FINAL REPORT OF THE BANKRUPTCY FORECLOSURE SCAM TASK FORCE

UNITED STATES BANKRUPTCY COURT CENTRAL DISTRICT OF CALIFORNIA

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FINAL REPORT OF THE BANKRUPTCY FORECLOSURE SCAM TASK FORCE[1]

I. BACKGROUND

In 1996, Geraldine Mund, Chief Judge of the United States Bankruptcy Court for the Central District of California, established an Ad Hoc Task Force to investigate abusive bankruptcy filings and to recommend possible solutions. The principal focus of the Task Force has been the recent rash of serial filings by individuals and entities solely for the purpose of delaying foreclosures on single family homes. The Task Force's scope was not limited to the serial filing problem, however, and it looked into a variety of systemic abuses. This report summarizes the work of the Task Force and its recommendations for action.

> *For purposes of this study, a bankruptcy case is considered to be "abusive" if it was filed to delay or defraud creditors, without any intention of complying with the requirements to obtain a discharge or complete a plan.*

The Task Force's definition of "abuse" thus differs sharply from another usage that has recently become relatively commonplace: lenders and others debating consumer bankruptcy policy sometimes use the term "abusive bankruptcies" to refer to cases in which debtors seek to discharge substantial credit card and other unsecured debt that possibly could be partially repaid via Chapter 13. By contrast to those arguments over the appropriate *scope* of consumer discharges, the cases of concern here do not seek *any* discharge, because they are never intended to be completed. All they seek is the automatic stay.

Of greatest concern to the Task Force are the numerous abusive bankruptcies being filed by entrepreneurial individuals who advertise themselves as "mortgage consultants" or "foreclosure specialists." The abusive filings force lenders to expend considerable time and money obtaining relief from the automatic stay, and victimize

1. This report appears in its original form, with only minor formatting changes.

misinformed, vulnerable homeowners suffering serious financial setbacks. These victims are charged fees for the scam artists' services, and are often left without a home, but with a record of unwanted bankruptcies.

The Task Force brought together governmental and law enforcement agencies, public interest organizations, the legal community, lending institutions and the Bankruptcy Court, in a concerted effort to examine the problems and to develop solutions to minimize the numbers and impact of fraudulent filings. Its first meeting on July 22, 1996 was attended by representatives from the Bankruptcy Court, the Office of the United States Trustee, the United States Attorney's Office, the District Attorney's Office, the California Department of Real Estate, the California Bankers Association, Public Counsel, and various lending institutions. The nature of the problems identified via anecdotal evidence prompted expansion of the Task Force membership to include representatives from the Federal Bureau of Investigation, the Internal Revenue Service, and the Federal Trade Commission. In addition, so many bankruptcy attorneys wanted to participate that a special "open mike" forum was held in December 1996, to receive testimony on foreclosure fraud.

During 1996 and 1997, the Task Force developed and analyzed proposals for legislative and administrative reforms, gathered data to document the incidence of abusive bankruptcies filed to stop or delay foreclosures, and attempted to estimate the losses attributable to scam-induced delays. The Bankruptcy Court's study of the incidence of such filings has been compiled as part of this report. Estimating lender losses caused by these scams, however, proved to be extremely difficult. The Task Force settled for a loss analysis of selected examples of serial filings, for the purpose of illustrating the costs resulting from these scams. An effort to establish an interagency process for sharing information about individuals and organizations suspected of involvement in foreclosure scams was stymied by technological and institutional barriers.

In part, the Task Force's composition and approach emulated that of the Ninth Circuit's Ad Hoc Committee on Unlawful Detainer and Bankruptcy Mills. Created in 1992 by Chief Judge Clifford Wallace, the Unlawful Detainer Committee coordinated and initiated efforts to reduce the number of bankruptcy cases being filed in the

Central District of California solely to stop residential evictions. Through procedural and legislative reforms, that Committee succeeded in substantially reducing the percentage of bankruptcy filings attributable to evictions over a four-year period.

In this report, the Bankruptcy Foreclosure Scam Task Force describes:

- the types of problems identified in the course of its meetings, hearings, and studies,
- the existing efforts to deal with these problems,
- its studies to determine their frequency and the magnitude of associated losses and costs, and its recommendations.

The Task Force's proposed solutions emphasize administrative, practice, and rule changes that can be implemented by the Central District Bankruptcy Court within the current statutory and national rules framework. The Task Force also suggests certain changes to state and federal laws that would help to eradicate abusive practices.

II. THE NATURE AND PATTERNS OF ABUSIVE BANKRUPTCY FILINGS

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. Under § 362 of the Bankruptcy Code (11 U.S.C. § 362), the filing of a bankruptcy petition automatically stays all actions or proceedings to enforce a claim against that debtor or the debtor's property, without the debtor having to prove any entitlement to injunctive relief. Section 362 requires a halt to all collection actions, suspension of any foreclosures, and termination of repossession activity. For a financially distressed homeowner facing foreclosure, a completed bankruptcy case buys needed time to cure mortgage arrearages by means of a payment plan under Chapter 13, or provides the "fresh start" of a Chapter 7 discharge by eliminating the burden of a possible deficiency judgment.

In the Central District of California, however, many bankruptcy cases are filed by people who apparently have no intention to complete them. Bankruptcy cases filed solely for delay have been a problem ever since the concept of the voluntary petition was introduced in American bankruptcy law. In recent years, the Central District has witnessed the emergence of a new phenomenon on a substantial scale: some people have apparently created whole businesses

out of the delay possibilities provided by the automatic stay. Advertising themselves as "foreclosure services" or "mortgage consultants," these opportunists know that, once a foreclosure trustee learns that a bankruptcy petition has been filed, the sale will be delayed until relief from stay is obtained from the bankruptcy court. They also know that title companies will not insure foreclosure title without a lift stay order. Most make false promises or misrepresentations to the homeowners. For the period from petition filing to stay termination, the opportunity exists for these services to collect partial mortgage payments or rent in exchange for stalling the foreclosure. In addition, some individuals indulge in serial filings on their own or with relatives.

