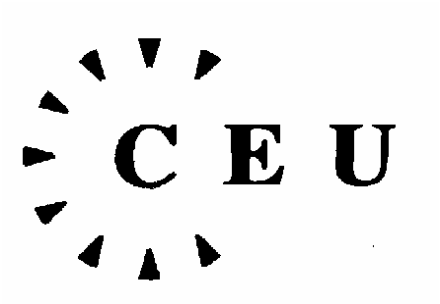

Bankruptcy Crimes in Serbia and the United States: Comparative Analysis

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ABSTRACT

This thesis provides a comparative analysis of the bankruptcy crime regulation in the United States and in Serbia with the purpose of exploring the United States model as a potential role model for the improvement of Serbian regulation of bankruptcy crimes. I argue that Serbian legislators should look up to the United States model and consider the introduction of bankruptcy crimes into the legislative acts as a separate category of crimes, which will address not only abuses of bankruptcy law, but also noncompliance with the requirements of bankruptcy law. By introducing the crimes addressing noncompliance with the requirements of bankruptcy law, Serbian legislators would strengthen the confidence in the bankruptcy system and create a legal system which would adequately and effectively responds to the fraudulent business activities.

INTRODUCTION

Every business is established with great eagerness and belief that nothing can go wrong. However, business can fail causing devastating consequences and, at that moment, bankruptcy law comes into play:

> *"That evening the banker phones. He wants to see me in my office at eight in the morning. I meet him. He is there with his lawyer, the receiver, and the bailiff. The lawyer reads the demand. "Can you pay off your loan in the next hour?" How many people could repay their operating loan in that time? I couldn't. There had been no previous mention of foreclosure. The receiver asks me to call my employees together. He fires everyone. The bailiff changes the lock. They take my car. They accompany me to my house to pick up my wife's car. By 9:30 the same day: 40 years of hard work, all my dreams, my future, and my retirement are gone."*[1]

Bankruptcy law takes a role of a strict but fair judge collecting all of the debtor`s assets and distributing them equally to all of the debtor`s creditors. It also provides a debtor with an opportunity to survive, if a suitable reorganization could be achieved.

However, once bankruptcy occurs, a debtor loses its freedom to conduct business as it seems right and becomes monitored by creditors, trustee and bankruptcy judge. Businesses used to absolute freedom of decision making aimed at gaining a profit are now being forced to follow the strict rules of bankruptcy law, without any profit to look forward to.

In a distress situation, businesses have an innate urge to survive or at least to shield part of their assets for future endeavors. This, entrepreneurial, survival motive, however, in some cases may be a strong incentive to turn a business into a dark alley of various fraudulent and miscreant conducts which law defines as bankruptcy crimes. By addressing fraudulent activities within the bankruptcy proceedings, as well as any abuse of bankruptcy law,

[1] JOHN R. SUTHERLAND & MICHAEL KING, GOING BROKE: BANKRUPTCY, BUSINESS ETHICS, AND THE BIBLE, at 12 (Herald Press (PA)) (1991)

bankruptcy crimes provide additional protection to bankruptcy law, thereby improving its efficiency.

Recent huge corporate failures put a spotlight on bankruptcy crimes. They opened a debate about the efficiency of legal systems and possible improvements of bankruptcy crimes regulation, as well as on the governments' willingness to punish perpetrators of these crimes.

The aim of this thesis is to emphasize the importance of a comprehensive bankruptcy crimes regulation and to propose the United States law as a role model for improvements of current Serbian regulation of bankruptcy crimes.

In achieving this aim, the thesis uses comparative analysis method and provides analysis of bankruptcy crimes regulation in the United States and in Serbia. It also addresses the theoretical concepts underling the regulation of bankruptcy crimes.

This thesis does not analyze bankruptcy crimes in relation to individuals as debtors, since Serbian law does not recognize bankruptcy of natural persons.

The first chapter of the thesis addresses the basic concepts of white collar crimes and explains the intersection between the bankruptcy law and criminal law in relation to bankruptcy crimes regulation.

The second chapter provides detailed analysis of bankruptcy crimes regulation in the United Stated with emphasis on the bankruptcy law principles which are protected by such regulation.

The third chapter presents the current bankruptcy crimes regulation in Serbia, its flaws and possible solutions for its improvement.

CHAPTER 1 – BANKRUPTCY AND CRIME

1.1 General overview

The relationship of debt and crime is well established in today`s world. After recent huge corporate scandals which revealed the fragile structure of legal systems and massive fraud schemes, corporate fraud, politely referred as creative earnings management, which in the past occupied mostly the white-collar crimes scholars, entered into the every day life of millions of people. Who the criminals are in these cases, who the victims are, what the proper sanction would be and whether our legal systems are well tailored to discourage these types of behaviors.

One of the benefits of these scandals is that, finally, after years of moral indifference towards them, they became widely recognized as crimes, not only among scholars and lawyers but also among ordinary people. These scandals have not only raised the level of social condemnation of white collar crimes, they have also revealed the devastating consequences of such crimes to the whole society. People have become aware that damages, although, not visible as those caused by violent crimes, target numerous victims which sometimes are not even aware of their victimization.

However, white collar crimes are still leaving a bad taste in our mouth. As Kurt Eichenwald points out in his article "White-Collar Defense Stance: The Criminal-less Crime" referring to the short imprisonment sentences imposed for price fixing to officers of the Archer Daniels Midland Company, one of the biggest world`s agricultural processors:"Again, executives who effectively cheated every grocery store in the country received shorter sentences than if

they had robbed just one."[2] Although today`s level of awareness of white collar crimes is higher then it was before, the question regarding the adequate sanctions for these crimes remains open. Imposing severe sentences would certainly have deterrent effect on fraudulent corporate behaviors. However, it would also trigger the resistance of corporate world who would start doing business more cautiously, avoiding risky transactions and generating lower incomes. At the end of the day it all comes down to establishing the right balance between the "controls over business activities with the need to promote and support them".[3]

Bankruptcy crimes are type of white collar crimes. They can be defined as "offence[s] of knowingly and fraudulently doing any of proscribed acts … in an effort to defeat bankruptcy-code provisions. It is the illegal exploitation of the bankruptcy system in favor of one's personal gains."[4] They have two major characteristics: first, they are identified as crimes, from both legal and moral point of view; second, they are identified as conducts undermining the basic principles of bankruptcy law. Further discussion will focus on intersection between the bankruptcy law and criminal law in relation to bankruptcy crimes.

1.2 Intersection between Bankruptcy Law and Criminal Law

Bankruptcy Law Perspective

Bankruptcy law is designed to provide help to a debtor and its creditors when business failure occurs and debtor`s assets become insufficient for covering all of its debts. In such situations, rules of contract law and civil enforcement turn out to be scarce, since they lie on the presumption of a solvent debtor unwilling to pay its debts.

[2] Kurt Eichenwald, *The Nation; White-Collar Defense Stance: The Criminal-less Crime*, THE NEW YORK TIMES, Mar. 3, 2002, http://www.nytimes.com/2002/03/03/weekinreview/the-nation-white-collar-defense-stance-the-criminal-less-crime.html. (last visited Mar 24, 2013)
[3] J Minkes, *Silent or invisible? Governments and corporate financial crimes*, 9 CRIMINOLOGY & PUBLIC POLICY 467–473, at 469 (2010)
[4] CRIMINAL BANKRUPTCY LAW & LEGAL DEFINITION, http://definitions.uslegal.com/c/criminal-bankruptcy/ (last visited Mar 25, 2013)

When an insolvent debtor cannot pay its debts when due, bankruptcy law intervenes. It turns upside down the rules of nonbankruptcy laws: private individual enforcement of a debt is replaced by the rule of collective enforcement, the rule of priority of payments founded on temporal element is replaced by the bankruptcy priority rules based on the characteristics of transactions; freedom to enter into all types of transactions and assume the risk of such transactions is restricted, and no risk is allowed to be undertaken during the bankruptcy proceedings. This does not mean that bankruptcy law disregards the rules of nonbankruptcy law; it rather changes those rules of nonbankruptcy law which are conflicting with the purpose of bankruptcy.[5]

Although bankruptcy regulation differs worldwide depending on the adopted policy reasons, there are two common objectives of bankruptcy, usually called "twin pillars" of modern bankruptcy law: to provide a debtor with a fresh start (for business debtors, it is the possibility of financial rehabilitation through the process of reorganization) and to assure equal distribution of all of the debtor`s assets to the creditors.[6]

These two basic notions of bankruptcy law are designed to help "honest but unfortunate debtor" and they greatly rely on the honesty of all participants in the bankruptcy proceedings. Lack of such honesty is the key element of all bankruptcy crimes. Full and truthful disclosure of all relevant information is the cornerstone of bankruptcy law. And when bankruptcy crimes disregard this duty criminal law has to interfere and sanction such behavior.

