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Debt and Crime: Inevitable Bedfellows

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INTRODUCTORY ARTICLE

DEBT AND CRIME: INEVITABLE BEDFELLOWS

The intersection of fraud, bankruptcy and asset forfeiture

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Consider the origins of debt and of crime. Both are as old as humanity. They inhere not so much in human nature (whatever that means), as in the nature of community itself.

Where community is absent, the mythical hermit depends on no one, owes no one, needs from no one, is at risk from no one. He (for in myth this figure is rarely a she)[1] may be at risk of starvation, and of the brutal hardship of bearing sole responsibility for his own health, welfare, shelter, and life. But he does not risk being in debt. He does not risk

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Each of the principal authors of the papers in this Symposium is a member of the Working Group and each presented at: *A Cross-Disciplinary Dialogue: White Collar Crime, Asset Forfeiture and Business Bankruptcy* (Conference at the Golden Gate University School of Law, San Francisco, November 4-5, 2011). Many thanks to each of them for their role in this critical dialogue. Interested persons are encouraged to contact any of them for more information on the Working Group's ongoing projects.

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Finally, many warm thanks to Sarah Welling for her insights on criminal forfeiture and her thoughtful comments on an earlier draft of this Article.

[1] On hermits and seekers, see Isabel Colegate, *A Pelican in the Wilderness: Hermits, Solitaries and Recluses* (Counterpoint Press 2002); Peter France, *Hermits: The Insights of Solitude* (Griffin 1998).

crime, for there is no one against whom he might trespass or who might trespass against him.

The moment one steps away from abject self-sufficiency, places trust in another human being, and becomes a member of a community, however, one risks both debt and crime.

The moment our ancient ancestors lent a tool or a ration of food to a neighbor, they became what today we know as creditors, at risk of never being repaid in full. The borrower became a debtor, at risk of being unable to repay his debt, regardless of how honest or sinister his intentions may have been at the outset.

So, too, is the concept of crime inherently communal, and not simply because there can be no victims in the absence of community. More significantly, the very idea of crime, as recognized and defined by any particular society, rests in the notion that certain acts (or omissions) inflict harm upon society itself. Without a "public" to protect and vindicate, or a "societal" debt to be repaid, the injury one inflicts would remain solely between the culprit and the victim—a wrong certainly, but a private wrong, not a "crime."[2]

Perhaps not surprisingly, then, references to both debt and crime appear in some of the earliest human records.[3]

Fraud, like a deranged matchmaker, brings debt and crime together. Regardless of the face financial fraud takes, from massive securities fraud, to breathtaking Ponzi schemes, to individual one-on-one capers, society must determine whether fraud creates a private debt best left to private resolution, or a crime upon society, or both.

Of late, the verdict has been "both." In the wake of the "great recession," courts have encountered a substantial increase in the number of high profile parallel criminal prosecutions and individual and business bankruptcies arising from dramatically collapsing fraudulent schemes.

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[2] Wrongs society does not define as criminal are, in fact, left to private resolution. Contract breach may be an example, depending upon whether one sees breach as wrong or simply an economic choice. Similarly, in the absence of community, two hermits stealing from each other would be left to settle their own disputes without public intervention or assistance.

[3] For a detailed study of an infamous early 18th Century bankruptcy fraud, see Emily Kadens, *The Pitkin Affair: A Study Of Fraud In Early English Bankruptcy*, 84 AM. BANKR. L.J. 483 (2010). For engaging histories of fraud and confidence scams, see David Maurer, *The Big Con: The Story of the Confidence Man* (1st Anchor Books ed., Anchor 1999) (1940); Donald McCormick, *Taken For A Ride: The History Of Cons And Con-Men* (Hardwood-Smart 1976). See also *Shell Games: Studies in Scams, Frauds, and Deceits (1300-1650)* (Mark Crane et al. eds., Centre for Reformation and Renaissance Studies, 1st ed. 2004) (presenting thirteen case studies); *On the Edge of Truth and Honesty: Principles and Strategies of Fraud and Deceit in the Early Modern Period* (T. Van Houdt et al. eds., Brill Academic Pub. 2003) (presenting twelve case studies).

