

VOLUME 5: BANKRUPTCY FRAUD AND ABUSE ENFORCEMENT PROGRAM

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APPENDIX 5-1

Memorandum Dated October 10, 1995, from The Attorney General on Bankruptcy Fraud

VOLUME 5: BANKRUPTCY FRAUD AND ABUSE ENFORCEMENT PROGRAM

CHAPTER 5-1: POLICY AND DUTY TO INVESTIGATE AND REFER

5-1.1 **POLICY OF THE DEPARTMENT OF JUSTICE**

On October 10, 1995, Attorney General Janet Reno issued a memorandum reaffirming the position taken by the Department in 1992 which made "the aggressive prosecution of bankruptcy fraud a high priority of the Department of Justice." In the memorandum, General Reno stated "[i]t is imperative that the integrity of the bankruptcy system, an integral component of our national economy, be preserved and enhanced." She identified the basic components essential to a successful bankruptcy fraud effort--training; a team approach and coordination of all available resources; and prosecutorial discretion that focuses on the merits of a case rather than "a blanket declination policy based solely on dollar amounts." A complete copy of this memorandum is provided at Appendix 5-1.

5-1.2 **DUTY TO INVESTIGATE AND REFER**

5-1.2.1 **United States Trustee, 28 U.S.C. § 586(a)(3)(F)**

The United States Trustee has the duty of "notifying the appropriate United States attorney of matters which relate to the occurrence of any action which may constitute a crime under the laws of the United States and, on the request of the United States attorney, assisting the United States attorney in carrying out prosecutions based on such action." It is noteworthy that this section encompasses any crime, not just bankruptcy crimes, and imposes a duty to assist, as well as to report evidence of crimes.

5-1.2.2 **Judges and Private Trustees, 18 U.S.C. § 3057(a)**

A judge or private trustee "having reasonable grounds for believing that any violation under chapter 9 of this title or other laws of the United States relating to insolvent debtors, receiverships or reorganization plans

has been committed, or that an investigation should be had in connection therewith, shall report to the appropriate United States attorney all the facts and circumstances of the case, the names of the witnesses and the offense or offenses believed to have been committed. Where one of such officers has made such report, the others need not do so."

5-1.2.3

Chapter 11 Trustees and Examiners, 11 U.S.C. §§ 1106(a)(3) & (4)

A chapter 11 trustee or examiner has the duty to "investigate the acts, conduct, assets, liabilities, and financial condition of the debtor"; to file a statement of any such investigation conducted "including any fact ascertained pertaining to fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor"; and to transmit the statement to "any creditors' committee or equity security holders' committee, to any indenture trustee, and to such other entity as the court designates."

CHAPTER 5-2: DETECTING FRAUD AND ABUSE

5-2.1

DETECTION BY THE UNITED STATES TRUSTEE

5-2.1.1

Section 341 Meetings

The section 341 meeting provides an excellent opportunity to detect fraud and abuse. Questions by creditors, especially banks and other financial institutions, will often disclose the use of false social security numbers, the omission of assets, the improper disposition of property, as well as other irregularities.

The person conducting a section 341 meeting should verify the identity of the individual testifying and, in the case of a corporate debtor, the authority of the individual to testify on behalf of the debtor. All co-debtors should be present at the section 341 meeting, e.g., where a married couple files jointly, both spouses must be present and identified on the record.

The debtor should affirm, on the record, that he/she signed the petition and schedules submitted to the court, that he/she read them before signing them, and reaffirm that they are true and correct. If the debtor is hesitant on any of these issues, follow up questions should be asked. Creditors should be allowed sufficient time to ask questions, especially those relating to the accuracy of the filings or pleading. The hearing should be continued, rather than concluded, if satisfactory answers are not provided at the initial meeting.

5-2.1.2

Rule 2004 Examinations

The United States Trustee may also conduct an examination of debtor or other party pursuant to Rule 2004 of the Federal Rules of Bankruptcy Procedure. Where such an examination reveals evidence of fraud or abuse, it is important to ask follow-up questions to fully develop the relevant facts.

5-2.1.3

Use of Outside Agencies to Verify Accuracy of Information on Petition and Schedules

A debtor's petition and schedules should be examined for completeness and consistency. It is possible to verify the accuracy of information contained in a petition by checking it against information obtained from other agencies.