[5] DOUGLAS G. BAIRD, THE ELEMENTS OF BANKRUPTCY at 5 (Foundation Press 5th ed) (2010)
[6] Karen M. Gebbia, *Debt and Crime: Inevitable Bedfellows*, 42 GOLDEN GATE UNIVERSITY LAW REVIEW 525–537, at 530 (2012)

Criminal Law Perspective

Criminal law is designed to sanction acts which attach the heaviest consequences. It is the *ultima ratio* of every legal system. It punishes those who violate the basic values of society, establishing, at the same time, the boundaries of permissible behavior.

The importance of intersection between the criminal law and moral wrongfulness is often emphasized in the criminal law literature.[7] If certain act is perceived morally wrong, it is highly recommended that criminal law sanctions such act. On the other hand, criminal law does not sanction everything the society condemns. It is designed to punish moral wrongfulness which causes devastating damages to the society, and not unpleasant feelings, and its main task is to identify such moral wrongfulness, even if individuals are not able to comprehend it.

Moral wrongfulness behind the bankruptcy crimes and other white collar crimes is often imperceptible to individuals who are not directly victimized by them. Regulating these types of crimes is one of the most difficult tasks of criminal law; it has to sanction conducts which are not perceived as morally wrong and which are usually regulated by some other area of law.[8] With bankruptcy crimes, criminal law penalizes noncompliance with the requirements of bankruptcy law in order to strengthen its underlying policies and prevent the harm society might not even be aware of.

Intersection between bankruptcy and criminal law

The key element which connects bankruptcy law and criminal law is fraud. It "like a deranged matchmaker, brings debt and crime together."[9] Fraud is perceived from the

[7] *E.g.*,J. C. BOUTELLIER & HANS C. J. BOUTELLIER, CRIME AND MORALITY - THE SIGNIFICANCE OF CRIMINAL JUSTICE IN POST-MODERN CULTURE (Springer 1) (2002)
[8] STUART P. GREEN, LYING, CHEATING, AND STEALING: A MORAL THEORY OF WHITE-COLLAR CRIME at 24 (Oxford University Press, USA) (2007)
[9] *See* GEBBIA, *supra* note 6 at 526

perspectives of both bankruptcy law and criminal law as extremely dangerous. Without it, criminal law would not interfere with bankruptcy law and debt would remain "a private wrong, not a crime."[10]

Bankruptcy law and criminal law fight against financial fraud by different means which on the surface may appear conflicted. This can be detected from differences between the bankruptcy law rules on distribution of debtor`s assets and forfeiture rules of the criminal law. Bankruptcy law collects all of the debtor`s assets and distributes them equally to all creditors, making no distinction between the creditors who actually suffered the damages due to the debtor's fraud and those who were not direct victims of the fraud. On the other hand, criminal law forfeitures only those assets which are directly related to a crime and distributes them only to those victims to whom they belong.[11]

Although criminal law and bankruptcy law fight against fraud with different weapons, thereby applying different rules, they both share the notions of retributive and restorative justice. They are both punishing the fraudster: bankruptcy law by disregarding the false claims or disallowing discharge to the fraudulent debtor and criminal law by imposing severe penalties. They also protect the injured parties and try to restore their statuses preceding the fraud: bankruptcy law by providing equitable distribution of debtor`s assets to all of its creditors and criminal law by providing compensation to the victims of a fraud.[12]

These common notions of the bankruptcy law and criminal law make their intersection possible and effective. As long as "they hold firmly to the same fundamental principles regarding financial fraud: the honest but unfortunate debtor should not be shackled for life;

[10] *Id.* at 526
[11] *Id.* at 534
[12] *Id.* at 528

the dishonest cheat should pay; the victims should be compensated"[13] their differences do not present an obstacle for a successful fight against bankruptcy crimes.

This theoretical background is relevant for comprehensive understanding of bankruptcy crimes. Bankruptcy is an unpleasant event businesses are forced to participate in. It urges them to face their failures and affects their future plans. At the same time, it helps them to reinstate their business goals and conduct their business activities more cautiously.

Companies rely on initiative and creativeness as cornerstones of every successful business activity and perfect combination of these two results in gaining profit, the driving force of any economic activity. Once the decision to set up a business is made "[c]ompanies can have four stages in their life cycle: the start–up or development phase, the growth phase, the maturity or stabilization phase, and in many cases, the disruption or decline phase."[14] Through all these stages, and especially at the moment when business becomes aware of its disruption stage and financial distress, profit is the only value embraced by the business. But sometimes, and recently quite often, it blurs the edges of allowed behavior, obliterate rational, law obeying business decision making, neglects the basic notions of human decency and produces devastating consequences for the whole society. When this happens all eyes are focused on never praised but inevitably indispensable law.

[13] *Id.* at 536
[14] IAN RATNER ET AL., BUSINESS VALUATION AND BANKRUPTCY at 1 (Wiley 1) (2009)

CHAPTER 2 – BANKRUPTCY CRIMES IN THE UNITED STATES

2.1 General overview

Title 18 of the United States Code regulates crimes and criminal procedure and its chapter 9 (often referred to as Bankruptcy Criminal Code) is devoted to bankruptcy crimes. Along with this chapter, other chapters of Title 18 of the United States Code also contain provisions regarding the so–called related bankruptcy crimes, e.g., aiding and abetting (18 U.S.C. § 2), conspiracy (18 U.S.C. § 371), laundering of monetary instruments (18 U.S.C. § 1956).[15] With this type of criminal protection, the United States bankruptcy system is capable to respond not only to the criminal activities arising from or closely connected to bankruptcy proceedings, but also to remote transactions whose final result is bankruptcy of a company. In this way, legal system is well equipped to recognize and combat complex fraudulent bankruptcy crimes schemes by decomposing them into separate criminal offences punishable both separately and jointly. Certain criminal activities may be classified under two or more offences provided in Title 18 of the United States Code. This raises the problems of statutory overlap and multiplicity of charges, explicitly prohibited by the Double Jeopardy Clause "which protects not only subsequent prosecution for the same offence, but multiple punishments for the same offence."[16] Therefore, prosecutors must be careful with designing their charges in order to avoid violation of the Double Jeopardy Clause, but at the same time, they are provided with wide spectrum of offences which facilitate their fight against the fraudulent activities. This is one of the reasons for perceiving the United States bankruptcy law as perfect, fully completed system. By emphasizing the bankruptcy crimes as a separate

[15] UNITED STATES CODE TITLE 18, (last visited March 9, 2013), http://www.law.cornell.edu/uscode/text/18?quicktabs_8=1#quicktabs-8

[16] STEPHANIE WICKOUSKI, BANKRUPTCY CRIMES at 92 (Beard Books 3rd ed) (2007)

area of crimes, regardless of the other criminal law provisions which might be applicable to transactions closely related to bankruptcy proceedings, the United States legal system provides overall protection of bankruptcy system and assures that compliance with requirements of the bankruptcy law is regarded as fundamental for the whole society.

Bankruptcy law is designed to help both creditors and debtors when financial hardship occurs. It sets up the rules which facilitate the communication between them and assures that both parties will get as much as possible in given circumstances. Usually, a company`s bankruptcy is an unfortunate consequence of a business failure, but sometimes it might be part of a fraudulent scheme designed with the intention to obtain profit by all means.

Fraudulent business transactions which lead to bankruptcy of the company may take various forms. One of the most reputable authors in the field of bankruptcy crimes, Ms. Stephanie Wickouski, identifies the following four as the most common bankruptcy fraud schemes:[17]

The bustout

"A bustout is conducted by a company that is set up to fail from the outset."[18] This type of bankruptcy fraud involves a company which developed good credit ratings and gained confidence of its business partners based upon which it is able to persuade its creditors that current delays in its payments are only temporary and that they should not commence any legal action against it since debts will be paid as always. Nevertheless a company has no intention of paying its debts and starts selling its assets below the market price or conceals them in a related company, which leaves no assets for satisfying its creditors` claims. Relationship between a company and its creditors was based on a confidence established by

[17] *Id.* at 10–13
[18] BROWN B. JOE ET AL., IDENTIFYING BANKRUPTCY FRAUD, at 1, https://docs.google.com/gview?url=http://www.crfonline.org/orc/pdf/ref11.pdf&chrome=true, (last visited March 9, 2013)

prompt payments at the beginning of the cooperation, which in its essence was deceptive and employed for the purpose of committing fraud.[19]

The spread usage of this type of bankruptcy fraud is evidenced by its quite accurate definition provided in The Merriam–Webster online dictionary as "a confidence scheme in which an established business is taken over, a large stock of merchandise is purchased on credit and quickly sold, and the business is then abandoned or bankruptcy is declared. *"*[20]

This definition encompasses another variation of the bustout bankruptcy fraud in which a company is sold to a new owner, the so–called "take–down" man, who participates in the fraud scheme from the beginning, but who is the first to inform the creditors about company`s financial difficulties caused by the previous owner. He also promises to pay all debts and even asks the creditors for further investments in order to help him heal the company but the final result is the same, creditors` claims are not paid and company`s assets are insufficient for covering them.[21]

The bleedout

The bleedout bankruptcy fraud is more sophisticated than the bustout, but the goal is the same, leaving company`s creditors with no assets for satisfying their claims. This is achieved by depleting company`s assets usually over a long period of time, through highly complicated transactions, which involve "[i]nsider transactions, particularly capital infusion characterized as loans."[22] Unlike the bustout scheme which is usually invoked by a short life span companies which rely on initial confidence established with their creditors, the bleedout does not rely exclusively on its creditors' trust. Instead, it relies on its long lasting existence on the

[19] *See* WICKOUSKI, *supra* note 16 at 10
[20] THE MERRIAM-WEBSTER ONLINE DICTIONARY, http://www.merriam-webster.com/dictionary/bustout (last visited March 9, 2013)
[21] *See* WICKOUSKI, *supra* note 16 at 10
[22] *Id.* at 11

market and acquired reputation, intentionally and self–confidently conducting its business activities in a fraudulent way.[23] Detailed classification of types of bleedout schemes such as: corporate raider bleedouts, "white knight" bleedouts, parallel entities and abuses of assignment for the benefit of creditor (ABC)/insider sales[24] only emphasizes the complexity of this type of bankruptcy fraud schemes present in various types of industries.

