed, even if concealed assets are not property of the estate,\textsuperscript{96} and even if bankruptcy proceedings ultimately are abandoned. Thus, it is not a defense to fraud to challenge the validity of the bankruptcy proceedings themselves.\textsuperscript{97}

It is worth noting that occasionally acts of theft or embezzlement that occur during bankruptcy are unrelated to the bankruptcy proceedings, in which case, no violation of § 152 is involved.\textsuperscript{98} Such cases are relatively infrequent. More often, a question arises as to fraud prior to bankruptcy. In the case of "bust-out" schemes, most of the fraud may occur before filing bankruptcy, and the defendants may have formulated no specific plan to enter into bankruptcy. However, because such schemes to bilk creditors lead inevitably to the bankruptcy of the corporate vehicle for the scheme, courts have held that they involve misuse of the bankruptcy system. Even if defendants do not actively plan to file bankruptcy, most are or should be aware that it will result from their fraud.\textsuperscript{99} A similar argu-

\begin{itemize}
\item \textsuperscript{94} Fraudulent conduct before the bankruptcy is generally in the form of a fraudulent transfer or concealment. United States v. West, 22 F.3d 586 (5th Cir.), \textit{reh'g en banc denied}, 32 F.3d 586, \textit{cert. denied}, 115 S.Ct. 584 (1994).
\item \textsuperscript{96} United States v. Martin, 408 F.2d 949 (7th Cir. 1969).
\item \textsuperscript{97} United States v. Beery, 678 F.2d at 865-66 (10th Cir. 1982) (defendant knew of appointment of trustee; guilty of concealment although he considered bankruptcy proceedings invalid and openly resisted efforts to seize assets).
\item \textsuperscript{98} In United States v. Tashjian, 660 F.2d 829 (1st Cir. 1981), \textit{cert. denied}, 454 U.S. 1102 (1981), for example, conviction on one count of transferring property in contemplation of bankruptcy was reversed on the ground that, the particular property was obtained through a separate fraud unrelated to bankruptcy. Although the defendants took part in a fraudulent bust-out scheme in which they generally received shipments of goods on credit, planning to escape liability through bankruptcy, in one instance an order for electronic calculators was placed in the name of a fictitious company, for delivery to the bust-out company. The court held that because defendants did not believe that the bust-out company would be responsible for the proceeds of this fraud, it was not intended to defeat the bankruptcy laws and therefore was not a violation of § 152. See United States v. Giuliano, 644 F.2d 85 (2d Cir. 1981) (embezzler unaware of bankruptcy filing or appointment of trustee).
\item \textsuperscript{99} E.g., United States v. Giuliano, 99 F.2d 85 (2d Cir. 1981) (bust-out scheme and racketeering); United States v. Ciampaglia, 628 F.2d 632 (1st Cir. 1980) (bust-out scheme leading to involuntary bankruptcy; business run in "highly unusual manner and not as a normal, legitimate enterprise," running up debts over $1 million in half year).
\end{itemize}
ment applies to looters who acquire failing companies and seek to transfer as many assets as possible prior to total failure of the companies.100 Thus, courts have been willing to find bankruptcy fraud in most cases where fraud led to bankruptcy, as well as those in which it followed a bankruptcy filing.

4. Subject Matter of Fraud

Generally, bankruptcy frauds fall into two classes: those involving transfer or concealment of property, and those involving information. Thus, conviction depends in part on the existence of property or of a fraudulent communication of some sort. Courts have taken a flexible approach in finding subject matter to support fraud convictions.

With respect to property, § 152 specifically requires that the subject matter of the concealment be the “property belonging to the estate of a debtor,” but only a tenuous connection with the bankrupt estate needs to be established.102 Illegal concealment includes concealment of property that may not ultimately be determined to be part of the estate.103 The interest can be legal, possessory, or equitable at the commencement of the case.104 However, it may be a valid defense to assert that the trustee did not choose to establish title to the property because it may have gone to bona fide purchasers.105 In order to use this defense, however, the debtor must first list the asset on its schedules, as there is no “assumed abandonment” by the trustee. Any asset not properly scheduled remains property of the bankruptcy estate.106

There is, however, some requirement that property have some value before it is considered a part of the estate. Several debtors have argued this position, and although unsuccessful, the cases are

102. See, e.g., United States v. Strauch, 1995 WL 377192 *5 (9th Cir. 1995) (noting that the property of the debtor's estate includes property in which a creditor has a security interest) (citing In re Contractors Equip. Supply Co., 861 F.2d 241, 244 (9th Cir. 1990)); but see Mitsu Mfrs. Bank v. Unicom Computer Corp. (In re Unicom Computer Corp.), 13 F.3d 321, 324 (9th Cir. 1994) (indicating that an asset held in trust by a debtor for another is not property of the bankruptcy estate or the debtor). In Strauch, the debtor unsuccessfully attempted to argue that a “garden variety financing agreement in which ITT's loan of funds to 3-D was secured by the inventory 3-D purchased with the advance funds” as a trust, attempting to escape criminal liability by arguing that the property was not a part of the estate.
106. Jeffry v. Desmond, 70 F.3d 183 (1st Cir. 1993).
clear that under proper circumstances it could prove to be a valid defense. An example is found in United States v. Standard where the debtor argued that his failure to reveal an investment in an oil and gas company was not fraudulent concealment because the investment was worthless when he filed his bankruptcy. The court held that there need only be some evidence shown that the debtor expected some recovery from his investment and failed to disclose that expectancy. There is no requirement that the concealed asset have substantial value or that it be important to a reorganization or liquidation.

The subject matter of the fraud is that property which the debtor has a connection or nexus to the actual interest. A proper example of this point is explained in Standard where the debtor had an investment with an oil and gas company, Transwestern. He failed to disclose the investment to the trustee; upon discovering the hidden asset, the debtor was charged with a violation of § 152. The subject matter of the fraud was the investment in Transwestern. One of the debtor's arguments was that the criminal conviction was invalid because it improperly stated the subject matter of the fraud. He argued that the investment was inevitably paid by a subsidiary, and therefore, he could not have failed to disclose an investment in Transwestern because it never existed. The court found the source of payment to be irrelevant and that the subject matter of the fraud was properly the debtor's investment in Transwestern.

Fraudulent concealment or transfer may exist where the legal interest in property is not in the estate, which retains only an equitable interest. Typically, such an equitable interest is in the continued use of an asset to which title has been transferred, as, for example, an automobile, or in the right to somehow regain possession. However, equitable interests may be created by reliance as well as when a debtor allows a creditor to rely on apparent corpo-

108. Id. at *9.
109. United States v. Grant, 971 F.2d at 809. The Grant court does state that de minimis value may be probative evidence of the absence of an intent to defraud. Although "there appears to be no appropriate correlation between the overall value of a debtor estate and the public policy favoring debtor protection of creditors from fraudulent debtor conduct, except perhaps in the rare event where the value of the estate (large or small) exceeds all possible claims against it." Id. at 809. See supra note 67 and accompanying text.
111. United States v. Weinstein, 834 F.2d 1454 (9th Cir. 1987); United States v. Moynagh, 566 F.2d 799, 803 (1st Cir. 1977), cert. denied, 435 U.S. 917 (1978).
112. See, e.g., United States v. McClellan, 868 F.2d 210 (7th Cir. 1989).
113. See, e.g., United States v. Martin, 408 F.2d 949 (7th Cir. 1969) (payments to lawyer and accountant of corporation refunded in part to defendants); In re Vecchione, 407 F. Supp. 609 (E.D.N.Y. 1976) ("systematic plan to nominally divest [bankrupt] of assets through sham intra-family transfers").
rate ownership of assets that are actually owned personally. Further, because the bankruptcy trustee may be able to use state law principals such as corporate piercing under the "alter ego" theory, fraud will arise when concealment or transfers involve property that can be reached by the trustee using those principles. Of course, when an asset is not titled in the bankrupt estate, a defendant may be able to argue that he acted in good faith and lacked fraudulent intent.

When a charge is brought for making a false oath in a bankruptcy proceeding, courts have inferred that materiality is an element of the offense. Just as property need not ultimately be determined to be part of the estate for concealment of it to be criminal, "materiality does not require a showing that creditors are harmed by the false statements . . . . Materiality is . . . established when it is shown that the inquiry bears a relationship to the bankrupt's business transactions or his estate, or concerns the discovery of assets, including the history of a bankrupt's financial transactions." Materiality is a question of law, and courts have generally construed it very broadly.

In United States v. O'Donnell, for example, the defendant said that he was employed when he was actually not employed. He argued that this was immaterial on the grounds that overstating his earning capacity could not harm creditors. The court held that even if these statements merely served to assure him of a particular forum, they were material.

Of course, § 152 includes deceptive practices that do not fall squarely under the heading of perjury. Written misstatements, such as failing to list an asset, as well as concealment or destruction of records, are all prohibited.

Courts have indicated that this requirement of full disclosure is a stringent one. A striking example of this is afforded in United States v. Weinstein in which the defendant claimed that his defense had been harmed by the accidental destruction by the trustee of crucial records. The court of appeals upheld the trial court in refusing to

117. See, e.g., United States v. Cherek, 734 F.2d 1248, 1255 (7th Cir. 1984) (Marovitz, J., dissenting).
119. Key, 859 F.2d at 1261 (quoting O'Donnell, 539 F.2d at 1237).
120. Key 859 F.2d at 1261.
121. O'Donnell, 539 F.2d at 1238.
believe that the defendant, a CPA and attorney, had not kept secondary records from which he could reconstruct the missing materials. Although in this case the defendant was not charged with destruction of records, the court clearly felt that he had not made full disclosure and that it was appropriate for him to bear any possible loss caused by the destruction.