Examples include the *Madoff* case,[4] Adelphia securities fraud, [5] Petters Ponzi schemes,[6] fraud within the law firms operated by Marc Dreier[7] and Scott Rothstein,[8] and many others.[9] When fraud is practiced[10] on the massive scale seen in these cases, criminal law and bankruptcy law intersect.

Criminal law and bankruptcy law approach fraud with a variety of objectives, only some of which overlap.[11] Each contains elements of

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[4] *In re* Bernard L. Madoff Inv. Sec. LLC, No. 08-01789 (Bankr. S.D.N.Y. 2008); Nos. 10-2378-bk(L), 10-2676-bk(con), 10-2677-bk(con), 10-2679-bk(con), 10-2684-bk(con), 10-2685-bk(con), 10-2687-bk(con), 10-2691-bk(con), 10-2693-bk(con), 10-2694-bk(con), 10-2718-bk(con), 10-2737-bk(con), 10-3188-bk(con), 10-3579-bk(con), 10-33675-bk(con) (2d Cir. 2010); United States v. Madoff, No. 08 Mag. 2735 (S.D.N.Y. 2008); United States v. Madoff, No. 09 Cr. 213 (DC) (S.D.N.Y. 2009); S.E.C. v. Madoff, No. 08 Civ. 10791 (LLS) (S.D.N.Y. 2008).

[5] *In re* Adelphia Commc'ns Corp., No. 02–41729(REG) (Bankr. S.D.N.Y. 2002); *In re* Adelphia Commc'ns Sec. Litig., No. 02-1781 (E.D. Pa. 2002); United States v. Rigas, Nos. 05–3577–cr(L), 05–3589–cr(CON) (2d Cir. 2005).

[6] *In re* Petters Co., No. 08-45257 (Bankr. D. Minn. 2008); United States v. Petters, No. 10-1843 (D. Minn. 2010); S.E.C. v. Petters, No. 09-1750 (ADM/JSM) (D. Minn. 2009); United States v. Petters, No. 08-5348 (ADM/JSM); *see also* Carey Spivak, *Lawsuit Over Ponzi Scheme Seeks $1 Billion From M&I*, JS ONLINE (Apr. 1, 2012), *available at* www.jsonline.com/business/lawsuit-over-ponzi-scheme-seeks-1-billion-from-mi-ki4q25j-145716085.html (discussing suit against Petters' former lender).

[7] *In re* Dreier, LLP, Nos. 10 Civ. 4758(DAB), 10-Civ. 5669(DAB) (S.D.N.Y. 2008); *In re* Dreier, LLP, No. 08-15051 (SMB) (Bankr. S.D.N.Y. 2008); United States v. Dreier, No. 09 CR 085 (JSR) (S.D.N.Y. 2009).

[8] United States v. Rothstein, No. 09-60331-CR (S.D. Fla. 2009); *In re* Rothstein Rosenfelt Adler, No. 09-34791-BKC-RBR (Bankr. S.D. Fla. 2009); *In re* Rothstein Rosenfelt Adler, No. 11-61338-CIV (S.D. Fla. 2011).

