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### A Study on Bankruptcy Crime Prosecution Under Title 18: Is the Process Undermining the Goals of the Bankruptcy System?

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## **A STUDY ON BANKRUPTCY CRIME PROSECUTION UNDER TITLE 18: IS THE PROCESS UNDERMINING THE GOALS OF THE BANKRUPTCY SYSTEM?**

### ABSTRACT

*The bankruptcy system was devised to provide debtors with a fresh start and to provide creditors equitable shares of assets in satisfaction of the debts they are owed. When debtors, creditors, trustees, or others involved the bankruptcy process compromise the system by committing bankruptcy fraud, the consequences are numerous. In order to protect the important interests of the government and the federal bankruptcy system's paramount interest in preserving the honest administration of bankruptcy proceedings and ensuring a distribution to creditors, the federal bankruptcy system depends upon the United States Trustee Program to identify bankruptcy fraud and upon the United States Attorney's Office to take appropriate action under title 18 of the United States Code.*

*First, this Comment discusses the laws pertinent to bankruptcy fraud in depth and details the United States Trustee Program and its responsibility to identify and investigate bankruptcy fraud in coordination with the United States Attorney's Office and other law enforcement agencies. Second, it then seeks to provide insight into the factors that may affect whether a case is chosen to be prosecuted or dismissed. Third, it will then provide an analysis of the available data compiled on bankruptcy fraud cases from the fiscal years of 2010 and 2011 with respect to the following factors: specific bankruptcy fraud criminal violations, other United States Code violations, the identity of the defendants, the types of bankruptcy filing involved, the verdicts, and the sentences resulting from guilty verdicts. Finally, this Comment concludes that bankruptcy fraud is not being sufficiently prosecuted independently of other United States Code violations and as a result, creditors, debtors, the government, the court, and the public are harmed and the policies underlying the bankruptcy system are undermined.*

### INTRODUCTION

Bankruptcy fraud is an under prosecuted crime, directly affecting the integrity and honest administration of the entire bankruptcy system. The

principal factor in determining whether a bankruptcy fraud crime is prosecuted is whether it accompanies a general fraud prosecution, irrespective of the merits of the bankruptcy fraud case itself. This Comment examines bankruptcy cases involving bankruptcy fraud to argue that bankruptcy fraud is under prosecuted. As revealed in the study, bankruptcy crimes are typically not prosecuted independently of non-bankruptcy crimes. Despite acknowledgement by the federal government that bankruptcy fraud is widespread, bankruptcy fraud is not widely prosecuted.

Part I.A of this Comment will first present a discussion of the four categories of bankruptcy crime as defined under §§ 152–157. Then, in Parts I.B and C, it will proceed to discuss the current system utilized by the United States Trustee Program for identifying fraud, abuse, and error, the process for making referrals to the United States Attorney’s Office, and finally the rate and extent of prosecution of bankruptcy fraud. In Part II, this Comment will present a study based on the cases the United States Attorney’s Office chose to prosecute in the fiscal years of 2010 and 2011 and will analyze the variables that were determined by this study to have the greatest influence on whether a case was prosecuted. Finally, based on the results of this study, this Comment will argue that bankruptcy fraud is not being prosecuted independently of non-bankruptcy related crimes and will briefly discuss the potential effects failure to prosecute may have on the public, the government, and the policies underlying the bankruptcy system.

## I. BACKGROUND

### A. *An Introduction to Bankruptcy Crimes Under Title 18 of the United States Code*

The federal bankruptcy system “depends on full disclosure by debtors, creditors, and professionals in order to resolve disputes and to distribute money and property.”<sup>1</sup> The provisions in title 18 were enacted “to preserve honest administration in bankruptcy proceedings and to ensure the distribution to creditors of as large a portion of the bankrupt’s estate as possible.”<sup>2</sup> These provisions “were enacted to serve the important interests of the government,

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<sup>1</sup> OFFICE OF THE INSPECTOR GEN., THE U.S. TRUSTEE PROGRAM’S EFFORTS TO PREVENT BANKRUPTCY FRAUD AND ABUSE (Mar. 2003), available at <http://www.justice.gov/oig/reports/OBD/a0317/findings.htm>.

<sup>2</sup> U.S. DEP’T OF JUSTICE, *Bankruptcy Fraud*, in CRIMINAL RESOURCE MANUAL 838, available at <http://www.justice.gov/usam/criminal-resource-manual-838-bankruptcy-fraud> (last updated May 2009).

not merely to protect individuals who might be harmed by the prohibited conduct.”<sup>3</sup> The objectives of bankruptcy law, to provide the debtor with a fresh start, to provide equitable distribution to creditors, and to serve the important interests of the government, are frustrated when participants in the process engage in dishonest activity.<sup>4</sup> In order to protect these important interests, the federal bankruptcy system depends upon the United States Trustee Program to identify bankruptcy fraud and abuse and to prosecute it.<sup>5</sup>

The United States Code provides 18 U.S.C. §§ 152–157 to combat bankruptcy crime and protect the important interests of both private citizens and the government.<sup>6</sup> These six sections and their sub-parts can be broken down into four general categories of bankruptcy crimes.

The first category of bankruptcy crime involves the concealment of assets.<sup>7</sup> This often occurs when a debtor or his attorney seeks to avoid forfeiture of certain assets to the bankruptcy estate.<sup>8</sup> The second category encompasses intentionally filing false or incomplete forms.<sup>9</sup> The first and second categories of crimes often occur in conjunction in that both categories are implicated when a debtor or his attorney conceals assets and fails to include the concealed assets in the debtor’s financial schedules.<sup>10</sup> The third category is composed of crimes attributed to filing bankruptcy numerous times within a specific time frame and to filing bankruptcy concurrently in several states.<sup>11</sup> Finally, the fourth category involves bribery and extortion of court-appointed trustees and other parties.<sup>12</sup> Together, these provisions “attempt to cover *all the possible methods* by which a bankrupt or *any other person* may attempt to defeat the

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<sup>3</sup> Stegeman v. United States, 425 F.2d 984, 986 (9th Cir. 1970).

<sup>4</sup> See generally United States v. Grant, 971 F.2d 799 (1st Cir. 1992) (stating that a chapter 7 debtor who commits bankruptcy fraud hinders the trustee’s ability to make informed decisions and utilize informed judgment and thus hinders distribution); Ralph C. McCullough II, *Bankruptcy Fraud: Crime Without Punishment*, 96 COM. L.J. 257, 256–60 (1991).

<sup>5</sup> OFFICE OF THE INSPECTOR GEN., *supra* note 1.

<sup>6</sup> See 18 U.S.C. §§ 152–157.

<sup>7</sup> *Id.* § 152(1).

<sup>8</sup> See, e.g., Singh v. Attorney Gen. of the U.S., 677 F.3d 503 (3d Cir. 2012) (noting that in his filing for bankruptcy under penalty of perjury, the defendant failed to include accounts payable relevant to his financial state).