B. Initiation of Investigation and Prosecution

The process for prosecuting a bankruptcy crime is relatively straightforward. The first step is usually taken by a bankruptcy official who refers a case to the United States Attorney for investigation. Alternately, an FBI investigation into an unrelated fraudulent scheme may discover bankruptcy fraud. In 1926, Congress first passed a form of the present § 3057 of the Criminal Code, requiring trustees, receivers, and referees to refer suspected violations of the bankruptcy laws to the United States Attorney for investigation and prosecution. This section has been referred to infrequently, and, judging by the number of bankruptcy fraud prosecutions, little heeded. Nevertheless, a court has observed that it represents "a congressional directive to the district offices of the United States Attorneys to become more active in the prosecution of bankruptcy fraud cases." Today, 18 U.S.C. § 3057 requires any "judge, receiver or trustee having reasonable grounds for believing that any violation of . . . [any law] relating to insolvent debtors . . . has been committed . . . [to] report to the appropriate United States Attorney all of the facts and circumstances of the case, the names of the witnesses and the offense or offenses believed to have been committed." If reported, the United States Attorney is required to conduct an investigation and report his finding to the bankruptcy judge. If it appears probable that an offense has been committed, then the United States Attorney is required to present the case to a grand jury, unless the attorney decides that the "ends of public justice do not require investigation or prosecution."

With all the mandatory language, one wonders why so few bankruptcy fraud cases are prosecuted. Perhaps one reason why § 152 basically remains an idle threat is that, even though § 3057 requires the United States Attorney to investigate upon a report, courts have

122. 834 F.2d 1454, 1463 (9th Cir. 1987).
125. Id. at 253.
127. Id. § 3057(a).
128. Id. § 3057(b).
129. Id.
found that § 3057 does not empower the bankruptcy court to force the United States Attorney to investigate. Another reason for the infrequency of reporting and investigation is the relatively burdensome standard a bankruptcy officer must surmount in order to initiate investigation. In *In re Parr*, the court found that reasonable grounds must be supported by facts, not suppositions. Bankruptcy courts have to piece together facts showing the crime. By the time such facts come to light, the requirement to report has vanished; because if the bankruptcy judge has already heard and tried the fraud in a civil court, there is no need to report.

The trend has been to attempt to settle all matters pertaining to a debtor within the jurisdiction of the civil courts, even when possible fraud is involved. *In re Parr* provides an example where a debtor apparently intentionally defrauded creditors and failed to provide the bankruptcy court with full disclosure of assets. The bankruptcy judge held the debtor in contempt and certified the case to the district court as was then necessary to levy a fine in excess of $250. A creditor in the case sought through a motion to have the court refer the case for criminal investigation. Inexplicably, the court held that it lacked the power to direct an investigation by the United States Attorney, and also that “reasonable grounds” did not exist for believing that the bankruptcy laws had been violated. While the conclusions of the appeals court in *Parr*, reversing the decision below, accord with the evidence of continuing legislative intent,

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131. Id.
134. Pursuant to form Bankruptcy Rule 920(a)(94), 28 U.S.C. § 1481, effectively repealed in 1984, restricted the criminal contempt power of bankruptcy judges and called for certification of such matters to the district courts, but the 1984 amendments to the Judicial Code, 28 U.S.C. § 152-57, made bankruptcy judges judicial officers of the district court, potentially allowing them to punish civil and criminal contempt. The Advisory Committee Note to the 1987 Amendments to the Bankruptcy Rules indicates an intent to limit the authority of bankruptcy judges to punish for contempt, but decisions are divided on precisely what contempt powers remain with the bankruptcy judges. *Compare In re Kennedy*, 80 B.R. 674 (Bankr. D. Del. 1987) (1987 amendment to Rule 920 allows bankruptcy court to determine civil contempt and punish to enforce compliance) *with Plastiras v. Idell* (*In re Sequoia Auto Brokers Ltd., Inc.*), 827 F.2d 1281 (9th Cir. 1987) (bankruptcy judge must certify facts to district court for *de novo* review of contempt), superseded by statute in *Caldwell v. Unified Capital Corp.* (*In re Rainbow Magazine, Inc.*, 77 F.3d 278 (9th Cir. 1996) (stating that 1987 amendments to the Bankruptcy Rules change result from *Sequoia*); *I.A. Durbin, Inc. v. Jefferson Nat'l Bank*, 793 F.2d 1541 (11th Cir. 1986) (contempt determination is *res judicata* in core proceedings, not binding in non-core proceedings).
135. *In re Parr*, 13 B.R. at 1020. The motion by the creditor sought referral of the case to the Suffolk County District Attorney as well. The court denied this on the grounds that if it lacked the authority to do so, and on appeal this holding was sustained.
many courts remain disinclined to further that intent, as shown by
the comparatively infrequent criminal investigations they order. In
particular, creditors moving for investigations on grounds similar to
those in Parr have met with little success.136 It is not surprising that
in recent years creditors have turned to self help, taking advantage
of the broad scope of the RICO statutes to prosecute actions against
fraudulent debtors.137 Of course, civil RICO allows for punitive
damages, an added motivation for a creditor to bring charges if the
party committing the fraud retains assets apart from the bankrupt
debtor.

Referral of a case for investigation will not necessarily lead to
prosecution, and it does not confer jurisdiction upon any particular
court. However, the Bankruptcy court has no authority to refer
cases to state authorities,138 who prefer in any case to defer to fed-
eral criminal laws in the bankruptcy area. Investigation by the FBI
for a federal crime under § 152 will bring the case into a federal
district court, but the FBI has a $50,000 declination policy.139 As a
result, many bankruptcy crimes that might be prosecuted under both
state and federal law cannot, as a practical matter, be brought into
either system.140

Perhaps another reason that bankruptcy fraud crimes go relatively
unprosecuted is because of the enormous loads that those entrusted
with its enforcement are expected to shoulder, while at the same
time, search for fraud. At the forefront is the bankruptcy trustee
and the bankruptcy court. Logically, they are the first line of
defense because they are the first line of neutral, disinterested per-
sons. Moreover, they ideally serve as a good initial filter because
they theoretically look at each individual bankruptcy. This is espe-
cially true for the trustee who reviews each debtor’s petition and
schedules to look for assets. However, use of these overly burdened
public servants as the front line has its problems. The bankruptcy
system handles literally hundreds of thousands of cases each year,
particularly in the consumer bankruptcy arena.141 For the fiscal year
that ended on September 30, 1995, according to statistics released by
the Administrative Office of the United States Courts, 883,457

136. See In re Featherworks Corp., 36 B.R. 460 (E.D.N.Y. 1984) (debtors acted on
advice of attorneys, “among the most respected lawyers appearing in this court,” so
no evidence of fraudulent intent; creditor's motion for referral of § 152 charge denied).
137. See infra notes 228-29 and accompanying text.
139. The $50,000 floor, as high as it may sound, is probably not even accurate. An
anonymous government official has been quoted as stating that the United States
Attorneys will not prosecute bankruptcy fraud cases involving less than $100,000. Maggs,
supra note 9, at 7.
140. See Alan Sbarium, Bankruptcy Fraud, 6 NABTALK 11 (1990).
141. The increase in federal bankruptcy cases are in the non-business, consumer area.
Its increase more than offsets the slight decrease in business bankruptcy filings. News of
bankruptcy cases were filed in federal bankruptcy court. That is a 5.5 percent increase over fiscal year 1994, when 837,797 cases were filed. In the following three months of 1996, filings totaled 233,593, up from the 208,187 bankruptcy cases filed in the same months of 1995.\textsuperscript{142} In processing these bankruptcies, trustees distribute billions of dollars to creditors, and bankruptcy courts discharge billions of dollars in unpaid debts.\textsuperscript{143} A fraud is by nature a cover-up, requiring time to investigate the facts of the case on a level sufficient to find it. With the case load that these persons already carry, that kind of circumspection proves to be impossible.

C. CONSTITUTIONAL CONSIDERATIONS IN SECTION 152

PROSECUTIONS

When a case is referred for investigation, the possibility of criminal charges brings into play the constitutional considerations that apply in all criminal cases. For example, the Sixth Amendment right to counsel may protect documents given to an attorney. However, these rights attach only when the case "proceed[s] from the investigative to the accusatorial stage."\textsuperscript{144} They do not apply to protect documents given to an attorney during the civil bankruptcy proceedings: "there is no constitutional right to counsel in civil cases on which to hang a CONSTITUTIONAL attorney-client privilege."\textsuperscript{145}

Because bankruptcy fraud investigations ordinarily develop as outgrowths of other forms of legal action, defendants have been able to claim in various ways that their constitutional rights have been violated. Such attempts have been generally unsuccessful. When civil bankruptcy proceedings have already been instituted, delay before criminal charges are brought, for example, does not violate a defendant's rights to a speedy trial.\textsuperscript{146} Just as \textit{Miranda} warnings have been held to be unnecessary during bankruptcy proceedings before actual investigation for fraud has begun,\textsuperscript{147} courts have allowed prosecutors to use evidence procured through discovery in civil proceedings which lead to criminal fraud actions. One defendant moved for suppression of evidence against him that a trustee had procured through court order. The defendant character-

\textsuperscript{142} \textit{Id.}
\textsuperscript{143} Maggs, supra note 9, at 2.
\textsuperscript{144} United States v. White, 879 F.2d 1509 (7th Cir. 1989).
\textsuperscript{145} \textit{Id.} at 1513 (emphasis in original). \textit{See} United States v. Jackson, 836 F.2d 324 (7th Cir. 1987) (no need during initial bankruptcy hearings to give \textit{Miranda} warning of possible criminal proceedings).
\textsuperscript{146} United States v. Filiberti, 353 F. Supp. 252 (D. Conn. 1973) (holding that 18 U.S.C. § 3057, requiring United States Attorney to present matter of bankruptcy fraud to grand jury "without delay," does not confer procedural rights on defendant, and that Sixth Amendment rights to speedy trial does not apply to preindictment delay) (citing United States v. Marion, 404 U.S. 307 (1971)).
\textsuperscript{147} \textit{Id.} at 252.
ized the trustee as acting as the "cat's paw" for the prosecution and charged that the prosecution involved "the abuse of administrative process [involving] [t]he deliberate use by the government of an administrative warrant for the purpose of gathering evidence in a criminal case."148 The court rejected this argument, holding that the record did not "manifest an appeal in bad faith to the bankruptcy court or an impermissible degree of cooperation with the prosecution that would taint the evidence and prevent its consideration."149

Evidence of bankruptcy fraud may also be drawn from other criminal investigations. For example, in United States v. Murray,150 FBI agents made a search of the defendant's home in connection with a tax evasion investigation. The agents were aware of a concurrent investigation for bankruptcy fraud, and when they saw boxes of stereo equipment that were apparently assets of a bankrupt business, they telephoned the prosecuting attorney to find whether these might be evidence of concealment. Later, the defendant moved for suppression of the evidence as unlawfully seized, but the court ruled that it was admissible under the "plain view" doctrine.

