

## **Partners in Combatting Crime: The Vital Roles of Chapter 7 Trustees and the United States Trustee Program**

By

Alison Goldenberg, Trial Attorney, Denver, CO  
Serene Nakano, Trial Attorney, New York, NY  
Andy Velez-Rivera, Trial Attorney, New York, NY

*“Trustees are integral to the USTP’s criminal enforcement program.” Director Clifford J. White  
III, Executive Office for United States Trustees*

### **Introduction**

The trusted and continuing nationwide partnership between the United States Trustee Program (USTP or Program) and chapter 7 trustees is essential to protecting the integrity and efficiency of the bankruptcy system. With a goal of protecting the public from fraud and abuse, the USTP carries out enforcement, regulatory, and administrative activities that are critical to the proper functioning of the bankruptcy system. The USTP serves as a vigilant “watchdog” of the bankruptcy system and combats deceptive actions by debtors, creditors, professionals and other third parties.

Along with administrative, regulatory and civil enforcement activities, criminal enforcement is a USTP priority. Chapter 7 trustees, as well as USTP field office staff across the country, play an essential role in the identification and referral of bankruptcy fraud and other crimes. Chapter 7 trustees are on the front lines in the battle against bankruptcy crimes and play a crucial role in identifying and initiating civil investigations, and referring possible criminal activity. In addition to notifying the Program of suspected wrongdoing, trustees routinely provide additional assistance after a referral is made. This can include providing documents and related information to law enforcement and, on occasion, appearing as trial witnesses. The Program values the significant contributions chapter 7 trustees make in combating bankruptcy fraud and encouraging public confidence in the federal judicial system.

### **The Duty to Refer Violations**

The duty to refer violations of federal law and report criminal conduct highlights the importance of the partnership and coordination between the USTP and chapter 7 trustees. Both the USTP and chapter 7 trustees have a statutory responsibility to identify and refer potential fraud or criminal activity in a case. The USTP is required by 28 U.S.C. § 586(a)(3)(F) to refer potential criminal violations to the United States Attorney, and upon request, to assist the United States Attorney in prosecuting the matter. Pursuant to 18 U.S.C. § 3057(a), trustees with reasonable grounds to believe that a violation of federal law has occurred have a duty to report the facts and circumstances to the appropriate U.S. Attorney. *The Handbook for Chapter 7 Panel Trustees* (“*Handbook*”) also discusses the chapter 7 trustee’s duty to report criminal conduct. *See Handbook*, Section 4.41-4.45. The duty to refer is not limited to thresholds or guidelines, or whether there is proof beyond a reasonable doubt.

Trustees are in an excellent position to ferret out bankruptcy fraud and abuse. The trustee's initial review of the Schedules and Statement of Financial Affairs may uncover potential crimes, fraudulent transactions, fictitious entities, credit bust-outs, theft, embezzlement by professionals, and other potential fraud. Creditors and other interested parties such as former employees, ex-spouses, ex-business partners, trade creditors, or neighbors may contact the trustee regarding undisclosed assets or transfers. The meeting of creditors is a vital opportunity for chapter 7 trustees to discover potential fraud. Indeed, prompt communication between the USTP and chapter 7 trustees is critical to pursuing appropriate civil remedies as well as making timely criminal referrals.

It is essential that the chapter 7 trustee and the USTP coordinate their efforts in the criminal referral process. Fulfillment of statutory duties promotes the integrity of the bankruptcy system and creates partnerships with federal, state, and local law enforcement partners. Besides upholding a statutory duty, referring criminal activity also serves another purpose. The information provided may help law enforcement on other pending investigations against a subject or target.

### **Partnership with United States Trustee Program**

The partnership between the USTP and chapter 7 trustees has continued to strengthen via collaboration, increased education about the ever-changing landscape of fraud schemes, and our shared commitment to protecting the integrity of the federal court system. Both the USTP and chapter 7 trustees take action against debtors, creditors, and others who attempt to exploit and compromise the integrity of the bankruptcy system. USTP offices across the country continuously provide bankruptcy fraud training to their staff, law enforcement officials, and trustees. Indeed, the scope and variation of criminal schemes make it increasingly important for everyone to timely communicate and candidly discuss matters in order to maintain operational excellence. Teamwork and partnerships are an absolute necessity in investigations against parties who seek to advance their own economic interests to the detriment of stakeholders in a bankruptcy case.