<sup>9</sup> 18 U.S.C. § 152(2)–(4) (2012).

<sup>10</sup> See, e.g., United States v. Hughes, 396 F.3d 374 (4th Cir. 2005) (finding that the defendant presented the court with false filings understating the value of his wife’s personal property and attempted to sell valuable assets belonging to his wife without permission from the bankruptcy court).

<sup>11</sup> 18 U.S.C. § 152(9).

<sup>12</sup> *Id.* § 156(6).

Bankruptcy Act through an effort to keep assets from being equitably distributed among creditors.”<sup>13</sup>

These provisions seek to protect the economy and court system from the damaging consequences that result from bankruptcy crime.<sup>14</sup> There are at least three social and economic consequences that result from bankruptcy crime. First, bankruptcy crime affects tax revenues in both federal and state governments.<sup>15</sup> Second, bankruptcy crime causes the costs of lending to increase.<sup>16</sup> Lending costs increase when a lender suffers a decrease in the return on investment because it incurs costs that may not already be factored into the cost of lending money.<sup>17</sup> As lenders learn that they are absorbing losses due to frequent bankruptcy crimes, they may increase lending costs to offset the decreased return on investment.<sup>18</sup> As a result, these costs are then passed on to borrowers.<sup>19</sup> Third, prevalent fraud has the potential to undermine public confidence in the integrity of the bankruptcy system.<sup>20</sup>

### B. *Catching the Crime*

The United States Trustee Program is the division of the United States Department of Justice that seeks “to promote the efficiency and protect the integrity of the Federal bankruptcy system.”<sup>21</sup> The U.S. Trustee oversees the conduct of all parties involved in bankruptcy proceedings and all administrative functions in order to “further the public interest in the just, speedy and economical resolution of cases filed under the Bankruptcy Code.”<sup>22</sup> The U.S. Trustee also works with the Office of the United States Attorney, the

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<sup>13</sup> Stegeman v. United States, 425 F.2d 984, 986 (9th Cir. 1970) (emphasis added) (citing 2 COLLIER ON BANKRUPTCY ¶ 1151 (Matthew Bender ed., 14th ed. 1968)).

<sup>14</sup> See *id.* (citing 1 COLLIER ON BANKRUPTCY, *supra* note 13, ¶ 5) (discussing the adverse effects bankruptcy crime has on commerce and credit).

<sup>15</sup> See Craig Peyton Gaumer, *Bankruptcy Fraud: Crime and Punishment*, 43 S.D. L. REV. 527, 536 (1998).

<sup>16</sup> See Nicole Forbes Stowell & Katherine Barker, *Fraud, Fraud, Fraud: Mortgage Fraud and Bankruptcy Fraud*, 40 REAL ESTATE REV. J. 6 (2011) (“Not only does bankruptcy fraud diminish the integrity of the bankruptcy system, it also reduces the dollar amount received by creditors and increases the costs of borrowing to honest debtors and creditors.”).

<sup>17</sup> See *id.*

<sup>18</sup> See *id.*

<sup>19</sup> See *id.*

<sup>20</sup> See Gaumer, *supra* note 15, at 527; see also Stowell & Barker, *supra* note 16, at 6.

<sup>21</sup> *About the Program*, U.S. DEP’T OF JUSTICE (Mar. 6, 2014), [http://www.justice.gov/ust/co/ust\\_org/index.htm](http://www.justice.gov/ust/co/ust_org/index.htm).

<sup>22</sup> *Id.*

Federal Bureau of Investigation, and other law enforcement agencies to identify and investigate bankruptcy crime and abuse.<sup>23</sup>

In general, jurisdictions allow a trustee either to report directly to the United States Attorney's Office and furnish the United States Trustee with a copy of the crime report or to coordinate with the United States Trustee, who may then forward the report to the United States Attorney.<sup>24</sup> After inquiring into the facts of the report, the United States Attorney may present the matter to a grand jury or may "decide that the ends of public justice do not require investigation or prosecution."<sup>25</sup>

The United States Trustee Program currently has four primary methods of identifying bankruptcy fraud, abuse, or error: (1) private trustees review bankruptcy cases; (2) the United States Trustee Program field offices review bankruptcy cases; (3) the United States Trustee Program receives tips from persons who "could have a grievance with the debtor or who might be offended by the debtor's behavior and misuse of the bankruptcy system"; and (4) the United States Trustee Program performs debtor audits.<sup>26</sup>

### *1. The Primary Methods of Identifying Bankruptcy Crime*

#### *a. The Private Trustees' Review of Case Information*

Private trustees have a number of duties under 11 U.S.C. § 704.<sup>27</sup> In chapter 7 cases, the trustee has a duty to collect and liquidate the property of the debtor's bankruptcy estate.<sup>28</sup> In chapter 13 cases, the trustee must fulfill the duties of § 704(a)(2)–(9)<sup>29</sup> as well as evaluate and assist in the performance of

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<sup>23</sup> *Id.*

<sup>24</sup> EXEC. OFFICE FOR U.S. TRS., U.S. DEP'T OF JUSTICE, HANDBOOK FOR CHAPTER 7 TRUSTEES 8-47 to -48 (2001), *available at* [http://www.justice.gov/ust/eo/private\\_trustee/library/chapter07/docs/7handbook0301/ch7hb0701.pdf](http://www.justice.gov/ust/eo/private_trustee/library/chapter07/docs/7handbook0301/ch7hb0701.pdf).

<sup>25</sup> 18 U.S.C. § 3057(b) (2012).

<sup>26</sup> NOREEN CLANCY & STEPHEN J. CARROLL, IDENTIFYING FRAUD, ABUSE, AND ERROR IN PERSONAL BANKRUPTCY FILINGS 1, 10 (2007).

<sup>27</sup> 11 U.S.C. § 704. These duties include but are not limited to "collecti[ng] and reduci[ng] to money property of the estate" to distribute to creditors, "be[ing] accountable for all property received," "ensur[ing] the debtor has performed his intention," "investigat[ing] the financial affairs of the debtor," and "examin[ing] proofs of claims and object[ing] to the allowance of any claim that is improper". *Id.*

<sup>28</sup> *Id.* § 704(a)(1) ("The trustee shall collect and reduce to money the property of the estate for which such trustee serves, and close such estate as expeditiously as is compatible with the best interests of parties in interest.")