D. IMMUNIZED TESTIMONY

Another potential problem typical of criminal cases derives from provisions for immunized testimony. Under the Bankruptcy Act, testimony from the debtor was compelled and immunity was automatically extended to him for oral testimony.151 Because this immunity was limited to direct use of testimony and did not protect against derivative use leading to discovery of other incriminating evidence, it was held to provide less protection than that guaranteed by the Fifth Amendment.152 Thus, a debtor could refuse to testify on constitutional grounds; on the other hand, a debtor who did testify might find that his testimony was not fully immunized and that he had waived his right to protection.153 In 1970, the Organized Crime Control Act provided for a broader immunity,154 coextensive with that of the Fifth Amendment, and in conjunction with testimony in bankruptcy proceedings.155 This had the salutary effect of

149. Id. at 94.
150. 751 F.2d 1528 (9th Cir. 1985), cert. denied, 474 U.S. 979 (1985).
155. See United States v. Seiffert, 463 F.2d 1089 (5th Cir. 1972). See also Annotation, Construction and Application of provision of § 7(a)(10) of Bankruptcy Act (11 U.S.C. § 25
empowering courts to compel testimony. Unfortunately, it also provided a blanket immunity for nearly all testimony, and it shifted the prosecution in bankruptcy fraud cases the burden of proving that none of its evidence was derived from protected sources.

The Bankruptcy Code takes a different approach to the problem of immunity. Rather than providing for blanket immunity, it grants no automatic immunity at all and gives the court the power to compel testimony on a grant of immunity when necessary, in accordance with federal criminal law. "If a party in interest feels that the debtor has not been forthright in disclosing assets or in his or her responses to questions in the required disclosures, that party may examine the debtor under oath regarding any omission or error." Bankruptcy Code § 542 provides that:

after notice and a hearing, the court may order an attorney, accountant or other person that holds recorded information, including books, documents, records or papers relating to the debtor’s property or financial affairs, to turn over or disclose such information to the trustee.

Thus, all testimony and evidence produced during bankruptcy proceedings will be available for use in a criminal fraud prosecution unless the witness specifically invoked his Fifth Amendment privilege and was given immunity in order to compel his testimony. Besides making a much greater range of evidence available for

(a)(10), as amended, that no Testimony given by bankrupt in bankruptcy proceedings, nor any Evidence directly or indirectly derived from such Testimony, Shall be Offered in Evidence Against Him in any Criminal Proceeding, 22 A.L.R. FED. 643 (1972).

156. Of course, false testimony remained admissible for us in later perjury prosecution, and in certain situations, testimony may be available for impeachment purposes. See United States v. Moss, 562 F.2d 155 (2d Cir. 1977).

157. See, e.g., United States v. Beery, 678 F.2d 856 (1982) (trustee witness at grand jury hearing and trial; burden on government to prove evidence was derived from legitimate independent sources if defendant can show he was required to give testimony) (citing Kastigar v. United States, 406 U.S. 441 (1972) (“One raising a claim under this statute [18 U.S.C. § 6002] need only show that he testified under a grant of immunity in order to shift to the government the heavy burden of proving that all of the evidence it proposes to use was derived from legitimate independent sources”)).


160. 11 U.S.C. § 542. Burris cites that the defense of attorney-client privilege in a bankruptcy setting is unclear under current law and is left to be determined by the courts on a case by case basis. Burris, supra note 159, at 32. However, courts can find a lawyer’s advice discoverable if the advice falls within crime/fraud exception to the attorney-client privilege. Id. (citing United States v. Ballard, 779 F.2d 287 (5th Cir.), cert. denied, 475 U.S. 1109 (1986); United States v. Zolin, 491 U.S. 554 (1989) (The attorney-client relationship ceases to protect future wrongdoing). “The Debtor’s actions that lead to . . . prosecutions from bankruptcy fraud could fall within” this fraud and crimes exception to the privilege. Id.

161. United States v. Jackson, 836 F.2d 324 (7th Cir. 1997).
fraud prosecutions, the approach taken by the Code ensures that the state will only lose its ability to use testimony following an explicit decision to grant immunity. In the past, when evidence of a fraud was inadvertently developed in a bankruptcy hearing, subsequent prosecution often became impossible because of a lack of admissible evidence. Now, a debtor can no longer rely on this shield. Presumably, in cases involving egregious fraud, bankruptcy courts may choose to refrain from compelling testimony in exchange for immunity to ensure a better case in a related criminal prosecution.

The Code, therefore, makes prosecutions for fraud easier from an evidentiary standpoint. Because evidence developed in bankruptcy proceedings is now available for later use in prosecutions, officials involved in civil actions should remain mindful of the effect their actions may have on subsequent criminal proceedings. For example, the loss of records\textsuperscript{162} or their routine destruction at the end of a bankruptcy case may weaken a prosecutor's case, or give a defendant grounds for a due process complaint.\textsuperscript{163} Of course, when a debtor perjures himself or herself and commits a continuing fraud by failing to disclose assets, that is evidence of a new crime that may be used even if the testimony originally had immune status.\textsuperscript{164}

E. Jurisdiction, Venue and Limitations

The close relationship between civil bankruptcy and criminal fraud affects matters of jurisdiction and venue. As a criminal matter, a fraud prosecution is not within the jurisdiction of the bankruptcy court, but that of federal district court.\textsuperscript{165} Early decisions

\textsuperscript{162} In United States v. Weinstein, 834 F.2d 1454 (9th Cir. 1987), records were accidentally destroyed when the trustee changed offices. The court rejected the defendant's motion to reverse his convictions after considering the "quality of the Government's conduct and the degree of prejudice to the accused." United States v. Roberts, 779 F.2d 565, 569 (9th Cir.), cert. denied, 479 U.S. 839 (1986). Specifically, it focused on the "incredible" contention by the defendant—a lawyer and CPA—that he had kept no secondary records of his investments.

\textsuperscript{163} See United States v. Feldman, 425 F.2d 688 (3d Cir. 1970), in which a trustee recommended an investigation of the debtor on the grounds of concealment of assets. The trustee then destroyed records in his possession without giving notice to the debtor. The court found that this probably did not result in prejudice giving rise to a due process claim, but noted that "At the least, [the government] should see that such records are offered to any potential defendant, with the clear admonition that prosecution is being considered, before they are destroyed." \textit{Id. at 690 n.2.}

\textsuperscript{164} See United States v. Moss, 562 F.2d 155, 154 (2d Cir. 1977) (citing Glickstein v. United States, 222 U.S. 139 (1911); Bryston v. United States, 396 U.S. 64 (1964)). \textit{See 2 Collier on Bankruptcy \S 344} (Lawrence P. King et al. eds., 15th ed. 1996), for a review of the development of the doctrine of immunity in bankruptcy proceedings, and a summary of the criminal law provisions governing under what circumstances a debtor may assert his privilege against self-incrimination.

\textsuperscript{165} This is so even when the action for fraud takes the form of a civil RICO claim. \textit{See} Rubin Bros. Footwear, Inc. v. Chemical Bank (\textit{In re} Rubin Bros. Footwear, Inc.), 73 B.R. 346 (S.D.N.Y. 1987), in which a RICO defendant sought unsuccessfully under 28
had held that concealment must be “done somewhere,” and that “there and there alone has the court jurisdiction of the offense.”

More recently, courts have recognized that the physical location of assets does not determine the locus of the fraud. “A man who is not in bankruptcy may have buried treasure all over the world. He commits no offense.” The offense of concealment is one against the trustee, and it falls within the jurisdiction of the court where the trustee is located.

Because the situs of the bankruptcy controls jurisdiction in bankruptcy fraud cases, evasion of prosecution is rather difficult. In *Stegeman v. United States*, the defendants transferred assets from Oregon to Canada and fled there to escape creditors. Involuntary bankruptcy occurred shortly thereafter. The court held that “[t]o exclude concealment by debtors outside the United States from the statute’s [§ 152] coverage would frustrate the statute’s purpose by creating an obvious and readily available means of evasion.” Further, it was not necessary to personally serve the debtors with an order to file a schedule of assets. Finally, statements made by the defendants to an FBI agent in Canada were admissible despite the lack of *Miranda* warnings because the defendants were not in custody at the time. Thus, § 152 creates a powerful enforcement tool for use against persons who flee creditors in an effort to abandon their obligations.

Just as concealment takes the venue of the trustee rather than that where the assets involved are located, the offense dates from the time of bankruptcy, not from the initial time of concealment. The Criminal Code states that “[t]he concealment of assets of a bankrupt or other debtor shall be deemed to be a continuing offense until the debtor shall have been finally discharged or a discharge denied, and the period of limitations shall not begin to run until such final dis-

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U.S.C. § 157(d) to remove the case to bankruptcy court because it was not brought under a law “regulating . . . interstate commerce.”