The information chapter 7 trustees gather from their day-to-day administration of cases is crucial to the USTP's ability to effectively address abusive conduct through civil enforcement actions and referral of criminal activity to our law enforcement partners. Moreover, approximately two dozen USTP Trial Attorneys are designated as Special Assistant United States Attorneys to assist in criminal investigations and prosecutions throughout the country. Notifying the USTP of suspected criminal conduct is an integral first step that can lead to a successful civil enforcement action and/or criminal prosecution.

### **Successful Criminal Prosecutions**

Two notable cases showcase the coordination between chapter 7 trustees and the USTP and their indispensable roles in identifying and reporting bankruptcy-related crimes. In one case, the chapter 7 trustee learned of the concealed assets at the first meeting of creditors. Similarly, in another case that was converted from chapter 11 to chapter 7, the Manhattan field office notified the chapter 7 trustee about unaccounted-for funds from a real estate sale that eventually led to the

prosecution of the debtor's bankruptcy attorney. These cases highlight the significant work being done throughout the country by private trustees and the USTP to identify, investigate and refer suspected criminal wrongdoing. They also showcase the assistance provided to law enforcement.

The successful prosecution in a case in the Northern District of Illinois illustrates the coordination between the USTP, the chapter 7 trustee, and the U.S. Attorney's office for the Northern District of Illinois. Pursuant to testimony at the first meeting of creditors, chapter 7 trustee Stephen G. Balsley immediately alerted the USTP regarding potential concealment of assets, false statements, and false oaths.

The bankruptcy filed by debtor Lynn Y. Zoiopoulos, a former physician, appeared to be a no-asset case with significant business and personal debt. At the section 341 meeting, the chapter 7 trustee, Stephen G. Balsley, placed the debtor under oath and asked her whether her Schedules and Statement of Financial Affairs were true and correct and whether she had listed all of her assets. The debtor responded in the affirmative to those questions. The trustee also asked a series of specific questions covering assets, transfers, and gifts.

The truthfulness of her answers to certain of the trustee's questions was called into doubt upon questioning by a creditor. In response to the creditor's questions, the debtor admitted to her ownership of some previously undisclosed assets, but denied that she had an interest in her grandmother's probate estate. The trustee immediately asked follow-up questions and demanded that the debtor turn over the assets she had just admitted to owning. When the debtor failed to comply, he obtained a turnover order from court, took the debtor's 2004 examination, and filed adversary proceedings against the debtor and other parties. These civil enforcement actions led to the discovery of additional acts of fraud by the debtor. The trustee's prompt administration of the estate resulted in recovering assets for creditors and provided information that formed the foundation of the criminal referral made by the USTP to the United States Attorney.

Following the criminal referral to the United States Attorney's office, a USTP Trial Attorney provided assistance to law enforcement, including facilitating the turnover of the chapter 7 trustee's file to the FBI. The USTP attorney was also scheduled to testify at trial regarding bankruptcy procedure and the documents filed in the bankruptcy but did not do so because the defendant pled guilty.

On February 24, 2014, Zoiopoulos was charged with two counts of making false statements in a bankruptcy case and three counts of mail fraud. On February 8, 2016, she pleaded guilty to making false statements in a bankruptcy case. In her plea agreement, the defendant admitted that she was the executor of her deceased grandmother's estate and that she had concealed her interest in the decedent's estate and an annuity. Before filing for bankruptcy, the defendant, as executor, opened a probate estate bank account with the balance reaching up to \$855,178. From that account, she embezzled \$550,000 to purchase an annuity contract for herself, which after its purchase became an asset of the estate. During the bankruptcy case, the defendant took the remaining \$227,171 balance of the annuity and used the money for her own benefit, despite knowing that the money was an asset of the bankruptcy estate. The debtor also admitted to

concealing other property, including several serigraphs and sculptures that were later forfeited pursuant to the plea agreement.

The defendant was sentenced to 30 months in prison for making false statements in her bankruptcy case and was ordered to pay restitution of \$858,765.

Besides taking action against debtors, the USTP also pursues civil and criminal enforcement remedies against other participants in the system, including bankruptcy attorneys who fail to discharge their responsibilities to their clients or engage in other abusive conduct. The *Carlebach* case is particularly instructive on how a successful partnership between the Program and a chapter 7 trustee led to successful civil and criminal enforcement actions.