<sup>29</sup> *Id.* § 704(a)(2)–(a)(9).

the debtor's repayment plan.<sup>30</sup> Trustees, under both chapters, also have a duty to investigate the financial affairs of the debtor and to report potential bankruptcy crime to the Office of the United States Attorney.<sup>31</sup> Because trustees have these duties to oversee the financial affairs of each case assigned to them, they are potentially better able than other parties involved in the bankruptcy process to identify and report bankruptcy crimes.<sup>32</sup>

However, these trustees review all documentation manually and because none of the documentation is data-enabled for a system to detect key indicators of bankruptcy crime, trustees may be forced to focus their detailed reviews on only a small number of cases.<sup>33</sup> In addition to identifying fraud and referring allegations to the United States Attorney's Office, the trustee is also required to assist in carrying out prosecutions based on the referrals.<sup>34</sup>

*b. The Field Office's Review of the Case*

Field offices of the United States Trustee Program often act as a check on trustees.<sup>35</sup> In order to perform this check on the trustees, field offices conduct the means test<sup>36</sup> on all bankruptcy cases in order to detect income abuse.<sup>37</sup>

In cases where a debtor's bankruptcy documents raise suspicions of bankruptcy crime, field offices will often conduct a more detailed review of the

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<sup>30</sup> *Id.* § 1302 (“The trustee shall . . . appear and be heard at any hearing that concerns (A) the value of property subject to a lien; (B) confirmation of a plan; or (C) modification of the plan after confirmation . . . advise, other than on legal matters, and assist the debtor in performance under the plan.”).

<sup>31</sup> *Id.* § 704(a)(4) (“The trustee shall . . . investigate the financial affairs of the debtor”); 18 U.S.C. § 3057 (“[A]ny judge, receiver, or trustee having reasonable grounds for believing that any violation under chapter 9 of this title . . . has been committed . . . shall report to the appropriate United States Attorney . . .”).

<sup>32</sup> See CLANCY & CARROLL, *supra* note 26, at 10.

<sup>33</sup> *Id.*

<sup>34</sup> See 28 U.S.C. § 586(a)(3)(f). United States Trustees are required to “notify the appropriate United States Attorney of matters which relate to the occurrence of any action which may constitute a crime . . . and, on the request of the United States Attorney, assist the United States Attorney in carrying out prosecutions based on such action.” *Id.*

<sup>35</sup> See CLANCY & CARROLL, *supra* note 26, at 11 (explaining that even though the United States Trustee Program primarily relies on trustees to detect bankruptcy crime, the field offices also review bankruptcy petitions and schedules).

<sup>36</sup> 11 U.S.C. § 707(b). The means test is the test used by courts to determine eligibility for chapter 7 or in the alternative chapter 13 bankruptcy based on the debtor's income and expense information. Generally, if the debtor has an above-median income, he or she is not eligible for chapter 7 bankruptcy and would be forced into chapter 13 bankruptcy, requiring them to repay a portion of their debts through a payment plan.

<sup>37</sup> CLANCY & CARROLL, *supra* note 26, at 11 (noting that because the United States Trustee Program review includes means testing under § 707(b) of the Bankruptcy Code, “[it] reviews 100 percent of cases for income abuse and has provided field offices with extensive training and other guidance on means testing”).

bankruptcy case through a paper audit of the debtor's bankruptcy documents.<sup>38</sup> The field office may perform investigations by using online databases or may request additional financial information from the debtor.<sup>39</sup>

Under 11 U.S.C. § 343, any creditor, private trustee, examiner, or the United States trustee may examine the debtor under oath in a § 341 meeting.<sup>40</sup> Such examination, under 11 U.S.C. § 343 or under Federal Rule of Bankruptcy Procedure 2004, "may relate only to the acts, conduct, property or to the liabilities and financial condition of the debtor, or to any matter which may affect the administration of the debtor's estate, or to the debtor's right to discharge."<sup>41</sup>

The field offices also use fraud indicators generated by the United States Trustee Program in order to better review cases.<sup>42</sup> These fraud indicators include claims of theft or large gambling losses prior to filing, no ownership interest in residence, failure to file tax returns, repayments to friends or relatives with little or no documentation, and failure to list prior bankruptcies.<sup>43</sup> Although a fraud indicator may be present in a case where there has been no fraudulent actions or behavior, the United States Trustee Program, trustees, and law enforcement officials must still investigate if an indicator is present to determine whether prosecutable bankruptcy crime exists.<sup>44</sup>

### *c. Tips from Other Persons*

The United States Trustee Program also receives and relies on tips of fraud in its investigations.<sup>45</sup> These tips may come from any number of parties, including former spouses, business partners, ex-employees, creditors, and others.<sup>46</sup> Tips of fraud accounted for approximately 48% percent of fraud

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<sup>38</sup> *Id.*

<sup>39</sup> *Id.* (explaining the process for verifying information in the filing: (1) the reviewers may use online databases like ChoicePoint or LexisNexis, "which provide aggregate-level credit information or information on SSNs or vehicle ownership"; and (2) the field office may ask the debtor questions to clarify information or may request additional financial information).

<sup>40</sup> 11 U.S.C. § 343; *see id.* § 341. During a § 341 meeting, the trustee is required to inform the debtor of the consequences of bankruptcy discharge upon credit history, the debtor's ability to later file a bankruptcy petition, the effects of receiving a discharge, and the effects of reaffirming a debt. *Id.*

<sup>41</sup> FED. R. BANKR. P. 2004.

<sup>42</sup> *See* CLANCY & CARROLL, *supra* note 26, at 11.

<sup>43</sup> OFFICE OF THE INSPECTOR GEN., *supra* note 1 (describing the fraud indicators in detail and describing the process for after a case is screened and an indicator is detected).

<sup>44</sup> *Id.*

<sup>45</sup> *See* CLANCY & CARROLL, *supra* note 26, at 11–12.

<sup>46</sup> OFFICE OF THE INSPECTOR GEN., *supra* note 1.

referrals to the United States Trustee Program and to the United States Attorney's Office from 1999 to 2001 across five field offices.<sup>47</sup>

Tips, however, are potentially unreliable.<sup>48</sup> Although they are helpful for targeting bankruptcy crime, tips are a passive method and cannot be used as a substitute for effectively promoting the integrity of the bankruptcy system and preventing and detecting bankruptcy fraud.<sup>49</sup> Relying on tips risks expending the resources, time, and effort of the United States Trustee Program or trustee to investigate potentially illegitimate claims.<sup>50</sup>

#### *d. Debtor Audits*

In addition to active policing by the trustee and investigating tips of fraud, the United States Trustee Program, under § 603 of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), is required to audit samples of individual chapter 7 and chapter 11 filings.<sup>51</sup> When conducting these audits, the United States Trustee Program analyzes the debtor's petition and accompanying financial statements for complete correctness and truthfulness.<sup>52</sup>

The United States Trustee Program estimates that nearly 10% of all bankruptcy cases involve an element of fraud,<sup>53</sup> however, the recent audits conducted by independent firms under the direction of the United States Trustee Program have suggested that the estimate should be significantly higher.<sup>54</sup> For example, in 2014, 23% of the 1,637 audited cases included at

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<sup>47</sup> *Id.*

<sup>48</sup> *Id.* (noting that "although tips are a valuable tool for detecting fraud, if the United States Trustee intends for the trustees to bear the main responsibility for fraud prevention and detection, the trustees require more definitive guidance and training on the specific steps they are required to take, and time and resources must be made available for that purpose").