Examples of inquiries include: a suspicious social security number can be verified with the Social Security Administration; the status of loan payments and the transfer of property can be verified with the Federal Deposit Insurance Corporation; and the status of postpetition tax payments can be verified with the Special Procedures Branch of the Internal Revenue Service. In addition, under the provisions of 31 U.S.C. § 5319, information collected about monetary transactions over \$10,000 may be secured by a request of the Director through the Financial Crimes Enforcement Network (FinCEN) of the Department of Treasury. Requests for FinCEN information are reserved for cases involving serious irregularities.

5-2.1.4

On-line Investigative Public Records Information

The Program has contracted with CDB Infotek to provide on-line access to public records information. Every office has access to the database by a dial-up line. The Infotek service can be a resource to identify and locate assets, verify social security numbers, and obtain litigation history information.

Information printed from the database should be handled as "Limited Official Use" information. See USTM 6-21.4 for additional information on document/information security.

5-2.1.5

Investigations Must Have Legitimate Civil Purpose

All investigations conducted by the United States Trustee, including section 341 meetings and Rule 2004 examinations, must relate to a valid civil enforcement goal of the United States Trustee. No investigation may be conducted purely for the purpose of developing evidence to support a criminal referral. U.S. v. Unruh, 855 F.2d 1363, 1374 (9th Cir. 1987), cert. denied, 488 U.S. 474 (1987). Criminal sanctions may not be threatened in the course of a civil proceeding.

5-2.2

THIRD PARTY SOURCES

5-2.2.1

Referrals from Panel and Standing Trustees

Case trustees should be encouraged to bring any evidence of fraud or misconduct to the attention of the United States Trustee. Trustees may become discouraged from making referrals because of the relatively few resulting criminal prosecutions. It is important to assure them that referrals serve multiple purposes, including tracking trends in fraudulent activity and documenting the need for additional investigative and prosecutorial resources. The United States Trustee should also emphasize that the level and effectiveness of a trustee's referrals are important elements in the performance rating process.

Case trustees should prepare their own criminal referral letters, under the supervision of the United States Trustee. Referrals of debtors should be transmitted under 18 U.S.C. § 3057, through the United States

Trustee. If a case trustee makes a referral directly to a law enforcement agency, a copy should be furnished to the United States Trustee.

5-2.2.2

Complaints from Various Third Parties

Creditors, employees, former business associates, estranged or former spouses, and significant others are all likely candidates to provide information about possible criminal misconduct. Often such complaints are made via the telephone or a complainant may request to meet in person to discuss his/her concerns.

It is generally advisable to request a complainant to provide a written summary of his/her complaint, together with all documentation or other evidence that supports the allegations. This not only assists in "weeding out" complaints that are based on mere suspicion or rumor, but it also provides a documented, first-hand statement that can form the basis of a criminal referral.

5-2.2.3

Third Party Motions, Adversary Proceedings, and Rule 2004 Examinations

The United States Trustee should monitor third party actions against a debtor for evidence of criminal misconduct. Particular attention should be given to cases where multiple relief from stay actions have been filed or where a creditor moves to deny a debtor's discharge. Rule 2004 examinations conducted in support of third party motions can yield useful facts relating to fraud and misconduct.

CHAPTER 5-3: REFERRALS TO LAW ENFORCEMENT AGENCIES

5-3.1

PRIOR APPROVAL FOR CERTAIN REFERRALS

5-3.1.1

Public Officials and Private Trustees or Their Employees

Where the subject of criminal conduct is a public official, a private trustee, or an employee of a private trustee, the United States Trustee must notify the Deputy Director in writing, with pertinent details on the

matter, and provide a copy to the General Counsel and Assistant Director for Review and Oversight. Thereafter, the United States Trustee should furnish copies of all correspondence related to the matter to the Deputy Director, the General Counsel, and the Assistant Director for Review and Oversight. The United States Attorney must also be notified of the existence of any inquiry into the conduct of such individuals.

5-3.1.2 **Referrals Outside the Federal System**

The General Counsel must be notified prior to any referral being made outside of the federal system.

