

Commercial Fraud Task Force Committee

The ABI Commercial Fraud Task Force Committee facilitates information sharing, training, and education between ABI members and the public-private sector to combat commercial bankruptcy fraud.



Those Pesky Schedules: Be Careful, Creditors and Others Are Reading Them!

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Numerous recent decisions highlight the need for accuracy and attention to detail in preparing and filing the schedules and statement of financial affairs (SOFA). While some of the cases involve fraudulent or criminal conduct, they should remind us that accuracy and completeness are critical. Even errors in the schedules, or SOFA, with no actual intent to defraud creditors can cause litigation expense and delay the entry of discharge.

The first case is *U.S. v. Archibald*, in which the debtor filed a chapter 13 petition in 2003, listing a 100 percent interest in a company that owned an adult entertainment club, valued at \$2,000. 212 Fed. Appx. 788, 789-790. On the secured creditor's motion to dismiss, the debtor testified that the sum of \$2,000 represented his initial investment in the club, and on cross-examination, he admitted that the company had no debt and was worth approximately \$4.0 million. *Id.* at 790. The debtor then testified, in response to questions by the court, that the \$2,000 was the value of the last license for the club and admitted again that the club was worth \$4.0 million. *Id.* The court therefore dismissed the chapter 13 proceeding, finding that the debtor had abused the bankruptcy process. *Id.*

The debtor's troubles did not end there. After the trustee referred the matter to the FBI, the debtor gave several contradictory explanations for his valuation and therefore, was indicted for knowingly and fraudulently concealing property of the estate (18 U.S.C. §152(1)) and making a false oath in a bankruptcy case (18 U.S.C. §152(2)). *Id.* at 790-791. A jury convicted the debtor on both counts, rejecting his argument that he was unfamiliar with bankruptcy law and the process of filling out bankruptcy petitions. *Id.* at 794. One key piece of evidence was the debtor's 1991 chapter 13 filing, which was converted to chapter 7 because the debtor's failure to list the *same company* in his schedules. *Id.* On appeal, the Eleventh Circuit concluded that evidence of intent to conceal assets was sufficient. *Id.* at 798. The debtor knew the company was worth well more than \$2,000 – he estimated the value of the club between \$3.0 and \$5.0 million in several pre-petition loan applications – and his explanations for the \$2,000 valuations were “woefully inconsistent.” *Id.* Thus, the debtors' conviction was affirmed.

Problems with schedules and the SOFA can also complicate criminal prosecutions. In *U.S. v. Naegele*, 2007 WL 1140116 (D.D.C. 2007), the debtor, a lawyer, filed a chapter 7 proceeding and received a discharge. *Id.* at *1. A few years later, the debtor was indicted for allegedly

making misstatements in his schedules and SOFA. *Id.* Shortly before the criminal trial, the debtor learned that the signature page for his SOFA had never been filed with the bankruptcy court; instead, it appeared that the signature page for the schedules had been filed twice. *Id.* at *1-3. Accordingly, the debtor moved to dismiss the count of the indictment related to the SOFA on the basis that the prosecution could not prove a violation of 18 U.S.C. §152(3), which requires filing of sworn documents. *Id.* at *7. The court agreed, dismissing that count of the indictment and holding as a matter of law that the last page of the SOFA had to be filed in order for a crime to have been committed. *Id.* at *10.

The debtor also moved for dismissal of the entire criminal prosecution as a penalty for the prosecutor's alleged misconduct in either knowingly presenting false evidence to the grand jury, *i.e.*, that the SOFA signature page had been filed, or acting in conscious indifference to the truth. *U.S. v. Naegele*, 2007 WL 1140117. Following an "extraordinary two-day evidentiary hearing," the court concluded that the prosecutor's failure to realize that the signature page of the SOFA was not filed with the court was not prejudicial to the debtor, and so denied the motion. *Id.* at *4-6. Thus, the prosecutor's failure to recognize which signature page went with which document (the schedules versus the SOFA), cost the government several counts of the indictment and significant litigation expense.

Even if "inaccuracies" in the schedules do not lead to criminal proceedings, they can cost the debtor significant sums in litigation costs, and jeopardize the discharge. For example, in *Abbey v. Retz (In re Retz)*, 2007 WL 892504 (Bankr. D. Mont. 2007), a creditor objected to the debtor's discharge under §727(a)(4), alleging that the debtor failed to adequately disclose fourteen items. On plaintiff's motion for summary judgment, the court recognized that the issue was whether the debtor acted with the requisite intent and whether the false statements and omissions were material. *Id.* at *8. The court began its analysis by noting that it could find the requisite fraudulent intent "where there has been a pattern of falsity or from a debtor's reckless indifference to or disregard of the truth." *Id.* (internal citations omitted). The second requirement to be met, that the nondisclosures were "knowingly" made, could not be met on mere recklessness, but could be met upon proof of a "reckless disregard of both the serious nature of the information sought and the necessary attention to detail and accuracy in answering." *Id.* at *9 (internal citations omitted). The court denied the motion for summary judgment, based largely upon the affidavits of the debtor and his counsel, explaining the errors in the schedules, including the fact that the trustee, not the debtor, had all of the business records, and that numerous items in the draft schedules prepared by the debtor were omitted when the attorney finalized them. *Id.* at *10-13. The debtor further explained that because of his location and upon counsel's advice, he signed the declarations despite not having seen the final schedules. *Id.* Thus, what appears to consist largely of sloppiness and inattention to detail, led to protracted, contested litigation which, three years into the bankruptcy case, was nowhere near complete.

Similarly, in *United States v. Harrison*, 2007 WL 784341 (S.D. Tex. 2007), the debtor transferred numerous items, failed to disclose those transfers, and failed to disclose other assets in his bankruptcy schedules, including his interest in the sole proprietorship from which he made his living. *Id.* at *3-9. The schedules also mischaracterized debt to the IRS, failed to disclose several lawsuits, and reported income different from that reported in his tax returns. The debtor also made false statements at his 341 meeting of creditors by failing to disclose assets. *Id.* After the debtor obtained a discharge in his no asset chapter 7 case, the IRS sought to revoke his discharge and foreclose upon the transferred assets. The court, reviewing the debtor's lack of

candor in his schedules and at the 341 meeting, concluded that the debtor obtained his discharge through fraud and therefore, revoked it under §727(d). *Id.* at *9.

Certainly, some of these cases present extreme examples. Nonetheless, they do serve as an important reminder to maintain accuracy in both completing and filing the schedules and SOFA.