<sup>49</sup> *Id.*

<sup>50</sup> *See id.*

<sup>51</sup> Pub. L. No. 109-8, § 603(a), 119 Stat. 23, 122 (codified at 28 U.S.C. § 586 (2012)).

<sup>52</sup> *Id.*

<sup>53</sup> CRIMINAL DIV., U.S. DEP'T OF JUSTICE, FRAUD SECTION: ACTIVITIES REPORT FISCAL YEARS 2000 AND 2001, available at <http://www.justice.gov/criminal/fraud/documents/reports/2000-01/actrpt02.pdf>.

<sup>54</sup> *See* Stowell & Barker, *supra* note 16, at 8–10. *See generally* CLANCY & CARROLL, *supra* note 26, at 1; Clifford J. White III & Thomas C. Kearns, *BAPCPA Update: Debtor Audit Procedures and the Reporting of Material Misstatements*, AM. BANKR. INST. J., Dec. 2007/Jan. 2008, at 14 (discussing audits performed by the United States Trustee).

least one material misstatement.<sup>55</sup> Furthermore, in the three preceding years, 25% of the audited cases included at least one material misstatement.<sup>56</sup>

Under BAPCPA, the United States Trustee Program has the latitude to audit 1 out of every 250 consumer bankruptcy cases and is also given the authority to audit cases in which a consumer's income or expenditures vary greatly from the statistical norm in the jurisdiction in which the case is filed.<sup>57</sup> Despite this authorization, in the fiscal year of 2011 the United States Trustee Program randomly audited *only* 1 out of every 1,700 consumer bankruptcy cases.<sup>58</sup> In the public report detailing the audit, the United States Trustee Program stated that the low audit rate was due to "budgetary reasons."<sup>59</sup>

When a case is audited, an independent firm hired by the United States Trustee Program compares the original petition and financial schedules the debtor filed with additional documents that the firm may request from the debtor.<sup>60</sup> The audit firms also use commercially and publicly available databases to search for unreported assets and to verify the market value of assets.<sup>61</sup>

Once an audit is complete, the audit firm files a Report of Audit with the court and transmits a copy of the report to the United States Trustee Program.<sup>62</sup> The Report of Audit contains information on any material misstatements that the debtor may have made.<sup>63</sup> However, the Report of Audit is not a final determination and has no legal effect; whether the debtor made any material

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<sup>55</sup> EXEC. OFFICE FOR U.S. TRS., U. S. DEP'T OF JUSTICE, PUBLIC REPORT DEBTOR AUDITS BY THE UNITED STATES TRUSTEE PROGRAM FISCAL YEAR 2014 5 (2015) [hereinafter DEBTOR AUDITS 2014], *available at* [http://www.justice.gov/ust/eo/public\\_affairs/reports\\_studies/docs/Debtor\\_Audits\\_FY\\_2014\\_Public\\_Report.pdf](http://www.justice.gov/ust/eo/public_affairs/reports_studies/docs/Debtor_Audits_FY_2014_Public_Report.pdf).

<sup>56</sup> EXEC. OFFICE FOR U.S. TRS., U. S. DEP'T OF JUSTICE, PUBLIC REPORT DEBTOR AUDITS BY THE UNITED STATES TRUSTEE PROGRAM FISCAL YEAR 2013 5 (2014) [hereinafter DEBTOR AUDITS 2013], *available at* [http://www.justice.gov/ust/eo/public\\_affairs/reports\\_studies/docs/Debtor\\_Audits\\_FY\\_2013\\_Public\\_Report.pdf](http://www.justice.gov/ust/eo/public_affairs/reports_studies/docs/Debtor_Audits_FY_2013_Public_Report.pdf); EXEC. OFFICE FOR U.S. TRS., U. S. DEP'T OF JUSTICE, PUBLIC REPORT DEBTOR AUDITS BY THE UNITED STATES TRUSTEE PROGRAM FISCAL YEAR 2012 5 (2013) [hereinafter DEBTOR AUDITS 2012], *available at* [http://www.justice.gov/ust/eo/public\\_affairs/reports\\_studies/docs/Debtor\\_Audits\\_FY\\_2012\\_Public\\_Report.pdf](http://www.justice.gov/ust/eo/public_affairs/reports_studies/docs/Debtor_Audits_FY_2012_Public_Report.pdf); EXEC. OFFICE FOR U.S. TRS., U. S. DEP'T OF JUSTICE, PUBLIC REPORT DEBTOR AUDITS BY THE UNITED STATES TRUSTEE PROGRAM FISCAL YEAR 2011 2 (2012) [hereinafter DEBTOR AUDITS 2011], *available at* [http://www.justice.gov/ust/eo/public\\_affairs/reports\\_studies/docs/Debtor\\_Audits\\_FY\\_2011\\_Public\\_Report.pdf](http://www.justice.gov/ust/eo/public_affairs/reports_studies/docs/Debtor_Audits_FY_2011_Public_Report.pdf).

<sup>57</sup> Pub. L. No. 109-8, § 603(a)(2)(D), 119 Stat. 23, 122 (codified at 28 U.S.C. § 586 (2012)).

<sup>58</sup> DEBTOR AUDITS 2011, *supra* note 56, at 2.

<sup>59</sup> *Id.*

<sup>60</sup> *Id.* (describing the how the audit process and case designation process works).

<sup>61</sup> *Id.*

<sup>62</sup> *Id.*; *see* CLANCY & CARROLL, *supra* note 26, at 23.

<sup>63</sup> *See* DEBTOR AUDITS 2011, *supra* note 56, at 3 (A material misstatement "generally relates to [an] understatement or omission of the debtor's assets, income, or the pre-petition transfer of property").

misstatement is a question for the court.<sup>64</sup> Assuming the court determines a material misstatement has occurred, the United States Trustee Program determines what action is appropriate.<sup>65</sup> The United States Trustee Program has the authority to take several different actions depending on the circumstances of the case: it could make a motion for denial or revocation of discharge, or report the material misstatement to the Office of the United States Attorney.<sup>66</sup> It is possible for a debtor to cure a material misstatement revealed by an audit by filing amended schedules or proving that the material misstatement was unintentional.<sup>67</sup> If a debtor is able to cure a material misstatement, the United States Trustee Program may decide to take no further action against the debtor.<sup>68</sup>

The table below shows the nationwide aggregate audit outcomes for the fiscal year of 2011.<sup>69</sup>

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<sup>64</sup> *Id.*

<sup>65</sup> *Id.*

<sup>66</sup> *Id.* at 3–4.