Looting

Looting as a type of bankruptcy fraud is different from the previous two types of bankruptcy frauds because it starts once the company is in a financial distress which will inevitably end with its bankruptcy. Here, the owner of a company did not conduct her business activities in a fraudulent manner until she was faced with the forthcoming bankruptcy. Financial distress triggers fraudulent intent and behavior which are perceived as the only way of rescuing the business from an inevitable end. Here "[t]he principal obtains a straw buyer to act secretly on his behalf and purchase the failing company`s assets at a low price."[25] The creditors are deceived with regard to the true value of the assets and the existence of a disinterested buyer thereby releasing their claims at much lower price. Looting may occur during the negotiations over the potential workout, but also within the bankruptcy proceedings, even with the approval of the bankruptcy judge. The central characteristic of looting and the reason for its perception as a bankruptcy fraud is a nondisclosure of a relationship between the debtor and the buyer.[26]

Skimming

Skimming as a type of bankruptcy fraud can occur before or after the bankruptcy was filed. Here "the basic idea is to drain cash flow while not paying the mortgage or third party

[23] *Id.* at 11
[24] *See* BROWN *supra* note 18 at 4-5
[25] *See* Wickouski *supra* note 16 at 11
[26] *Id.* at 11

creditors."[27] Skimming as a bankruptcy fraud scheme is closely connected with the real estate industry, where mortgage payments are not made although the property generates income and the bankruptcy petition is filed.

Identification of these and other bankruptcy fraud schemes as an overall context in which bankruptcy crimes occur is helpful for discovering and prosecuting such crimes. On the other hand, the legislator`s decision not to criminalize the whole schemes as bankruptcy crimes, rather certain specific acts within them, provides more possibilities for successful prosecution releasing it from the burden of proving highly complicated fraudulent scheme usually involving multiple participants.

2.2 Bankruptcy Crimes under the Chapter 9 Title 18 of the United States Code

Bankruptcy crimes are regulated in chapter 9 of Title 18 of the United States Code. The underlying idea of this chapter is to provide additional protection of bankruptcy law by criminalizing noncompliance with the most important requirements of the bankruptcy law. The common goal of all bankruptcy crimes is to protect the basic notions of the bankruptcy law: full and truthful disclosure of all relevant information, equal distribution of the debtor`s assets to all creditors and the opportunity of fresh start for a debtor.

Sections bellow analyze each of the bankruptcy crimes with particular focus on the bankruptcy law rules the protection of which is additionally upheld by the criminal law rules. The following overview of bankruptcy crimes in the United States follows the structure presented by Ms. Stephanie Wickouski in her book Bankruptcy crimes.

[27] *Id.* at 12

2.2.1 Concealment of Assets

According to section 152 (1) of title 18 of the United States Code

> *A person who knowingly and fraudulently conceals from a custodian, trustee, marshal, or other officer of the court charged with the control or custody of property, or, in connection with a case under title 11, from creditors or the United States Trustee, any property belonging to the estate of a debtor; … shall be fined under this title, imprisoned not more than 5 years, or both.*[28]

A perpetrator of this crime can be a debtor[29] or any other person. In *United States v. Fraidin*[30] the court addressed this issue stating that: "…prosecution for concealment of a bankrupt's assets is not restricted to the bankrupt himself. If it were, the two defendants…[and] their status was that of undisclosed owners of or that they had some interest in the bankrupt's business; or that they were acting as his [debtor`s] agent in the alleged concealment of his assets" (emphasize added). Although addressing the United States Bankruptcy Act of 1938, known as the Chandler Act, which was subsequently replaced by the Bankruptcy Reform Act from 1978, this court decision clarified and provided guidelines for future interpretations of the term "a person" used by the legislator, as applying to all persons related to or having any interest (direct/indirect or disclosed/undisclosed) in a bankrupt company.

Concealment, as an act of committing this crime, is interpreted broadly to include not only a physical hiding of an asset[31], but also omission of any assets from the schedule[32], misleading and vague description of an asset[33], withholding knowledge or preventing disclosure or recognition.[34] The underlying policy of such a broad interpretation is to protect one of the fundamental principles of bankruptcy law: full disclosure of all of the debtor`s assets, in order

[28] 18 U.S.C. § 152 (1), http://www.law.cornell.edu/uscode/text/18/152, (last visited March 11, 2013)
[29] *See* 18 U.S.C. § 151 which defines debtor as *"a debtor concerning whom a petition has been filed under title 11."* http://www.law.cornell.edu/uscode/text/18/151 (last visited March 11, 2013)
[30] *United States v. Fraidin, 63 F. Supp. 271 (D. Md. 1945)*
[31] *Coghlan v. United States, 147 F.2d 233 (8th Cir. 1945)* at 237
[32] *Id.* at 236
[33] *See* WICKOUSKI *supra* note 16 at 29 & *United States v. Grant, 971 F.2d 799 (1st Cir. 1992)*
[34] *United States v. Turner, 725 F.2d 1154, 1157 (8th Cir. 1984)*

to satisfy all claims of the debtor`s creditors to the greatest possible extent adhering to the principle of *pro rata* distribution. By concealing some of the property of the estate, a debtor deceives its creditors about the value of its assets, forces them to lower their claims and shifts the whole burden of its bad business judgments to its creditors.

"Any property belonging to the estate of a debtor"[35] encompasses all property in which a debtor holds legal or equitable interests as well as the property which may be exempted under the provisions of Bankruptcy Code.[36] Such a broad definition of property forces debtor to fully disclose all of its assets, enables the trustee to properly administrate the property of the estate and provides the maximum protection of creditors.

In order to determine concealment of assets court must establish that a perpetrator acted "knowingly and fraudulently" i.e., with the intention to impede the bankruptcy proceedings and defraud creditors. Since a mental state of a perpetrator is not easy to establish, courts have determined that these elements of *mens rea* can be ascertained circumstantially.

Knowing excludes mistaken or accidental nondisclosure of an asset e.g., wrong interpretation of a vague term used to describe certain bankruptcy requirement might be treated as a mistake or accidental nondisclosure if a defendant`s interpretation of a vague term is reasonable (often referred to as literal true defense)[37]. However, since business does not leave much space for mistakes and oversights, and calls for everyday cautious and diligent scrutiny, mistaken concealments are very rare in practice.

Courts have interpreted knowingly as to include not only the proactive knowledge about the concealment, i.e., perpetrator knowingly takes actions in order to conceal the assets, but also the so–called "willfully blindness", i.e., debtor`s deliberate passive and ignorant attitude

[35] *See* 18 U.S.C. § 152 (1), http://www.law.cornell.edu/uscode/text/18/152, (last visited March 11, 2013)
[36] *See* WICKOUSKI, *supra* note 16 at 31-33
[37] *Id.* at 30

towards preparation of documents which are to be submitted in fulfillment of certain bankruptcy requirements.[38] This interpretation excludes defenses based on reliance on a counsel's advice since it is hardly conceivable that an honest, but unfortunate old hand at business would not read schedules prepared by his lawyer. Although in most cases, knowing and willful concealment is to be presumed, the courts have been careful in applying this presumption, especially in cases involving joint bankruptcy filings by spouses in which one partner was not actively involved in business but merely signed the papers prepared by the other. The courts, relying on factual background of a specific case in front of them, have developed the following standard for assessment of the knowing part of *mens rea*:

> *[T]he issue should be whether the total circumstances, including but not limited to the bare fact of the defendant's signature, warrant a confident inference that the defendant knew what he was signing,…or, what has the same legal significance, deliberately refused to acquaint himself with the contents, fearing what he would discover if he did.*[39]

Fraudulent concealment of assets means that a person is acting with the intent to deceive and hinder the assets from the bankruptcy estate. This element presupposes the defendant`s awareness of the existence of bankruptcy proceedings, since concealment of assets of a debtor`s estate can occur only in relation to a bankruptcy case. This does not mean that concealment of assets cannot occur before initiating bankruptcy proceedings, but it can be detected only once bankruptcy is commenced, which is why this crime is treated as a continuing offence: the main purpose of concealment is to hinder assets, so they could never be reached by the creditors and it has an ongoing existence until it is revealed.[40] This specific characteristic of concealment has led to a different rule regarding the statute of limitation for this crime; according to section 3284 of the United States Code: "…the period of limitations

[38] *Id.* at 30
[39] *United States v. White, 879 F.2d 1509 (7th Cir. 1989)*
[40] *E.g., Sultan v. United States, 249 F.2d 385 (5th Cir. 1957)*

shall not begin to run until such final discharge or denial of discharge."[41]Since in a corporate bankruptcy case, discharge cannot be neither granted nor denied, the statute of limitation begins to run from the moment of filing of a bankruptcy petition or converting the chapter 11 case into chapter 7 case.