5-3.2 **PRIOR CONSULTATION WITH THE UNITED STATES ATTORNEY**

Prior consultation with the United States Attorney regarding the referral process, preferably in the context of a working group or task force, is valuable to the development of an effective working relationship. (See USTM 5.18.) It is important to understand the level of available resources, the types of cases that are of particular interest, and any overriding enforcement policies, such as a threshold dollar loss, that are considered by the United States Attorney. While these considerations should not influence the number and type of referrals made, they can help focus resources on those referrals that are most likely to be prosecuted.

5-3.2.1 **Formulating Mutual Policies on Referrals**

Under some circumstances, it may be advisable to formalize an understanding with the United States Attorney and other investigative agencies as to what and how matters should be referred. For example, it may be appropriate to prepare a detailed referral package only in cases where the matter meets the minimum enforcement guidelines of the United States Attorney. Cases that fall below that threshold may be sent over with a less detailed referral, as appropriate. Copies of all referrals should normally be sent to the appropriate investigative agency(s) at the same time they are sent to the United States Attorney.

Consideration may be given to establishing different types or classes of referrals, with a description of the type of referral appropriate for each. Some different classes of referrals that might be considered include:

Class 1: The United States Trustee considers the case a priority and has already conducted an extensive civil investigation that has resulted in significant evidence of a federal crime. Class 1 cases may also involve special concerns such as trustee defalcation, misuse of funds by professionals, or other particularly serious law violations. The United States Trustee should request the appropriate investigative agency and the United States Attorney to give the case priority, consistent with resource availability.

Class 2: The complaint sets forth sufficient grounds to warrant further investigation and is accompanied by supporting documents and other relevant evidence, but the case does not meet the "highest priority" standard. The United States Trustee should prepare a detailed referral memorandum to the United States Attorney.

Class 3: The complaint either falls below established guidelines or lacks available supporting evidence. The United States Trustee should prepare a summary cover sheet and forward the matter to the United States Attorney and the appropriate investigative agency(s), along with a statement that the matter is furnished for their information and that the United States Trustee will consider the matter declined unless the United States Trustee is notified otherwise.

5-3.2.2

Consultation Regarding a Particular Referral

Where the referral involves a matter of particular concern to the United States Trustee, it may be beneficial to inform the United States Attorney and/or the Federal Bureau of Investigation of the existence of an investigation prior to preparing the referral package. Prior consultation can serve several valuable purposes -- it can determine the level of available investigatory and prosecutorial resources and encourage a reallocation of resources if necessary. It can also stimulate interest in the case by explaining its significance in the context of the bankruptcy system. Finally, if it appears that prosecution is likely, special effort may be devoted to preparation of the referral package.

5-3.3 **THE REFERRAL PACKAGE**

5-3.3.1 **Tailoring the Package**

The level of detail in a referral package may vary. The most complete packages should be prepared for those matters that are of high priority to the United States Trustee and are likely to result in prosecution. Other cases may warrant an abbreviated package or simply a cover sheet or form referral. Tailoring the package to the matter may increase the number of referrals, as well as help focus enforcement resources on those that are of the highest priority. The package described in the following paragraphs is appropriate for priority referrals.

5-3.3.2 **Introductory Paragraph**

The referral should begin with a brief introductory paragraph summarizing the main crimes involved. It is important to get to the crux of the charges right away, reserving a more complete explanation of the complexities and procedural history for the full narrative. Charges should be labeled in criminal terms, such as "concealment of assets" or "false statements," rather than in terms of civil issues such as "multiple filings" or "bad faith filing."

5-3.3.3 **The Narrative**

The most important part of the referral package is the narrative description of the facts. The narrative should read like a story, weaving the facts with the law to explain not only what happened, but the significance of the acts described. The narrative should address the nature and amount of loss, where appropriate. If no monetary value can be established, the significance of the crime to the bankruptcy process should be explained.

The narrative should identify the proposed defendant(s), as well as relevant witnesses and their relation to the facts, from which their potential testimony and significance to the case can be easily determined. It should also clarify any aggravating factors, such as the abuse of a position of trust or conduct undermining the integrity of the

bankruptcy system, that may justify prosecution regardless of the amount of loss.