For purposes of this report, the Task Force has adopted the term "foreclosure scam" to refer to the filing of multiple or fraudulent bankruptcy petitions to delay residential foreclosures, without any intent to complete the cases. Often the only document filed by the debtor in such cases is a "face-sheet" petition, the bare minimum documentation required to file a bankruptcy under Fed. R. Bankr. P. Rule 1007. Other cases are filed with all the required documents, but only one or two creditors are listed. Whether the schedules are missing or filed, these cases are characterized by the debtors' failure to take further action to complete their cases. This lack of prosecution surfaces at several stages: no appearance is made at the § 341(a) meeting with the trustee; no opposition is made to lift stay motions; no response is filed to orders to show cause to dismiss. Without any effort other than the filing of a petition, the debtor thus obtains the benefit of the automatic stay for weeks or months. Sometimes, of course, these orphaned cases may have been filed in good faith, even though the debtors later abandon them. The problem for the Central District Bankruptcy Court is not the isolated abandonment of individual cases, but rather the wholesale filing of cases for purposes of delay and fraud.

The Task Force has identified at least five different types of foreclosure scams operating in the Central District of California.

A. The "Fractional Interest Transfer" Scam

The existence of foreclosure services came dramatically to the Bankruptcy Court's attention in 1994, when "fractional interest

transfer" cases began surfacing in significant numbers in all divisions of the court. These cases clogged the relief from stay calendars, each resulting in dozens of motions on different properties. A few cases topped 100 stay motions before the court began to take countermeasures. Generally, these cases shared the following characteristics:

- Almost all of the properties were unscheduled.
- The interest in the property was transferred to the debtor *after* the petition was already on file.
- The debtors received only a fractional interest in the property, usually 5 or 10%.
- Similar interests were transferred either simultaneously or serially to other debtors.
- Many of the transfer deeds were notarized by one or two specific individuals, one of whom had a history of various abusive bankruptcy schemes previously, as well as a criminal record for fraud.
- In many of the early cases, the debtor appeared to be wholly fictitious. In later cases, one turned out to be the janitor for the foreclosure services; more recently, homeless individuals have been paid $200.00 to allow themselves to be the subject of a voluntary petition.

Because the transferred interest is held by a debtor in bankruptcy, the original borrower's creditors cannot proceed with foreclosure on the property or obtain insurable title, unless they first obtain relief from the automatic stay. A lift stay motion heard on regular notice takes three to four weeks from service to entered order. Despite the availability of shortened notice hearings before many judges if there is evidence of fractional interest transfers, some of the most outrageous serial filings have delayed foreclosure for more than a year, as in the examples described in Attachment 3.[2]

For example, one homeowner facing imminent foreclosure on her home in San Bernardino was approached by a scam perpetrator, and agreed to sign a series of deeds of trust and grant deeds transferring fractional interests in her property. The homeowner paid the foreclosure consultant a few hundred dollars per month. The grantees of the fractional interests included homeless individuals, as well

2. All attachments on file with *Loyola of Los Angeles Law Review*.

as apparently fictitious people. Eight different grantees then filed bankruptcies one after the other. Each filing stayed foreclosure on the homeowner's home. From the first filing to the completed foreclosure took ten months. Another cluster of fractional interest cases surfaced in the San Fernando Valley. Apparently organized within an immigrant community, this group of filings followed the typical pattern of schedules devoid of real property listings, but scores of relief from stay motions relating to property interests transferred to the debtors post-petition. See Attachment 3 for more details. A plot involving filings in the Santa Ana division resulted in heavy sanctions being levied in 1997 against the perpetrator of a similar operation.

The inventiveness and speedy proliferation of the fractional interest scam may have been a Central District phenomenon, but the problems can surface in other districts as well. For example, a case involving fractional interest transfers tying up an Oxnard, California property landed in a New York bankruptcy court. *In re Cherokee New York Investments*, 27 B.C.D. 1010 (Bankr. E.D.N.Y. 1995). See Attachment 5 for the text of *Cherokee*.

B. Serial Filings by Related Debtors

The Task Force also investigated a more traditional form of abusive filings: sequential filings by the same person or by related individuals to stop foreclosures. Problems with such filings have cropped up in the district occasionally over the years. *See, e.g., In re Bradley*, 38 B.R. 425 (Bankr. C.D. Cal. 1984) (four Chapter 13 filings by a single debtor to stop foreclosure by holder of third trust deed, on which no payments had ever been made); *In re Villareal*, 46 B.R. 284 (Bankr. C.D. Cal. 1984) (three bankruptcy filings by the owner, delaying a home foreclosure by one year). More recently, these filings have sometimes included use of aliases and false social security numbers. In a typical cluster, a husband files an individual petition, often only listing the foreclosing lender as a creditor. When a relief from stay motion is about to be heard, the wife files a separate petition, invoking a new stay. Faced with a new relief from stay motion, another petition may be filed by the husband using a different alias or social security number. Some of these clusters include filings by other relatives. *See, e.g., In re Kinney*, 51 B.R. 840 (Bankr. C.D. Cal. 1985) (a series of ten filings finally required in-

junctive relief against all family members). See Attachment 5 for the text of *Kinney*.

C. Voluntary Dismissals of Serial Chapter 13 Cases

A troubling variant on the familial serial filings came to the attention of the Task Force: serial Chapter 13 filings and voluntary dismissals by the same individuals. These dismissals are generally timed to evade a trustee's dismissal order for failure to appear or to make mortgage and plan payments due before the § 341(a) meeting of creditors. Trustee orders usually include a 180-day prohibition on refiling. The voluntary dismissal orders do not. Section 1307(b) of the Bankruptcy Code gives a Chapter 13 debtor the right to dismiss a case upon request. According to Fed. R. Bankr. P. Rule 1017 (a), notice and hearing are not required, unlike Chapter 7 and 11 cases in which debtors' motions to dismiss their cases must generally be noticed to all creditors and the trustee. By submitting voluntary dismissals just before the trustee would be expected to submit a 180-day bar order, these debtors were able to refile another Chapter 13 immediately, thereby obtaining another automatic stay for 30 to 45 days. See Attachment 3 for a case history involving 16 serial Chapter 13 filings.