<sup>67</sup> *Id.* at 4.

<sup>68</sup> *Id.*

<sup>69</sup> *Id.* at 5.

	<b>Total</b>	<b>Random</b>	<b>Exception</b>	<b>% of Cases Designated</b>
Cases Designated for Audit	1,077	555	522	
Cases with No Report (As of December 1, 2011)	22	22	0	2
Cases with Report	1,055	533	522	98
Report of Audit Filed	1,008	507	501	94
No Material Misstatements	755	407	348	
% of Reports of Audit	75	80	69	
At Least One Material Misstatement	253	100	153	
% of Reports of Audit	25	20	31	
Report of No Audit Filed	47	26	21	4

In more than two-thirds of the cases with a material misstatement, the misstatement was income-related.<sup>70</sup> Further, in approximately half of the cases which included a material misstatement, the misstatement consisted of an asset misstatement or transfer-related material misstatement.<sup>71</sup> This data indicates an overall material misstatement rate of 25% across cases audited by the United States Trustee Program in the fiscal year 2011.<sup>72</sup>

### *C. Prosecution of Bankruptcy Fraud*

#### *1. Introduction*

Prosecuting bankruptcy crime cases deters fraudulent behavior.<sup>73</sup> The deterrent effect of enforcement actions may vary depending on the type of bankruptcy crime.<sup>74</sup> Some cases may involve minor misstatements that would not justify the use of limited resources even if these misstatements could be successfully prosecuted.<sup>75</sup> However, prosecution of cases that involve a

<sup>70</sup> *Id.*

<sup>71</sup> *Id.*

<sup>72</sup> *Id.* at 1.

<sup>73</sup> CLANCY & CARROLL, *supra* note 26, at 9.

<sup>74</sup> *See id.*

<sup>75</sup> *See id.*

common misstatement may have a significant deterrent effect.<sup>76</sup> This Subpart will discuss the proportion of bankruptcy crimes actually prosecuted and their outcomes.

## 2. Criminal Referral Outcomes

The number of criminal referrals has increased the past five years.<sup>77</sup> In the fiscal year of 2011, the United States Trustee Program made 1,968 criminal referrals, while in the previous fiscal year only 1,721 criminal referrals were made.<sup>78</sup> The five most common criminal referrals were based on tax fraud (35.8%), false oath or statement (33.2%), concealment of assets (24.8%), bankruptcy fraud schemes (21.5%), and identify theft or use of false personal information when filing a bankruptcy petition (15.1%).<sup>79</sup>

The following table represents the outcomes of the 1,968 criminal referrals the United States Trustee Program made during the fiscal year of 2011.<sup>80</sup>

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<sup>76</sup> See *id.* (“[I]f that case were representative of a large number of cases that involve the particular type of misstatement, a successful civil or criminal action might deter a significant amount of fraud, abuse, and error. How much fraud, abuse, and error the system catches may not be as important as how much it can deter.”).

<sup>77</sup> Compare U.S. DEP’T OF JUSTICE, UNITED STATES TRUSTEE PROGRAM ANNUAL REPORT, FY 2012 25 (2013) [hereinafter ANNUAL REPORT, FY 2012], available at [http://www.justice.gov/ust/eo/public\\_affairs/annualreport/docs/ar2012.pdf](http://www.justice.gov/ust/eo/public_affairs/annualreport/docs/ar2012.pdf), with U.S. DEP’T OF JUSTICE, UNITED STATES TRUSTEE PROGRAM ANNUAL REPORT, FY 2011 25 (2012), available at [http://www.justice.gov/ust/eo/public\\_affairs/annualreport/docs/ar2011.pdf](http://www.justice.gov/ust/eo/public_affairs/annualreport/docs/ar2011.pdf), and U.S. DEP’T OF JUSTICE, UNITED STATES TRUSTEE PROGRAM ANNUAL REPORT, FY 2010 25 (2011), available at [http://www.justice.gov/ust/eo/public\\_affairs/annualreport/docs/ar2010.pdf](http://www.justice.gov/ust/eo/public_affairs/annualreport/docs/ar2010.pdf), and U.S. DEP’T OF JUSTICE, UNITED STATES TRUSTEE PROGRAM ANNUAL REPORT, FY 2009 25 (2010), available at [http://www.justice.gov/ust/eo/public\\_affairs/annualreport/docs/ar2009.pdf](http://www.justice.gov/ust/eo/public_affairs/annualreport/docs/ar2009.pdf), and U.S. DEP’T OF JUSTICE, UNITED STATES TRUSTEE PROGRAM ANNUAL REPORT, FY 2008 25 (2009), available at [http://www.justice.gov/ust/eo/public\\_affairs/annualreport/docs/ar2008.pdf](http://www.justice.gov/ust/eo/public_affairs/annualreport/docs/ar2008.pdf).

<sup>78</sup> See ANNUAL REPORT, FY 2012, *supra* note 77, at 24. This represents a 14.4% increase in referrals as compared with the prior year.

<sup>79</sup> U.S. DEP’T OF JUSTICE, REPORT TO CONGRESS: CRIMINAL REFERRALS BY THE UNITED STATES TRUSTEE PROGRAM FISCAL YEAR 2011 3 (2012), available at [http://www.justice.gov/ust/eo/public\\_affairs/reports\\_studies/docs/criminal\\_report\\_fy2011.pdf](http://www.justice.gov/ust/eo/public_affairs/reports_studies/docs/criminal_report_fy2011.pdf).

<sup>80</sup> *Id.* at 5.

**Table 2: Outcome/Disposition of FY 2011 Referrals (as of 12/06/11)**

Outcome/Disposition	Referrals	
	Number	Percent
Under Review in United States Attorney's Office	736	37.4%
With Investigative Agency	534	27.1%
Formal Charges Filed (Case Active)	15	0.8%
Formal Charges Filed (Case Closed)	4	0.2%
-At least One Conviction or Guilty Plea	4	
-At least One Pre-trial Diversion	0	
-At least One Dismissal	0	
-At least One Acquittal	0	
Prosecution Declined by United States Attorney	677	34.4%
Administratively Closed	2	0.1%

1) Outcome and disposition information will change over time. The information contained in Table 2 reflects information contained in CETS as of December 6, 2011.

2) Rounded percent based on 1,968 referrals.

Many bankruptcy crime cases are complex and may take up to two years and significant resources to investigate. Because of this there were still 736 cases under review by the United States Attorney's Office in the fiscal year 2011.<sup>81</sup> Of those 1,232 cases reviewed, 19 referrals resulted in formal charges (1.5%) and 677 referrals (54.9%) were declined for prosecution.<sup>82</sup>

The fiscal years of 2008–2010 have outcomes similar to the fiscal year of 2011. The past five years of data reveals that, while the number of referrals has increased each year, the rate of filing formal charges and the rate of failure to prosecute has stayed constant.<sup>83</sup>

<sup>81</sup> *Id.*

<sup>82</sup> *Id.* This report does not provide any information as to why the cases were declined for prosecution; this could be because the offense was only an unintentional minor misstatement or the potential defendant was able to cure the error.

