

# Civil Enforcement Initiative Takes Off in Virginia

by Cecelia Ann Weschler

In October of 2001, the United States Trustee Program launched a nationwide campaign, the Civil Enforcement Initiative, aimed at advancing and protecting the integrity of the bankruptcy system. The United States Trustee Program, a component of the Department of Justice, was created in 1978 to act as a “watchdog over the bankruptcy process.”<sup>1</sup> The program has 21 regions and 95 field offices, including four field offices in Virginia: Alexandria, Norfolk, Richmond and Roanoke. In creating the Civil Enforcement Initiative, the program invigorated its traditional role as guardian of the bankruptcy system. By using the existing tools in its statutory tool chest more frequently and more assertively, the U.S. Trustees pledged to “bolster public confidence in the integrity and effectiveness of the bankruptcy system.”<sup>2</sup>



The director of the Executive Office for United States Trustees, Lawrence A. Friedman, has made the Civil Enforcement Initiative the program’s highest priority.<sup>3</sup>

While continuing to fulfill their other statutory mandates, the United States Trustees have stepped up their use of Sections 707(a) and (b) and 727 of the Bankruptcy

Code, among other provisions, to carry out the initiative.

United States Attorney General John Ashcroft recently endorsed the United States Trustee Program's (USTP or Program) determination to make bankruptcy fraud and abuse its top priority:

"The bankruptcy system is an integral part of our free market system. With 1.5 million consumer and bankruptcy business cases filed [each] year, the bankruptcy system touches all facets of our economy. And it is the job of the United States Trustees to police our bankruptcy system, to enforce the bankruptcy laws and to seek redress where necessary . . . . Too often our bankruptcy system is used as a vehicle to perpetuate a myriad of fraudulent schemes, including tax fraud, health care fraud, federally insured mortgage fraud, credit card fraud, identity theft and other crimes. Combating this fraud and abuse is your first priority." (Remarks to program employees, November 19, 2002.)

Statistics from the first fiscal year of the initiative are telling. During fiscal year 2002, the U.S. Trustee's field offices took more than 50,000 civil enforcement and related actions. These actions resulted in nearly \$160 million in debts not discharged in Chapter 7 or funds potentially available for distribution to creditors.<sup>4</sup>

Reducing the numbers of abusive debtors is one aim of the initiative. Abuse takes many forms. During Fiscal Year 2002, the field offices successfully pursued more than 5,000 debtors under 11 U.S.C. § 707(b), preventing the discharge of almost \$60 million in consumer debt. The program seeks to catch the classic cases of abuse that have subjected the bankruptcy system to scorn. A recent case typifies the effort. A (literally) high-flying debtor, a commercial pilot, earned \$11,500 monthly.

She paid \$3,000 monthly for her mortgage. Before filing, she bought a \$50,000 Mercedes to replace the \$90,000 Mercedes that had been repossessed. She listed over \$122,500 in consumer credit card debts on her schedules. Finding that the receipt of a discharge would be a substantial abuse of Chapter 7, the court granted the U.S. Trustee's motion to dismiss.

The field offices are also on the lookout for "credit card bust outs." In these cases, potential debtors "max out" numerous credit cards, usually by taking cash advances. Some live lavishly with no way to pay for their extravagance. Some buy goods for resale. Some hide assets or give the money to friends, relatives or radical groups. When their credit dries up, they file for bankruptcy protection, seeking to discharge hundreds of thousands of dollars in debt.

If the U.S. Trustee unearths hidden assets, he or she will object to the discharge under § 727(a)(2). Often, these debtors have failed to keep records and are subject to an objection to discharge under § 727(a)(3). Lavish spending on the eve of bankruptcy also subjects these debtors to § 707(b) dismissals. Finally, some of the cases have resulted in referrals by the U.S. Trustee for criminal prosecution.