D. The Involuntary Petition Scam

One abusive practice studied by the Task Force evolved as a method to evade an anti-fraud screen developed in response to the unlawful detainer problem. In its 1992 report, the Unlawful Detainer Committee had identified the need to expedite dismissals of incomplete cases to minimize the rewards of filing abusive unlawful detainer cases. As a result, the Central District Bankruptcy Court implemented an automated system of deficiency notices and dismissal orders that included a bar on any refilings for 180 days due to noncompliance with court orders to correct deficiencies. With the advent of full computerization of the docketing functions in the Clerk's Office in February 1995, the intake deputies could check new petitions against a listing of prior cases dismissed with 180-day bar orders, and refuse to accept them for filing unless the debtor obtained an order from the duty judge or an order eliminating the 180-day portion of the dismissal.

In 1992, the Bankruptcy Court experienced a surge of consumer involuntary filings that dramatically increased during 1994 and 1995. Most of the debtors had a prior petition dismissed with a 180-day bar. Based upon recent investigations, we now know that, for several years, the petitioning creditor was one particular individual with a history of personal bankruptcies in the Central District, or one of his known aliases. In the past two years, a broader group—a veritable cottage industry—has developed around this person. He originally launched his bankruptcy foreclosure business based upon his personal experience with the process. From each homeowner, he received a fee for postponing the foreclosure. The petitions were often not served on the debtor. Initially, the petitioning creditor personally appeared in opposition to relief from stay motions filed by the frustrated lenders, seeking further delay. When that tactic failed, he just filed another petition. Another variant was a petition filed by a partnership creditor, where the partnership bore the property street address as its name, and the debtor and petitioning creditor as the partners. In most of these cases, no returns of summons were ever filed, and thus no orders for relief were ever entered. Yet the foreclosures were usually delayed for months. In April 1998, this individual pled guilty to perjury and bankruptcy fraud, but only after being responsible for hundreds of bankruptcy filings. The small army of foreclosure scam operators that he inspired and trained, however, appears to be continuing to file cases in this district.

E. Phony Alias Amendments to Petitions

Another scam initially traced to the same inventive individual was a pattern of amendments to petitions that purported to add an alias name of the debtor that, in fact, was the name of an unrelated person. The amended petition was then recorded or otherwise used to stop eviction and foreclosure proceedings for the unrelated party.

III. IMPACTS OF FORECLOSURE SCAM FILINGS

A. Impact on the Bankruptcy Court

Most of the more than 100,000 annual bankruptcy cases filed in the Central District of California were good faith filings. However,

bankruptcy petitions filed solely to delay or hinder foreclosures have definitely added to the already heavy workload of the Central District Bankruptcy Court during a period of record filings. The Central District of California has experienced a tremendous increase in filings in recent years; in 1996, the number of filings in the District reached a historic high of 101,936, representing an increase of 24.8% over 1995 filings. In 1997, the District's filings grew another 15.1%, setting a new record at 117,318.

The abusive cases take more clerical and judicial time and attention than the typical legitimate case. More relief from stay motions are filed than in the average case, more orders to show cause are issued, more motions and orders to dismiss are required. The impact of the abusive filings has been felt in both the clerk's office and on court calendars. The docketing, noticing, calendaring of relief from stay motions and orders, dismissal motions, and orders to show cause on an expedited basis impose additional burdens on both clerk's staff and judges. The extra relief from stay motions have impacted the court calendars.

B. Impacts on the Victims: Lenders, Homeowners, Innocent Bystanders

1. Lenders

The obvious losers in these cases are the lenders who receive no payments for many months, even years, while being prevented from foreclosing by the repeated transfers and bankruptcy filings. The Task Force undertook several studies to assess the nature and extent of the losses caused by the abusive filings described above. It proved more difficult than expected to quantify the negative impact of these scams. A study conducted by the United States Foreclosure Network, a national organization of lender lawyers, gathered data from four lending institutions in 1993. The study found that the average loss from a typical cluster of multiple filings was $11,510 per loan, with an average delay of six months per loan. The Network's study attempted to extrapolate these figures into an overall estimate of losses. Assuming that approximately 10% of all bankruptcy filings involve multiple filings, the Network estimated a loss

of over $1 billion to the national mortgage lending industry in 1992 alone.

Based upon one investigation by the U.S. Attorney's Office, the losses in just one scheme totaled approximately $663,000 from rents and fees associated with 24 properties. The perpetrator of this scheme at various times controlled up to 150 different properties. Extrapolating the losses for the 24 properties to the entire group of 150, this single foreclosure scam operator may have caused more than $4 million in lender losses.

Unfortunately, sufficient financial information is not available from other pending U.S. Attorney foreclosure scam investigations to develop an accurate estimate for overall losses. At least 1000 different properties have been identified as part of three other foreclosure scams currently under investigation. Assuming a very conservative loss estimate of $5000 per property, losses for those three schemes total at least $5 million, bringing the estimate for all of these to $9 million. Many smaller operations also contribute to the loss totals.

2. Homeowners

Often the original homeowner loses as well, because many of the foreclosure services falsely promise to work out the foreclosure problems with the lenders. Debtors are often unaware that properties are being transferred into their cases to delay foreclosures. Other homeowners have not known that bankruptcy petitions were being filed in their names—sometimes contrary to assurances that no bankruptcy would be filed. After the case has been filed, the bankruptcy court lacks the power to eradicate the unauthorized filing from credit reports, as requested by unwitting and unwilling debtors. Once the series of phony bankruptcy filings is underway, any possibility of renegotiating the loan has been destroyed.