168. *Id.* at 884. Here assets were taken from Illinois to New Jersey, where they were found in a safe deposit box. The assets were never in Pennsylvania, where the defendant filed his bankruptcy petition, but the court held that Pennsylvania was where the concealment occurred. In a like manner, a building which could not be physically hidden would be concealed if a debtor failed to inform the trustee of its whereabouts, in which case the concealment would more obviously occur where the trustee was. The court likens such a concealment to the debtor standing in Pennsylvania in the line of sight of the trustee, preventing him from seeing assets lying across the New Jersey state line. See, e.g., *United States v. Gordon*, 379 F.2d 788 (2d Cir.) (venue is situs of trustee), *cert. denied*, 389 U.S. 927 (1967); *United States v. Martin*, 408 F.2d 949 (7th Cir.) (following *Schireson*; venue for concealment is where nondisclosure occurred), *cert. denied*, 398 U.S. 824 (1969).


charge or denial of discharge."{171} A waiver of discharge will also start the period running.{172} Thus, prosecutions for bankruptcy fraud may be brought any time within five years following determination of dischargeability.{173}

It is worth noting that the treatment of concealment as continuing offenses for purposes of limitations has application in other areas of bankruptcy, as well. In In re May,{174} for example, the court held that a transfer occurring more than twelve months prior to the bankruptcy petition could constitute a continuing concealment through the prepetition period, and thus, become a bankruptcy crime under § 152:

Acts producing legal effects may take some time to complete . . . . If their legal effect does not take place until within the twelve month period, they will be regarded as having occurred within that period. This is particularly true in regard to concealment which is treated as a kind of continuing wrong. The discharge will be denied if a concealment which commenced before the twelve month period continues within the period.{175}

On this basis, the court denied discharge and also referred the matter to the United States Attorney.{176}

F. Multiple Counts

When a defendant appears to have committed bankruptcy fraud, it is not always clear how many separate violations occurred or how many charges he may have to defend. This ambiguity has several causes. First, while the separate paragraphs of § 152 define separate crimes, these crimes often merge and cannot support separate convictions. As one court held, "saying that one has $5 when one has $10 is both a false statement and a concealment"—but it cannot sup-

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174. 12 B.R. 618 (N.D. Fla. 1980) (reviewing earlier denial of discharge based on fraud, following which matter was referred for investigation, not an issue in reported opinion).
175. Id. at 624-25 (citing 1 Cowans, BANKRUPTCY LAW AND PRACTICE, §§ 122, 123, 1247 (2d ed. 1978)).
176. Id. at 622-23. The court noted that under prior § 14(c)(91) of the Bankruptcy Act, still applicable to the case, discharge could also have been denied based on the § 152 violation which the Act incorporated as a ground for denial. Under Bankruptcy Code § 727(a)(4), acts which would be bankruptcy crimes will bar discharge, but the section does not incorporate § 152 itself.
port two convictions.\textsuperscript{177} Second, in many cases, the assets that are concealed are multiple. Finally, concealment may take place on several different occasions. Courts now routinely find separate offenses in the latter instance, but view as a single offense a one-time concealment that involves multiple assets.\textsuperscript{178}

This leads, at times, to anomalous results. In one case, for example, a debtor who entered into an arrangement to transfer title to two automobiles to his father committed only one crime even though the actual transfers of title took place on two dates: "when the impulse is single, but one indictment lies, it does not matter how long the action may continue. If successive impulses are separately given, even though all unite in swelling a common stream of action, separate indictments lie."\textsuperscript{179} Yet in another case citing the same Supreme Court passage, a court held that a debtor who concealed two automobiles could be convicted of two separate offenses although he claimed to have a "sole" objective in mind because he acted at separate times.\textsuperscript{180}

However, the rationale underlying these decisions is a reasonable one. "Surely, if an accused should conceal a dining room set, a china set, or one thousand silver dollars belonging to the estate of the bankrupt, his offense of failure to reveal or disclose would not be multiplied by the number of separate items concealed."\textsuperscript{181} Thus, a violation of a duty to disclose remains singular despite the number of assets involved. Balanced against this, however, is the concern that each subsequent act must be a separate offense lest "a defendant who has committed a first concealment [be allowed] to steal more on the theory that he would never become a sheep but always remain a lamb."\textsuperscript{182}

Although courts do not observe the distinction strictly, there is a tendency to treat most concealment prior to a petition as a single offense, and to consider post-petition concealment and transfers as

\begin{itemize}
\item \textsuperscript{177} United States v. Montilla Ambrosiani, 610 F.2d 65 (1st Cir. 1979), cert. denied, 445 U.S. 930 (1980). In this case, the defendant, a debtor in possession, was charged, \textit{inter alia}, with nine counts of fraud for failure to report monthly receipts which he rerouted to his personal account, and with one count of concealing the entire amount from the court and creditors. \textit{See supra} note 15 for cases dealing with merger of separate counts.
\item \textsuperscript{178} United States v. Haymes, 610 F.2d 309 (5th Cir. 1980) (several acts may be coupled together into one count that will support a guilty verdict); Bisno v. United States, 299 F.2d 711 (9th Cir. 1961), cert. denied, 370 U.S. 952, \textit{reh'g denied}, 371 U.S. 855 (1962) (several different items concealed does not amount to multiple offenses).
\item \textsuperscript{179} United States v. McClellan, 868 F.2d 210, 213 (7th Cir. 1989) (citing Blockburger v. United States, 284 U.S. 299, 302 (1932)).
\item \textsuperscript{180} United States v. Melton, 763 F.2d 401 (11th Cir. 1985).
\item \textsuperscript{181} Edwards v. United States, 265 F.2d 302, 206 (9th Cir. 1959).
\end{itemize}
separate offenses. 183 Separate transfers made in contemplation of bankruptcy, on the other hand, are more likely to be treated as separate offenses. 184

To an extent, making a distinction between separate offenses may seem an empty gesture because, in most cases, where convictions occur on multiple counts, courts give concurrent sentences, thus producing the same effect that a single conviction would have given. 185 Seldom do aggregate sentences for several counts exceed the statutory maximum of one year imprisonment and a fine of $5,000.00. 186 In fact, courts have expressly recognized that determining the precise number of offenses is often a moot point. 187 Nevertheless, the ability to bring action on multiple counts does increase the potential penalty, a possibility perhaps especially significant in cases where fines are imposed. 188

Courts are now beginning to consider this problem of multiple counts under the constitutional doctrine of double jeopardy. In United States v. Christner, 189 the defendant was sentenced to concurrent eighteen month terms of imprisonment for three charges of bankruptcy fraud. First, the defendant was charged with illegally

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184. See, e.g., United States v. Haymes, 610 F.2d 309 (5th Cir. 1980) (defendant charged with 40 counts, convicted of 28 counts for transfers from failing corporation).

185. See, e.g., United States v. Center, 853 F.2d 568 (7th Cir. 1988) (attorney who assisted corporation in effecting bankruptcy fraud convicted on two counts of falsifying and making false entries in document affecting or relating to affairs of a debtor; sentenced two concurrent terms of imprisonment of a year and a day each, with all but four months suspended, balance to be served on probation); Metheny v. United States, 390 F.2d 559 (9th Cir.), cert. denied, 393 U.S. 824 (1968). Cf. United States v. Melton, 763 F.2d 401 (11th Cir. 1985) (two counts of fraud for concealing two automobiles on separate occasions, consecutive sentences given). See also United States v. Butler, 704 F. Supp. 1351 (E.D. Va. 1989) (sentences for bankruptcy fraud to run concurrently with each other, but consecutively with other counts for wire fraud, RICO violation, and RICO conspiracy); United States v. Montilla Ambrosiani, 610 F.2d 65 (1st Cir. 1979), cert. denied, 445 U.S. 930 (1980); United States v. Weichert, 89 B.R. 346 (S.D.N.Y.), aff'd, 862 F.2d 305 (2d Cir. 1988).

186. The last unnumbered paragraph of 18 U.S.C. § 152 (1994) provides that offenders "shall be fined not more than $5,000 or imprisoned not more than five years, or both."

187. See United States v. Klupt, 475 F.2d 1015, 1016 n.2 (2d Cir. 1973): "In view of the mildness of the sentences imposed, we withhold any comment as to the appropriateness, on the facts of this case, of a ten-count indictment."

188. United States v. Moss, 562 F.2d 155 (2d Cir. 1977) (eleven counts of bankruptcy fraud under §152 and one count of conspiracy to violate §152; defendant sentenced to two years imprisonment on each count with eighteen months suspended, all twelve counts to run concurrently; and also fine of 5,000 on each count, giving total fine of $12,000 (appeals court found conviction only possible on seven counts, giving possible fine of $7,000 on remand); United States v. Haymes, 610 F.2d 309 (5th Cir. 1980) (29 concurrent three-year sentences, total fine of $14,500).

189. 66 F.3d 922, 927 (8th Cir. 1995).
transferring funds to his wife's account. Second, the defendant was charged with selling collateral, depositing the proceeds into a personal account, and then transferring those proceeds into a different third-party account. Third, the defendant was charged with failing to account for the sales and the two transfers in a periodic report to the bankruptcy court. The court, in finding that the defendant could be charged for all three, but not separately sentenced for all three, found:

The yardstick in determining whether there is . . . multiplicity is whether one offense of separate offenses are charged, and . . . this is a difficult and subtle question. The test announced most often in cases that offenses are separate of each other requires proof of an additional fact that the other does not. This seems of little value as a test. The real question is one of legislative intent, to be ascertained from all the data available. . . . First, a court must ask whether Congress "intended that each violation be a separate offense." . . . If it did not, there is no statutory basis for the two prosecutions, and the double jeopardy inquiry is at an end. . . . Second, if Congress intended separate prosecutions, a court must then determine whether the relevant offenses constitute the "same offense" within the meaning of the double jeopardy clause. . . . "The double jeopardy bar applies only to prosecutions or convictions which cannot survive the 'same elements' test." 190

Upon review of the statutory language, the court found that Congress intended that an act of intentionally concealing property of the bankruptcy estate and the act of knowingly making a false statement to the bankruptcy court under penalty of perjury constitute two separate offenses. Moreover, the court found that counts I and II required the proof of concealment, while count III did not. The court distinguished the facts of its case from that of United States v. Montilla Ambrosiani. 191 In that case, the court found that making false entries on a monthly bankruptcy report and the unlawful concealment of funds received and deposited by the defendant constituted one offense. According to the court in Christner, the fraud was based on the exact same acts of non-disclosure. 192

190. Id. at 926-28.
192. Christner, 66 F.3d at 929. For other cases involving questions of multiple counts and double jeopardy, see, United States v. Graham, 60 F.3d 463 (8th Cir. 1993) (separate false statements may be charged in separate perjury counts if they require different factual proof of their falsehood, notwithstanding their relationship to common nexus of fact, but if government, in proving one case has inadvertently proven all of them, then double jeopardy is violated. Transamerica Premier Ins. Co. v. Chaplin (In re Chaplin), 179 Bankr. 123 (E.D. Wis. 1995) (Discharge of bankruptcy and then criminal prosecution is permissible under double jeopardy as discharge is civil in nature and did not involve imprisonment or penalty).
IV. ROLE OF SECTION 152 IN THE BANKRUPTCY SYSTEM

Particularly in this new decade, which has shown a marked increase in bankruptcies, it seems that placing burden on bankruptcy trustees to police fraud by seeking after hidden assets is futile. Trustee's and courts may attempt to provide remedies for creditors after such frauds occur, but equally important is prevention through enforcement of criminal penalties. Fortunately, no new legislation is required to control bankruptcy fraud (nearly all looters could be effectively prosecuted under the prohibitions of § 152 against transfer and concealment of assets in contemplation of a case under Title 11).\(^{193}\)

It is particularly regrettable that most bankruptcy fraud prosecutions occur for fraud that is also prohibited by non-bankruptcy law, while crimes directly against the bankruptcy system frequently go unprosecuted. Where § 152 has its most significant application, it has remained unenforced, while it has been used more freely to add additional charges in cases where its presence has been less crucial. Unfortunately, prosecutions for bankruptcy crime under § 152 have been infrequent where the fraud is committed directly against the court, the trustee, and the creditors, and where the bankruptcy statutes may provide the exclusive ground for prosecution.