Serial filers are another area of abuse. Many U.S. Trustee field offices encounter debtors who have filed five or more cases unsuccessfully. These debtors file repeatedly to forestall foreclosures. After deter-

ial filers from filing bankruptcy again for a certain period of time.

The U.S. Trustees are also filing more complaints objecting to debtors' discharges. In 11 U.S.C. § 727, Congress authorized the U.S. Trustees, among others, to sue those debtors whose serious misconduct should preclude them from receiving a Chapter 7 discharge. The U.S. Trustees pursue these cases when debtors conceal or transfer assets, destroy or fail to keep and provide financial records, make false statements or engage in other severe wrongdoing. In Fiscal Year 2002, more than 300 debtors were denied discharges under Section 727 as a result of the U.S. Trustees' efforts. In these cases, more than \$40 million in debts were excepted from discharge.

The program also seeks to find those who use incorrect Social Security numbers on their petitions. This form of abuse is devastating for innocent strangers who find, often years later, that their credit reports contain a bankruptcy case they never filed. In cases in which the debtors' social security number is incorrect, the program requires the debtors to amend their petitions and notify creditors and all major credit reporting agencies of their errors. The program seeks sanctions against those who do not rectify their wrongs. Those who appear to possess criminal intent are referred to the United States Attorneys for prosecution.

The Civil Enforcement Initiative aims to do more than catch abusive debtors. It

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mining that a multiple filer is truly abusing the system, the field offices seek to deny the debtor's discharge or dismiss the case. They often obtain orders enjoining the ser-

endeavors to protect debtors and other victims of those who abuse the process. The program has directed its civil enforcement efforts at unscrupulous bankruptcy

petition preparers and “mortgage assistance” companies, for example.

Petition preparers often pluck their clientele from those facing imminent foreclosure of their homes. Some illegally render

fees paid and often award the debtor damages as well.<sup>5</sup> An attorney’s choice to charge a low fee is an insufficient excuse for failing to attend the debtor’s mandatory meeting of creditors or for failing to perform the basic services required

plaints objecting to discharges under 11 U.S.C. § 727 as well. In the same six-month period, they made 50 inquiries under Section 727 and filed 11 complaints objecting to discharge. The Virginia offices are also working to banish unscrupulous petition preparers, making 53 inquiries into their work between October 1, 2002, and March 31, 2003.

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legal advice and perpetrate mortgage fraud. Filing bankruptcy petitions for unknowing debtors is a particularly egregious trick.

Some “mortgage assistance” companies direct their clients to make their mortgage payments to them. Instead of forwarding the payments to the lenders, they pocket the debtors’ money. Often without the debtors’ knowledge, they file a bankruptcy petition on the debtors’ behalf and use the automatic stay to perpetuate the scam. When the debtors do not attend the meeting of creditors, the case is dismissed. Undeterred, the “mortgage assistance” company continues filing cases for the debtors until the United States Trustee seeks an injunction against further filing. Eventually, the debtors lose their home, when a competent, honest attorney could have saved it.

The program is also determined to protect consumer debtors from attorneys who may harm their often-desperate clients by performing shoddy work. Exercising their prerogative under 11 U.S.C. § 329 and Federal Rule of Bankruptcy Procedure 2017, the U.S. Trustees are inquiring into the fees debtors’ attorneys charge and the services they provide. When an attorney has charged too much for too little, the courts will order the attorney to return the

to properly represent a debtor. In such circumstances, the United States Trustee may seek the disgorgement of a meager fee.

Additionally, the program monitors Chapter 11 debtors to see that they comply with their statutory obligations. When they fail to do so, the field offices use the tools found in 11 U.S.C. § 1112 to dispatch these debtors from the protection of Chapter 11. Finally, the Civil Enforcement Initiative seeks to fight fraud and abuse by making criminal referrals and assisting United States Attorneys in prosecuting criminal cases.

The four Virginia field offices are hard at work in carrying out the civil enforcement effort. The Virginia offices conduct some review of each Chapter 7 petition. They search for discrepancies in the sworn papers. They scrutinize each case for abuses of the system. The offices receive many civil and criminal referrals from Chapter 7 and 13 trustees and from citizens reporting suspected fraud and criminal activity.