3. Innocent renters

Many unsuspecting renters have also been victimized by the foreclosure scams. Often the scam operator will break in and take over a property that is sitting empty awaiting completion of foreclosure proceedings or will obtain control of the property from the defaulting homeowner who has moved out. The property is then rented to tenants who are led to believe that they are dealing with an author-

ized agent or owner. Tenants often pay substantial security deposits and months of rent that they are unable to recover, following their eventual eviction by the foreclosing financial institution. Tenants have also been promised various "rent-to-own" programs or lease/purchase options, leading them to make significant property improvements before they are unexpectedly evicted.

4. Identity theft victims

When debtors use false social security numbers, the real holders of those numbers may suffer adverse credit reports or other consequences. A typical case involves debtors who use their real names, or variants thereof, on a bankruptcy petition filed to avoid eviction or foreclosure, but use an altered or entirely invented social security number to prevent credit reporting agencies from correctly reporting their bankruptcies. Sometimes the bankruptcy is then reported as having been filed by the holder of the social security number. Another type of fraud involves people who have created a credit history using both a false name and a false social security number, and then file bankruptcy to avoid collection efforts. Occasionally, filing petitions under false names has been done with the intent of harming the people whose names and social security numbers have been forged without their consent. During the past three years, the U.S. Trustee's Office and the U.S. Attorney's Office in the Central District have received nearly 1200 complaints of bankruptcy fraud, of which about 22% are believed to involve identity theft either in the form of forgery of signatures on petitions, or use of false social security numbers.

The bankruptcy courts are unable to offer any particularly effective remedies when these innocent bystanders file motions seeking orders to clear their credit records. In appropriate cases, however, the court may enter findings that the petition was unauthorized and unintended, which sometimes assists such unwilling debtors in dealing with the reporting agencies.

IV. METHODOLOGY

A. Court Studies

1. Incidence study

The Task Force conducted a study to determine the incidence of foreclosure scams in the District (the "Study"). The guiding assumption underlying the Study was that, if bankruptcy cases were being filed to take improper advantage of the automatic stay, the affected creditors would bring that abuse to the court's attention by the allegations set forth in motions for relief from stay. Therefore, by examining relief from stay motions, the Study should be able to estimate the number of abusive filings of the various types described above. To conduct this analysis, the Analysis & Information Department of the Bankruptcy Court created a database consisting of all cases filed in the Los Angeles division during April 1996, in which relief from stay motions were filed. Although the foreclosure scam problem is known to be district-wide, the incidence study focused on the Los Angeles division simply because the available research assistance needed for the intensive file review process was located there.

The analysis of the April bankruptcy cases was conducted in November 1996, six months after filing. Within this first 180 days of a case's life – indeed, usually within the first 90 days – most of the relief from stay motions based upon the kinds of abusive patterns described above will have been filed, due to lenders' urgent desire to recover the properties. Indeed, at the time of our November review, a majority of the cases were already *closed* as the result of a dismissal or full administration, with the primary exception being confirmed Chapter 13 cases still in the process of payments. A total of 3947 new cases of all types were filed in Los Angeles during April 1996, of which 3119 (79%) were Chapter 7 cases, 50 Chapter 11s (1%), and 778 Chapter 13s (20%). By November, 1066 relief from stay motions had been filed in these cases, a ratio of approximately one motion for every 3.7 April cases. This ratio is roughly equivalent to a comparison of total annual relief from stay motions versus

total annual case filings (3.2 motions per filing in 1996 Los Angeles cases).[3]

The motions were not, however, evenly distributed, as multiple relief from stay motions were filed in some cases. As a result, only 849 (22%) of all April cases were the target of a lift stay motion ("Lift Stay Cases"). The Study focused upon these Lift Stay Cases to attempt to assess how many of these cases were abusive filings to take improper advantage of the automatic stay. Fully 50% of these cases were filed by debtors *pro se* (424 of 849), as compared to 39.6% *pro se* filings for the April cases in general. Within this pool, an average of 1.26 motions per Lift Stay Case were filed.

Once the pool of Lift Stay Cases was identified, the dockets for these 849 cases were printed to identify the relief from stay motions for review. All of the 1066 relief from stay motions were then reviewed. The initial review was conducted by a group of law students from Loyola Law School under the supervision of Professor Dan Schechter. The students were trained by Donna Curtis, law clerk to Judge Fenning, in both the assessment of the motion and the review of the case docket to extract the required information and categorize the motions.

The initial review consisted of collecting certain information from each motion, identifying whether real property was the subject of the motion, and whether the motion contained bad faith allegations. For purposes of the Study, motions for relief from stay were divided into the following categories:

1. residential property, including post-foreclosure unlawful detainer filings by the former owner, accounting for 54.3% of the motions;
2. unlawful detainers involving residential rental property (21%);

3. This annualized comparison is not exact: the relief from stay motions filed during 1996 would not all have been filed in 1996 cases, but would include older cases as well. Moreover, cases filed late in the year would generate lift stay motions during 1997, rather than 1996. Despite this Doppler-shift effect, the rough correspondence of these figures suggests that the ratio of motions to filings in April is representative of the overall caseload of the division.

3. other real property motions, including commercial real property, apartment houses, and multifamily units (8.9%); and
4. non-real-estate-related motions, including personal property (*e.g.*, cars, equipment), and non-bankruptcy litigation (15.8%).

Motions falling into the first category were then examined in detail. A second review for quality control and analysis was conducted by Judge Fenning's chambers staff to assure the accuracy of the tabulated information. The Analysis & Information Department of the Central District Bankruptcy Court Clerk's Office then computerized the information and generated reports.

The most important findings, from the viewpoint of identifying abusive filings, are:

- *More than 34.1% of the residential motions (18.6% of total motions) involve property other than the debtor's listed residence address.*
- *More than 17.6% of the residential motions (9.6% of total motions) involve multiple transfers of interests in the property, mostly fractional in nature. This category overlaps the non-owner occupied category above, and is thus not cumulative.*
- *Of these two categories, 41.2% of the cases were pro se filings.*

The results of the Study are set forth in detail in Attachment 4.