2.2.2 False Oaths, Accounts and Declarations

According to sections 152 (2) and 152 (3) of title 18 of the United States Code

> *A person who*
>
> *(2) knowingly and fraudulently makes a false oath or account in or in relation to any case under title 11;*
>
> *(3) knowingly and fraudulently makes a false declaration, certificate, verification, or statement under penalty of perjury as permitted under section 1746 of title 28, in or in relation to any case under title 11; ... shall be fined under this title, imprisoned not more than 5 years, or both.*[42]

These two separate crimes are analyzed together since 152 (2) covers only making the false oath, while 152 (3) is designed to cover cases where applicable by law, written unsworn declarations are given instead of an oath. These two crimes prohibit providing both false oaths and false declarations as their substitutes, in bankruptcy or any other proceedings related to bankruptcy. Section 152 (2) also criminalizes making false accounts which covers various types of accountings filed during the bankruptcy proceedings (accounts submitted by a debtor, regular monthly reports, trustees' reports etc.). The underlining policy of these crimes is to protect proper functioning of bankruptcy proceedings and to assure that statements and documents based upon which bankruptcy is conducted are complete and true. Otherwise, trustee and all other participants in bankruptcy proceedings would be operating with incomplete, untrue information and the whole purpose of a bankruptcy system, designed to help the debtor and its creditor resolve their financial difficulties would be undermined.

[41] U.S.C. § 3284, http://www.law.cornell.edu/uscode/text/18/3284 (last visited March 11, 2013)
[42] 18 U.S.C. §§ 152 (2) & 152 (3) http://www.law.cornell.edu/uscode/text/18/152 (last visited March 11, 2013)

A perpetrator of these crimes can be any person who makes a false oath, account or declaration in or in relation to bankruptcy proceedings. Usually it would be a debtor or her counsel, but it is applicable to all other participants in bankruptcy. Filing of a bankruptcy petition, listing all of the assets in the schedules, debtor`s testimony at the creditor`s meeting, trustee`s reports and various other procedural requirements of bankruptcy law provide opportunities for giving false oaths, declarations or accounts.[43]

False oath, declaration or account must be made knowingly and fraudulently. In a well – known case against the lawyer John Gellene, a partner in a New York law firm, who was charged of making a false material declaration in bankruptcy proceedings in which he represented his client, Mr. Gellene tried to defend himself by relying on a narrow interpretation of "intent to defraud" as opposed to "intent to deceive". He argued that: "[t]o deceive is to cause to believe the false or to mislead; to defraud is to deprive of some right, interest or property by deceit. Therefore … the defendant must have a specific intent to alter or to impact the distribution of a debtor's assets and not merely to impact the integrity of the legal system, as the government argued."[44]This appealing interpretation was not successful and Mr. Gellene was convicted. The court stated that intent to defraud is to be interpreted broadly to include not only actions which have harmful effect on creditor`s rights, but also those directed towards impeding the bankruptcy as a whole, which are usually done with the intention to deceive.

Another essential element of crimes of making a false oath, account or declaration is materiality. False oath, account or declaration must be given in relation to a document or information materially significant for the bankruptcy proceedings. Courts have established that materiality in the context of these crimes is a question of law, determinable in relation to

[43] *See* WICKOUSKI, *supra* note 16 at 41

[44] *United States v. Gellene, 182 F.3d 578, 586 (7th Cir. 1999)*

the requirements of the bankruptcy law. Materiality does not mean that false oath, account or declaration relates exclusively to the assets of the debtor`s estate, but to any requirement of the bankruptcy law which protects the proper functioning of a bankruptcy proceedings as a whole. "[M]ateriality does not require a showing that creditors are harmed by the false statements ... Materiality is ... established when it is shown that the inquiry bears a relationship to the bankrupt's business transactions or his estate, or concerns the discovery of assets, including the history of a bankrupt's financial transactions." [45]

Frequently, charges of making a false accounts or declaration go hand in hand with charges of concealment of assets, since concealment of assets is usually done by non–listing certain assets on bankruptcy schedules. At first sight, this might seem as a violation of Double Jeopardy Clause which prohibits multiple charges for the identical conduct. However, courts' view, based upon perception of concealment as a continuing offence, is that these are two separate crimes, since once the false schedule was filed; concealment continues to exist as a separate offence until it is revealed.[46]

2.2.3 False Claims

According to section 152 (4) of title 18 of the United States Code

> *A person who knowingly and fraudulently presents any false claim for proof against the estate of a debtor, or uses any such claim in any case under title 11, in a personal capacity or as or through an agent, proxy, or attorney;... shall be fined under this title, imprisoned not more than 5 years, or both.*[47]

This provision is mainly directed towards creditors who assert false claims against the debtor`s estate. However, use of the term person suggests that a perpetrator of this crime can be any person, not only creditors, which makes this provision also applicable to a debtor

[45] *United States v. Key, 859 F.2d 1257,1261 (7th Cir. 1988)*
[46] *Sultan,* 249 F.2d at 386
[47] 18 U.S.C. § 152 (4), http://www.law.cornell.edu/uscode/text/18/152 (last visited March 12, 2013)

listing a non–existent claim on its bankruptcy schedules. What constitutes a claim, as defined by Bankruptcy Code, is any debt arose before the commencement of bankruptcy proceedings.

The crime is committed by presentation of a proof of a claim against the estate. In bankruptcy proceedings, creditors file their claims and if no objection is made, the amount of claim which is to be paid is equal to the amount the creditor stated in its claim. By filing a false claim, a creditor causes serious harm to other creditors and lowers the amount which is to be paid to other creditors. This conduct seriously undermines one of the main principles of bankruptcy law: achieving maximum value for debtor`s estate and distributing it to all creditors *pro rata*. Filing of a non–existent claim means that other creditors are receiving less than they should have received in the absence of a false claim.

One of the important questions in relation to this crime is how to qualify creditors` aggressive approach toward a debtor for the purpose of obtaining maximum protection of their claims. Creditors sometimes deliberately file claims overstating the amount of a debt with the intention to force the debtor to negotiate a settlement. Although case law does not provide many guidelines for such situations, filing of an overstated claim should be considered as filing of a false claim. [48]

Mens rea part of this crime requires knowing and fraudulent presentation of a false claim, which is to be interpreted as in other bankruptcy crimes.

[48] *See* WICKOUSKI, *supra* note 16 at 52

2.2.4 Receiving Property with the Intent to Defeat the Bankruptcy Code and Bribery

According to sections 152 (5) and 152 (6) of title 18 of the United States Code:

> *A person who*
>
> *(5) knowingly and fraudulently receives any material amount of property from a debtor after the filing of a case under title 11, with intent to defeat the provisions of title 11;*
> *(6) knowingly and fraudulently gives, offers, receives, or attempts to obtain any money or property, remuneration, compensation, reward, advantage, or promise thereof for acting or forbearing to act in any case under title 11; … shall be fined under this title, imprisoned not more than 5 years, or both.*[49]

The main goal of this section is to protect one of the most important principles of bankruptcy law: equitable distribution of debtor`s assets to creditors. Under the rule of bankruptcy, after the commencement of the case, payments of debts arose before the bankruptcy can be done only in accordance with the principle of equitable distribution or with the approval of the court. Any conduct which is aimed at avoiding such rules is criminalized under this section.

Section 152 (5) prohibits disposition of assets outside the rules of bankruptcy law. A perpetrator of this crime can be any person: debtor who favors one particular creditor and pays its claim which reduces the assets available for other creditors, creditor who receives such payment, as well as third party who obtains any of debtor`s belongings knowing that it comes from the property of the bankrupt debtor.

These transfers, which are made in violation of the bankruptcy rules, should be distinguished from transfers made in the debtor`s ordinary course of business during the bankruptcy which do not require court`s approval. Bankruptcy law allows debtor to use, sell or lease property in the ordinary course of business in order to provide the debtor with the opportunity to increase the value of the estate. Since bankruptcy law does not define "ordinary course of business", courts have developed criteria for establishing whether certain transfer falls within this

[49] 18 U.S.C. §§ 152 (5) & 152 (6), http://www.law.cornell.edu/uscode/text/18/152 (last visited March 12, 2013)

category. First, courts are establishing vertical dimension of a transaction by posing the question whether such transaction was ordinary in debtor`s prebankruptcy activities i.e., whether the debtor was engaged in such transactions on a regular basis. Secondly, courts are establishing horizontal dimension of a transaction by posing the question whether such transaction is considered as an everyday transaction to a debtor`s businesses alike. If answers to both questions are positive, transaction falls in ordinary course of business and court approval is not needed.[50]

Another important element of this crime is materiality, which unlike the materiality as a question of law in making false oath, accounts or declaration, is a factual question. This crime exists only if material amount of the property of the debtor is transferred outside the rules of the bankruptcy law.