[9] *See, e.g.*, Associated Press, *Ohio Man Admits to Swindling Fellow Amish of Millions*, N.Y. TIMES (Mar. 15, 2012), *available at* www.nytimes.com/2012/03/16/business/amish-man-admits-to-a-17-million-fraud.html?_r=1 (discussing the fraud conviction and bankruptcy of Monroe Beachy, age 77); Jennifer Edwards, *Cladek's Victims Now Facing Lawsuits*, ST. AUGUSTINE RECORD (Jan. 29, 2012), *available at* http://staugustine.com/news/local-news/2012-01-28/cladeks-ponzi-victims-bleeding-continues (noting Lydia Cladek's fraud conviction); Casey Grove, *Ponzi Scheme Defendant Gets Five Years For Theft*, ANCHORAGE DAILY NEWS (Apr. 28, 2012), *available at* www.adn.com/2012/04/27/2443074/woman-awaiting-sentence-on-ponzi.html (discussing the five-year state law theft sentence of Anchorage resident Samantha Delay-Wilson, age 65, who awaits sentencing on federal fraud charges); Richard Prior, *Judge Rules That Reorganization Will Benefit Cladek Victims Most*, ST. AUGUSTINE RECORD (Feb. 2, 2011), *available at* http://m.jacksonville.com/news/metro/2011-02-02/story/judge-rules-reorganization-will-benefit-cladek-victims-most (discussing fraud indictment and bankruptcy of Lydia Cladek, then age 69); David Winzelberg, *4 Brokers in Nick Cosmo Agape World Ponzi Scheme Arrested*, LONG ISLAND BUS. NEWS (Apr. 25, 2012), *available at* http://libn.com/2012/04/25/4-associates-of-ponzi-scheme-artist-nick-cosmo-arrested/ (noting additional arrests relating to the Cosmo / Agape fraud and bankruptcy).

[10] Fraud is practiced but never perfected, as those with the hubris to believe they have devised the perfect scheme inevitably discover.

[11] This Article limits its discussion to federal criminal and bankruptcy law. The concepts discussed apply, generally, to other forms of state law proceedings, such as receiverships and assignments for the benefit of creditors; however, the particulars of those proceedings vary from state to state. The uniformity of federal law provides a clear model for the discussion.

both restorative and distributive justice—the notion that the fraudster should be held accountable, the injured should be compensated, and distribution should be fair.[12] Yet, criminal law and bankruptcy law inculcate these goals with profoundly different understandings, histories, contexts and practices. Consequently, the long arm of the law and the strong arm of the trustee have uniquely honed tools, unavailable to the other, for achieving their purposes.[13] Inevitably, then, tension arises when criminal law and bankruptcy law simultaneously attempt to gather and distribute property garnered through fraud.

FRAUD AND CRIMINAL LAW[14]

Criminal law has long known how to respond to fraud: find the culprit, bring charges, obtain a conviction, impose a penalty. Put aside for a moment the bodily fate of the wrongdoer,[15] and consider the economic aspects of the penalty: how does criminal law move from

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[12] In the past decade or so, much academic debate in the criminal justice community has swirled around the phrase "restorative justice." To some, the phrase has come to represent a "third model" of criminal justice that seeks not only restitution to victims but healing, in a sense, of the victims, offenders, and community. *See, e.g.*, Annalise Acorn, *Compulsory Compassion: A Critique of Restorative Justice* (Univ. of Wash. Press 2005); *Critical Issues in Restorative Justice* (Barb Toews & Howard Zehr eds., Criminal Justice Press 2004); Mark Umbreit & Marilyn Peterson Armour, *Restorative Justice Dialogue: An Essential Guide for Research and Practice* (Springer Publ'g Co., 1st ed. 2010); Daniel W. Van Ness & Karen Heetderks Strong, *Restoring Justice, Fourth Edition: An Introduction to Restorative Justice* (Anderson, 4th ed. 2010); Howard Zehr, *The Little Book of Restorative Justice* (Good Books 2002); John Braithwaite, *Narrative and "Compulsory Compassion,"* 31 LAW & SOC. INQUIRY 425 (2006); John Braithwaite, *Restorative Justice: Assessing Optimistic and Pessimistic Accounts*, 25 CRIME & JUST. 1 (1999); Symposium, *Criminal Justice System Reform Symposium*, 53 DRAKE L. REV. 575 (2005); Symposium, *The Utah Restorative Justice Conference*, 2003 UTAH L. REV. 1 (2003).

Because the focus of this Symposium is on compensating for financial injury perpetrated by fraud (whether deemed criminal or not), this Article uses the phrase "restorative justice" in both a broader and narrower sense: broader because it includes "justice" under both criminal and non-criminal (bankruptcy) law; narrower because it focuses solely on restoring value to the victims, not on other types of "restoration" to victims, offenders or communities.