To prove a bankruptcy crime, the prosecution must show a "knowing and fraudulent" intent; therefore, the narrative should address the specific intent requirements of the alleged violation. A defendant's knowledge and intent may be ascertained from circumstantial evidence, United States v. Martin, 408 F.2d 949, 954 (7th Cir.), cert. denied, 396 U.S. 824 (1969); but, it is important to articulate what factors indicate the subject intended to defraud.

The narrative should also indicate the potential defenses that are likely to be available. Though it is not necessary to resolve an issue or any discrepancy in versions of an event, it is important to fully disclose problems or concerns. The return of a concealed asset or the fact that assets in question were ultimately used to pay creditors is not a defense to a bankruptcy crime, United States v. Klupt, 475 F.2d 1015, 1018 (2d Cir. 1973); however, it is a factor that would be considered in determining whether to bring a criminal prosecution.

5-3.3.4

Summary Information

The narrative portion of the referral should be followed by summary information, that includes:

1. A list of proposed defendants, including, if possible, their addresses; telephone numbers; and the names, addresses, and telephone numbers of their respective attorneys.
2. A list of potential witnesses, including, if possible, their addresses; telephone numbers; and the names, addresses, and telephone numbers of their respective attorneys, if any.
3. An estimate of the amount of loss involved and/or damage to the bankruptcy system, if not covered in the narrative.
4. Any information regarding previous investigations, referrals, reconstructions, etc., done in connection with the case by either the United States Trustee or other individuals or agencies.

5. Any relevant exhibits, such as copies of the petition and schedules, related correspondence, tapes or transcripts of the section 341 meeting or 2004 examination, etc. Where exhibits are lengthy, may be sufficient to identify what exhibits are available; however, attaching a key exhibit, such as a deposition or witness statement, may be beneficial.

5-3.3.5

General Information

The referral memorandum should conclude by providing the following general information:

1. The name, address, and telephone number of the contact person in the United States Trustee's office for the referral. This should be an attorney.
2. A request that the United States Attorney and the investigative agency provide the name of the Assistant United States Attorney and agent assigned to the referral.

5-3.3.6

Other Procedural Requirements

All referrals should be personally reviewed and signed by the Assistant United States Trustee in charge of an office. In the absence of an Assistant, the United States Trustee may designate a senior attorney advisor to review and sign referrals.

Where the subject of a criminal referral is a public official, a private trustee, or an employee of a private trustee, or a referral is made outside the federal system, the General Counsel should be consulted. (See USTM 5-3.1.1, 5-3.1.2 and 5-7.)

A copy of any referral that does not assume an immediate declination (i.e., a class 3 referral) should be provided (without exhibits) simultaneously to the Executive Office for United States Trustees, Attention: General Counsel; and to Special Assistant United States Trustee, Joe B. Brown, in the Nashville, Tennessee, office.

**CHAPTER 5-4: DECLINATION OF REFERRED CASES
BY THE UNITED STATES ATTORNEY**

5-4.1 REPORT OF DECLINATION TO THE ATTORNEY GENERAL

The United States Attorney is required to report cases that have been declined for investigation or prosecution to the Attorney General through the Fraud Section of the United States Department of Justice, Criminal Division. See 18 U.S.C. § 3057(b). In the absence of any comment by the Fraud Section, it is presumed that the Attorney General concurs in the United States Attorney's decision.

**5-4.2 APPEAL OF DECISION BY UNITED STATES ATTORNEY NOT
TO PROSECUTE**

If a United States Trustee disagrees with a decision by the United States Attorney not to investigate or prosecute, the United States Trustee should attempt to resolve the disagreement with the supervisory Assistant United States Attorney or the United States Attorney. If no resolution is reached, the United States Trustee may, in consultation with the General Counsel, seek approval of the Deputy Director to request formal reconsideration by the Fraud Section of the Criminal Division.

CHAPTER 5-5: TRACKING CRIMINAL REFERRALS

**5-5.1 TRACKING WITHIN THE UNITED STATES TRUSTEE
PROGRAM**

5-5.1.1 Tracking by the Office of Review and Oversight

The Office of Review and Oversight (ORO) maintains a data base to track criminal referrals made by the Program. At the end of each calendar quarter, ORO will furnish each United States Trustee with a

report detailing the referrals made by his/her region. The referrals will be divided into two categories.

