



CRACKING DOWN ON 'THE BLEED OUT'

Authorities taking a harder line against bankruptcy schemes

By **RICHARD P. FINKEL**

What do Kurt Claywell, Joseph Russo, Ronald Lupica and Gary Blonder all have in common? Each man served time in federal prison for bankruptcy-related crimes. The United States Trustee Program, a division of the Department of Justice, estimates that more than 10 percent of all bankruptcy filings involve some kind of fraud or abuse. In June 2007, the Executive Office for the United States Trustees issued "Report to Congress: Criminal Referrals by the United States Trustee Program Fiscal Year 2006." The report lists 925 bankruptcy related criminal referrals for the year, a 24 percent increase from 2005.

'Truth or Consequences'

The Department of Justice has launched a nationwide law enforcement effort to combat bankruptcy fraud called "Operation Truth or Consequences." This initiative encourages the public to report suspected bankruptcy fraud by e-mail. In Connecticut, the U.S. Attorney has formed the Bankruptcy Fraud Working Group to investigate and prosecute bankruptcy crimes. The group includes representatives from the U.S. Attorney's Office, the Office of the U.S. Trustee, the Internal Revenue Service, the FBI, the Secret Service, the Social Security Administration and the U.S. Postal Inspection Service.

Bankruptcy fraud is a crime which carries penalties of fines and imprisonment.

Richard P. Finkel, CPA, CFE, CIRA, CFF, is a partner in Blum Shapiro's Litigation Services and Business Valuation Group in West Hartford.

Under 18 U.S.C. Section 152, there are five types of bankruptcy fraud: (1) concealment of assets; (2) false oaths, statements and disclaimers; (3) filing a false claim against the estate; (4) bribery; and (5) concealment, destruction or withholding of documents.

The vast majority of reported bankruptcy crimes are false oaths or statements and concealment of assets. However, many bankruptcy crimes involve complex fraud schemes. Two of the most common schemes are the "bleed out" and the "bust out."

A "bleed out" usually involves an existing company that had been successful in the past but which is now in financial trouble. The assets are transferred or dissipated by insiders, while the debt remains with the failing company. For example, a construction company filed a Chapter 7 bankruptcy petition listing millions of dollars in liabilities and almost no assets. A forensic accounting investigation determined that prior to the bankruptcy filing, the company had transferred equipment, construction contracts, materials and accounts receivable to a newly formed entity.

The new entity was owned by the mother-in-law of the owner of the bankrupt company, and it went on to complete the transferred construction contracts, using the materials and equipment received from the old company. The new entity then collected the payments for these contracts, leaving the bankrupt company and its creditors with no assets and no income.

The "bust out" generally involves a business which is set up to fail, much like Max Bialystock and Leo Bloom's scheme in *The Producers*. The bust-out artist will obtain inventory on credit, often using fraudulently manufactured financial statements. The



goods are sold but the creditors go unpaid. Under pressure from creditors, a Chapter 11 bankruptcy is filed. Using the automatic stay provisions of the bankruptcy code, the perpetrator can sell the remaining inventory and then disappear.

Connecticut Cases

Connecticut has seen its share of bankruptcy fraud related cases. In June 2008, Kurt C. Claywell was sentenced to 60 months in prison and ordered to pay \$86,000 in restitution for conspiring to commit bankruptcy fraud by concealing assets. He pleaded guilty in July 2007, admitting that he knowingly failed to disclose certain facts in his September 2005 Chapter 7 bankruptcy filing; that he concealed assets from the court and the bankruptcy trustee and that he directed a friend to conceal re-

cards from the bankruptcy trustee.

Claywell had failed to disclose ownership of 35 acres, wine valued at approximately \$35,000 and a rare book collection. He also hid the transfer of \$115,000 into a limited liability company. At the time of his sentencing, Claywell was already serving a 66-month sentence in prison for a prior conviction on tax and mail fraud.

In April 2006, Joseph J. Russo was sentenced to 24 months in prison for bankruptcy and tax fraud. Russo pleaded guilty in May 2005 to knowingly concealing assets in his 2002 bankruptcy filing and willfully failing to file tax returns. Russo also failed to disclose approximately \$141,000 on his bankruptcy schedules and admitted that he took steps to hide the money by putting it in an account in his father's name.

In June 2008, Ronald A. Lupica was sentenced to 15 months in prison, followed by three years of supervisory release. In July 2007, he pleaded guilty to bankruptcy fraud, tax evasion and mail fraud. The bankruptcy charges stem from Lupica's intent to commit fraud by receiving \$1,700 in payments on a \$168,000 note from a debtor who had filed bankruptcy.

Gary S. Blonder was denied a discharge of his debts in February 2001, for failure to keep and preserve adequate records and for failure to adequately explain the loss of assets. Blonder stated in his bankruptcy filing that he transferred antiques, paintings and other collectables valued at \$1,377,000 to a corporation which he controlled. He later testified that the items in question were, in fact, never physically

transferred to the corporation but were located at his personal residence, where they were co-mingled with other antiques he personally owned. The bankruptcy trustee removed all of the antiques from Blonder's home and sold them at auction, netting only \$150,000. Blonder was later indicted by a grand jury on charges of concealing assets from the Federal Deposit Insurance Corp., and making false statements to the U.S. Government. He pleaded guilty and was sentenced to 28 months in prison.

As the number of bankruptcy filings continues to grow, so will the imaginations and the inventiveness of those who attempt to commit fraud. New and increasingly sophisticated schemes will be hatched in a never-ending attempt to conceal assets from creditors. ■

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If you would like additional information about this article or our services, please contact:

Richard P. Finkel, CPA, CFE, CIRA, CFF
860 561-6891
rfinkel@blumshapiro.com

John H. Kramer, ASA, CPA/ABV, CFE, CFF
860 561-6807
jkramer@blumshapiro.com

John S. Pavlovich, CPA/ABV, CFA
860 570-6328
jpvavlovich@blumshapiro.com

Mark S. Campbell, CPA/ABV, CFF, JD
203 319-6073
mccampbell@blumshapiro.com

Michael E. DiGiacomo, CPA, CFE, CFF
203 319-6070
mdigiacomo@blumshapiro.com