Regarding restorative justice and white collar crime, see Zvi D. Gabbay, *Exploring the Limits of the Restorative Justice Paradigm: Restorative Justice and White-Collar Crime*, 8 CARDOZO J. CONFLICT RESOL. 421 (2007); Joan MacLeod Heminway, *Hell Hath No Fury Like an Investor Scorned: Retribution, Deterrence, Restoration, and the Criminalization of Securities Fraud Under Rule 10B-5*, 2 J. BUS. & TECH. L. 3 (2007).

[13] For example, forfeiture's relation back doctrine is not available to the bankruptcy trustee, and the bankruptcy trustee's avoiding powers are not available in forfeiture proceedings.

[14] The author thanks Alice Dery, Kathy Phelps and Sarah Welling for contributing significantly to the author's appreciation of the concepts addressed in this section.

[15] Procedures and penalties for criminal activity have changed over the millennia; however, whether mere imprisonment or something worse awaits the perpetrator is not relevant to the current inquiry. In the context of imprisonment for debt, see *infra* note 21.

acting upon the criminal to acting upon property and returning property to victims?

During the last several decades, criminal law has embraced with enthusiasm the notion of restorative and distributive justice, expressed in terms of victims' rights. At the same time, the breadth of the federal government's criminal, and to a lesser extent civil, asset forfeiture powers, has expanded dramatically, as thoughtfully and accessibly explained by Professor Welling.[16]

Forfeiture allows the government to seize property that was involved in, facilitated, or is the proceeds of a wide array of crimes, including fraud. Today, the government routinely seizes property as a mandatory component of federal sentences.

With the growth of the victims' rights movement, the practice of restorative justice is rapidly changing from an arcane notion of discretionary compassion in favor of innocents, to a perceived entitlement that requires the government to fashion reasoned means of distributing literally billions of dollars of ill gotten gains to fraud victims.

Consider two simplified examples: how might forfeiture affect (i) a thief, and (ii) a drug smuggler using a stolen boat?

Criminal forfeiture necessarily defines both the target property and any "victim" potentially entitled to compensation in reference only to the offense of conviction. The thief might be ordered to return the stolen goods, which property (or value) may be returned to the victim.

The smuggler's boat and contraband (drugs) may be seized under civil forfeiture, an *in rem* doctrine with ancient maritime roots. Under criminal forfeiture, an *in personam* action against the convicted smuggler, the government might also seize proceeds of the sale of the illegal drugs.

What of the smuggler's "victims"? If the smuggler had stolen the boat, the owner (if innocent) may petition for its return. It is unlikely that any claimant would be foolish enough to assert title to the illicit drugs. Unless the smuggler legitimately acquired other goods on credit, or employed honestly innocent sailors, it is difficult to identify other "victims" who might seek compensation. Moreover, neither the thief nor the smuggler is likely to file bankruptcy in an effort to discharge or restructure debts arising from the illegal activities. Thus, one might conclude that the gathering and distribution of assets through forfeiture is fairly straightforward.

This would be so until one considers fraud. Depending on the crimes charged (securities fraud, mail fraud, wire fraud, etc.), the

[16] Sarah N. Welling, *Friction in Reconciling Criminal Forfeiture and Bankruptcy: The Criminal Forfeiture Part*, 42 GOLDEN GATE U. L. REV. 551 (2012).

forfeitable property identified as being involved in, facilitating, or constituting proceeds of the crime may include virtually all of the assets of the (possibly legitimate) business. The definition of victims, again in reference to the crimes of conviction, may include vast numbers of shareholders, investors and others who claim to have been duped.[17] (Although Professor Rapoport's piece in this issue casts a critical eye on these "innocent" victims, asking what they should have known and when they should have known it.[18]) The definition of victims might not, however, include many others who suffered harm from the business collapse, such as suppliers, utilities, trade creditors, employees, and lenders whose dealings with what they perceived to be a legitimate business unwittingly enabled the fraud to continue.

To the extent that criminal law finds a way to prosecute the fraudster, retrieve the fraudulently derived funds, and return them in some equitable fashion to victims, the law has come full circle—from defining fraudulent activity as a crime upon society that warrants public vindication, to imposing restitution as a logical aspect of the wrongdoer's sentence, to employing public power to facilitate victim compensation (which is, in a sense, debt repayment).

