USTP Participates in Nationwide Sweep
Targeting Investment Fraud Schemes

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Nationwide Sweep

Operation Broken Trust, a nationwide law enforcement sweep targeting investment fraud, was announced by Attorney General Eric Holder on December 6, 2010. The operation was designed to highlight the impact investment fraud schemes have upon individuals from all walks of life. It featured both civil and criminal cases, including several cases in which the U.S. Trustee Program (USTP or Program) played a role.

"Operation Broken Trust is the first national operation in history to target the many different types of investment fraud schemes that prey directly on the investing public," Attorney General Holder stated.[1] Covering the period from August 16, 2010, through November 29, 2010, Operation Broken Trust (OBT) involved 231 criminal cases against 343 defendants and 60 civil enforcement actions against 189 civil defendants. OBT's criminal cases involved more than $8.3 billion in estimated losses and its civil cases involved estimated losses of more than $2.1 billion. In total, the fraud schemes targeted by OBT harmed more than 120,000 victims throughout the country.[2]

Enforcement actions taken as a result of OBT involved a range of different investment fraud schemes, all of which prey directly on the investing public. The operators of these types of schemes often promise high returns to investors, but engage in little or no legitimate investment activity. Such schemes include Ponzi schemes, affinity fraud, prime bank/high-yield investment scams, foreign exchange (FOREX) frauds, business opportunity fraud and other similar schemes. In some instances, operators of these schemes filed for bankruptcy in an attempt to avoid claims by victim-investors.[3]

OBT was organized by the President's interagency Financial Fraud Enforcement Task Force, a multi-agency group that includes the Department of Justice and components such as the USTP. During the sweep, the USTP worked closely with various other agencies including the Federal Bureau of Investigation, Securities and Exchange Commission, U.S. Postal Inspection Service, Internal Revenue Service and Commodity Futures Trading Commission. The Program participated in the sweep by filing or resolving objections to discharge in bankruptcy cases involving alleged participants in investment fraud, and by referring to law enforcement a number

[1] "Attorney General Eric Holder Speaks at the Operation Broken Trust Announcement," available at http://www.justice.gov/iso/opa/ag/speeches/2010/ag-speech-101206.html.

[2] "Financial Fraud Enforcement Task Force Announces Results of Largest-Ever Nationwide Operation Targeting Investment Fraud," available at http://www.justice.gov/opa/pr/2010/December/10-ag-1390.html.

[3] Id.

of the criminal cases that were charged or resolved during OBT. This article discusses several of the bankruptcy-related investment fraud cases included in the nationwide sweep, and the Program's role in those cases.

Ponzi Schemes

In several OBT cases, Ponzi scheme operators were subject to civil enforcement activity by the USTP. A Ponzi scheme is an investment fraud that involves the payment of purported returns to existing investors from funds contributed by new investors. Ponzi scheme organizers often solicit investors by promising to invest in opportunities claimed to generate high returns with little or no risk. In many Ponzi schemes, the fraudsters solicit new investors in order to make promised payments to earlier-stage investors and to use for personal expenses, instead of engaging in any legitimate investment activity.[4]

One case included in OBT involved two defendants in the District of New Hampshire who pleaded guilty to charges relating to their participation in a Ponzi scheme that defrauded private lenders out of $33 million. One defendant ultimately filed personal bankruptcy, but the U.S. Trustee's Manchester office obtained a waiver of his chapter 7 discharge. The debtor operated a mortgage brokering firm that was involved in obtaining private lending for residential and commercial borrowers. The other defendant owned and operated a mortgage servicing entity, created to provide services to private lending customers. The debtor admitted soliciting individual consumers as private lenders and falsely representing that their money would be or had been used exclusively to fund one or more specific private mortgage loans. He failed to disclose his intent to use all or part of the private lenders' money to fund mortgages in which they had not agreed to invest, to make interest payments to other lenders and themselves, to defray the mortgage brokering firm's operating expenses and to fund his personal expenditures. In August 2010, the Bankruptcy Court for the District of New Hampshire approved his waiver of discharge. The following month, he pleaded guilty to mail fraud and wire fraud charges.

In another case, a debtor who was an investment manager was convicted by a jury in the Eastern District of New York for operating a long-running and large-scale Ponzi scheme. The U.S. Trustee's Brooklyn office had referred the criminal matter to the U.S. Attorney's office after the debtor filed bankruptcy. The U.S. Trustee also objected to the debtor's discharge, which resulted in his waiver of discharge. The debtor's scheme began in the late 1970s, when he began accepting money from individual investors for purported stock option investments. To induce investments and discourage withdrawals, the debtor guaranteed specific rates of return, issued account statements that showed growing account balances, represented that investing in his business was safe, and promised that withdrawals could be made easily. Evidence presented at the criminal trial established that the debtor operated a Ponzi scheme, paying returns from existing investors' deposits and from money paid by new investors. He never produced or earned the rates of return he advertised, and he lied to investors about his company's investments and falsely assured investors about their risk of loss. Approximately 800 individuals invested a total of more than $40 million ~~dollars~~ in his business. The debtor testified during his 11 U.S.C. § 341 meeting of creditors that he owed $60 million to investors.