<sup>83</sup> See U.S. DEP'T OF JUSTICE, REPORT TO CONGRESS: CRIMINAL REFERRALS BY THE UNITED STATES TRUSTEE PROGRAM FISCAL YEAR 2010 (2011), available at

## II. ANALYSIS

This study of prosecuted bankruptcy crime presented in this Comment sheds light on what factors may increase the likelihood of prosecution. Potentially 10% to 25% of filings possess an aspect of fraud, meaning nearly 375,000 out of 1.5 million bankruptcy filings per year may violate bankruptcy crime provisions of title 18.<sup>84</sup> Analyzing the data surrounding bankruptcy fraud prosecutions may elucidate why less than two hundred cases are prosecuted per year, while more than one thousand cases with known fraudulent aspects are dismissed after an indictment has been brought or are never prosecuted at all. Because bankruptcy fraud referrals from the United States Trustee Program to the United States Attorney's Office are not made public, this Comment is unable to analyze those referrals and instead focuses on all criminal bankruptcy fraud cases commenced in the fiscal years of 2010 and 2011. This study used Bloomberg Law to gather data from federal district court criminal case dockets involving bankruptcy crime. After an initial overview of numerous dockets, several variables appeared, on the surface, to impact whether cases were prosecuted and the outcome of the cases. Thus, these are the variables, described in more detail in Part A of this section, chosen to be analyzed in this study. Based on the study, this Comment argues that that when bankruptcy crimes are committed and charged in conjunction with non-bankruptcy related crimes they are more likely to be prosecuted and result in convictions.

### A. Methodology

This study analyzed seven variables: (1) the specific bankruptcy crime(s) the defendant was charged under, (2) the specific non-bankruptcy crime(s) the defendant was charged under, if any, (3) the type of defendant charged, (4) the type of bankruptcy filing, (5) the dollar amount at stake, (6) the outcome of the case, and (7) the resulting sentence imposed in cases in which the defendant was convicted.

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[http://www.justice.gov/ust/eo/public\\_affairs/reports\\_studies/docs/criminal\\_report\\_fy2010.pdf](http://www.justice.gov/ust/eo/public_affairs/reports_studies/docs/criminal_report_fy2010.pdf); U.S. DEP'T OF JUSTICE, REPORT TO CONGRESS: CRIMINAL REFERRALS BY THE UNITED STATES TRUSTEE PROGRAM FISCAL YEAR 2009 (2010), available at [http://www.justice.gov/ust/eo/public\\_affairs/reports\\_studies/docs/criminal\\_report\\_fy2009.pdf](http://www.justice.gov/ust/eo/public_affairs/reports_studies/docs/criminal_report_fy2009.pdf); U.S. DEP'T OF JUSTICE, REPORT TO CONGRESS: CRIMINAL REFERRALS BY THE UNITED STATES TRUSTEE PROGRAM FISCAL YEAR 2008 (2009), available at [http://www.justice.gov/ust/eo/public\\_affairs/reports\\_studies/docs/criminal\\_report\\_fy2008.pdf](http://www.justice.gov/ust/eo/public_affairs/reports_studies/docs/criminal_report_fy2008.pdf).

<sup>84</sup> See CRIMINAL DIV., *supra* note 53; DEBTOR AUDITS 2014, *supra* note 55, at 5; DEBTOR AUDITS 2013, *supra* note 56, at 5; DEBTOR AUDITS 2012, *supra* note 56, at 5; DEBTOR AUDITS 2011, *supra* note 56, at 2.

The first variable coded for bankruptcy crime under 18 U.S.C. §§ 152–157.<sup>85</sup> This study sought to determine whether certain bankruptcy crimes are more prevalent than others. A source has noted that bankruptcy crime is often prosecuted in conjunction with several other crimes.<sup>86</sup> In light of that assertion, the second variable coded for the specific crimes that the sources claimed were frequently prosecuted along with bankruptcy crimes (“designated charges”). Designated charges include money laundering, conspiracy, bank fraud, wire fraud, mail fraud, and unlawful transactions. General charges include all other non-bankruptcy related charges that were also charged in this body of cases.

The third variable coded for the type of defendants in these cases. These included four different classes of individuals: (1) pure consumers,<sup>87</sup> (2) sole proprietors, (3) officers of the court, and (4) corporate insiders.

The fourth variable coded for three types of bankruptcy filings: chapter 7, chapter 11, and chapter 13. Chapter 7 and chapter 13 encompass most consumer bankruptcy filings, whereas chapter 11 encompasses financially distressed business debtors. The study coded for this variable to determine whether fraud occurs more often in certain types of filings as opposed to others.

The fifth variable coded for the dollar amount at stake. “Dollar amount at stake” means the dollar amount of money that the debtor either illegally caused not to be included in the estate or the dollar amount, in general, that the debtor caused in damages by committing fraud. The purpose of coding this variable was to evaluate whether the dollar amounts at stake had bearing on the outcome or sentencing of cases.

Sixth, this study coded for the outcome of the case, as either guilty (including by plea agreement), not guilty, or dismissed. Seventh, this study coded for the resulting sentences in the cases, including any prison sentence, restitution, or probation ordered by the court. The sixth and seventh variables were coded so that they could be compared with the other variables in the study to analyze whether guilty verdicts and harsh sentencing are associated with certain bankruptcy crime violations under title 18.

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<sup>85</sup> See 18 U.S.C. §§ 152–157 (2012).

<sup>86</sup> CLANCY & CARROLL, *supra* note 26, at 9.

<sup>87</sup> A “pure consumer” is an individual debtor with only consumer debt.

### 1. *Choosing a Data Sample*

In choosing a data sample, this study selected cases from the fiscal years of 2010 and 2011. To offset effects of the recession, cases prior to 2010 were not selected. This study excluded the years after 2011 due to insufficient data because many cases after 2011 are still pending. From that broad sample, the study screened cases for inclusion in the data set.

First, the study executed a search query which included the terms “bankruptcy fraud” and/or “18 U.S.C. § 152,” “18 U.S.C. § 153,” “18 U.S.C. § 154,” “18 U.S.C. § 155,” “18 U.S.C. § 156,” and/or “18 USC § 157.”<sup>88</sup> The code sections were inputted into the Bloomberg Law<sup>89</sup> search function using the formula [title of the code: code section], for example “18:152,” which represents 18 U.S.C. § 152.