FRAUD AND BANKRUPTCY LAW

Bankruptcy law has also long known how to address the type of financial collapse associated with fraud. It grants discharge relief only to the "honest but unfortunate" debtor, employs a variety of tools to maximize asset recovery and value, and assiduously strives to distribute value equitably among creditors and other parties in interest. These objectives are commonly synthesized as the "twin pillars" of modern bankruptcy law: (i) the debtor's tenet of a "fresh start" (the phrase typically employed with respect to individual debtors) or financial rehabilitation (of business debtors), and (ii) creditors' rights tenets of restorative and distributive justice, expressed in terms of collective enforcement, maximization of value, and equitable distribution.[19]

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[17] 39 C.F.R. § 233.7(j)(8) (Westlaw 2012).

[18] Nancy B. Rapoport, *Black Swans, Ostriches, and Ponzi Schemes*, 42 GOLDEN GATE U. L. REV. 627 (2012).

[19] Grogan v. Garner, 498 U.S. 279 (1991) ("[A] central purpose of the Code is to provide a procedure by which certain insolvent debtors can reorder their affairs, make peace with their creditors, and enjoy 'a new opportunity in life and with a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt,"' but such "fresh start" is limited to the "'honest but unfortunate debtor"' (quoting Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934)); Louisville Land Bank v. Radford, 295 U.S. 555, 587-88 (1935) ("[T]he original purpose of our bankruptcy act was the equal distribution of the debtor's property among his creditors . . . . The discharge of the debtor has come to be an object of no less concern than the distribution of his

Much of the policy debate swirling around bankruptcy law has focused on the propriety and parameters of the debtor's fresh start (or financial rehabilitation). These debates are bound up in fundamental notions of personal responsibility and diligence on the part of both the debtor and its creditors, the societal burden of unproductive debtors bound over to poor houses or debtors' prisons, and the perceived risks and benefits of encouraging risk taking and entrepreneurial activity, among other policies.[20] While the particulars of that debate are beyond the scope of this Article,[21] what is clear is that bankruptcy law strives to

property."); Williams v. U.S. Fidelity & Guaranty Co., 236 U.S. 549, 554-55 (1915) ("[T]he purpose of the bankruptcy act [is] to convert the assets of the bankrupt into cash for distribution among creditors and then to relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh . . . ."); H.R. REP. NO. 95-595, 95th Cong., 1st Sess. 125 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963 ("The purpose of straight bankruptcy . . . is to obtain a fresh start, free from creditor harassment and free from the worries and pressures of too much debt."); *see also* Crocker Nat'l Bank v. Am. Mariner Indus., Inc. (*In re* Am. Mariner Indus., Inc.), 734 F.2d 426, 431 (9th Cir. 1984) ("[T]he purposes of business reorganization . . . [are] to initially relieve the debtor of its prepetition debts, to free cash flow to meet current operating expenses, and ultimately to permit the debtor 'to restructure a business's finances so that it may continue to operate, provide its employees with jobs, pay its creditors, and produce a return for its stockholders.'" (quoting H.R. REP. NO. 95-595, at 220 (1977)); Robert Ginsburg & Robert Martin, *Ginsburg & Martin On Bankruptcy*, § 1.01(H) (Aspen 2012) (referring to the "twin pillars").

[20] The fundamentals of the "traditionalist" and "economic / collective enforcement" perspectives on bankruptcy policy are debated in Douglas G. Baird, *Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren*, 54 U. CHI. L. REV. 815 (1987), and Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775 (1987).

[21] Accounts vary regarding what might have happened to the hapless debtor in ancient and early modern times. A few things are clear.

First, in at least some locales, under some circumstances, at some times in the not terribly distant past, failure to pay one's debt could lead to imprisonment, debt bondage or involuntary servitude, physical mutilation, or capital punishment.

