For $800 and the Deed To Your Home--
Bankruptcy Foreclosure Scams
Target Distressed Home Owners

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"Attention Home Owner: Save your homes--Stop foreclosure now! Before you file bankruptcy call me first. We refinance mortgages regardless of your credit history!" Unless your home has been listed for foreclosure, you've probably never received an advertisement like this in your mailbox, but you may have seen similar solicitations printed in the local newspaper or posted on the grocery store bulletin board. These solicitations may signal that a lucrative type of fraud–-the bankruptcy foreclosure scam–-has established a foothold in your community.

In May 1998, the Bankruptcy Foreclosure Scam Task Force of the United States Bankruptcy Court for the Central District of California issued its final report[2] describing several bankruptcy foreclosure scams operating in the region; explaining how they hurt bankruptcy courts, lenders, and homeowners; and recommending ways to combat them in the Central District of California.

But bankruptcy foreclosure scams should not be dismissed as solely "an L.A. problem." The most complex and lucrative bankruptcy foreclosure scams have arisen in major metropolitan areas on the West Coast; in August 1998, one Los Angeles-area perpetrator was sentenced to 71 months in prison and ordered

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[1]All views expressed in this article are those of the author and do not necessarily represent the views of, and should not be attributed to, the United States Department of Justice or the United States Trustee Program. The author wishes to thank all of the United States Trustee Program employees who provided invaluable information and assistance in the development of this article.

[2]<u>Final Report of the Bankruptcy Foreclosure Scam Task Force</u>, United States Bankruptcy Court, Central District of California, May 1998 ("Task Force Report"). The text of the report is posted on the American Bankruptcy Institute's web site at www.abiworld.org.

to pay more than $72,000 in restitution for running a scam involving more than 200 fraudulent bankruptcy filings. However, Mom-and-Pop operations are appearing even in mid-size Midwestern cities. And some perpetrators are not only reaching across state lines to recruit local "customer representatives," but are also seeking referral affiliations with local consumer bankruptcy attorneys.

Reports from United States Trustee Program personnel around the country make clear that bankruptcy foreclosure scams are geographically widespread, as well as varied in their methodology.

Types of Foreclosure Scams

"For the cost of a bankruptcy filing fee, a debtor can immediately obtain one of the most powerful injunctions available under American law: the automatic stay," the foreclosure scam task force pointed out. The task force report described bankruptcy foreclosure fraud as the practice of filing for bankruptcy to delay or defraud creditors, without intending to comply with the requirements for obtaining a bankruptcy discharge or completing a repayment plan.

The foreclosure scam most commonly associated with the West Coast is the fractional interest transfer. Typically, a partial interest––perhaps 5 percent or 10 percent––in property held by a homeowner facing foreclosure is transferred to a real or fictional entity already in bankruptcy. Because the property interest is then held by a bankruptcy debtor, the original owner's creditor cannot foreclose until the bankruptcy court lifts the automatic stay.

Some scams involve fractional interests transferred with the knowledge of the original property owner. Often, however, the original owner first transfers the property to the perpetrator of a foreclosure scam, who then transfers the fractional interest without the original owner's knowledge. Sometimes a property is moved from case to case as the stay is lifted; one residential property was linked to 24 different bankruptcy cases[3].

The task force report explained how one homeowner facing foreclosure was persuaded by a scam perpetrator to sign deeds

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[3]"The Foreclosure Must Go On; L.A. Bankruptcy Judges Give the Hook to 'Artful Dodger' Debtors," 84-May A.B.A.J. 32.

of trust and grant deeds transferring fractional interests in her property. The homeowner paid the foreclosure consultant several hundred dollars per month so she could stay in her home. The fractional interest recipients included apparently fictitious individuals as well as homeless persons recruited for a fee to participate; eight recipients filed for bankruptcy one after the other. Each filing stayed foreclosure on the property, causing a 10-month delay between the first filing and the completed foreclosure.