Because of the variety of the factual patterns, indicia of fraud in these cases are less conclusive than in the Unlawful Detainer Incidence Study. The multiple transfer cases are the only category that rarely offer an innocent alternative. While we know anecdotally that most of the non-residence situations are also suspect, some percentage is likely to reflect divorce or separations with multiple marital residences; yet others, small investment properties held by consumers in addition to their own homes. We were somewhat surprised that so many of these cases involved represented debtors. In future studies, we will probably analyze *pro se* cases separately from represented ones, to provide a better basis for developing correlations with fraud criteria.

2. Cost study

To develop an estimate of economic losses suffered by lenders as a result of fraudulent filings, the incidence study was used to identify the five bankruptcy cases in which the highest number of relief from stay motions had been filed. Judge Fenning's staff contacted the movant's attorneys for the more than forty motions filed in these five cases to request that they provide certain information, including the total number of bankruptcy filings relating to the property, the amount of time that elapsed from the first filing to the successful completion of the foreclosure process, and the estimated losses in unpaid arrears and foreclosure and attorney fees resulting from the delays caused by the serial bankruptcy filings. These results are summarized in Attachment 3.

3. Lender study

From its inception, the Task Force wanted to try to quantify the actual lender losses resulting from the fractional interest foreclosure scam. The lender representatives undertook to review their own institutions' records to determine whether that kind of information could be compiled. They also contacted others in the mortgage lending business to determine what other sources of reliable information was available. It turned out that the institutions did not maintain records in a format that permitted a ready cross-reference from bankruptcy filing data to loan history information. Therefore, the more anecdotal information about the small sample involved in the Court's cost study proved to be the only direct data available to the Task Force.

V. REMEDIES

A. Guiding Principles

First Premise: *Make it easy for interested parties to understand what happened in the bankruptcy case and the intended effect of bankruptcy court orders.* Law enforcement agencies, foreclosure agents, title companies, state courts, and other parties confronted with questions about the effect of the automatic stay or the effect of dismissal of a particular bankruptcy case should not have to research

the law to determine whether they can proceed with enforcement. To the maximum extent possible, the bankruptcy court's orders should expressly set forth the legal effect of dismissal or relief from stay, rather than presume understanding of the underlying legal principles.

Second premise: *Minimize the benefits of abusive filings by expedited review and disposition.* To the extent possible consistent with due process, the bankruptcy court should expedite review and disposition of identifiable types of cases known to be potentially fraudulent. Depriving the filers of any extended automatic stay protection will minimize the effectiveness of the filing as a tool for fraudulent activities.

Third premise: *Solve the problems locally if possible.* Given the evident ingenuity of those behind the various bankruptcy scams, flexible and immediate responses are required. The quickest responses are those that can be implemented by judges in the day-to-day management of their cases, and the clerk's office in the daily processing of filings. Local rule amendments can take years, but may be desirable to implement on a interim basis via general order, pending local rule amendment. By contrast, efforts to obtain changes in the national rules or the Bankruptcy Code are likely (and understandably) to be resisted if the problems are perceived to be isolated and local. Proving more widespread incidence of the patterns of abuse identified in this report would require resources and time beyond our reach.

Fourth premise: *Use criminal remedies only as a supplement to broader, faster administrative and procedural solutions.* Highly publicized criminal prosecutions, convictions, and incarcerations may deter other frauds, and take career criminals off of the streets. However, the criminal process is too slow and too limited to be the primary line of defense against bankruptcy fraud. There are too many minor fraud cases, involving serial filings by family groups to save one or two properties—too small to warrant major fraud prosecutions. The fraud scams large enough to warrant full-fledged investigations and prosecution require painstaking, paper-intensive investigations, which take years. The two most prolific perpetrators of abusive filings in the Central District Bankruptcy Court have been the subject of dozens, if not hundreds, of referrals to the United States Attorney for prosecution. Indeed, referrals date back to at

least as early as January 1987 for one (involving a 1984 fractional interest transfer filing), and 1990 for the other. Indictments were finally brought against them in 1997.

Investigations of bankruptcy fraud are difficult for many reasons. The amount of loss per case is small, even though the cumulative effect is great; the witnesses often move without forwarding addresses; the paper trails are hard to follow, and hard to prove; and positive identification is often extremely elusive. Investigative and prosecutorial resources are scarce and subject to many competing demands. However, the Court has appreciated the innovative efforts of the United States Attorney's Office in Los Angeles, which has become the national leader in developing increasingly effective methods to address this burgeoning area of "white collar crime."

Nevertheless, during the decade from the first referrals to the indictments, thousands of fraudulent cases have been filed by these individuals and their confederates. The administrative and case management countermeasures taken by the Central District Bankruptcy Court have been crucial to contain the fraud problems while the criminal investigations proceeded. If the pending indictments result in convictions and long prison sentences, these particular individuals should be out of circulation for many years. If so, some of the endemic fraud problems in the Central District may ease, for these creative one-man crime waves appear responsible for many of the current scams. Unfortunately, during their many years of operation, they have educated many others in the art and profit of bankruptcy fraud, so their legacy may linger.

B. Counter Measures Already Implemented

1. Automatic 180-day bar dismissal orders

During the early 1990s, several anti-fraud measures were implemented by the Central District Bankruptcy Court as the result of the work of the Unlawful Detainer Committee. Fortunately, the advent of full computerization of the court's docketing and intake functions helped to make these measures far more effective during the past three years. The most important of these countermeasures have been automatic dismissals with 180-day filing prohibitions. These automated orders are issued for failure to comply with the notices of

deficiencies issued for incomplete petition filings and for two missed §341(a) appearances. If the debtor fails to file schedules, statements of affairs or other documents with the petition, the Intake Clerk issues a Notice of Deficiency and order to file the missing documents by the deadline set in Fed. R. Bankr. P. Rule 1007. If the required papers are not filed, on the sixteenth day after the petition date, the case is dismissed with a 180-day bar on refiling, due to the failure to obey the order to complete the necessary documentation. Similarly, a debtor's second failure to appear at a § 341(a) meeting also results in the issuance of a 180-day bar dismissal order. If another petition is attempted to be filed for a debtor who is subject to such a dismissal order, the computer system will notify the Intake Clerk of the bar order. Debtors can move to vacate or modify the dismissal orders for good cause shown, but such motions are relatively infrequent.