In order to be held liable, a perpetrator has to act knowingly and fraudulently, and with the intent to defeat the rule of bankruptcy law. The perpetrator of this crime has to be aware of the bankruptcy proceedings, has to have knowledge that a transaction is under special regime of bankruptcy law and has to engage in it with the intention to avoid application of the bankruptcy rule. This additional element of *mens rea* intends to protect innocent party to a transaction, who did not know that transfer of debtor`s property or payment was done against the rule of bankruptcy law.

Section 152 (6) prohibits bribery between any participants in bankruptcy proceedings aimed at achieving certain outcome which would not be achieved if bankruptcy rules were followed. This section addresses situations in which debtor offers more favorable treatment to a creditor in return for creditor`s forbearance to exercise some of its legal rights, such as to object to a proposed plan of reorganization as well as situations in which one creditor offers to pay off

[50] *See* WICKOUSKI, *supra* note 16 at 55–56

another creditor in return for the latter`s withdrawal from the bidding process for sale of debtor`s assets.[51] These secret arrangements are harmful for other bankruptcy participants who are not aware of them and who receive less than they would have received if bankruptcy rules were followed.

The most important element of this crime is a conspiracy between a bribe giver and a bribe taker; terms of their arrangement are not disclosed to other creditors, and if both parties remain silent, bribery may never be discovered. For this reason, practice has identified two situations which should trigger the suspicion of bribery: "…the dismissal of an action against a debtor seeking to bar discharge under § 727 of the Bankruptcy Code, or a dismissal of the case agreed upon between the debtor and creditor."[52]

A perpetrator of this crime can be any person who offers or accepts bribery, whether it is a debtor, creditor or a person acting on their behalf.

A perpetrator has to act knowingly and with the fraudulent intent, which is the crucial element for distinguishing regular bankruptcy negotiations form the bribery.

2.2.5 Fraudulent Prebankruptcy Transfers

According to section 152 (7) of title 18 of the United States Code:

> *A person who in a personal capacity or as an agent or officer of any person or corporation, in contemplation of a case under title 11 by or against the person or any other person or corporation, or with intent to defeat the provisions of title 11, knowingly and fraudulently transfers or conceals any of his property or the property of such other person or corporation…shall be fined under this title, imprisoned not more than 5 years, or both.*[53]

This section penalizes two types of fraudulent transfers: transfers made on the eve of a corporate bankruptcy and transfers made with the intent to defeat the bankruptcy law rule.

[51] *Id.* at 59-60
[52] *Id.* at 58
[53] 18 U.S.C. §152 (7), http://www.law.cornell.edu/uscode/text/18/152 (last visited March 12, 2013)

The main purpose of criminalization both types of fraudulent transfers is to protect debtor`s creditors.

Within the first type of transfers, we can distinguish transfers triggering bankruptcy and transfers which do not cause bankruptcy, but are made during the financial hardship period which is highly likely to end with bankruptcy. If company goes bankrupt, such transfers, which in the absence of bankruptcy would be completely legal, might fall under this section.

The second type of fraudulent transfers covered by this section are transfers made after the bankruptcy filing with the intention to defeat the rule of bankruptcy law. The main difference between this section and concealment of assets belonging to the estate is that the property which is being transferred under this section does not have to be the property of the estate. Good examples of post petition transfers of property not belonging to the estate, but considered in the context of bankruptcy crimes, would be a transfer of a share in a debtor which influences the value of the estate[54] or transfers relating to debtor`s share in a company placed in trust.[55]

A perpetrator of this crime can be any person who acts in some capacity on behalf of the company. In order to be liable, a perpetrator has to act knowingly and fraudulently.

2.2.6 Concealment or Destruction of Records

According to sections 152 (8) and 152 (9) of title 18 of the United States Code:

> *A person who*
> *(8) after the filing of a case under title 11 or in contemplation thereof, knowingly and fraudulently conceals, destroys, mutilates, falsifies, or makes a false entry in any recorded information (including books, documents, records, and papers) relating to the property or financial affairs of a debtor; or*
> *(9) after the filing of a case under title 11, knowingly and fraudulently withholds from a custodian, trustee, marshal, or other officer of the court or a United States Trustee entitled to its possession, any recorded information*

[54] *United States v. Gooodstein, 883 F.2d 1362, 1370 (7th Cir. 1989)*
[55] *United States v. Moody, 923 F.2d 341 (5th Cir. 1991)*

> *(including books, documents, records, and papers) relating to the property or financial affairs of a debtor, … shall be fined under this title, imprisoned not more than 5 years, or both.*[56]

The purpose of these incriminations is to ensure that bankruptcy proceedings are conducted based on complete and truthful information regarding the property of a debtor. These crimes, although protect the interests of creditors, primarily protect the integrity of a bankruptcy system. The confidence in bankruptcy system would be seriously undermined if operating with incomplete financial information is not criminalized, and bankruptcy rules requiring full disclosure from all participants would hardly make any sense. No creditor would file the exact amount of its claim or adhere to the principle of collective distribution of debtor`s assets if there was an even remote possibility of benefiting at the expense of others by cheating and lying without suffering consequences for such behavior.

A perpetrator of these crimes can be a debtor or any other person who is in possession of recorded information relating to the property and financial affairs of a debtor. The term "recorded information" is interpreted broadly to include both written and electronically stored information, encompassing not only documents which certify the existence of an asset or transaction, but also the e-mail correspondence, notes, even a recorded phone conversations.[57]

Section 152 (8) prohibits concealment, destruction, falsification or alteration of such information after or in contemplation of a bankruptcy filing, while section 152 (9) prohibits withholding of information after commencement of a bankruptcy case. Penalizing withholding of information as a separate crime only emphasizes the importance of the role of trustees, marshals and other officers of a court without whom bankruptcy, as a system, could

[56] 18 U.S.C. §§ 152 (8) & 152 (9) http://www.law.cornell.edu/uscode/text/18/152 (last visited March 12, 2013)
[57] *See* WICKOUSKI, *supra* note 16 at 67

not function. It also strengthens the confidence in bankruptcy as a system for finding the most suitable solution for overcoming the financial difficulties.

A person is charged for these crimes if she acted knowingly and fraudulently. Standards developed by courts for determining knowing and fraudulent intent are explained in detail above under 2.2.1.

2.2.7 Embezzlement Against Estates

According to Section 153 of title 18 of the United States Code:

> *(a) …A person described in subsection (b) who knowingly and fraudulently appropriates to the person's own use, embezzles, spends, or transfers any property or secretes or destroys any document belonging to the estate of a debtor shall be fined under this title, imprisoned not more than 5 years, or both.*
> *(b) … A person described in this subsection is one who has access to property or documents belonging to an estate by virtue of the person's participation in the administration of the estate as a trustee, custodian, marshal, attorney, or other officer of the court or as an agent, employee, or other person engaged by such an officer to perform a service with respect to the estate.*[58]

Although this section incriminates two separate acts: embezzlement of property and destruction/secretion of documents of the estate, they are closely connected and share the same purpose: to assure that the property of the estate and its proceeds are distributed correctly and to preserve evidence of such distributions and other undertakings contained in bankruptcy documents.

A perpetrator of this crime can be a debtor in possession or an officer of the court who is professionally involved in bankruptcy proceedings, such as trustees, marshals, attorneys as well as persons hired by them. These persons are responsible for proper functioning of bankruptcy proceedings and they are entrusted with property of the estate which is to be administrated in accordance with the provisions of the bankruptcy law. The bankruptcy law

[58] 18 U.S.C. § 153, http://www.law.cornell.edu/uscode/text/18/153 (last visited March 12, 2013)

confers them with vast powers, and abuse of such powers could have devastating consequences for creditors of the estate and could damage the integrity of the bankruptcy system. This is especially true for the officers of the court who, unlike debtor in possession, are completely disinterested and not affected by the outcome of bankruptcy proceedings.

In order to be held liable for embezzlement against the estate, a perpetrator has to act with knowledge and fraudulent intent.