Many more variations of bankruptcy foreclosure fraud are surfacing around the country. Probably the most widespread involves the use of foreclosure notices to identify individuals facing the loss of their homes. The scam perpetrator contacts the home owner, advertising “mortgage assistance” or “foreclosure counseling” and promising to work out the home owner’s problems with the mortgagee or to obtain refinancing for an up-front fee typically ranging from $250 to $850. The perpetrator may direct the home owner to “fill out some forms,” including a blank bankruptcy petition, or may collect the information needed to complete a petition later. The perpetrator subsequently files a bankruptcy petition in the home owner’s name, after filling in the bankruptcy papers signed by the home owner or forging the home owner’s signature. The bankruptcy petition invokes the automatic stay, the imminent foreclosure is postponed, and the home owner stops receiving collection calls and letters.

In most cases, the perpetrator does not tell the home owner about the bankruptcy petition, instead convincing the home owner that foreclosure activity has ceased because mortgage problems have been worked out. The perpetrator may tell the home owner that he or she might receive a notice from the court, which should be ignored. The home owner may even be told that the perpetrator has gone to court on the home owner’s behalf. No one appears at the Section 341 meeting, the case is dismissed, the foreclosure goes forward, and the home is lost.

Permutations of this scam include the perpetrator’s collecting monthly mortgage payments from the homeowner, falsely stating that they will be forwarded to the mortgagee. In these cases, each defrauded homeowner pays not only the up-front fee for “services,” but also hundreds or thousands of dollars in mortgage payments.

In another increasingly common alternative, the scam perpetrator convinces the home owner to quit-claim the residence to the perpetrator or to sell the residence for a nominal fee such as $1. The home owner agrees to transfer title because he or she has little or no equity in the property. The perpetrator charges the home owner “rent” or a “consultant’s fee” or “management fee” to stay in the residence while the mortgage problems are worked out, after which the home owner will be able to “apply for repurchase” of the property or share the profits if the perpetrator sells the property.

But it costs money for the perpetrators to file all of these bankruptcy cases. To avoid bankruptcy filing fees, some perpetrators transfer an interest of the home owner’s quit-claimed property into the name of an existing bankruptcy debtor–-perhaps a Chapter 11 business debtor across the country–-in a variation of the fractional interest scam. Typically, the debtor learns that a property interest has been transferred into its bankruptcy estate when it is contacted by counsel for the property owner’s secured creditor, who has learned it cannot foreclose because the property is owned by a bankruptcy debtor.

Detecting and Reporting Scams

Bankruptcy foreclosure scams can be exceptionally difficult to detect because the cases are usually dismissed for failure to participate, leaving no sign of the defrauded home owner. Many cases proceed no further than the Section 341 meeting, so Chapter 7 and 13 trustees form the “front line” of foreclosure scam detection.

Warning signals to tip off a trustee that a home foreclosure scam is operating include: a proliferation of pro se petitions filed with no schedules; a series of debtors with similar petitions or schedules; debtors’ failure to show up at the Section 341 meeting; multiple debtors represented at the meeting by a bankruptcy petition preparer or other non-attorney; debtors who attend the meeting but are confused about whether they are in bankruptcy; and a rash of debtors who clearly lack sufficient income to fund a Chapter 13 repayment plan.

Bankruptcy judges are another valued source of information. Suspicious cases have been flagged by judges in districts across the country, from Los Angeles to Detroit to Baltimore to Miami. One judge noticed that an attorney was filing many cases that were not being properly serviced. This can indicate that a scam perpetrator is either referring home owners to an attorney to assist them in filing bankruptcy, or sending completed bankruptcy papers to the attorney to file in court with or without the home owners' knowledge. Scam perpetrators use the latter method to avoid liability for violating Bankruptcy Code Section 110's restrictions on bankruptcy petition preparers.

In addition, secured lenders can flag foreclosure scams, because they have unique access to relevant documentation. A secured lender receives all of the bankruptcy cover sheets on a particular piece of property. These documents may disclose that different debtors are all linked to the property. The secured lender may the only entity that can pull together this revealing information.