While this dismissal procedure was partly in effect earlier, the full integration of the Central District Bankruptcy Court's computer system within the past two years now means that the effectiveness of the prohibition is much greater than in 1995. It will continue to be an important barrier against serial and abusive filings.

2. "In Rem" and "Blanket" relief from stay orders

To prevent the foreclosure scams from effectively blocking foreclosures, some Central District judges are willing to issue relief from stay orders that provide what has come to be known as "*in rem*" relief. These orders state that the lift stay order will be effective concerning the property in any future bankruptcy case filed by any person or entity, without the need for seeking relief from stay in any other pending or future bankruptcy case. Other Central District judges refuse to issue *in rem* orders on the ground that they lack jurisdiction or statutory authority to do so. The validity and effectiveness of *in rem* orders have been questioned, but not resolved by binding precedent. *Compare In re Abdul-Hasan*, 104 B.R. 263 (Bankr. C.D. Cal. 1989) (Mund, B.J.), *and In re Fernandez*, 212 B.R. 361 (Bankr. C.D. Cal. 1997) (Donovan, B.J.), *with In re Snow*, 201 B.R. 968 (Bankr. C.D. Cal. 1996) (Bufford, B.J.). *See also,* Luis F. Chaves, *In Rem Bankruptcy Refiling Bars: Will They Stop Abuse of the Automatic Stay Against Mortgagees?*, 24 CAL. BANKR. J. No. 1, p.3 (1998). See Attachment 5 for the text of these opinions.

The bankruptcy bar has been understandably frustrated with the inconsistencies among the district's judges on this issue. While all of the judges recognize the problem, concerted efforts to reach agreement on permissible scope of relief have been unsuccessful, in the absence of a Ninth Circuit ruling or statutory amendment. Partly in response to these concerns, the Central District Bankruptcy Court has decided to adopt new forms for relief from stay motions and orders that include an attachment listing the kinds of extraordinary relief in terminology that is acceptable to those judges who authorize such orders. When the new forms are implemented, the judges will be able to check boxes indicating which types of relief are being authorized. The current drafts of these new forms are included in Attachment 7. This partial remedy is all that can be accomplished locally, absent statutory amendment.

Another approach is an order to show cause procedure in cases that have been determined to be fractional interest foreclosure scams. Some judges issue orders to show cause on shortened notice to debtor and all creditors why the fractional interest case should not be dismissed. The dismissal order incorporates a provision annulling the automatic stay retroactive to the petition date as to any properties in which the debtor purportedly held an interest. Examples of such orders are included in Attachment 7. Dismissals with prejudice might be another option, except that creditors rarely request dismissal and almost never give notice of their motions to all those who would be entitled to notice of a motion to dismiss the case, as opposed to relief from stay, under Fed. R. Bankr. P. Rule 2002. *See, e.g., In re Leavitt*, 209 B.R. 935, 941-42 (9th Cir. BAP 1997) (By permitting dismissal of cases with prejudice, 11 U.S.C. § 349 was intended to authorize the court to "control abusive filings 'beyond the limits of §109(g),'" including the power to bar "indefinitely future abusive filings by Debtor related to the existing, dischargeable debt."). See Attachment 5 for the text of *Leavitt.*

3. Petition preparer legislation

One of the recommendations of the Unlawful Detainer Committee was legislation to regulate petition preparers by requiring disclosures and other actions. This proposal was ultimately incorporated into 11 U.S.C. § 110 as part of the 1994 Bankruptcy Amendments.

In 1995, the District Court for the Central District of California adopted General Order 95-03, which was amended in 1996, to provide the necessary procedures and forms to implement the petition preparer legislation. During the past two years, the United States Trustee has actively enforced this legislation by filing disgorgement motions and other enforcement actions. See Attachment 6 for a report of the United States Trustee regarding petition preparers. Whether §110 will prove helpful in combating foreclosure scams is hard to assess at this stage, since its prophylactic effects are difficult to quantify.

4. Orders to show cause to dismiss involuntary petitions

At first, the involuntary petition scheme took advantage of the historic scarcity of consumer involuntaries and the absence of clerk or chambers monitoring procedures for this previously rare category. When the pattern of abusive filings was identified by the United States Trustee, the Task Force reviewed all involuntary petitions filed in April 1996, and determined that none of the consumer cases was *bona fide*, that is, all of them were variants of the same pattern described above, all apparently filed by the same individual or his confederates. All judges in the district were notified of this scam in August 1997. At the September 1997 Board of Judges meeting, the full Court approved a procedure requiring the Clerk's Office to send copies of all non-business involuntary petitions promptly to the assigned judge, urging judges to consider issuing orders to show cause to dismiss involuntaries that failed to comport with the statutory requirements. Within just a few months, the number of consumer involuntary petitions was cut in half. The petitioning creditor's 1997 arrest and subsequent guilty plea in response to indictment on a variety of state and federal fraud charges has apparently put him out of circulation, for in recent months, these abusive filings have substantially disappeared. See Attachment 8.

5. Phony alias amendment countermeasures

Similar remedial efforts have helped to stem the tide of phony alias amendments. In 1997, the Task Force reported to the Central District judges that a pattern had suddenly developed involving amendments to bankruptcy petitions, adding names of unrelated in-

dividuals as debtors in the case. The amendments were apparently being filed by one of the known foreclosure scam operators to avoid having to pay filing fees to commence new bankruptcies for the people whose names were being added. Moreover, because their social security numbers were not being reported at all, the added "debtors" would have little risk that their credit ratings would suffer. In response to this new scheme, the Court is developing a procedure to review and strike such amendments. As with abusive consumer involuntaries, these bad faith alias amendments can be minimized by the combination of screening processes.