The events that led to the issuance of a contempt citation and both federal and state criminal charges against attorney P. David Carlebach began in November 2014 with Carlebach's seemingly routine filing of a chapter 11 petition in the Southern District of New York for 199 East Seventh Street, LLC ("199"), which owned five cooperative units valued at \$1.6 million. After extended hearings, the bankruptcy court issued an order in September 2015 approving a sale to a buyer and specifying that the sale proceeds would be paid to certain creditors.

The case then seemed to stall. Because the debtor had not filed a report of sale, a plan or disclosure statement, or operating reports in several months, the United States Trustee moved to convert or dismiss the case in June 2016. Just before the hearing, Carlebach gave a USTP Trial Attorney contradictory and confusing explanations about what happened to the sale proceeds of over \$1 million, and whether transfer taxes due to New York City ("City") had been paid. Carlebach also submitted a post-closing bank statement showing that the debtor wired him \$30,000, but the bankruptcy court had never approved any attorney fees. And doubts existed when Carlebach filed alleged closing papers showing that transfer taxes of \$23,500 had been paid to the City. In September 2016, with the USTP's firm recommendation, the bankruptcy court converted the case to chapter 7.

The United States Trustee appointed Albert Togut to serve as the chapter 7 trustee in the converted case. Following his appointment, the USTP Trial Attorney informed the trustee that he strongly suspected that Carlebach had received the sale proceeds without a court order and had filed fraudulent documents. Within days of being appointed, the trustee obtained discovery orders and issued subpoenas. In tandem, at the Trial Attorney's urging, the City promptly filed a letter advising that the 199 debtor had neither filed real property tax returns nor paid transfer taxes. Insisting that the *ex parte* motion filed by the trustee violated his due process rights and that the debtor paid the taxes at closing, Carlebach objected. But at the trustee's request, and with the filed support of the USTP, the bankruptcy court issued an Order to Show Cause to consider a contempt citation and sanctions due in part to Carlebach's failure to turn over all estate funds that had been disbursed without court approval.

Despite the bankruptcy court's many exhaustive efforts over several months to persuade Carlebach to avoid contempt by complying with the court's discovery orders, on January 18, 2017, the bankruptcy judge found Carlebach in contempt and directed the U.S. Marshals to take him into custody until he purged himself of contempt. In his bid to thwart the ruling, Carlebach

appealed and sought a stay. When that failed, Carlebach filed a personal chapter 13 bankruptcy case across state lines in New Jersey and sought yet another stay. The trustee and the USTP both appeared in New Jersey and successfully objected to the stay. Carlebach appealed that denial to no avail.

Following the bankruptcy court's issuance of a bench warrant, Carlebach became a fugitive and remained so for many months. In that time, with the trustee's assistance, the USTP's Manhattan Office continued investigating Carlebach's conduct in *199* and other bankruptcy cases and found many financial irregularities. The bankruptcy court and the USTP's law enforcement partners at the federal and state levels were notified. The USTP also referred Carlebach to the Disciplinary Committees of the Federal and State Bars, and obtained an order revoking Carlebach's electronic filing privileges in the bankruptcy court.

After evading apprehension for months, Carlebach was eventually taken into custody and incarcerated based on an arrest warrant issued by a state court. In March 2018, in the U.S. District Court for the Southern District of New York, Carlebach pleaded guilty to one count of embezzlement from a bankruptcy estate – transferring \$30,000 from a client's bankruptcy estate to himself. Additionally, in May 2018, Carlebach pleaded guilty to one count of Grand Larceny in the Second Degree and one count of Scheme to Defraud in the First Degree, relating to *199* and several other bankruptcy cases based on his admitted engagement in a systematic ongoing scheme to embezzle over \$1.8 million from escrow funds deposited into his attorney escrow account. Sentencing is scheduled for both the federal and states cases later this year.

## **Conclusion**

The USTP and trustees play a vital role in ensuring the integrity and efficiency of the bankruptcy system. Chapter 7 trustees are integral to the effective functioning of the bankruptcy system, serving as fiduciaries in hundreds of thousands of cases each year and fairly administering those cases. Prompt referral of criminal conduct identified by trustees does make a difference and contributes significantly to combatting fraud and abuse in the system through civil and criminal enforcement actions. Through collaboration and partnership, our ability to address wrongdoing in the bankruptcy system is greatly enhanced.