Between October 1, 2002, and March 31, 2003, the Virginia offices made 399 inquiries into suspected cases of substantial abuse of Chapter 7 and filed 63 motions under 11 U.S.C. § 707(b). The Virginia field offices are filing more com-

The Virginia offices are writing the story of civil enforcement one case at a time. One Norfolk case highlights the effort to address wrongs suffered by victims of attorney malfeasance. A creditor garnished \$4,000 in the savings account of a single mother of four. The woman filed Chapter 7, but her attorney did not properly exempt the garnished funds. The chapter 7 trustee easily obtained the funds for the benefit of the debtor’s creditors; he referred the case to the Office of the U.S. Trustee because of the attorney’s malfeasance. The U.S. Trustee sought and obtained an order requiring the debtor’s attorney to pay the debtor the \$4,000 she would have been able to exempt had her attorney properly done so.

Another recent Norfolk case typifies the suits under 727. The debtor’s schedules and tax returns, both signed under penalty of perjury, presented two wildly diverging pictures of the same business. When the debtor testified under oath that he had no records to substantiate either picture, the U.S. Trustee successfully objected to his discharge under 11 U.S.C. § 727(a)(3).

The effort to refer suspected crimes to the United States Attorneys is ongoing in Virginia. The integrity of the bankruptcy system hinges on honest disclosure by all participants. As a consequence, the prosecution of false oaths and other crimes is crucial. The Virginia field offices launched 16 preliminary investigations in the six-month period from October 1, 2002, through March 31, 2003. In the same period, 4 defendants either plead guilty or were convicted of federal bankruptcy

crimes in Virginia. The United States Attorneys for the Eastern District of Virginia are especially vigorous in prosecuting bankruptcy crimes. The criminal activities uncovered often include the making of false oaths in sworn bankruptcy papers or in hearings in the cases.

Many Virginia attorneys welcome the U.S. Trustee's efforts. Some report that they screen cases more critically for fraud or abuse. Many have expressed their hope the U.S. Trustee's enhanced use of existing laws will stave off the controversial bankruptcy reforms Congress has threatened for the last several years. Other Virginia attorneys protest that the initiative has chilled their clients' ability to make use of the bankruptcy laws. Without a doubt, the Civil Enforcement Initiative has invigorated the United States Trustees in their work as watchdogs of the bankruptcy sys-

tem. Given the breadth of the abuses unearthed to date, these sentries are unlikely to abandon their posts anytime soon. ☺

Endnotes:

- 1 *House Report* No. 989, 95th Cong., 2d Sess., at 88 (reprinted in 1978 *U.S. Code Congressional & Admin. News* at 5787, 5963, 6049).
- 2 Press release, Executive Office for United States Trustees, "U.S. Trustee Program Launches Bankruptcy civil Enforcement Initiative," October 30, 2001.
- 3 Friedman was appointed as director the Executive Office for United States Trustees on March 4, 2002.
- 4 Antonia G. Darling and Mark A. Redmiles, "The Civil Enforcement Initiative: A Review of the First Ten Months and a Look at the Next Stage," [www.usdoj.gov/ust/press/articles](http://www.usdoj.gov/ust/press/articles). The nationwide statistics for the program, as well as some of the examples herein, are derived from this article.
- 5 See *In re Soulisak*, 227 B.R. 77, 82 (E.D. Va. 1998)(Bostetter, Jr., J.)(11 U.S.C. § 329 and state ethical rules permit unethical conduct to serve as a factor in analyzing reasonableness of legal fees paid by a debtor) (all fees ordered to be disgorged in four Chapter 7 cases because lawyers violated Virginia ethics rules governing the unauthorized practice of law).



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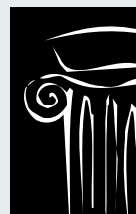


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