6. 180-day bar orders for serial voluntary chapter 13 dismissal orders

When the Task Force determined that serial Chapter 13 cases were becoming endemic, it notified all judges and urged that they review all proposed voluntary dismissals. The review involves a quick investigation as to whether two elements are present: (1) whether the debtor has filed and dismissed other cases, which can be determined by cross-checking name and social security numbers against the case filing index; and (2) whether a relief from stay motion has been filed, which can be determined by a quick docket check, thus triggering the refiling prohibition of 11 U.S.C. § 109(g). Where these elements are present, the judge can then include in the dismissal order a 180-day bar restricting refiling. Most voluntary dismissals, of course, do not involve such elements, and continue to receive a straight dismissal order.

The goal of entering 180-day bar orders was to stop future refilings at the intake window. For the deputy clerks to be able to identify refilers, however, requires that the 180-day bar dismissal order be accessible in the computer system. It turned out that no docket code existed for voluntary Chapter 13 dismissal orders with bar provisions. In 1997, the Clerk's Office added a new docket code to capture this information and facilitate effective screening of these cases. While no study has been conducted to compare the number of voluntary dismissals before and after implementation of the 180-day bar dismissal orders for abusive Chapter 13 cases, the judges report a significant decline in the apparently abusive serial dismissals.

C. Task Force Recommendations for Additional Measures

Like the HIV virus, fraud is impossible to eliminate completely from the bankruptcy system with currently available weapons. However, the anti-fraud measures described in the preceding section have enabled the Central District Bankruptcy Court to knock back waves of escalation and defeat some specific schemes by eliminating weaknesses in the system upon which the fraud virus preys. The Task Force has identified other countermeasures that could substantially assist in the fight against bankruptcy foreclosure fraud. These proposals fall into five categories.

- Changes in case management by individual judges
- Modification of local rules or procedures
- Modification of national bankruptcy rules or procedures
- Statutory changes to Bankruptcy Code and related laws
- Criminal penalties

Remedies in the first two categories can be implemented locally. To the extent possible, the Task Force believes that the Central District should be seeking to identify solutions that are within our local control, because changes on the national level are more difficult to achieve politically, and probably could not be implemented for years. Nevertheless, permanent solutions to some of the problems will probably require statutory changes.

1. Judicial case management changes

Delay is the primary goal of the abusive foreclosure filings. Providing for quick relief from stay in such cases should reduce the incentive to file foreclosure scam bankruptcies. Therefore, the Task Force urges that all judges in the Central District:

- Authorize any relief from stay motion involving fractional interest or serial filings to be set for hearing on shortened notice *without* requiring an order shortening time;
- Issue orders to show cause on an expedited basis to dismiss cases in which fractional interest transfers are revealed by relief from stay motions, with a "blanket" or "*in rem*" order to be the result.
- Continue to issue orders to show cause to dismiss involuntary petitions in all consumer cases.

- Continue to assure that the 180-day prohibition on refiling be included in any voluntary dismissal order in Chapter 13 cases involving serial filings or post-relief from stay requests.
- Issue blanket relief from stay orders, where appropriate, when presented with credible evidence of fractional interest or multiple filing abuse in a particular case.

2. Modification of local rules and procedures

Court-wide changes in case processing and dismissal procedures have proven to be an effective method for containing the problem of fraudulent bankruptcy filings. However, such measures cannot eliminate the problem because, as long as serial filers can get the benefit of the automatic stay, there will be serial filers. One of the most effective defenses in this ongoing battle has been the Central District's automated dismissals of individual cases with 180-day bar provisions. This barrier, however, can be breached, as the Chapter 13 Case Study demonstrates. See Attachment 3. We need more tools to deal with the ever-evolving schemes. Set forth below are the most promising proposals identified by the Task Force.

a. "operation identification"

The Task Force has determined that approximately 22% of the foreclosure scam bankruptcy cases were filed without the permission or informed consent of the named debtor, or with the use of false names or social security numbers. The most effective solution for all of these types of fraudulent filings is to require photographic identification of individual debtors and evidence of their addresses and social security numbers. Such identification is commonly required for cashing checks, and for obtaining driver's licenses, passports, and other governmental benefits. Being familiar, therefore, identification requirements should receive ready acceptance by honest debtors, provided that the procedures are reasonable.

This solution has been dubbed "Operation Identification." It relies on the authority of the local courts to establish reasonable requirements to address local needs, just as the Central District has adopted mandatory forms for Chapter 13 plans and relief from stay motions, review procedures for applications for installment fee

requests, and similar measures to address the needs of this extraordinarily high-volume court. The proposed procedure would be embodied in an amendment to the local bankruptcy rules, following the usual review and comment process for the approval of such procedural changes. The elements of Operation Identification may be summarized as follows:

1. Unrepresented individual debtors would be required to file personally, or appear within a week to provide the necessary identification.
2. At the Intake Window, the clerk's office would photograph the person presenting the petition. The photograph would simultaneously record the individual, together with the following:
   - The bankruptcy petition
   - The photographic identification (California driver's license, or equivalent)
   - Social Security Card or other evidence of social security number (wage statement, etc.)
   - Evidence of residential address (utility bill or equivalent).
   - Possibly also an inkless thumb print on the petition.

*Conformed copies of the filed petition would *not* be provided to the debtor until satisfaction of the identification procedures.

*Failure to appear personally to file an individual petition would result in issuance of deficiency notice requiring appearance for a photograph with the necessary identification papers within one week of petition filing.

*Failure to appear with identification would result in dismissal with 180-day bar for failure to comply with the court order to appear.

*Represented individuals would be required to present such identification to the attorney, who would be required to file a declaration or certificate that the identification had been inspected, and attaching copies.

*Debtors could file a motion to postpone the deadline for compliance, or to be excused from compliance for good cause shown, with such motions to be heard on shortened notice by the judge to whom the case has been assigned.