Second, although the modern embrace of corporate debtor rehabilitation may be a relatively recent development, debt forgiveness with creditor consent is an ancient tradition, and mandatory debtor discharge in the absence of creditor consent was available by law in England by the early 1700s.

Third, although in earlier usage, divergent meanings may have been attributed to the terms "bankruptcy" and "insolvency," based perhaps on factors such as the merchant or non-merchant nature of the debtor and the fraudulent or non-fraudulent reasons for non-payment, both bankruptcy and insolvency arose from credit given and not honored, and the terms are interchangeable today.

See generally Emily Kadens, *The Pitkin Affair: A Study of Fraud In Early English Bankruptcy*, 84 AM. BANKR. L.J. 483 (2010) (noting available sanctions for acts of bankruptcy in the late 17th and early 18th century, including incarceration, mutilation, and capital punishment; noting the introduction of the concept of discharge under early 18th century English bankruptcy law; discussing terminology); Emily Kadens, *The Last Bankrupt Hanged*: *Balancing Incentives in the Development of Bankruptcy Law*, 59 DUKE L.J. 1229 (2010) (discussing the use of punishment and debt relief as incentives for debtor cooperation); Sandor E. Schick, *Globalization, Bankruptcy and the Myth of the Broken Bench*, 80 AM. BANKR. L.J. 219 (2006) (examining sanctions for non-payment and the possibility of debt relief under early bankruptcy law; noting availability of debt relief under compositions and the like); Charles Jordan Tabb, *A History of Bankruptcy Laws in the*

ensure that fraud does not pay and that dishonest debtors cannot avail themselves of relief.[22]

In this regard, one could argue that criminal law and bankruptcy law are in accord. Although criminal law ultimately sets free the fraudster who has paid his debt to society, neither criminal law nor bankruptcy law "discharge" an individual from fraud-based claims nor protect the fraudster's future earnings from the collection efforts of the diligent creditor who is determined to renew judgments and attach assets until finally paid.[23] As a practical matter, however, given the cost, time and unlikelihood of recovery out of bankruptcy from the convicted fraudster, the claimant's best and perhaps only hope for recovery may be through a bankruptcy or forfeiture distribution.[24]

United States, 3 AM. BANKR. INST. L. REV. 5 (1995) (tracing development of bankruptcy laws, including sanctions for acts of bankruptcy and the concept of the discharge).

Finally, although debt imprisonment was abolished by the mid-19th century under federal law and most states' laws, it is troubling that current law increasingly permits civil imprisonment for failure to pay debt, often without regard to whether that failure was innocent or nefarious. *See generally* Jayne S. Ressler, *Civil Contempt Confinement and the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005: An Examination of Debtor Incarceration in the Modern Age*, 37 RUTGERS L.J. 355 (2006); *see also* Susie An, *Unpaid Bills Land Some Debtors Behind Bars*, NPR (Dec. 12, 2011), *available at* www.npr.org/2011/12/12/143274773/unpaid-bills-land-some-debtors-behind-bars; Lynn Mucken, *Are Debtors Prisons Coming Back?*, MSN MONEY (Mar. 22, 2011), *available at* http://money.msn.com/saving-money-tips/post.aspx?post=bf5c3932-1d21-436f-b20f-093e0da61b6c; Jessica Silver-Greenberg, *Welcome to Debtors' Prison, 2011 Edition*, WALL ST. J. (Mar. 16, 2011), *available at* http://online.wsj.com/article/SB10001424052748704396504576204553811636610.html; Editorial, *The New Debtors' Prisons*, N.Y. TIMES (Apr. 5, 2009), *available at* www.nytimes.com/2009/04/06/opinion/06mon4.html.

[22] *See* 11 U.S.C.A. §§ 523, 727 (Westlaw 2012) (addressing discharge of the debtor and dischargeability of particular debts); 11 U.S.C.A. § 362(b)(1) (Westlaw 2012) (excluding criminal prosecutions from the scope of the automatic stay).