2.2.8 Adverse Interest and Conduct of Officers

According to Section 154 of title 18 of the United States Code:

> *A person who, being a custodian, trustee, marshal, or other officer of the court*
>
> *(1) knowingly purchases, directly or indirectly, any property of the estate of which the person is such an officer in a case under title 11;*
> *(2) knowingly refuses to permit a reasonable opportunity for the inspection by parties in interest of the documents and accounts relating to the affairs of estates in the person's charge by parties when directed by the court to do so; or*
> *(3) knowingly refuses to permit a reasonable opportunity for the inspection by the United States Trustee of the documents and accounts relating to the affairs of an estate in the person's charge,*
> *shall be fined under this title and shall forfeit the person's office, which shall thereupon become vacant.*[59]

The purpose of this section is to protect the integrity of bankruptcy by assuring that professionals involved in bankruptcy proceedings do not abuse powers conferred on them. During the whole bankruptcy proceedings, they are in possession of all information regarding the value of the estate, settlements that are being negotiated and potential buyers of the property. They have access to all documents and they can channel further development of bankruptcy proceedings. They can easily abuse all these powers for personal gain. Whether they purchase an asset or keep it reserved exclusively for one buyer, the consequence is the

[59] 18 U.S.C. § 154 http://www.law.cornell.edu/uscode/text/18/154 (last visited March 12, 2013)

same: other creditors or potential buyers are excluded from the race not because they gave bad offers, but because their offers were not considered at all.

This section prohibits any type of self–dealing or insider trading in bankruptcy proceedings. Self–dealing occurs when an officer of the court acts in her own interest rather than in the best interest of the creditors. Insider trading exists in situations when an officer of the court reveals information, which other bankruptcy participants are not aware of, to a particular buyer who benefits from such privileged information. An officer of the court can do this in numerous ways: by decreasing the value of an asset and purchasing it afterwards; by structuring the sale process in a way that a person related to an officer of the court turns out to be the only successful bidder or by denying other interested parties` requests for inspection of documents in order to keep information privileged and benefit from it.[60]

This section also strengthens the monitoring powers of the United States Trustee by criminalizing trustee`s attempt to avoid supervision of her work.

In order to be held liable under this section, an officer of the court does not have to act with the fraudulent intent which makes this crime easier to prove since any conduct outside of the scope of the officer`s authorities can fall under this provision.

On the other hand, sanction for this crime is fine and removal from the office, which when interpreted with the lack of fraudulent intent, reveals real motives for prescribing this crime: forcing officers of the court to act professionally, within the boundaries of their authorities.

2.2.9 Fee Agreements in Cases under Title 11 and Receiverships

According to Section 155 of title 18 of the United States Code:

> *Whoever, being a party in interest, whether as a debtor, creditor, receiver, trustee or representative of any of them, or attorney for any such party in*

[60] *See* WICKOUSKI, *supra* note 16 at 75-76

> *interest, in any receivership or case under title 11 in any United States court or under its supervision, knowingly and fraudulently enters into any agreement, express or implied, with another such party in interest or attorney for another such party in interest, for the purpose of fixing the fees or other compensation to be paid to any party in interest or to any attorney for any party in interest for services rendered in connection therewith, from the assets of the estate, shall be fined under this title or imprisoned not more than one year, or both.*[61]

This section prohibits entering into any agreement between the parties in interest (debtor, creditors or trustee which includes their representatives) in relation to their fees which are to be paid from the debtor`s estate. It is enacted as a response to an earlier practice of lawyers who would agree in advance how much they would be paid as trustees or representatives of a debtor. Their fees were enormously high and paid form the estate to the detriment of creditors.[62]

According to the bankruptcy law fees and compensations to a trustee and persons engaged by him has to be notified to creditors and has to be approved by a court. Bankruptcy law also imposes the duty of disclosure of all previous relations between a debtor and its lawyer, debtor`s lawyer and creditors, and requires that professionals employed by the trustee are disinterested persons i.e., persons with no adverse interests towards debtor and the estate.

The purpose of this section is to provide additional protection for the above stated requirements of the bankruptcy law. Any type of agreement (in practice usually oral) concluded knowingly and fraudulently with the intention to circumvent bankruptcy provisions regarding the amount of fees qualifies for this crime.

[61] 18 U.S.C. § 155 http://www.law.cornell.edu/uscode/text/18/155 (last visited March 12, 2013)
[62] *See* WICKOUSKI, *supra* note 16 at 78

2.2.10 Bankruptcy Petition Preparer Fraud

According to section 156 of title 18 of the United States Code:

> *(a)…In this section…*
>
> *(1) the term "bankruptcy petition preparer" means a person, other than the debtor's attorney or an employee of such an attorney, who prepares for compensation a document for filing; and*
> *(2) the term "document for filing" means a petition or any other document prepared for filing by a debtor in a United States bankruptcy court or a United States district court in connection with a case under title 11.*
>
> *(b) …If a bankruptcy case or related proceeding is dismissed because of a knowing attempt by a bankruptcy petition preparer in any manner to disregard the requirements of title 11, United States Code, or the Federal Rules of Bankruptcy Procedure, the bankruptcy petition preparer shall be fined under this title, imprisoned not more than 1 year, or both.*[63]

This provision is enacted in response to the bankruptcy mills as type of bankruptcy fraud schemes usually targeting individual debtors. A perpetrator of this crime promises to a debtor preventing foreclosure on its property or refinancing its debt and charges commission for these services. What mill actually does is preparing and filing incomplete petition which causes either lifting of the automatic stay or dismissal of the petition. At the end, debtor`s financial situation is worse than at the beginning, debts still exist and compensation paid to the mill turns out to be unnecessary expense.[64]This provision, although not so applicable to the cases of corporate bankruptcy, protects uninformed and naïve debtors.

A perpetrator of this offence can be any person, except for the debtor`s lawyer, who participated in preparation of the bankruptcy petition (or other related document) and who received compensation for such preparation. A petition preparer is held liable even if she didn`t file the petition, but only prepared it, as well as in cases when she provided an advice regarding such preparation, as long as she was compensated for her services.[65]

[63] 18 U.S.C. § 156, http://www.law.cornell.edu/uscode/text/18/156 (last visited March 13, 2013)
[64] *See* WICKOUSKI, *supra* note 16 at 12–13
[65] *Id.* at 84

A debtor`s lawyer is explicitly excluded as a perpetrator of this offence. However, it should be noted that the debtor`s lawyer is also liable for preparing and filing incomplete petition in accordance with the Bankruptcy Abuse Prevention and Consumer Protection Act which prescribes that lawyer`s signature on a bankruptcy petition certificates that information contained in a petition are complete and accurate.

What is essential for this crime is "the abuse of the bankruptcy process by invoking the automatic stay without any intention of fully pursuing the bankruptcy case."[66] Preparing documentation with the knowledge that petition will be filed without any intention of complying with the requirements of the bankruptcy law makes such behavior criminal.

2.2.11 Bankruptcy Fraud

According to section 157 of title 18 of the United States Code:

> *A person who, having devised or intending to devise a scheme or artifice to defraud and for the purpose of executing or concealing such a scheme or artifice or attempting to do so—*
> *(1) files a petition under title 11, including a fraudulent involuntary petition under section 303 of such title;*
> *(2) files a document in a proceeding under title 11; or*
> *(3) makes a false or fraudulent representation, claim, or promise concerning or in relation to a proceeding under title 11, at any time before or after the filing of the petition, or in relation to a proceeding falsely asserted to be pending under such title,*
> *shall be fined under this title, imprisoned not more than 5 years, or both.*[67]

This section is aimed at prohibiting any type of abuse of bankruptcy proceedings. Unlike other bankruptcy crimes, which penalize specific fraudulent conduct and its implications on bankruptcy proceedings, this provision *prohibits* "fraudulent use of a bankruptcy case, or a fraud concerning the bankruptcy case."[68]

[66] *Id.* at 84
[67] 18 U.S.C. § 157, http://www.law.cornell.edu/uscode/text/18/157 (last visited March 13, 2013)
[68] *See* WICKOUSKI, *supra* note 16 at 88

Abuse of bankruptcy proceedings in the context of this section can be found in various bankruptcy fraud schemes, when bankruptcy is used in an attempt to disguise such fraud, e.g., when final take – down phase in a bustout scheme involves filing a petition, or in equity skimming when bankruptcy is filed to prevent the foreclosure and extend the period of skimming the rental income.[69]

A perpetrator of this crime can be any person who invented a fraudulent scheme whose integral part is abuse of bankruptcy proceedings. In order to be liable, a perpetrator of this crime has to act with the intent to defraud and such intention has to anticipate fraudulent abuse of bankruptcy proceedings. For example, if false financial statements are filed with the intention to diminish the value of the estate in a planned forthcoming bankruptcy, such conduct constitutes bankruptcy fraud. If false financial statements are filed without such intention and later used in bankruptcy, there is no bankruptcy fraud.

[69] *Id.* at 88

CHAPTER 3 – BANKRUPTCY CRIMES IN SERBIA

3.1 General overview

Serbian law does not recognize bankruptcy crimes as a separate category of crimes. The provisions relating to bankruptcy crimes can be found in the Criminal Code of the Republic of Serbia and the Bankruptcy Act of the Republic of Serbia. As a consequence of such scattered regulation, the level of protection of bankruptcy law through criminal law is lower than in the United States. Serbian legislator focuses mainly on criminal protection of the general economic system thereby addressing bankruptcy issues only partially. The consequence of this universalistic approach is that only few provisions of the Serbian criminal law deal with the direct noncompliance with the bankruptcy law rules.