Operation Identification would be simpler and more effective if the clerk's office could be authorized to reject any petition lacking this identification at the outset. However, Fed. R. Bankr. P. Rule 5005 prohibits rejection of filings for non-compliance with local rules or procedures. Therefore, the petition must be accepted for filing, with any deficiencies to be resolved later. The short deadline to comply is required to assure that the identification requirements are satisfied before the Notice of Commencement is processed. Refusing to provide conformed copies of the petition prevents their use to stop foreclosures.

b. alias amendments

The local rules should be amended to emphasize that a noticed motion, supported by admissible evidence, is required to add any alias to an existing petition. If an alias amendment is attempted by filing without supporting motion and evidence, then a deficiency notice should be issued by the clerk, and the alias should be automatically stricken unless a conforming motion is filed within one week.

c. shortened notice of relief from stay motions for serial filings

The local rules should be modified to shorten the notice required for relief from stay motions in subsequent filings. No minimum period of notice is required by the national rules. *See* Fed. R. Bankr. P. Rules 2002, 4001, 9014. In effect, the Central District should adopt the approach of strict scrutiny of the automatic stay in serial filing cases, by allowing relief from stay motions in the subsequently filed cases to be heard quickly, without having to apply for an order shortening time. The basic concept is that, after one bankruptcy filing relating to real property, the debtor must be immediately prepared to justify the continuance of the stay in any future filings. The suggested notice would be 7 to 10 days, with service required to be by overnight mail or the equivalent.

d. modification of form of dismissal orders

Many cases in the Central District are dismissed for failure to file schedules or appear at the § 341(a) meeting of creditors. A form dismissal order is issued that includes a 180-day prohibition on refil-

ing. When a foreclosure sale was conducted during the brief life of the dismissed case, lenders have to reopen cases to annul the stay and validate the foreclosure sale. Including language in these form dismissal orders that makes the dismissal *nunc pro tunc* as of the petition date would effectively eliminate most of the uncertainty about intervening foreclosures or other actions.

e. index of properties

During the Task Force investigation, it proved difficult to identify all the bankruptcy filings that affected particular properties. The Task Force considered recommending that an index of real property be created by requiring that the property address be identified on a cover sheet for each motion for relief from stay, and entered into the computerized docketing system so that the court and public can search by property address to identify all filings affecting that property, at least to the extent that the property was the subject of a relief from stay motion. This proposal, however, does not appear to be technologically feasible at this time.

3. National rules changes

The Federal Rules of Bankruptcy Procedure should be amended expressly to authorize broader remedies at the local level of the type proposed above than are currently permitted. The text of the proposed amendments is set forth in Attachment 9.

a. identification requirements

Fed. R. Bankr. P. Rule 5005 should be modified to permit courts to impose reasonable identification requirements for the filing of bankruptcy petitions. Such an amendment would authorize the clerk to reject petitions if required identification was not provided, thereby preventing the automatic stay from arising and avoiding the need for a deficiency procedure of the type set forth above. Local variance should be permitted as to any specific form of identification.

b. alias amendments

Fed. R. Bankr. P. Rule 1009(a) should be modified to require a noticed motion, after notice and hearing, before any alias amend-

ments are effective to add a debtor name to a petition. Currently, Rule 1009 only requires notice "to affected parties" after the amendment is filed, but does not require any notice before amendment, nor any evidence that the alias has in fact been used by the debtor. Modifying Rule 1009 will permit amendments to be approved before they are effective, instead of stricken afterwards.

c. real property schedule

Fed. R. Bankr. P. Rule 1007(a) should be amended to require that Real Property Schedule A must be included with the petition in all cases, so that the court records establish under penalty of perjury the debtor's interests in real property, even if the remaining schedules are never filed.

4. Amendments to the bankruptcy code

a. modification of 11 U.S.C. § 362

The ultimate answer for many of the foreclosure fraud scams investigated by the Task Force may lie in modification of the automatic stay by amendment to § 362 of the Bankruptcy Code. The Task Force proposes several changes. The guiding principles are that bankruptcy courts should be able to issue orders, based upon cause shown, that will prevent the automatic stay from arising in serial filings, and that the automatic stay should not apply to real property that has not been fully and properly disclosed to the court and creditors as part of the schedules filed with the court. Accordingly, the following statutory amendments should be considered to address the abuses described in this report:

- Modify § 362 expressly to allow *in rem* orders under defined notice and cause standards.
- Modify § 362 to provide that the automatic stay does not protect unscheduled real estate in consumer cases. Omitted or later-acquired real estate would not be protected by the automatic stay, unless the debtor brought a motion showing good cause for the omission or post-petition acquisition. Schedule A for real property should be required even with emergency filings in consumer cases in order for the automatic stay to apply.

Proposed statutory language to accomplish these objectives is set forth in Attachment 9.

b. authorization for social security number verification

The Task Force also determined that an ability to cross-check social security numbers of debtors would greatly minimize the use of false SSN identifiers. The Bankruptcy Code and/or the relevant portion of the laws governing Social Security should be amended to permit the bankruptcy courts to access the Social Security data base for identification purposes.

5. Potential criminal penalties

As noted above, criminal remedies are an important tool in the effort to eliminate bankruptcy foreclosure scams. Several possible changes in existing law were identified by the Task Force as having potential to facilitate prosecution of the perpetrators of such scams. These proposals would require amendment to the relevant California and federal statutes as follows:

1. Broaden the California rent skimming statute to specify banks and other lenders as a category of victim.
2. Add a provision under Title 18 that is similar to Title 12 U.S.C. § 1709-2.

Proposed language is set forth in Attachment 10.

VI. CONCLUSION

The Task Force is confident that the anti-fraud measures already implemented, together with those proposed in this report, will enable the Central District of California Bankruptcy Court to meet the challenges of the many foreclosure scams in this district. The Task Force will continue to assess the incidence of such filings in coming years, and will report annually on the results of these efforts so long as is necessary. Suggestions and comments on this on-going effort are welcomed and should be addressed to the Clerk of the Bankruptcy Court or to the Chief Judge.