Second, the study narrowed the results to include only cases on federal court dockets. This is because the United States Trustee Program refers suspected crime to the United States Attorney’s Office,<sup>90</sup> which initially files the cases in federal district court. Finally, the study restricted the results to criminal cases only. This query produced 183 results.<sup>91</sup>

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<sup>88</sup> This was done in BloombergLaw’s “Search within results” feature and inputted as “bankruptcy fraud.”

<sup>89</sup> BLOOMBERG LAW, <http://www.bloomberglaw.com> (last visited May 1, 2015).

<sup>90</sup> *About the Program*, *supra* note 21.

<sup>91</sup> There are two specific limitations to this study. First, docket entries in some cases, including all or some related information and details pertaining to those cases, were sealed. Second, docket entries in some cases required a courier service to be retrieved. Due to these limitations, no cases were analyzed in this study.

<b>Figure 1: Bankruptcy Charges in Conjunction with All Other Non-Bankruptcy Related Charges</b>		
	Case Proportions	Case Percentages
<i>Bankruptcy Charge(s) in Conjunction with Designated Charge(s)</i>	53/107	49.5%
<i>Bankruptcy Charge(s) in Conjunction with General Charge(s)</i>	27/107	25.2%
<b>TOTAL</b>	<b>80/107</b>	<b>74.7%</b>

In Figure 1, the first row, “Bankruptcy Charge(s) in Conjunction with Designated Charge(s),” pertains to the number of bankruptcy crime cases that also involved designated charges. Fifty-three of the 107 total cases involved individuals charged with bankruptcy fraud and one or more of the following designated crimes: money laundering, conspiracy, bank fraud, wire fraud, mail fraud, and unlawful transactions. A guilty plea or verdict as to one or more charges was achieved in fifty-one out of fifty-three cases involving designated charges; all charges were dismissed in only two out of the fifty-three cases.

The second row, “Bankruptcy Charge(s) in Conjunction with General Charge(s),” pertains to the number of bankruptcy crime cases that also involved general charges. Twenty-seven of the 107 cases involved individuals charged with bankruptcy fraud and one or more general charges. General charges analyzed in the study included, but are not limited to, structuring transactions, income tax evasion, and social security fraud. A guilty plea or verdict was achieved in twenty-five out of twenty-seven cases involving only general charges; all charges were dismissed in only two out of the twenty-seven cases.

These results indicate that 80 out of 107 bankruptcy fraud charges, or 74.8% of the sample, were brought in conjunction with other non-bankruptcy related charges. Furthermore, it is clear from these results that when non-bankruptcy related charges are involved in bankruptcy fraud prosecutions the cases are aggressively pursued and almost always result in a guilty plea or guilty jury verdict to one or more charges.

The question arises whether bringing non-bankruptcy related charges prompts the prosecution of bankruptcy fraud cases or vice-versa. The majority of designated charges and general charges carry heavier penalties than bankruptcy-related charges. The potential penalties for bankruptcy crimes under title 18 range from less than one year in prison<sup>92</sup> to up to five years in prison<sup>93</sup> in addition to a fine.<sup>94</sup> Designated crimes carry much harsher sentencing provisions. For example, an individual convicted of money laundering may be fined “not more than \$500,000 or twice the value of property involved in the transaction, whichever is greater, or imprisonment for not more than twenty years, or both.”<sup>95</sup> An individual convicted of bank fraud may serve up to thirty years in prison as well as a \$1,000,000 fine,<sup>96</sup> while an individual convicted of either wire fraud or mail fraud may serve a twenty-year prison sentence in addition to a \$1,000,000 fine.<sup>97</sup> Considering the potential penalty terms for bankruptcy fraud with the terms for designated charges, the codified policies suggest that designated charges differ in nature from the bankruptcy offenses and in general prove to be more serious offenses, potentially causing more serious harm to the public.<sup>98</sup>

Additionally, Figure 2 identifies the disposition of cases involving only bankruptcy fraud crime charges. The data reveals that when bankruptcy fraud is charged alone, 66.7% of such cases are dismissed.

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<sup>92</sup> 18 U.S.C. §§ 155–156 (2012).

<sup>93</sup> *Id.* §§ 152–153, 157.

<sup>94</sup> *Id.* § 156.

<sup>95</sup> *Id.* § 1957; *see, e.g.*, *United States v. Gordon*, 379 F.2d 788, 790 (2d Cir. 1967) (noting that even though bankruptcy fraud violations carry maximum sentences, such as up to one or five years in prison, these provisions create separate crimes and may be indicted separately).

<sup>96</sup> 18 U.S.C. § 1344.

<sup>97</sup> *Id.* §§ 1343, 1341.

<sup>98</sup> *See* 28 U.S.C. § 991(b)(1) (asserting that the sentencing policies and practices for the federal criminal justice system must fulfill the purposes of 18 U.S.C. § 3553 and are meant to “provide certainty and fairness in meeting the purposes of sentencing . . . and reflect, to the extent practicable, advancement in knowledge of human behavior as it relates to the criminal justice process”).

**Figure 2: Bankruptcy Charges Only**

	Case Proportions	Case Percentages
<i>Verdict: Guilty</i>	9/27	33.3%
<i>Verdict: Not Guilty</i>	0/27	0.000%
<i>Dismissed</i>	18/27	66.7%

Twenty-seven out of 107 cases analyzed in this study contained only bankruptcy fraud charges. Eighteen out of these twenty-seven cases were dismissed; only nine cases were prosecuted and resulted in a guilty plea or guilty jury verdict as to one or more charges.<sup>99</sup>

This study found no other variable, aside from the variable of accompanying non-bankruptcy related charges, to account for the discrepancies in the decisions to prosecute or dismiss cases. No specific bankruptcy violation resulted in a harsher sentence than any other nor did the type of defendant or type of filing bear on the outcome of any case. Surprisingly, the dollar amount at stake also did not have an affect on how prosecutors chose to proceed with a case. Finally, there was no link between any specific bankruptcy crime violations and the outcome of a case or the resulting sentence of a convicted defendant.

Only one factor contributed to whether cases were prosecuted and resulted in guilty pleas or guilty jury verdicts: the involvement of non-bankruptcy related charges. In 2010 and 2011, eighty cases were prosecuted when bankruptcy crime was charged in conjunction with non-bankruptcy related crime, while only twenty-seven cases were prosecuted when only bankruptcy crime charges were involved. Furthermore, nearly 100% of cases resulted in guilty pleas or guilty jury verdicts when bankruptcy crime was charged in conjunction with non-bankruptcy related crime, while only 33.3% of cases

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<sup>99</sup> The court dockets did not provide any reasoning behind the dismissals of these cases.

resulted in guilty pleas or guilty jury verdicts when only bankruptcy crime charges were involved. Thus, this study can only conclude that when bankruptcy crimes are committed and charged in conjunction with non-bankruptcy related crimes they are nearly twice as likely to be prosecuted and are significantly more likely to result in convictions.