It is indisputable that regulation of bankruptcy related crimes contributes to setting up the framework for permissible business activities and protects the economic system. Serbian legislator recognizes the importance of identifying fraudulent business transactions and provide sanctions for such transactions. However, having concentrated on bankruptcy related crimes, Serbian legislator neglected the importance of providing criminal law safeguards to specific bankruptcy rules.

Further, Serbian bankruptcy crimes regulation is primarily focused on fraudulent schemes related to bankruptcy treating noncompliance with the requirements of the bankruptcy law almost exclusively as a matter out of the scope of criminal law.

Such approach by Serbian legislator towards bankruptcy crimes reflects the overall attitude towards bankruptcy law in Serbia. Bankruptcy is perceived as a procedure for handling the final stage of a company`s life when not much can be done. The reaction of most Serbian creditors (save for creditors from specialist lending and banking industry), whose debtor is

facing bankruptcy, is quite passive. They would file their claims without any expectations and do not engage in negotiations over the possible workouts. Even in the process of reorganization, creditors get involved as little as possible, exercising only their voting rights in relation to a proposed plan. Quite often, creditors just wait for the final bankruptcy court decision regarding the distribution of the debtor`s assets, acting as if they had written off their unpaid claims.

This attitude towards bankruptcy reveals lack of awareness of bankruptcy as an integral part of the overall economic activities. Market oriented economy, especially in the countries with a long history of planned economy, has to be accompanied with modern legislation which will appropriately support the importance of complying with legal rules in order to establish confidence in the legal system, provide guidelines for proper functioning of economy and prevent the urge to circumvent the rule once gaining profit is established as a driving force of every business activity. Rules of company law, contract law, civil enforcement procedure and bankruptcy law, if not provided with the additional protection of criminal law, cannot be fully effective and are exposed to the risk of being taken for granted.

This is of the utmost importance in the context of bankruptcy law. If noncompliance with the requirements of the bankruptcy law is not followed by criminal sanction, every business transaction turns out to be the risky. The rules of bankruptcy law designed to provide equal protection to all creditors, become meaningless if those, among equal, who break the law obtain the same, if not higher, satisfaction of their claims. Of course, bankruptcy is not the cornerstone of business activity, but it is an indispensable element, which if functioning properly, increases the confidence among creditors and establishes the culture of collecting debts through legal means. Current Serbian legislation of bankruptcy crimes does not provide creditors with such confidence. They know that certain unlawful conduct will be sanctioned

but they have no guarantee that full compliance with the bankruptcy law requirements will be accomplished. Therefore, creditors in Serbia have passive attitude towards bankruptcy which prevents business activity from reaching its full potential.

Without bankruptcy crimes, as a special category of crimes, noncompliance with bankruptcy requirements is not regarded as deeply wrong and the criminal law which provides an inadequate response ultimately fails in its task to deter others from committing such crimes and to express social condemnation of such behavior. Thereby, current lack of confidence in bankruptcy proceedings remains alive.

3.2 Bankruptcy crimes contained in Criminal Code

Serbian Criminal Code places bankruptcy crimes in the section devoted to crimes against economic system. The following provisions reflect focusing of the Serbian legislator on identifying and sanctioning abuse of bankruptcy proceedings and bankruptcy crime schemes, rather than penalizing specific noncompliance with bankruptcy rules occurring within such schemes.

3.2.1 Causing Bankruptcy

According to Article 235 of the Serbian Criminal Code:

> *a company`s representative who by mismanagement of assets or their disposal for a trifling amount, excessive borrowing, undertaking disproportionate obligations, concluding contracts with indebted entities incapable of payment, failing to collect debts when due, destroying or concealing assets, or by any other act contrary to good faith business practice causes company`s bankruptcy and damages to any other natural of legal person, shall be imprisoned from six months to five years. If such offence is committed negligently, the offender shall be imprisoned from three months to three years.*[70]

[70] *See* CRIMINAL CODE OF THE REPUBLIC OF SERBIA (Official Gazette of the RS, Nos. 85/05, 88/05, 107/05, 72/09, 111/209 & 121/2012) Article 235, http://www.paragraf.rs/propisi/krivicni_zakonik.html (last visited Mar 20, 2013) & unofficial English translation of the Serbian Criminal Code available at http://www.mpravde.gov.rs/en/articles/legislation-activities/relevant-legislation-in-the-area-of-judiciary/criminal-matter/

The main purpose of this provision is to protect creditors, as well as company`s shareholders and employees from the debtor`s bad faith business practice. A debtor cannot be held liable for business failures as long as its representatives act in good faith and in accordance with the standard of a prudent businessman. The company`s representatives should act within their capacities and in good faith e.g., without the intent to defraud, and their business decisions should be perceived as prudent and justified in the industry the debtor operates in.

A perpetrator of this crime is a debtor`s representative i.e., officers, directors, managers or any other company`s agent authorized to act on the company`s behalf.

This provision sanctions company`s representatives bad faith undertakings, which cause company to go bankrupt and damage others. Such provision raises several important issues. First, bad faith undertakings of the company`s representatives fall under this provision if two conditions are simultaneously met: (i) due to such undertaking, bankruptcy against the company is commenced and (ii) such undertaking caused damages to others.[71] The term others is construed broadly to include not only creditors but all damaged parties, such as company`s shareholders and employees.

Therefore, placement of assets out of a reach of creditors, which disables their foreclosure but does not cause bankruptcy of the company, does not fall under this provision. Similarly, concealment of assets which lead company to bankruptcy without causing damages to others leaves company`s representatives bad faith undertakings out of the scope of this provision.

Second, it might be difficult to prove the requirement that others suffered damages due to the bad faith undertakings of the company`s representatives. It is not clear what constitutes damages, i.e., whether the standards of tort law should be applied or the legislator assumes

[71] STOJANOVIC ZORAN, COMENTARY OF CRIMINAL CODE OF THE REPUBLIC OF SERBIA at 559 (Sluzbeni glasnik 1st ed) (2006)

that debtor`s bankruptcy causes damages to others *per se*. Even the authors[72] who take the position that commencement of bankruptcy proceedings is sufficient for damages to be assumed, cannot answer to what constitutes damages if, after the commencement of a bankruptcy case, a debtor is under reorganization process.

Third, causality between, particular bad faith undertaking of the company`s representatives, on the one side, and company`s bankruptcy and damages suffered by others, on the other side, is very difficult to establish. The business judgment rule might be invoked as a defense for each undertaking separately, making prosecution under this provision successful only in cases involving repeated bad faith undertakings of the company`s representatives over a longer period of time.

A perpetrator of this crime is held liable if she acted either with negligence or intentionally in which case, longer prison sentence can be imposed.

3.2.2 Causing False Bankruptcy

According to Article 236 of the Serbian Criminal Code:

> *company`s representative who with the intention to evade payments of company`s debts and other obligations, causes company`s bankruptcy, due to simulated or actual depletion of company`s assets by any of the following acts: 1) concealment, simulated disposition, disposition bellow the market value or without the compensation of all or part of the company`s assets, 2) concluding simulated contracts by which company undertakes debts or acknowledging non-existing debts; 3) concealment, destruction or alteration of company`s records, so the company`s profit or the liabilities to assets ratio cannot be detected from them, or by making false documents or in any other way creates an impression that the company`s indebtedness justifies commencement of bankruptcy, shall be punished by imprisonment of six months to five years. If due to such behavior, company`s creditors suffer serious damages, the offender shall be punished by imprisonment of from two to ten years.*[73]

[72] *Id*. at 559–560
[73] *See* CRIMINAL CODE OF THE REPUBLIC OF SERBIA *supra* note 59, Article 236

The underlying policy of this provision is to sanction various abuses of bankruptcy proceedings as part of bankruptcy fraud schemes. It sanctions knowing and fraudulent undertakings by company`s representatives with the intention to evade payments of company`s debts. Fraudulent actions of the company`s representatives are designed to deplete the value of the company`s assets and force company into bankruptcy. In such cases, bankruptcy is commenced not because company suffered business failure, but rather because company`s representatives never had the intention of managing the company`s assets properly. The reason why the legislator uses the term false bankruptcy is to emphasize that bankruptcy was planned from the beginning.

The main difference between this crime and causing bankruptcy is the fraudulent intent of company`s representatives aimed at avoiding payments of company`s debts. Although, mismanagement of assets exists in both crimes, here it is driven by the intention of avoiding payments of company`s debts. Obviously, this intent to avoid payments is difficult to prove, however without such intention, false bankruptcy charges cannot be prosecuted successfully.

Another important difference between causing bankruptcy and causing false bankruptcy is that for latter crime, causing damages to others is not a requirement. Mere fraudulent acts undertaken with the intention to avoid payment of debts followed by company`s bankruptcy make this provision applicable. It is indisputable that due to such acts of the company`s representatives, creditors as well as company`s shareholders, employees, tax authorities, and others suffer damages, but such damages are not an essential element of this crime. Nevertheless, Serbian legislator takes damages suffered by the company`s creditors into consideration prescribing specially severe type of this crime if serious damages are suffered by the company`s creditors.

A perpetrator of this crime can be any representative of the company acting on the company`s behalf. This crime cannot be based on negligence i.e., a perpetrator has to act knowingly and fraudulently with the specific intent to avoid payments of the company`s debts.