1. Open referrals, which encompass all referrals last reported as either ongoing, open, or pending, as well as those with a pending indictment, information, or complaint.
2. Referrals with final dispositions, which encompass all referrals last reported as having been closed by the investigative agency, or declined by the United States Attorney or other appropriate authority, or which have a final conviction, acquittal, or dismissal of charges.

5-5.1.2

Tracking Within the Region/Office

Each region/office must track all referrals it has made until they are closed through declination, prosecution, etc., and submit an updated report to ORO each quarter providing information on new referrals and the status of all open referrals, paying particular attention to those that are more than one year old.

Where the United States Trustee knows that the case will be declined (i.e., a class 3 referral), the referral may be opened and closed at the same time on the quarterly report.

5-5.2

CASE TRACKING WITHIN THE UNITED STATES ATTORNEY'S OFFICE

Each United States Attorney's office uses a system that tracks cases from the time a file is opened until a case is closed. Cases that are declined with less than one hour's work are not reported on this system. Investigations and other proceedings where no formal charges have been lodged are called "matters," and each is given its own initial matter number. A matter becomes a "case" and is assigned a case number only after formal charges have been made via indictment or information. Usually, there is at least a 30-day lag in updates to the United States Attorneys' tracking system. At the present time, the system only tracks cases by the lead charge.

CHAPTER 5-6: DISCLOSURE OF REFERRALS

5-6.1

NEED FOR CONFIDENTIALITY OF REFERRALS

Department of Justice policy provides that criminal investigations may not be disclosed, absent unusual circumstances. Thus, the standard response to a question by the public, including the news media, of whether a matter has been referred for investigation or is under investigation should be: "We cannot either confirm or deny that such a matter has been referred or is under investigation." Any questions about indictments, pleas, and sentencing should be referred to the appropriate United States Attorney's office.

It is helpful to the system to have all criminal referrals processed through the United States Trustee's office. Where a panel trustee or a judge refers a criminal matter to the United States Trustee, he/she should be advised whether a referral was made. If the United States Trustee makes the referral, the panel trustee or judge does not have to make a duplicate referral. If the United States Trustee does not make a referral, the panel trustee or judge may have a duty under 18 U.S.C. § 3057 to make a referral if he/she has a reasonable suspicion that a crime has been committed. Pursuant to 18 U.S.C. § 3057, the panel trustee or judge has a right to make his/her complaint directly to the United States Attorney.

The United States Trustee should have an understanding with the United States Attorney for his/her district(s) on how complaints should be handled. Generally, United States Attorneys prefer that the United States Trustee offices screen complaints and be the central source for all referrals.

Once a referral is made, any information about the progress of an investigation should be on a strict, need-to-know basis and should be cleared with the United States Attorney.

Creditors and other individuals may provide information to the United States Trustee about criminal matters. If a referral has been made, the complainant should be advised that the matter has been referred and that

they should contact the United States Attorney's office for further information. If a United States Trustee decides not to make a referral based on the complaint of a private party, the individual should be advised of that fact. That individual is then able to take any other action he/she deems necessary, including making his/her own direct complaint to the United States Attorney. As a practical matter, where a referral is made, the complaining party will learn some details of the investigation, since investigative agents will usually have to contact him/her for additional information about the complaint.

5-6.2

DISCOVERY OF A UNITED STATES TRUSTEE'S CRIMINAL REFERRAL

A United States Trustee's referral of a bankruptcy fraud should not be discoverable. "There is a qualified privilege against disclosing material in the file of a government law enforcement investigation, civil or criminal, if: . . . the investigation is pending or, although presently closed, has a substantial possibility of being reactivated, and revelation of the material may prejudice the success of the investigation or a proceeding to which the investigation is directed." United States v. Am. Tel. & Tel. Co., 86 F.R.D. 603, 639 (D.C. Cir. 1979); In re Stockbridge Funding, 153 B.R. 654 (Bankr. S.D.N.Y. 1993)(recognizing a "bankruptcy crime--investigation privilege" for trustee's communications with United States Attorney).