Bankruptcy fraud involving a debtor who attempts to keep assets from the reach of the court commonly results in measures falling short of prosecution. Obviously, such assets may be recovered for the benefit of the creditors as fraudulent conveyances.\(^{194}\) Further, such fraudulent behavior may also cause the court to deny discharge of debts.\(^{195}\) These results, however, must be viewed as essentially remedies for the creditors rather than as penalties. Demanding that a debtor restore to the estate assets he has appropriated will help make up what has been stolen, but it leaves the debtor no worse off than he would have been had he originally surrendered the assets. He risks nothing by attempting to hide assets that may later be recovered. At the same time, there is a substantial risk to the cred-

\(^{193}\) An interesting example of looting punishable as a bankruptcy crime occurs in *United States v. Overmyer*, 867 F.2d 937 (6th Cir.), cert. denied, 493 U.S. 813 (1989). In *Overmyer*, the defendant had been drawing substantial assets from a warehousing company after it had gone in Chapter 11. To account for these missing assets, he filed a proof of claim based on a restructured equipment lease at an inflated price. Charged with six counts of bankruptcy fraud, two counts of conspiracy to commit bankruptcy fraud, and one count of mail fraud, he was only convicted on the charge for filing a false proof of claim.


\(^{195}\) Specific debts incurred through fraud are excepted from discharge by § 523(c) of the Bankruptcy Code, and discharge in general may be denied in cases of fraud in cases under Chapters 7 and 11 pursuant to § 727(a) and (d), and § 1141(d)(3)(C).
tors that such assets may be depleted or rendered inaccessible by transfers to bona fide purchasers.

For similar reasons, denial of discharge does not present a substantial deterrent to a debtor who hides assets. In many cases, of course, the named debtor is simply a corporate shell, and denial of discharge is inapplicable. Unless the trustee is able to pierce the corporate veil or to obtain judgments to recover substantial fraudulent conveyances, the parties controlling the insolvent corporation may escape with their credit intact, and quite possibly with some or all of the assets they have transferred from the debtor, and indirectly stolen from the creditors.¹⁹⁶

Stated bluntly, the relationship between civil remedies in bankruptcy and prosecution under § 152 is the same as that between actions for civil conversion and criminal theft. Within certain bounds, civil remedies aimed at restitution and reparation best protect the interests of the victim. When a person intentionally ignores the property rights of others, he also violates social norms, and the law imposes criminal sanctions to punish and deter such conduct. A tender of stolen property may suffice to compensate the victim of theft, but it does not satisfy the outrage to society, which is offended not by the particular harm but by the prohibited behavior itself and the likelihood of its repetition.

Unfortunately, bankruptcy courts have always been concerned principally with protection of existing creditors, and they lack even the jurisdictional power to punish those who commit criminal fraud. On the other hand, for whatever reason, bankruptcy courts have been slow to refer such cases to authorities with power to prosecute, and those authorities have been reluctant to interfere in what they perceive properly as the business of the bankruptcy courts.

The generalization that bankruptcy fraud is infrequently prosecuted is difficult to quantify because no accurate estimates exist as to the true frequency of criminal violations. As noted earlier, it is nevertheless incredible that out of nearly 883,457 bankruptcies filed in 1995, only one hundred and fifty eight criminal complaints were filed.¹⁹⁷ Indeed, over the last several decades few cases involving bankruptcy fraud appear in the appellate reporters—and the personal impact of criminal convictions in general should be expected to result in a high percentage of appeals in most criminal cases. Most bankruptcy practitioners will also agree that prosecutions for fraud are rare.¹⁹⁸

¹⁹⁶. Excusing controlling persons from liability for bankruptcy fraud—which is the true effect of failure to prosecute—contrasts with the policy of automatically reaching through the corporate veil to impose liability on such persons in cases of securities fraud and unfair trade practices.
¹⁹⁷. See supra note 9.
¹⁹⁸. See, e.g., Sibarium, supra note 140, at 11, commenting on the small number of prosecutions. Sibarium cites an informal survey of attorneys and government officials.
When fraud or bankruptcy crimes are mentioned, it is generally in the context of a question as to dischargeability. An electronic search of recent cases illustrates this impression. Out of a total in all federal reporters of 178 cases that mention both fraud and denial of discharge, only five of them also mentioned crime or prosecution, and of these, only one involved an actual prosecution.¹⁹⁹ That single case was in 1956, and, ironically, it led to acquittal on appeal.

A similar search of recent bankruptcy cases which simply mention § 152 shows that only a third of these cases involved prosecutions.²⁰⁰ More often, this section is merely referred to in passing, and it is often used to support a denial of discharge. For example, of sixty-four cases involving denial of discharge in which § 152 was mentioned, only a single case mentioned criminal prosecution.

The low incidence of prosecution for bankruptcy fraud reflects a tension between actual practice and the mandate of Congress.²⁰¹

¹⁹⁹. The LEXIS search of federal cases employed was: BANKRUPT! W/50 FRAUD W/25 DISCHARGE! W/5 DEN!; adding at second level: 2/50 (PROSECUT! OR CRIM!). The search produced 178 cases at the first level and 6 at the second level. Obviously, these numbers are not perfectly accurate, but they do serve to show the infrequency of prosecution. Of the six cases found at the second level, one had nothing to do with bankruptcy. Othonson v. Department of Justice, Immigration & Naturalization, 711 F.2d 267 (D.C. Cir. 1983) (footnote referring to res judicata effect of bankruptcy crime conviction in subsequent denial of discharge proceeding). Three cases involved denial of discharge based on fraud but did not involve criminal action under § 152. Oberst v. Oberst [In re Oberst], 91 B.R. 97 (Bankr. C.D. Cal. 1988) (characterizing denial of discharge as the “harshest sanction in bankruptcy” and suggesting it should require “almost criminal” level of behavior); CPI Oil Refining v. Dennis [In re Dennis], 78 B.R. 1012 (Bankr. N.D. Ala. 1987) (prior wire fraud conviction evidence to deny discharge; In re Orenduff, 226 F. Supp. 312 (N.D. Okla. 1964) (discharge revoked because of conduct sufficient to constitute crime under § 152). Only a single case as a prosecution under § 152 concealing assets. United States v. Camp, 140 F. Supp. 98 (D. Haw. 1956). Finally, one case involved a dispute whether objection to discharge had been timely made. In re Schwartz & Meyers, 64 B.R. 948 (Bankr. S.D.N.Y. 1986).

²⁰⁰. The LEXIS search at the first level was: BANKRUPT! W/50 (§ 152 or SEC. 152 OR SECTION 152); at the second level the modifiers added were: W/50 (CRIM! OR PROSECUT!). This search yielded 399 cases at the first level and 142 at the second level. Most of the cases at the second level involved the United States as a plaintiff, while those cases found at the first level only were for the most part adversary proceedings involving debtors and creditors or the trustee. While the results of this search are only approximate, they do indicate that § 152 is invoked twice as frequently for evidence for denial of discharge as it is used to provide a basis for prosecution.

²⁰¹. Mac.Lachlan, U.S. Trustees Have Few Fans, Nat'l L.J., Oct. 29, 1990, 1-35, esp. at 35, cols. 3-4, reflects the general impression that bankruptcy fraud prosecution receives low priority, noting that prosecutors prefer to deal with “real crimes” rather than serving as “collection agents.” Despite this, Joseph M. Whittle, chairman of the Attorney General's Advisory Committee, asserts that bankruptcy crime is vigorously prosecuted. Id. In questioning the effectiveness of the United States Trustee program, Mac.Lachlan notes that simply keeping up with the numerous Chapter 7 filings will probably prevent United States Trustees from performing other duties such as investigating fraud.
Even among the relatively few cases in which bankruptcy courts consider the possibility of prosecution, the courts most often display a real reluctance to exercise their power to refer cases for prosecution.\textsuperscript{202} In \textit{In re Schwartz & Meyers}, for example, the court ignored part of a letter from an attorney recommending that the case be referred for prosecution.\textsuperscript{203} When courts decline to refer cases for criminal investigation, the matter will likely end there because no party will usually have an interest in pursuing it on appeal. For this reason, few appellate decisions set out guidelines indicating under what circumstances such references should be made. This is both indicative of the courts' lack of interest in referring cases for investigation and a possible cause for the attitude that such referrals are not mandated.

As noted, already, the court in \textit{Flushing Savings Bank v. Parr (In re Parr)} expressly rejected this attitude.\textsuperscript{204} There, a creditor bank appealed a number of issues, one of which was the bankruptcy court's failure to request the United States Attorney and Suffolk County District Attorney to investigate possible criminal violations under 18 U.S.C. § 3057. The court had denied the bank's motion for an investigation on the grounds that: (1) the court lacked the power to direct an investigation, (2) reasonable grounds did not exist for believing the bankruptcy laws had been violated, and (3) the court lacked authority to order the county district attorney to investigate.\textsuperscript{205} While the district court agreed that the referral to the state authorities was beyond the powers of the court, it emphasized the

\textsuperscript{202} Lack of judicial concern with bankruptcy crimes may go even further than that, in that some courts appear reluctant to give force to § 152 even when offenses are prosecuted. In United States v. Overmyer, 867 F.2d 937 (6th Cir. 1989), for example, a voluminous record showed probable looting of substantial funds from a bankruptcy corporation, and a systematic plan designed to conceal the looting through filing of a false claim. The jury found the defendant guilty, but the district court granted a motion for acquittal. The appeals court reversed and reinstated the jury verdict, noting that "[t]he jurors are to be commended for "seeing through" defendant's elaborate paper chase." Id. at 955.