[23] If the creditor's claim is against the business entity through which the fraudster operated his scheme, that claim might be discharged under a chapter 11 plan of reorganization. 11 U.S.C.A. §§ 1141(d)(1)-(3) (Westlaw 2012). Even if the claim is not discharged, because the debtor has liquidated, the creditor will be unable to collect post-bankruptcy from a business debtor that no longer exists. 11 U.S.C.A. §§ 727(a), 1141(d) (Westlaw 2012). The claimant might sue the fraudster individually, if a cause of action exists. If that suit rests on fraud (rather than, for example, piercing the corporate veil on a contract claim), and the claimant establishes the requisite elements of non-dischargeabilty, the claim will not be discharged in the individual's chapter 7 or chapter 11 case. 11 U.S.C.A. §§ 523(a)(2), 523(a)(4), 523(c), 1141(d)(2) (Westlaw 2012).

[24] Given his age (he turned 74 on April 29, 2012), and 150-year sentence (his projected release date is November 14, 2139), no one expects Bernie Madoff to pay creditors from future income. *See* Biography, Bernard Madoff, www.biography.com/people/bernard-madoff-466366 (last visited Apr. 29, 2012) (noting Madoff's birth date and sentence); Zachery Kouwe, *Madoff Arrives at Federal Prison in North Carolina*, N.Y. TIMES (July 14, 2009), *available at* www.nytimes.com/2009/07/15/business/15madoff.html (noting Madoff's projected "release date"). Other fraudsters, however, might have the means to pay creditors outside of bankruptcy. For example, Michael Milken, of "junk bond" fame, blamed by some for the savings and loan debacle of the 1980s, served twenty-two months of a ten-year prison term for securities fraud. His current net worth, as of March 2012, is estimated at $2.3 billion. His fraud did not force him into bankruptcy. *See* Stuart Pfeifer & Tom Petruno, *Michael Milken Is Still Seeking Redemption*, L.A. TIMES (Feb. 3,

Once again, put aside for a moment the fate of the debtor under bankruptcy law, and consider the fate of the debtor's property and of those injured through the debtor's fraud. In this regard, the essential elements of modern bankruptcy law emphasize (i) collective enforcement (with the attendant notion of value maximization), and (ii) equitable distribution.

The Bankruptcy Code fosters collective enforcement by attempting to bring all assets and all claimants into a single forum to the greatest extent possible. This approach is perceived to maximize value for the entire body of interest holders by replacing the potential for multiple, costly, time consuming, parallel enforcement proceedings commenced by a variety of stakeholders racing to maximize their individual recoveries, with a single, efficient collection and distribution scheme.[25] (Although, as noted by Jerry Munitz in this issue, constitutional questions concerning the scope of bankruptcy jurisdiction have bedeviled the courts since the Bankruptcy Code was enacted and continue to do so to this day.[26])

In furtherance of collective enforcement, the Bankruptcy Code: (i) grants the bankruptcy courts broad jurisdiction over all of the debtor's property, wherever located and by whomever held,[27] (ii) requires entities holding property of the debtor to turn that property over to the bankruptcy trustee or estate,[28] (iii) gives the trustee in bankruptcy "strong arm powers" that permit the trustee to stand in the shoes of an entity that could have avoided a transfer of property under non-bankruptcy law,[29] and (iv) grants the trustee additional, bankruptcy specific powers to recover for the benefit of the bankruptcy estate pre-

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2009), *available at* http://articles.latimes.com/2009/feb/03/business/fi-milken3 (noting Milken's efforts to obtain a presidential pardon); *The World's Billionaires: Michael Milken*, FORBES, www.forbes.com/profile/michael-milken/ (last visited Apr. 29, 2012) (noting Milken's estimated net worth).

[25] *See* sources cited *supra* notes 19 and 20.