Any efforts by any party to discover the contents of a criminal referral should be reported to the United States Attorney and should be resisted unless the United States Attorney desires to release the referral. The United States Attorney, as part of the discovery or plea negotiations, may want or need to release a part or all of a referral. After a conviction, the criminal referral should be released to the United States Probation Office for use in the preparation of the pre-sentence report.

CHAPTER 5-7: ALLEGATIONS INVOLVING LOSS OF ESTATE ASSETS BY A PRIVATE TRUSTEE OR AN EMPLOYEE OR AGENT OF A PRIVATE TRUSTEE

5-7.1 **GENERALLY**

The loss of estate assets or the inability to account for estate assets is a serious matter, and its expeditious resolution is a top priority. Allegations of the loss of estate assets by a trustee or anyone employed or retained by the trustee, regardless of the source, must be promptly investigated. When the United States Trustee believes that a trustee or an employee of a trustee is unable to account for estate assets, the procedures detailed in the following paragraphs must be followed.

5-7.2 **PRELIMINARY ASSESSMENT AND REPORT TO THE EXECUTIVE OFFICE**

The United States Trustee must immediately notify the Assistant Director for Review and Oversight and make a preliminary assessment of the likelihood of actual loss.

5-7.2.1 **Actions if No Loss Has Occurred**

If the preliminary assessment determines that no loss of estate assets has occurred, the United States Trustee should prepare a recommendation to the Assistant Director for Review and Oversight to terminate the inquiry. The United States Trustee should detail any action taken or to be taken to rectify any problems identified in the assessment. Upon concurrence of the Deputy Director, the inquiry shall be terminated.

5-7.2.2 **Actions if Loss Has Occurred**

If the preliminary assessment indicates a loss (including funds taken, advanced without order of the court, or borrowed and later repaid by the trustee) of estate assets, the United States Trustee shall immediately forward a written report to the Assistant Director for Review and

Oversight. The report should contain, at a minimum, the following information:

1. The name and location of the trustee.
2. Whether the trustee is active or inactive.
3. The number of open cases presently being handled by the trustees.
4. The names of any persons suspected of improper conduct in the handling of estate funds.
5. The number and location of bank accounts involved.
6. A factual narrative of the circumstances that can be verified as a result of the preliminary assessment.
7. The United States Trustee's recommendation of proposed action concerning the trustee and the estates under the trustee's administration.

In addition, certain situations, such as where there is evidence that the trustee mishandled estate assets or failed to take adequate precautions to safeguard the loss of estate assets, warrant immediate termination of future case assignments.

5-7.3

DISCUSSIONS OR NEGOTIATIONS REGARDING LOSSES

When there is a suspected loss of estate assets or an inability to account for those assets, there shall be no settlement negotiations, discussions, or agreements initiated or entered into regarding the return of funds, compensation, or resolution of the matter, absent the written approval of the Deputy Director.

5-7.4

ADDITIONAL ACTIONS IF TRUSTEE RESIGNATION OR REMOVAL MAY BE SOUGHT

If it appears likely that the United States Trustee will seek to remove the trustee from pending cases or initiate a criminal referral, or both, the United States Trustee should immediately notify the Deputy Director, to be followed by a written memorandum on the matter. Copies should simultaneously be provided to the Assistant Director for Review and Oversight and General Counsel.

Prior to requesting the trustee's resignation or instituting removal action in pending cases, the United States Trustee shall consult on the matter with the Deputy Director. If removal or resignation is initiated, consideration must be given to the appointment of a successor trustee or for the United States Trustee to serve as the trustee pending a further review of the case files.

5-7.5

INVESTIGATION OF A TRUSTEE'S FINANCIAL RECORDS

When the preliminary assessment indicates that assets cannot be accounted for or that embezzlement has occurred, an investigation of the trustee's case files and financial records will be initiated, with the approval of the Deputy Director. The Assistant Director for Review and Oversight, in consultation with the United States Trustee, will coordinate and oversee the selection of an investigation team, the determination of the type and amount of work required, and the nature and extent of records that must be gathered to carry out the investigation.

To facilitate the investigation, the United States Trustee should:

1. Prepare a list, reconciled with court records, of all open cases under the administration of the trustee.
2. If the trustee refuses to resign from assigned cases, prepare and file appropriate pleadings to remove the trustee from all cases. All motions to remove trustees must be reviewed and approved by the General Counsel.