\textsuperscript{203} 64 B.R. 948 (Bankr. S.D.N.Y. 1986). One issue in \textit{Schwartz & Meyers} concerned whether a letter from an attorney to the trustee which was forwarded to the judge could be construed as a filed complaint objecting to discharge. The court concluded that it could not. Significantly, the court also chose to overlook the recommendation in the letter that urged that the case be referred for prosecution. In view of the limitations problems possibly precluding denial of discharge and other civil penalties, it would have been particularly appropriate to refer the case for prosecution in order to promote the ends of justice. The case involved questionable real estate investment schemes operating in a pyramid fashion. See, Nat'l L.J., Vol. 17 No. 9 at 31 (Jan. 31, 1985).

\textsuperscript{204} 13 B.R. 1010 (E.D.N.Y. 1981).

\textsuperscript{205} Id. at 1020 (citing to \textit{In re Parr}, 4 B.R. 646 (Bankr. E.D.N.Y. 1980)). The bankruptcy court's decision appears to require nearly conclusive proof of guilt before a case is referred, inasmuch as the decision not to refer is based, \textit{inter alia}, on the fact that the movant bank's allegations of criminal wrongdoing are based on "information and belief" and the bank's "reasons to believe" that a transfer "may have been made knowingly, fraudulently, and with actual intent to . . . defraud." \textit{Parr}, 4 B.R. at 648-49.
importance of referring cases to the United States Attorney for investigation.

While the bankruptcy court in *Parr* had quibbled that it had power to “report” but not to “direct” an investigation, the district court read § 3057 differently. First, “[a]ny referee, receiver, or trustee having reasonable grounds [to suspect a violation] . . . SHALL REPORT TO THE APPROPRIATE UNITED STATES ATTORNEY ALL THE FACTS AND CIRCUMSTANCES.”206 Second, “the United States Attorney SHALL INQUIRE INTO THE FACTS AND REPORT THEREON TO THE JUDGE.”207

Thus, a reading of the entire statute leads to the conclusion that a court is compelled to direct the United States Attorney to investigate the facts whenever reasonable grounds exist for a belief that a violation of the bankruptcy laws has occurred and that such violations have not been litigated before the bankruptcy and appellate courts.208

In a footnote, the court went on to note that “courts have viewed the power to direct an investigation as an obligation to protect the rights of creditors, the dictates of the bankruptcy laws and the public.”209

Even if courts refer cases for protection, bankruptcy crimes will go unpunished unless the United States Attorney’s office follows up with vigorous prosecution. Commentators have noted that trustees and courts may sense the futility of referral when prosecutions are so seldom pursued, and therefore make few referrals.210 While the United States Attorney’s office denies that it neglects bankruptcy crimes, it is clear from the low number of prosecutions that only certain of these crimes strike prosecutors as “real crimes,” worthy of their attention.211 A large percentage of the crimes actually prosecuted involve multiple charges that additionally include wire fraud, racketeering, tax evasion, or the like. This pattern strongly suggests that the United States Attorney prefers to prosecute bankruptcy crime only when it is associated with other criminal acts as well. Often, the investigation of these other crimes will have been entirely independent of bankruptcy proceedings, stemming out of an FBI racketeering probe or a tax evasion case. Even among the few prosecutions of bankruptcy crimes unassociated with other crimes, not

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207. Id. § 3057(b).
209. *Flushing*, 13 B.R. at 1020 n.5 (emphasis added) (citing 1A *Collier on Bankruptcy* ¶ 14.01, at 1251 (14th rev. ed. 1978)).
210. See Sibarium, *supra* note 140, at 11; *MacLachlan, supra* note 201, at 35.
211. Id. See *supra* note 136 citing that an anonymous official at the United States Attorney’s Office stated that it would not even look at a bankruptcy fraud case that involved less than $100,000.00.
all result from referral from the bankruptcy court. Some result from investigations of independent origin, and some occur when the United States Attorney's office appears to have an interest beyond enforcement of the bankruptcy law. Only a handful of investigations arise through the referral process contemplated by Congress. Whatever underlying policy controls this pattern of prosecution, the message it sends is clear: debtors may violate the bankruptcy laws with impunity.

This preference for civil action (to protect the creditors' interests) over criminal sanctions (to punish and deter illegal behavior) is inexplicable in the face of actual experience. Obviously, criminal prosecution does not preclude denial of discharge or recovery of fraudulent conveyances, and it may indeed motivate debtors to repay creditors as much as possible to mitigate possible criminal penalties. Experience, however, teaches that denial of discharge in most cases adds little to the final recovery by creditors. While is is logically fitting to deny discharge to defrauding debtors, the opportunity to obtain judgments against them does not result in many funds actually being recovered.

The traditional approach of courts, thus, has been to begin by using minimal force, even in cases of outright fraud, and to only seek stronger sanctions when lesser methods fail. This approach has led to notable failures, and, most important, it has reduced the deterrent value of § 152. A few courts, however, have found ways to use criminal charges under this section both to punish offenders and also to benefit creditors. The futility of denial of discharge and similar remedies lies in the fact that the debtor, in the case of calculated bankruptcy fraud, is usually a corporate shell, and, in all cases, that the proceeds of the fraud have been shifted beyond the legal control of the debtor. Recognizing this and in responding to recent changes in federal criminal law, courts have begun to use the threat of imprisonment to encourage bankruptcy criminals to make restitution.

Use of the Federal Sentencing Guidelines has presumably

212. See, e.g., United States v. Gibbs, 594 F.2d 125 (5th Cir. 1979), cert. denied, 444 U.S. 854 (1979), in which the president of a failing company transferred funds out through the use of fictitious invoices. Investigation and prosecution for bankruptcy fraud resulted when the assistant manager notified the FBI of the fraudulent invoices.

213. In United States v. Jackson, 836 F.2d 324 (7th Cir. 1987), for example, a farmer had hidden collateral after filing under chapter 11, thus avoiding a security interest held by the FHA. The United States Attorney filed a complaint to have the debt adjudicated nondischargeable. Following their divorce, the farmer's wife reported to the FHA that the equipment was hidden on a bar on the farm, and this led to indictment of the farmer under § 152. It seems likely that the prosecution in this case may not have been due so much to the fact of the fraud as to the involvement of the FHA as a victim.


215. Restitution is authorized by 18 U.S.C. §§ 3663 and 3664, formerly §§ 3579 and 3580, first enacted in 1982. These sections provide that courts may make an order of restitution when sentencing a defendant convicted of an offense under Title 18. The
led to more uniform sentencing of all criminals, including those guilty of bankruptcy crime. The Guidelines reemphasize the statutory provisions calling for restitution.216

V. SECTION 152 AND RESTITUTION

In cases of calculated fraud, prosecution under § 152 followed by an order for restitution restores a logical priority. It convicts the criminal and puts others on notice that they will fare similarly if they engage in such activities; at the same time, it benefits the victims of the fraud by ordering restitution and creating the strongest of motivations for the criminal to make reparation. Such a procedure has many advantages. First, it preserves evidence and increases the chances of a successful and fair prosecution.217 Second, it reduces

restitution may be "in addition to or in lieu of any other penalty authorized by law." Id. § 3663(a)(1). While orders of restitution under this section have always been discretionary, amendments made in 1986 have softened the effect of the statute by relaxing the original requirement that a court which does not order full restitution must state on the record its reasons. 18 U.S.C. § 3663(a)(2), struck out by Pub. L. No. 99-646 § 8(b). Further, the original mandate that "[t]he court shall impose an order of restitution to the extent that such order is as fair as possible to the victim..." has undergone a shift in emphasis, and now reads: "To the extent that the court determines that the complication and prolongation of the sentencing process resulting from restitution under this section outweighs the need to provide restitution to any victims, the court may decline to make such an order." 18 U.S.C. § 3663(d), before and after amendment by Pub. L. No. 99-646, § 77(a).

Under § 3663(g) restitution becomes a condition to any probation or supervised release and failure of a defendant to comply with and order of restitution may lead to revocation of probation or supervised release, or even contempt proceedings pursuant to 18 U.S.C. § 3583(e). Bankruptcy cases have also cited the Federal Probation Act, former U.S.C. § 3651 (repealed in 1984 by Pub. L. No. 98-473, Title II, c. II, § 212(a)(1), (2)), which allowed courts to require restitution as a condition of probation. See, e.g., United States v. Weinstein, 834 F.2d 1454 (9th Cir. 1987). Similar provisions are contained in the present 18 U.S.C. §§ 3561-65 dealing with probation, which allow for restitution as a discretionary condition for probation, § 3563(b)(3), and for termination of probation upon violation of a condition, § 3565.

216. See Federal Sentencing Guidelines Manual (1988), which provides for "at least one of the following as a condition of probation [for a felony]: a fine, an order of restitution, or community service." Id. § 5B1.3, (citing 18 U.S.C. § 3563(a)(2)); Id. Part E, "Restitution, Fines, Assessments, Forfeitures."

For a recent case applying the Sentencing Guidelines to bankruptcy crime, combining jail terms with orders for supervised release and restitution, see United States v. Snover, 900 F.2d 1207, 1209-10 (8th Cir. 1990) (approving of upward departure from Guidelines because of aggravating factors, including "activity of a somewhat similar nature [to bankruptcy crime], though not resulting in criminal charges but intimating a deep attachment to the obtaining of money or property at the expense of others, thereby signaling the unlikelihood of rehabilitation without strong measures" (emphasis added)).

217. The effects of delay are more practical than legal in nature. Generally evidence of fraud discovered in civil proceedings will be available in a subsequent criminal proceeding. See United States v. Filiberti, 353 F. Supp. 252 (D. Conn. 1973) (preindictment delay does not violate right to speedy trial); Metheny v. United States, 365 F.2d 90 (9th Cir. 1966) (evidence from civil action available to prosecution). Some immunized testimony, however, may be unavailable. Supra, note 159.
the likelihood that the defendants will escape the jurisdiction of the court.\textsuperscript{218} Third, it increases the likelihood that assets will be recovered for the creditors.\textsuperscript{219} Fourth, by putting pressure directly on the defendants, it allows the court to force the recovery of assets that might be beyond the reach of the bankruptcy court.\textsuperscript{220} Fifth, it

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The practical results of delay may well prevent successful prosecution, however. First, the paucity of prosecutions in general suggests that a settled case in bankruptcy is unlikely to lead to prosecution, while an ongoing case with undischarged debts may possibly generate more interest. Second, the higher level of proof required in criminal cases might be better met when the evidence is fresh and witnesses closer to and more interested in the controversy. Third, prompt prosecution may avoid destruction of evidence. See United States v. Weinstein, 834 F.2d 1454 (9th Cir. 1987); United States v. Feldman, 425 F.2d 688 (3d Cir. 1970) (both cases involving lost or destroyed evidence before prosecution).