[4] U.S. Securities and Exchange Commission, "Ponzi Schemes—Frequently Asked Questions," available at http://www.sec.gov/answers/ponzi.htm.

In a case from the Middle District of Tennessee, the U.S. Trustee's Nashville office obtained the stipulated denial of a debtor's discharge in a civil action prior to the sweep, and made a criminal referral to the U.S. Attorney's office. During the sweep the debtor was sentenced to 96 months in prison and ordered to pay more than $7 million in restitution after pleading guilty to mail fraud and wire fraud related to his involvement in a Ponzi scheme. The debtor promised investors they would receive between 10 percent and 28 percent in annual returns, and he persuaded individuals to invest more than $7 million in investment accounts. Instead of investing the funds on the clients' behalf, the debtor used the funds to subsidize a lavish lifestyle that included expensive homes, cars, a country club membership and shopping trips during which he spent thousands of dollars on hotels and clothing. The debtor filed bankruptcy in an attempt to discharge his debts to the defrauded investors.

In another OBT matter, the U.S. Trustee's Seattle office obtained a debtor's waiver of the chapter 11 discharge of more than $100 million in unsecured debt arising from his Ponzi scheme and embezzlement activities. The debtor created and operated investment funds purportedly for the purpose of investing in seller-financed real estate contracts, hard money loans, real estate and mortgage-backed securities. Approximately 1,000 investors invested $350 million in four funds, which are currently the subjects of jointly administered chapter 11 cases. In November 2010, the debtor was indicted in the Western District of Washington on charges of wire fraud, money laundering and bankruptcy fraud resulting from his alleged use of more than $100 million in investor funds for unrelated business activities and personal expenses for private jets, yachts and a waterfront mansion.

Affinity Fraud

Consistent with the focus on protecting consumers, OBT included a number of affinity fraud cases. Affinity fraud refers to investment scams that prey upon members of identifiable groups, such as religious or ethnic communities, the elderly or professional groups. The fraudsters who promote affinity scams frequently are, or pretend to be, members of the group. They often enlist respected community or religious leaders from within the group to spread the word about the scheme, by convincing those persons that an investment is legitimate and worthwhile. Often, the community or religious leaders become unwitting victims of the fraudster's ruse.[5]

In a bankruptcy-related affinity fraud case included in OBT, a debtor waived his chapter 7 discharge pursuant to an agreed order entered by the Bankruptcy Court for the Northern District of Ohio. The waiver resolved an objection to discharge filed by the U.S. Trustee's Cleveland office alleging the debtor engaged in a scheme to defraud approximately a dozen investors out of around $1 million to fund his extravagant lifestyle and gambling habit. The debtor used his associations with a church to convince members to invest in day trading software he claimed to be developing. The U.S. Trustee's investigation revealed that the debtor instead used investors' money to purchase race horses, buy or lease luxury vehicles and maintain a $450,000 property held in his wife's name, and that he regularly created new corporations and accounts to hinder and delay investors' collection efforts. When he filed bankruptcy, the debtor initially claimed he had no financial accounts other than a brokerage account. Among other

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[5] U.S. Securities and Exchange Commission, "Affinity Fraud: How to Avoid Investment Scams that Target Groups," available at http://www.sec/gov/investor/pubs/affinity.htm.

assets involved in the fraud scheme, the U.S. Trustee discovered eight checking accounts created through corporate shells. Nearly all of these accounts had been used to finance gambling, casino vacations and/or luxury purchases.

Conclusion

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The FFETF sent a strong message with Operation Broken Trust. "To the public: be alert for these frauds, take appropriate measures to protect yourself, and report such schemes to proper authorities when they occur," Attorney General Holder stated. "And to anyone operating or attempting to operate an investment scam: cheating investors out of their earnings and savings is no longer a safe business plan – we will use every tool at our disposal to find you, to stop you, and to bring you to justice."

The Program is pleased to have participated in this significant law enforcement effort. Additional information about investment fraud schemes can be found at the FFETF's Web site, www.StopFraud.gov. As always, the USTP encourages bankruptcy judges, attorneys, trustees and others in the bankruptcy community to report suspected bankruptcy fraud and abuse to the U.S. Trustee Program, either through your local field office or through our Internet fraud hotline: USTP.Bankruptcy.Fraud@usdoj.gov.