3.3 Bankruptcy crimes contained in Bankruptcy Act

Bankruptcy crimes contained in the Bankruptcy Act are designed to provide additional compliance with the requirements of the bankruptcy law. Unlike, crimes provided in the Criminal Code, the following provisions are focused on sanctioning noncompliance with the rule of bankruptcy law, thus providing protection to bankruptcy law as a system. However, this protection in not comprehensive and ample as it could be, unlike the one provided by the US law.

3.3.1 Filing of False Claims

According to Article 204 of the Serbian Bankruptcy Act:

> *Whoever, in bankruptcy proceedings under this Law, files the false claim with the court, by submitting false documents or otherwise, shall be imprisoned from one to three years and fined in the amount of RSD 500,000* [approx. EUR 5,000] *to RSD 10,000,000* [approx. EUR 100,000].[74]

The purpose of this provision is to protect one of the basic principles of bankruptcy law: complete and accurate disclosure of all information relevant for conducting bankruptcy proceedings. If this principle is not followed, actual value of the debtor`s estate and the amount of creditor`s claims cannot be determined, and the principle of equal treatment of all creditors within the same class becomes meaningless. Serbian legislator does not provide explicit criminal sanctions for debtor`s nondisclosure of all relevant information, it rather focuses on creditor`s nondisclosure or false disclosure of such information. This reflects

[74] BANKRUPTCY ACT OF THE REPUBLIC OF SERBIA (Official Gazette of the RS, Nos. 104/09, 99/11, 71/12) Article 204, http://www.paragraf.rs/propisi_download/zakon_o_stecaju.pdf (last visited Mar 17, 2013) & unofficial English translation of the Serbian Bankruptcy Act available at http://www.alsu.gov.rs/bap/upload/documents/zakoni/Law%20on%20Bankruptcy.pdf

Serbian legislator`s standpoint that each creditor should take care of its own claim. Such approach neglects the importance of protecting the bankruptcy law as a system which rests on the principle of full disclosure.

This provision sanctions assertion of false claims against the debtor`s estate in order to protect the interests of honest creditors. It encompasses both filing of a false claim and providing false documents in support of such claim.

A perpetrator of this crime can be any person who knowingly and fraudulently files false claims against the debtor`s estate.

3.3.2 Disposal of Debtor's Assets after the Opening of Bankruptcy Proceedings

According to Article 205 of the Serbian Bankruptcy Act:

> *Whoever, after the commencement of bankruptcy proceedings and before the appointment of the trustee, or after the appointment of a trustee but before trustee gains control over the estate, disposes of assets belonging to the bankruptcy estate without any compensation or below the market value, shall be subject to imprisonment from one to five years and fined a minimum amount of RSD 500,000* [approx. EUR 5,000], *or, if such offence is committed out of self-interest* [koristoljublja], *an amount of up to RSD 10,000,000* [approx. EUR 100,000].[75]

This provision is designed to protect the assets of the estate between the commencement of bankruptcy and the moment when trustee gains control over the debtor`s estate.

This provision protects interests of the creditors by sanctioning disposal of debtor`s assets throughout the period of transfer of control over the estate from a debtor to a trustee. During this period, the debtor can be tempted to conceal its assets or to engage in conspiracy with a particular creditor, favoring such creditor over the others. The debtor can also try to dispose of its assets by selling them out of the rules of bankruptcy law, thereby causing damages to its creditors who will obtain less due to a diminished value of the estate.

[75] *Id.* at Article 205

A perpetrator of this crime can be any person, although this provision is primarily directed towards debtor`s disposal of assets. However, it encompasses any other person holding the debtor`s assets who, in accordance with the bankruptcy rules, is obliged to return such assets to a debtor after commencement of the bankruptcy proceedings.

In order to be held liable for this crime, a perpetrator has to be aware of the bankruptcy proceedings and has to act with the intent to circumvent the rule of bankruptcy law.

3.3.3 Misrepresentation and Concealment of Facts in a Prepackaged Reorganization Plan

According to Article 206 of the Serbian Bankruptcy Act:

> *Whoever, in a prepackaged reorganization plan, misrepresents or conceals the facts relevant for the court decision or for creditors voting for a proposed plan shall be subject to imprisonment from one to five years and fined a minimum amount of RSD 500,000* [approx. EUR 5,000], *or, if such offence has reason of self-interest* [koristoljublja], *an amount of up to RSD 10,000,000* [approx. EUR 100,000].[76]

This provision addresses specifically nondisclosure or misrepresentation of facts contained in a prepackaged reorganization plan. According to the Serbian Bankruptcy Act prepackaged reorganization plan can be submitted along with the proposal for opening the bankruptcy proceedings. Usually, this happens in cases when a debtor files bankruptcy petition proposing, at the same time, reorganization instead of liquidation of its assets. Prepackaged reorganization plan has to contain information about the debtor`s assets and liabilities as well as a list of all creditors. It has to be complete and accurate so that the court and the creditors can decide whether to support such a plan.

Since reorganization process is designed to help debtor to overcome financial hardship and continue its business activities, the legislator recognizes the possibility of fraudulent

[76] *Id.* at Article 206

misrepresentation of facts by the debtor in order to avoid paying certain obligations, or to use bankruptcy as a cover for some fraudulent transfers. The prepackaged reorganization plan submitted by the debtor itself requires diligent control over its content in order to prevent any fraudulent intention debtor might have.

A perpetrator of this crime can be any person who submits the prepackaged reorganization plan along with the bankruptcy petition, such as big creditors interested in recovering full amount of their debts, which would not be possible if the debtor`s assets were liquidated.

Misrepresentation or nondisclosure of an important fact has to be done knowingly and intentionally.

CONCLUSION

Upon detailed analysis of bankruptcy crimes regulation in the United States and in Serbia, it can be concluded that the United States law reacts more efficiently to bankruptcy crimes than Serbian law. This is not surprising since the United States have the strongest economy in the world and are well known pioneers in the field of business transactions. For these, strictly historical and economic reasons, the United States law is presumably the most developed law with respect to all fields of business transactions, including the bankruptcy law which addresses the conduct of business participants in times of financial hardship. Due to a high economic development and huge amount of transactions which involve the Unites States companies, their bankruptcy law is designed not only as a mechanism for protection of creditors' interests, but also as a system for providing debtor with the relief form the business failure.

The first chapter of this thesis addresses a theoretical background of bankruptcy crimes as type of white collar crimes. It places bankruptcy crimes in a category of crimes which requires legislators capable of recognizing the necessity of providing additional protection to bankruptcy law through the avenue of criminal law. This assumes sanctioning not only the conducts which as the end result, force company to bankruptcy, but also the conducts which undermine the basic principles of bankruptcy law. In order to ensure full efficiency of bankruptcy law, legislators must address not only bankruptcy related crimes which include fraudulent business transactions causing bankruptcy, but also bankruptcy crimes which refer to noncompliance with the requirements of bankruptcy law.

The United States law recognizes this subtle difference between bankruptcy crimes and bankruptcy related crimes and adequately responds to both categories of crimes.

The second chapter of this thesis provides detailed analysis of the United States bankruptcy crimes regulation emphasizing the benefits of the United States legislators' decision not to focus on sanctioning fraudulent bankruptcy schemes, but rather specific conducts within such schemes. Such an approach of the United States law assures successful prosecution of bankruptcy crimes, releasing the prosecutor from the heavy burden of proving bankruptcy fraud scheme as such, thus providing efficient and comprehensive protection of bankruptcy as a system.

Unlike the United States law, Serbian law reached for the regulation of various bankruptcy schemes involving fraudulent acts, leaving noncompliance with the requirements of bankruptcy law almost completely out of the criminal law avenue.

The third chapter reveals all weaknesses of the Serbian legislator`s approach, emphasizing how it influence the lack of confidence in bankruptcy proceedings in Serbia. Although it is indisputable that bankruptcy related crimes and bankruptcy fraud schemes have to be identified and sanctioned, Serbian legislators` attempt to sanction as a crime whole bankruptcy scheme rather than particular conducts within such a scheme has two major consequences: first, it is extremely difficult to prosecute such crimes. Therefore, prosecutors quite often reach for some other offences in order to avoid the danger of not being able to prosecute due to a complicated requirement of statutory provision. Second, such regulation leaves noncompliance with bankruptcy requirements without the additional protection of the criminal law which is, from the perspective of bankruptcy law, even more important than sanctioning of abuses of bankruptcy proceedings.

In order to strengthen the bankruptcy system, Serbian legislators should look up to the United States law and improve the current regulation of bankruptcy crimes by identifying bankruptcy

crimes as a separate category of crimes and by introducing offences addressing the noncompliance with the requirements of bankruptcy law.

These changes would protect the basic principles of bankruptcy law, raise the confidence in bankruptcy system and assure higher level of compliance with the requirements of bankruptcy law. By introducing these changes, Serbian legislator would create a legal system which would adequately and effectively respond to the fraudulent business activities, thereby increasing the level of business transactions and assuring the growth of the overall economic activities.

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