Consumer bankruptcy attorneys can also help bring foreclosure scams to light. A home owner whose bankruptcy case is filed by a scam perpetrator and dismissed for lack of participation may have to file for bankruptcy again. A client's story told to a bankruptcy attorney may reveal that the client was burned by a bankruptcy foreclosure scam.

Debtors' counsel should be aware that perpetrators seek out attorneys–-sometimes inexperienced attorneys without a well-developed reputation in the bankruptcy community--and offer case referral. Frequently, the attorney is expected to kick back part of the legal fee to the perpetrator in exchange for the referral.

Some scams are reported by victimized home owners, although many home owners never realize they were defrauded. A victim who complains to the perpetrator after foreclosure occurs–-assuming the perpetrator is still operating in the area–-may be told that the mortgage problems were too serious to work out or the home owner's credit was too bad to obtain refinancing. Sometimes, however, receipt of notice from the bankruptcy court prompts the home owner to call the court, the United States Trustee, the case trustee, or a bankruptcy attorney. Other complaints are brought by home owners who apply for credit and discover a bankruptcy filing listed on their credit records.

Foreclosure scams are most likely to flourish, and least likely to be detected, in judicial districts inundated with bankruptcy filings. If the private trustee can quickly identify a case as improperly filed and obtain its immediate dismissal, avoiding a six- to 12-month delay in foreclosure, a home owner may be more likely to complain about a "mortgage consultant's" poor service. However, with high bankruptcy case loads causing substantial delays in relief from stay, some defrauded home owners decline to report the scams, apparently deciding that the extra months of living in their homes offset their losses.

The most dramatic method of detecting bankruptcy foreclosure scams is through undercover investigations like "Operation Churn 'N Burn," a 1995 sting that resulted in seven convictions. In Churn 'N Burn, fictitious foreclosure actions were filed in the county court. Scam perpetrators zeroed in on two apparently distressed home owners, unaware that the "spouses" were Federal Bureau of Investigation agents and their "home" was provided by the U.S. Department of Housing and Urban Development[4].

But undercover operations targeting bankruptcy fraud are rare. In combating bankruptcy foreclosure fraud, the United States Trustee Program relies upon tipoffs from participants in the bankruptcy system–-the trustees, bankruptcy judges, bankruptcy clerks, secured lenders, and attorneys.

Who Are the Victims?

Bankruptcy foreclosure scams claim many victims, but the one that suffers the greatest harm is the bankruptcy system. The task force report noted that bankruptcy cases filed solely for delay take disproportionately more clerical and judicial time and attention because they usually involve more relief from stay motions, orders to show cause, and motions and orders to dismiss. Nationwide, foreclosure scams may cause the inappropriate filing of thousands of bankruptcy cases, including cases filed without the petitioners' knowledge, cases knowingly filed by property owners seeking only to benefit from the stay, and cases voluntarily filed by home owners after being strung along by scam perpetrators.

Lenders also suffer from foreclosure scams, receiving no payments for months or years while the repeated transfers and bankruptcy filings invoke the automatic stay. When the

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[4]"Nine Indicted by U.S. for Bankruptcy Fraud; Foreclosures Key to Alleged Scam," Chicago Tribune, May 19, 1995, 1995 WL 6208323; "Nine Charged in Bankruptcy Fraud Case," Chicago Sun-Times, May 20, 1995, 1995 WL 6654358; "Justice Announces Indictments of Nine, Including Lawyer, For Bankruptcy Fraud," BNA's Bankruptcy Law Reporter, May 25, 1995, p. 607.

case involves a federally insured mortgage loan, such as a Veterans Affairs or Federal Housing Administration loan, the government is ultimately a victim of bankruptcy fraud because it must cover the mortgagee's loss.