### CONCLUSION

A successful bankruptcy system heavily relies on the honest conduct of all parties involved, including debtors, creditors, attorneys, and the court.<sup>100</sup> Congress has recognized the necessity of honest administration in bankruptcy by enacting both BAPCPA and the relevant bankruptcy sections of title 18.<sup>101</sup> When the honest administration of bankruptcy is compromised, the United States government and the individual parties involved in the bankruptcy process are harmed.<sup>102</sup>

There are three injustices that result from misconduct in the bankruptcy system which undermine its policies. First, when creditors are not equitably compensated in bankruptcy due to the effects of bankruptcy crime, the costs of lending increase, thereby forcing creditors to shift these costs on to consumers.<sup>103</sup> The federal bankruptcy system provides that creditors are to be repaid equitably.<sup>104</sup> Often, and especially in chapter 7 cases, this means the creditor gets paid only a portion of the debt that is owed.<sup>105</sup> Because fraudulent activity decreases the value of the debtor's bankruptcy estate, the distribution that each creditor receives is less than what would be expected in an honest bankruptcy proceeding. Creditors face a high risk and the risk is passed on to borrowers in the form of higher lending costs if bankruptcy fraud is not prosecuted and the public is not deterred from such criminal acts. Considering there were over 1.2 million bankruptcy filings in the fiscal year of 2012<sup>106</sup> and

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<sup>100</sup> See OFFICE OF THE INSPECTOR GEN., *supra* note 1.

<sup>101</sup> See Pub. L. No. 109-8, 119 Stat. 23 (codified as amended in scattered sections of 11 U.S.C.); 18 U.S.C. §§ 152-157.

<sup>102</sup> See *Stegeman v. United States*, 425 F.2d 984, 986 (9th Cir. 1970).

<sup>103</sup> See *Stowell & Barker*, *supra* note 16 at 6 (explaining that “not only does bankruptcy fraud diminish the integrity of the bankruptcy system, it also reduces the dollar amount received by creditors and increases the costs of borrowing to honest debtors and creditors”).

<sup>104</sup> *Simonson v. Granquist*, 369 U.S. 38 (1962) (“[T]he broad aim of the act [is] to provide for the conservation of the estates of insolvents to the end that there may be as equitable a distribution of assets as is consistent with the type of claims involved.”).

<sup>105</sup> 11 U.S.C. § 726(b).

<sup>106</sup> See *Bankruptcy Fraud - Criminal Investigation (CI)*, IRS, <http://www.irs.gov/uac/Bankruptcy-Fraud-Criminal-Investigation-%28CI%29> (last updated Oct. 16, 2014).

bankruptcy fraud is estimated to occur in 10% to 25% of filings,<sup>107</sup> it is reasonable to infer that creditors incur substantial harm because of borrower insolvency.

Second, the government interest in collecting tax revenues is frustrated by bankruptcy fraud. Bankruptcy filings directly affect the collection of taxes.<sup>108</sup> For example, consider a debtor who owns property on which a tax was incurred before the commencement of the bankruptcy case. When the debtor files for bankruptcy, the debtor's property goes into the bankruptcy estate,<sup>109</sup> and the governmental unit becomes a creditor because of the taxes that had already accumulated on that property before the commencement of the case.<sup>110</sup> Under 11 U.S.C. § 507, allowed unsecured claims of governmental units, such as property taxes, are eighth in repayment priority, meaning that all secured claims and a number of other claims have priority over property taxes.<sup>111</sup> It follows that in many cases, after liquidation of the debtor's bankruptcy estate and distribution to creditors, there is little to no value remaining to distribute to the governmental units.<sup>112</sup> In such a situation, bankruptcy fraud would have the potential to diminish an already small bankruptcy estate. When there is a low rate of bankruptcy fraud prosecution, failure to prosecute bankruptcy crime independent of other crimes has the potential to negatively affect the amount of tax revenue the government generates.

Finally, the integrity of and public confidence in the bankruptcy system are seriously undermined by bankruptcy crime.<sup>113</sup> In 1998, Attorney General Janet Reno implemented Operation Total Disclosure, which was "an extensive nationally coordinated law enforcement effort against those who commit fraud crimes in the context of bankruptcy proceedings."<sup>114</sup> The purpose of the operation was to "protect the integrity of the bankruptcy system and enhance

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<sup>107</sup> See CRIMINAL DIV., *supra* note 53; DEBTOR AUDITS 2011, *supra* note 56, at 1.

<sup>108</sup> See INTERNAL REVENUE SERV., INTERNAL REVENUE MANUAL § 5.9.2 (2014), available at [http://www.irs.gov/irm/part5/irm\\_05-009-002.html](http://www.irs.gov/irm/part5/irm_05-009-002.html).

<sup>109</sup> 11 U.S.C. § 541.

<sup>110</sup> See *id.* § 507. This example assumes that the governmental unit is not a lien holder, and is thus an unsecured creditor (lien holders, secured creditors, are treated differently under the Bankruptcy Code).

<sup>111</sup> See *id.*

<sup>112</sup> See, e.g., *New Neighborhoods, Inc. v. W. Va. Workers' Comp. Fund*, 886 F.2d 714, 719 (4th Cir. 1989) ("Every priority claim lessens the dividend, if any, of a general creditor in the event of bankruptcy . . .").

<sup>113</sup> See *United States v. Messner*, 107 F.3d 1448, 1457 (10th Cir. 1997) ("A debtor [who commits bankruptcy fraud] violates the spirit as well as the purpose of bankruptcy."); Gaumer, *supra* note 15, at 536; *Bankruptcy Fraud - Criminal Investigation (CI)*, *supra* note 106; Stowell & Barker, *supra* note 16, at 6.

<sup>114</sup> Craig Peyton Gaumer, *Operation Total Disclosure*, AM. BANKR. INST. J., Apr. 1996, at 10, 10.

public confidence in that system.”<sup>115</sup> Through this mission, the Attorney General hoped this would lead to “a long-term increase in bankruptcy crime prosecutions.”<sup>116</sup> The data reported by the Department of Justice since Operation Total Disclosure was initiated, suggests that bankruptcy crime is still pervasive.<sup>117</sup> Furthermore, the results of this Comment indicate that despite its prevalence bankruptcy fraud is not being as aggressively prosecuted as Attorney General Reno had urged. The current high rate of fraud coupled with this Comment’s finding that bankruptcy fraud is not being strongly prosecuted independently of other crimes undermines public confidence in the bankruptcy system. It is essential to prosecute bankruptcy crime to deter fraud and to support the policies that underlie the bankruptcy system.

LEIA A. CLEMENT\*

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<sup>115</sup> *Id.*

<sup>116</sup> *Id.*

<sup>117</sup> See CRIMINAL DIV., *supra* note 53; DEBTOR AUDITS 2011, *supra* note 56, at 1.

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