218. In the \textit{Landbank Equity} cases, for example, prosecution appears to have been instituted only after the "masterminds" of the Landbank scheme had fled the jurisdiction. United States v. Butler, 704 F. Supp. 1338, 1341 (E.D. Va. 1989), \textit{aff'd}, 905 F.2d 1532 (4th Cir.), \textit{cert. denied}, 498 U.S. 900 (1990). The persons were eventually convicted and sentenced, \textit{inter alia}, for bankruptcy fraud, and were also ordered to pay restitution; however, they were also the attorney and accountant involved with the scheme and the court noted that they were "both professional men with significant ties to the community . . . not likely to flee." United States v. Butler, 704 F. Supp. 1351 (E.D. Va. 1989). In other words, the prosecution occurred at a time when all those who were likely to flee had already fled.


220. A good example of this occurs in United States v. McClellan, 868 F.2d 210 (7th Cir. 1989) where a physician faced with a likely civil judgment against him went on vacation in Europe after transferring a Porsche and DeLorean to his father, also a physician. The jury returned a verdict of $1,000,000 against him, and he filed Chapter 11 after returning from his vacation (expenses for which he had charged). Besides having the use of the cars, the defendant lived in a home in his mother-in-law's name. Convicted of bankruptcy fraud, the defendant was ordered to pay over $600,000 as a condition of his probation, pursuant to 18 U.S.C. § 3579. The defendant claimed that the amount of his restitution had been set too high in the light of the factors enumerated in 18 U.S.C. § 3580(a), specifically that the court had failed to consider his limited income of $200 per week. The Court of Appeals affirmed the large restitution order, however:

\begin{quote}
Noting that despite his current low income, McClellan retained "tremendous earning potential," the court ordered restitution in the amount of the victims' loss. They have approved an order of restitution that exceeded the defendants' current ability to pay and took into account potential increases in income. \textit{United States v. Fountain}, 768 F.2d 790, 802-03 (7th Cir. 1985) (approving order of restitution despite likelihood that defendants would remain imprisoned as long as they lived; possibility that they would profit from a book about their crime justified restitution order).
\end{quote}

\ldots

In McClellan's case, the sentencing judge clearly articulated reasons for the order of full restitution, specifically that McClellan chose to maintain a low income while his father's corporation paid all of his living expenses, that the arrangement was intended to shield him from creditors, and that he likely would continue his repeated manipulations to the end.

\textit{Id.} at 213 (footnote omitted).
properly separates the issues of criminality and civil liability.\textsuperscript{221} Finally, a successful prosecution establishes findings that may be binding in a later civil action in the bankruptcy court, whereas any initial finding of fraud in a bankruptcy court must be tried \textit{de novo} in a subsequent criminal proceeding.\textsuperscript{222} In short, prompt prosecution of criminal bankruptcy fraud offers many advantages and few disadvantages wherever sufficient evidence exists to support a case at all.

In its discussion of restitution, at least one court has focused on the central problem posed by bankruptcy fraud, namely that absent the threat of prosecution (and, possibly, an order of restitution), bankruptcy fraud gives rise to a no-lose situation. In \textit{United States v. Weichert},\textsuperscript{223} the defendant formed a corporation that received many of the assets and proceeds of assets of a bankupt corporation. He challenged the order of restitution on the grounds that there was no specific documentation as to the value of the diverted goods. The court rejected this argument because “[t]o forego the imposition of restitution because defendant has successfully camouflaged the amount of the loss caused by his fraud would serve to reward his wrongdoing.”\textsuperscript{224} Yet this is precisely what happens when bankruptcy fraud is not prosecuted because the wrongdoer is then guaranteed that he can never be liable for more than the actual proceeds of his fraud, and in fact, he gets to keep any diverted funds that cannot be traced by precise documentation.

“Clearly, equity demands that the wrongdoer, not the victim, suffer the consequences of the wrong.”\textsuperscript{225} The court in \textit{Weichert} recognized that a restitution order following prosecution correctly reached beyond the evidence of written records:

Grevelding’s statement that she made no book entries, coupled with her testimony that she kept this “inventory” on loose pieces of paper at Preslar’s direction, permits an inference that Preslar and defendant

\textsuperscript{221} Thus in cases of egregious conduct mere restitution may not in itself justify absolution for criminal behavior: “[A]lthough appellants imply that the return of the money . . . purged them of criminal responsibility, this theory is simply without foundation.” \textit{United States v. Klupt}, 475 F.2d 1015 (2d Cir. 1973) (return of proceeds of diverted checks to debtor did not cure violation of § 152) (citing \textit{United States v. Diorio}, 451 F.2d 21 (2d Cir. 1971) (jury question whether recantation of false oath was “prompted by an honest discovery of an earlier mistake on the one hand, or, on the other hand, by the realization that the jig was up and that the falsity has already been uncovered or was about to be uncovered by others”)).

\textsuperscript{222} 18 U.S.C. § 3664(e) (1994) provides that “[a] conviction of a defendant for an offense involving the act giving rise to restitution under this section shall estop the defendant from denying the essential allegations of that offense in any subsequent Federal civil proceedings or State civil proceeding . . . brought by the victim.”

\textsuperscript{223} 89 B.R. 346 (S.D.N.Y.), aff’d, 862 F.2d 305 (2d Cir. 1988), \textit{cert. denied}, 488 U.S. 1017 (1989).

\textsuperscript{224} \textit{Id.} at 349.

\textsuperscript{225} \textit{Id.}
intended that the slips be used, not as business records, but as instruments of fraud in their diversion of Energy's assets. The inference is clear that these disposable slips of paper were intended, not as an indelible record of overt sales, but as vanishing tallies of loot to be split between them. It is, therefore, more likely than not, that, after serving their fraudulent purpose, these records were destroyed in an effort to conceal the actual amount of any fraud.\textsuperscript{226}

The discussion in \textit{Weichert} centers on the wrongdoer's risk of a monetary penalty,\textsuperscript{227} but the principle properly applies to his risk of prosecution, as well. Just as one who destroys records to camouflage his fraud must risk a restitution order exceeding the precise amount of the fraud, so also should he risk criminal penalties for bankruptcy crimes rather than civil liability limited to the amount of the discovered fraud.

Unfortunately, few prosecutions are undertaken in the first place. The bankruptcy system, effectively operating without the criminal sanctions which are a natural complement to its civil jurisdiction, remains a tempting device for the use of "bust-out" artists and corporate looters. Perhaps frustrated by this situation and seeking to find legal remedies beyond the limits of the bankruptcy courts, many creditors have turned to the RICO statutes to bring charges with a criminal flavor against debtors and their principals when it appears the creditors will be unlikely to recover substantial assets from those defendants through the bankruptcy system.

\textbf{VI. RICO AND BANKRUPTCY FRAUD}

The advantage of a RICO action against an individual, non-debtor defendant is that it may allow a creditor to recover on his own behalf rather than sharing with other creditors a recovery made by the trustee.\textsuperscript{228} To a certain extent, this circumvents the intention of the bankruptcy laws, and courts have denied RICO claims on this basis, holding that they properly belonged as part of the estate, and that only the trustee has standing to bring such claims.\textsuperscript{229} In many

\textsuperscript{226} \textit{Id.} (emphasis added).

\textsuperscript{227} \textit{Id.} (citing Armorie v. Delamirie (the "Chimney Sweep's Boy"), 1 Strange 505, 93 Eng. Rep. 664 (1772) (goldsmith taking jewel from sweep's boy must, in absence of stolen jewel, make restitution in form of jewel of "first water").

\textsuperscript{228} The Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. § 1961 et seq. (1994), outlaws conspiracy resulting in a "pattern or racketeering activity," including bankruptcy fraud, 18 U.S.C. § 1962. The present discussion of RICO as it pertains to bankruptcy fraud presents only an overview, principally to illustrate the use of RICO claims by frustrated creditors to step in absent ordinary prosecution under § 152.

\textsuperscript{229} This is essentially a question of standing. See the full discussion of the problem in Barnett v. Stern, 93 B.R. 962 (N.D. Ill. 1988), \textit{rev'd}, 909 F.2d 973 (7th Cir. 1990), concluding that "When the trustee has standing, creditors do not." Noting that the trustee has broad powers to reach assets of the estate, the court concludes that the "trustee's avoiding powers would not ensure equitable distribution . . . if the trustee had
cases involving RICO claims, however, creditors seek a recovery that is beyond the powers of the bankruptcy court acting alone. It remains unsettled as to precisely what extent treble damages may properly be available under RICO for straightforward violations of § 152. Recent decisions have broadened the reach of RICO, even though the standing of creditors to proceed under the statute has been limited. Yet, bringing RICO claims is a clumsy solution to a

to compete with individual creditors for estate property." Id. at 968. Limitations on creditors' ability to enforce their rights are necessary to avoid "a multi-jurisdictional rush to judgment." Id. (quoting In re Mortgage Am. Corp., 714 F.2d 1266, 1274 (5th Cir. 1983)).

The problem is that the assets of the estate include only the debtor's rights and assets, and a RICO claim belongs to creditors. The court reasoned that this is a formalistic analysis similar to the reasoning that a corporation "cannot pierce its own veil," and that "[a] growing number of courts have reasoned that the Bankruptcy Code's fundamental principle of equitable distribution among creditors requires that the trustee pursue causes of action, such as alter ego claims, available to creditors generally." Barnett at 970 (citing In re S.I. Acquisition, Inc., 817 F.2d 1142 (5th Cir. 1987)).

The court concluded that the trustee rather than individual creditors had the sole standing to pursue the RICO claim, noting, however, that in certain cases where a RICO claim was peculiar to a single creditor or group, it might then be appropriate for that creditor or group to pursue the claim. Barnett at 972. n.4.

For other cases dealing with the trustee-creditor standing problem, see Bankers Trust Co. v. Rhoades, 859 F.2d 1096 (2d Cir. 1988) (trustee has sole standing), rev'd Bankers Trust Co. v. Feldesman, 676 F. Supp. 496 (S.D.N.Y. 1988) (creditor has standing); ANR Ltd., Inc. v. Chattin, 89 B.R. 398 (D. Utah 1988) (creditor has standing); Dana Molded Prods., Inc. v. Bordner, 58 B.R. 576 (N.D. Ill. 1986) (creditor lacks standing); Forty Eight Insulations, Inc. v. Black (In re Forty-Eight Insulations, Inc.), 63 B.R. 415 (N.D. Ill. 1986) (law firm, suing for indirect harm for loss of fees when clients could not recover personal injury settlements from debtor lacked RICO standing).

