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Closing Argument Mark S. Blackman

Bankrupt Ethics

Congress must act to stem the tide of multiple bankruptcy and scam filers.

Bankruptcy fraud is epidemic despite well-intentioned efforts to curtail the problem. Last year, the U.S. Bankruptcy Court for the Central District of California issued its "Final Report of the Bankruptcy Foreclosure Scam Task Force." The report details the many bankruptcy scams used by debtors and so-called "foreclosure specialists" who claim they can delay or even save a debtor's home from foreclosure. The task force suggested remedies and implemented countermeasures to combat the fraud. Some of its efforts have been effective, but as any creditor's legal counsel knows, much more needs to be done.

To help stem the tide of fraudulent bankruptcy filings, Congress must act to give the nation's bankruptcy courts explicit power, including authority to issue blanket and "in rem" relief orders, to deal with multiple bankruptcy and scam filers.

At the heart of bankruptcy fraud is the misuse of the "automatic stay" afforded debtors under Section 362 of the Bankruptcy Code (11U.S.C.§362). While intended to protect debtors and give them breathing room from their creditors, many debtors and "foreclosure specialists" have used the automatic stay to prevent lenders from completing a foreclosure for months and sometimes for years.

The automatic stay is the least expensive and most easily obtained injunction available. By filing a petition and paying a nominal fee, the debtor is given an automatic stay without ever having to appear in court. All actions against the debtor are then immediately stopped until the creditor takes affirmative action and seeks relief from the court. Unfortunately, even if the creditor obtains relief in a bankruptcy case, many debtors and other third parties engage in further schemes to endlessly delay the foreclosure process.

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The task force report detailed other types of fraud, including the "fractionalized interest" scam, in which a person transfers a small percentage of an ownership interest in property (usually 5 percent or 10 percent) to the bankruptcy debtor to take advantage of the automatic stay. On many occasions, multiple transfers are made to multiple debtors to delay the foreclosure for years. In other instances, debtors will transfer a fractionalized interest in real property to people who have filed or intend to file bankruptcy, forcing the creditor to seek relief for each debtor.

Unscrupulous debtors also file emergency "face sheet filings" and obtain a stay of actions against their creditors without ever intending to complete their bankruptcy.

Other scams include voluntary dismissals filed by debtors that are timed to avoid trustees' dismissal orders, which prevent the debtor from refiling new cases for 180 days. The scam works this way: Debtors filing a Chapter 13 bankruptcy petition know that they must pay a post-petition mortgage payment at a creditors meeting approximately six weeks after filing. On the eve of the meeting, the debtors file a voluntary dismissal, thus preventing a dismissal by the Chapter 13 trustee with a 180-day bar to refiling. The debtors then file another case and delay the process for an additional six weeks.

Another foreclosure-delay tactic is using aliases and phony Social Security numbers. Through computer records, the Central District can now identify debtors who were prevented from refiling because of a 180-day bar imposed by the court. This allows the court to reject subsequent petitions. Feeling the heat debtors now simply use an alias, alter or create a Social Security number and either amend an existing case or file a new one.

These unchecked foreclosure scams have taken a toll. In 1991, more than 78,500 bankruptcy petitions were filed in the Central District. By 1997, filings reached a record 117,318.

The Central District has implemented some countermeasures to bankruptcy abuse. These include automatic dismissals of face-page filing cases with a 180-day bar when the debtor fails to file schedules and statements within 15 days of the initial filing, or fails to appear at two "first meetings of creditors." Some judges have issued orders-to-show-cause to require debtors to show why fractionalized interest cases should not be dismissed with a 180-day bar. The court is developing a procedure to review and identify the use of phony Social Security numbers and alias amendments.

To help reduce serial filings and voluntary dismissals, judges have been urged to conduct a quick investigation of the dismissal to learn whether the debtor has filed previous cases and whether a creditor has filed a motion for relief from stay, thus allowing the court to invoke a 180-day bar under Section 109 (g) of the Bankruptcy Code.

Over the past 15 years, the Central District's judges have issued written court decisions attempting to deal with fraudulent bankruptcy filers. However, this has met with limited success. In *In re Kinney* (C.D. Cal. 1985) 51 B.R. 840, six family members filed 10 bankruptcy cases over a 25-month period. Judge Geraldine Mund held that multiple bankruptcies filed by a family of debtors resulted in the loss of the individuality of debtors, allowing the court to treat the family as one debtor for relief from stay motions.

In the case of *In re Willie Brown* (C.D. Cal. 1980) 7 B.R. 23, Judge Robert L. Ordin allowed a creditor to obtain relief from a stay and the creditor to foreclose without notice to the debtor with the condition that after the sale took place, the debtor be given an opportunity to show why the foreclosure sale should be set aside. The real property had been transferred on the eve of the foreclosure sale on two prior occasions to grantees who immediately filed bankruptcy.

Cases such as these give some hope to creditors and their legal counsel, but they are not binding on all judges in the Central District or the 9th United States Circuit Court of Appeals. While it is obvious that fraudulent bankruptcy filings must be stopped, some judges in the Central District and elsewhere are reluctant to become heavy-handed with debtors because the Bankruptcy Code does not authorize such action. Unless the 9th Circuit issues a ruling specifically authorizing in rem or blanket orders for relief from a stay, or the United States Congress amends the Bankruptcy Code to include such relief, fraudulent filings will continue to occur and the number of filings in the Central District will continue to soar.