Home owners who place their trust in scam perpetrators–-who may play up religious or ethnic identities with names like Christians Helping Homeowners–-can end up financially devastated. "We'll help you keep your piece of America," promised advertisements distributed by a Dallas "consultant" who was sentenced in August 1998 to 24 months in prison and ordered to repay $58,000 in restitution for bankruptcy fraud and bank fraud. Defrauded home owners paid the defendant from $2,000 to $15,000 in fees and mortgage payments; around 30 home owners are believed to have lost their homes due to her activities.

Varied Remedies

Foreclosure scams can look like easy money and can reach huge proportions. A successful criminal prosecution sends the message that scams will not be allowed to flourish. One Los Angeles-area defendant was sentenced in August 1998 to 71 months in prison and ordered to pay more than $72,000 in restitution for operating a massive bankruptcy foreclosure scam involving more than 200 fraudulent bankruptcy filings. Another L.A.-area defendant was charged of running a foreclosure scam affecting more than 500 homes.

Attorneys and analysts from the United States Trustee Program work closely with federal, state, and local prosecutors in cases involving bankruptcy foreclosure scams. Often, United States Trustee Program personnel not only put together the initial referrals–-a lengthy documentation process--but also assist in the investigation and development of the case. Criminal cases frequently involve charges under 18 USC 157, which imposes fines and/or imprisonment for the use of the bankruptcy system as part of a scheme or artifice to defraud. Alternatively, state and local authorities may bring charges under state anti-fraud provisions.

But bankruptcy fraud rarely ranks first among criminal prosecution initiatives, because of limited investigative and prosecutorial resources. The bankruptcy foreclosure fraud task force asserted that "the criminal process is too slow and too limited to be the primary line of defense against bankruptcy fraud." The amount of loss per case is small, witnesses often move without leaving forwarding addresses, paper trails are hard to follow, and positive identification can be elusive.

That makes it crucial to explore other ways to fight bankruptcy foreclosure scams. United States Trustees have successfully litigated civil actions against foreclosure scam perpetrators under Bankruptcy Code Section 110. In addition, active enforcement of state unauthorized practice of law provisions, as well as a vigilant state bar, can create an inhospitable atmosphere for petition preparers and lawyers who would engage in unlawful or unethical behavior.

The bankruptcy foreclosure fraud task force made several suggestions for combating bankruptcy foreclosure scams, including amending Section 362 to explicitly authorize the bankruptcy court to enter an “in rem” order–-that is, an order stating that a lift-stay order will remain effective as to a particular property in any future bankruptcy case, without the creditor’s seeking further relief from stay. The National Bankruptcy Review Commission made a similar recommendation in its final report[5], and several bankruptcy reform bills have included language to this effect. This position is not without controversy, however; despite the task force’s view, even some of the bankruptcy judges in the Central District of California believe they lack jurisdiction to issue such orders.

The task force also advocated amending Bankruptcy Rule 5005 to let the bankruptcy clerk reject a bankruptcy petition if the filer does not provide identification. This recommendation was intended to prevent scam perpetrators from filing petitions without the named debtors’ consent or with the use of false names or Social Security numbers. The United States Trustees are also considering steps they may take to protect against these abuses, including requiring identification at the Section 341 meeting.

Conclusion

Bankruptcy foreclosure fraud is a growing problem that threatens the integrity of the bankruptcy system as it takes advantage of families in distress. The United States Trustee Program is working hard to identify bankruptcy foreclosure scams around the country and to take appropriate action through criminal referrals and civil suits, but we need help from members of the bankruptcy community.

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[5]Bankruptcy, the Next Twenty Years, National Bankruptcy Review Commission Final Report, October 20, 1997, pp. 281-287.

The United States Trustee Program welcomes information that will help detect bankruptcy foreclosure scams, and is indebted to those trustees, judges, clerks, secured lenders, bankruptcy attorneys, and private citizens who report suspicious fact patterns. We also appreciate the efforts of federal and state law enforcement authorities who target these operations. We will continue to coordinate with all participants in the bankruptcy system to eradicate this destructive form of fraud.