230. In Barnett, for example, the debtor had hidden funds in two successive trusts. While the trustee normally would have been limited to the actual amount of funds concealed or diverted, the RICO and fraud claims added to this treble damages and $500,000 in punitive damages for fraud. However, the court ruled that "a RICO violation does not give rise to civil liability without proof of resultant injury." Barnett at 978. While fraud had been clearly shown, the court appeared to demand a strong showing of actual injury before awarding civil damages. It thus followed the long established pattern of seeking no more than the available recovery for creditors in bankruptcy, rather than punishing fraud through criminal liability in order to discourage such activity in the future.

231. See Bankers Trust Co. v. Feldesman, 566 F. Supp. 1235, (S.D.N.Y. 1983), aff'd 741 F.2d 511 (2d Cir. 1984), noting the advantages to creditors of a RICO action: "Perhaps enticed by the lure of a treble damage recovery, private litigants have attempted increasingly to utilize the civil remedies of [RICO] in a variety of factual settings ostensibly within the broadly-worded provisions of the statute but arguably far beyond the original contemplation of the framers of the legislation." The court rejected the RICO claim, concluding that otherwise "virtually every bankruptcy fraud could serve as a basis for a treble damage action under RICO." Id. at 1242. The court of appeals judgment was vacated in light of Sedima v. Imrex Co., 473 U.S. 479 (1985) (holding there is no requirement that a private RICO action can proceed only against a defendant that has been previously convicted of a predicate act or a RICO violation). See Bankers Trust Co. v. Feldesman, 473 U.S. 922 (1985).

problem that could often be solved through the straightforward application of the laws against bankruptcy crime. After all, RICO claims require a showing of criminal conspiracy and repeated action, while § 152 requires proof only of a single crime. A private treble damages suit also threatens an inequitable recovery because it is brought to benefit only a single creditor. In contrast, a conviction under § 152, followed by an order for restitution and coupled with a recovery of fraudulent conveyances (based on the conviction), will probably recover more assets and result in equitable distribution among all creditors. Moreover, whenever an individual feels it is worthwhile to bring a RICO action independently, there are likely to be substantial assets available to the defendant and a good showing of evidence of criminal acts. In other words, such cases are precisely those in which a prosecution under § 152 would be both successful and effective. Nevertheless, despite the lower court’s reluctance to apply RICO, the Supreme Court has repeatedly expanded RICO’s reach, and it remains a viable option to creditors and others who are affected by fraudulent or deceptive activities. Congress did narrow the scope of RICO with the Private Securities Litigation Reform Act of 1995, by removing securities regulations violations from the realm of RICO.

Attempts by frustrated creditors to apply RICO actions to bankruptcy fraud may needlessly complicate an already complex area of the law. These attempts are symptomatic of a system that has been crippled by debtors who have discovered that they may exploit the bankruptcy system without being held to their end of the bargain.

VII. CONCLUSION: THE NEED FOR PROSECUTION UNDER SECTION 152

Rehabilitation of the debtor and discharge of indebtedness were secondary developments in the history of bankruptcy law. Origi-

Based on the fraudulent recharacterization of a debt. The court did not reach the question of whether a § 152 violation was sufficient basis for the RICO claim, however, because it found mail and wire fraud to be adequately alleged.

The central transactions involved bankruptcy fraud in this case. The debtor corporation was facing imminent bankruptcy, and a creditor bank (owed approximately $700,000) was able to arrange for filing of the petition to be delayed and to put in control a consultant who worked to change the bank’s debt from unsecured to secured and to reduce and ultimately pay off the debt. The RICO predicate acts of wire and mail fraud were those which actually effected the bankruptcy fraud in this case, and the court ruled that the injuries flowing from these predicate acts were sufficient to constitute RICO injury.


nally, they became available to debtors (and, of course, agents and principals of debtors) only when the debtors cooperated in bringing all available assets before the court to be distributed equitably among the creditors. This tradeoff resulted in a two-pronged structure to the bankruptcy system in which criminal enforcement under § 152 plays an essential role.\(^{235}\)

On one hand, the trustee, acting for the benefit of the creditors, has a wide range of powers in his arsenal which he may employ to augment the estate. Most of these powers, however, emphasize benefit to creditors over penalty to the debtor. Obviously any action the trustee takes to bring assets into the estate will hurt some other party. Thus, a party to bankruptcy fraud will suffer the loss of his profits if the trustee is able to recover assets through civil action. The remedies available present a spectrum ranging from mild to rather drastic measures: equitable apportionment, equitable subordination, the strong arm clause, recovery of preferences, fraud actions, recovery of fraudulent conveyances, and denial of discharge.\(^{236}\) Yet all of these are purely remedial in the sense that they involve no real penalty—merely the recovery of that to which the party to the fraud never had a good legal or equitable title.\(^{237}\)

On the other hand, implicit in the exchange by which a debtor may be released from his debts in return for his cooperation, exists the notion that he will suffer a penalty if he seeks the benefit without extending his own cooperation.\(^{238}\) It is axiomatic that a court of equity will deny its benefits to a petitioner who enters with unclean hands. Unfortunately, the special nature of bankruptcy emasculates the force of this threat, and criminal sanctions must exist and be enforced to protect creditors against fraudulent conduct. “Whether

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\(^{235}\) See In re May, 12 B.R. at 620-22, esp. 621 n.1 (discussion of two-fold purpose of bankruptcy laws, range of remedies, and interrelationship of criminal and civil remedies).

\(^{236}\) Id. at 621.

\(^{237}\) See, e.g., Jennen v. Hunter (In re Hunter), 771 F.2d 1126 (8th Cir. 1985), in which the court applied a policy of strict construction of nondischargeability to effectuate “the Congressional policy of permitting [a debtor] a fresh start.” Id. at 1130 (citing In re Rahm, 641 F.2d 755, 756-57 (9th Cir.), cert. denied, 454 U.S. 860 (1981)). Noting that “[t]hese considerations, however are applicable only to honest debtors,” the court nevertheless went on to reject a creditor’s request that foreclosure proceeds should be applied first against dischargeable debt, thus leaving as large a nondischargeable balance as possible. Id. The court said that this approach would be “essentially punitive” and therefore inappropriate because such a penalty could only be properly imposed in separate litigation pertaining to the dishonest behavior itself.

\(^{238}\) Few courts have addressed the policy reasons underlying § 152, possibly because they are relatively obvious. See, e.g., United States v. Overmyer, 867 F.2d 937 (6th Cir. 1989), cert. denied, 493 U.S. 813 (1989) (stating that “criminal sanctions exist to assure that the information utilized in validating or rejecting a claim is credible information” (quoting from Order in district court below—which ironically reversed the jury verdict, later reinstated on appeal)).
direct or indirect, the principal purpose of [§ 152] is to promote commercial honesty."

Sadly, the failure of courts to prosecute bankruptcy fraud is a three-fold loss. The individual creditors in each case lose when fraud is not vigorously prosecuted. Second, justice in the bankruptcy system suffers when no penalties are meted out to those who abuse it. Finally, and most important, future creditors (and, as has been the case with the savings and loan debacle, the public at large) lose the continuing protection that would flow from the present enforcement of criminal statutes. § 152, like all criminal laws, operates both retrospectively and prospectively. It looks back to punish past crimes, but in doing so, it serves the important function of discouraging future repetition of the same crimes.

At a time when bankruptcy petitions occur in ever-increasing numbers, it is imperative that courts and prosecutors act to enforce the basic rules underlying the system. The burdens of crowded courts and needless litigation caused by devious creditors may be ameliorated if enforcement of bankruptcy fraud is allowed to play its proper role. Without enforcement, a debtor has little motivation to play by the rules. In other words, he may conceal assets without risking any loss other than that of the assets themselves. In many cases, the cost of policing and litigation may preclude such assets from ever accruing to the creditors. After all, the bankruptcy system is essentially one of self-reporting: "It is the debtor's duty to set forth its affairs in detail to ensure that those interested in the administration of the estate have completely dependable information on which they can rely and take appropriate action without the need to dig for those facts."

It has long been recognized that orderly administration of bankrupt estates would be impossible if the burden of enforcement had to be borne entirely by creditors and trustees:

It is not a requirement of ordinary diligence that a creditor should assume a bankrupt to be guilty of a false oath, and, upon such assumption, make, in each case, an independent investigation before agreeing to the terms of the composition. Because creditors must ordinarily rely, to a great extent, upon a bankrupt's statement of his affairs in considering the terms of a composition, and because ordinarily they will extend to the bankrupt a presumption of innocence of criminal offense or fraud, there is a practical danger that advantage may be taken of their reliance upon the bankrupt's sworn schedule.

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239. In re May 12 B.R. at 625 (citing 2A COLLIER ON BANKRUPTCY § 29.02[1]).
Such a “presumption of innocence of fraud” cannot exist in a vacuum. Prosecution under § 152 is an enforcement provision that is essential to discourage fraud so that courts, creditors, and trustees may rely on the veracity of the facts set before them. The time has come for prosecutors to recognize that the diversion of assets—often totaling millions of dollars—is criminal theft whether it is accomplished at gunpoint, by a direct fraud, or by indirect fraud which uses the bankruptcy system to apportion the loss among numerous creditors. Bankruptcy crime is “real” crime, and its practitioners may only be dissuaded by “real” punishment.

The Justice Department has announced a nationwide effort aimed at prosecuting people who illegally conceal assets, file fraudulent bankruptcy petitions, or otherwise abuse the bankruptcy system. The campaign, called “Operation Total Disclosure,” has resulted in criminal charges being filed against 123 defendants in 36 federal districts. The largest number of cases were brought in California, followed by Illinois, Nebraska and Texas. Congress and the attorney general’s office appear to recognize the need to increase focus on this area. The question now is whether pressure will continue to be applied. The goal is to make the threat of bankruptcy prosecution so real that a debtor is discouraged from engaging in that activity. To do that, the prosecutions need to be persistent, punishing, and public.