[26] Gerald F. Munitz, *Stories in the Development of Bankruptcy Law*, 42 GOLDEN GATE U. L. REV. 539 (2012); *see, e.g.*, N. Pipeline Constr. Co. v. Marathon Pipe Line Co., 459 U.S. 813 (1982) (addressing scope of bankruptcy court jurisdiction); Stern v. Marshall, 131 S. Ct. 2594 (2011) (same); Travelers Indemnity Co. v. Bailey, 129 S. Ct. 2195 (2009) (addressing collateral attack on orders alleged to be beyond scope of bankruptcy court's jurisdiction); Celotex Corp. v. Edwards, 514 U.S. 300 (1995) (addressing scope of bankruptcy court's "related to" jurisdiction and collateral attack on bankruptcy court order); Granfinanciera v. Nordberg, 492 U.S. 33 (1989) (addressing availability of jury trials in fraudulent transfer action in bankruptcy); *In re* Bellingham Ins. Agency, Inc., 661 F.3d 476 (9th Cir. 2011) (order dated November 4, 2011) (inviting briefs on bankruptcy jurisdiction question).

[27] 11 U.S.C.A. § 541 (Westlaw 2012).

[28] 11 U.S.C.A. §§ 542, 543 (Westlaw 2012).

[29] 11 U.S.C.A. § 544 (Westlaw 2012).

bankruptcy transfers that either preferred one creditor over others,[30] or were made with a fraudulent intent or effect.[31]

Through these powers, the Bankruptcy Code attempts to gather all of the debtor's property in one forum for equitable distribution. In this regard, bankruptcy law differs from forfeiture law, at least in theory, because forfeiture is limited to property tied to the particular crime(s) of conviction. Nevertheless, the enlarged definition of crimes for which forfeiture is authorized, combined with broad concepts such as substitute property, facilitating property, proceeds, and relation back (as outlined by Professor Welling), may result in broad forfeitures of virtually all of the assets that otherwise might be administered in a bankruptcy case. This is especially true in a Ponzi scheme where there arguably are few if any "clean" assets.

As with the debtor's property, the Bankruptcy Code seeks to gather all of the debtor's stakeholders in one forum. Claimants generally cannot opt out of the bankruptcy process, and typically will be bound by the discharge if they decline to participate.[32]

In this regard, bankruptcy law again differs from forfeiture law because bankruptcy law is not limited to distributing property to "victims" whose injuries relate directly to the specific crime(s) of conviction. Rather, it proceeds under a broad construct that accounts for all of the fraudster's stakeholders without regard to whether their claims or interests arise directly from the fraud. Nevertheless, it is intriguing to consider whether many of the entities that suffer harm from the debtor's fraud might in fact qualify as "victims" if the crimes were charged with their harms in mind (again blurring the line between private debt and public crime).[33]

Finally, after all of the assets and stakeholders have been brought together in the bankruptcy forum, the Bankruptcy Code mandates distribution according to a carefully constructed and detailed distribution scheme.[34] In so doing, it creates an "absolute priority" system under

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[30] 11 U.S.C.A. § 547 (Westlaw 2012).

[31] 11 U.S.C.A. § 548 (Westlaw 2012).

[32] 11 U.S.C.A. §§ 524, 1141 (Westlaw 2012). Under chapter 11, the discharge essentially replaces stakeholders' pre-bankruptcy claims and interests with entitlements created under the terms of the confirmed plan. 11 U.S.C.A. § 1141 (Westlaw 2012).

[33] Prosecutors, in their discretion, consider the costs and likelihood of success in determining what charges to present.

Note that attorneys are ethically barred from threatening criminal prosecution to seek advantage in civil debt collection. *See, e.g.*, CAL. RULES OF PROF'L CONDUCT R. 5-100 ("A lawyer shall not threaten to present criminal . . . charges to obtain advantage in a civil dispute.").

[34] Although bankruptcy lawyers may self-righteously claim that bankruptcy provides strict, clear and unwavering distribution rules, this is not entirely true. Chapter 7 establishes the basic priority and distribution scheme applicable in liquidation cases. 11 U.S.C.A. § 726 (Westlaw 2012).

which debt must be paid in full before equity takes a share, analogous to the familiar notion that an insolvent entity may not distribute dividends to shareholders when it is unable to pay creditors. The distributive precepts of insolvency law may come into tension with forfeiture law, particularly if forfeited assets are distributed to "victims" under priorities (or exclusivities) that differ markedly from the distributions that would have been made under bankruptcy law. This is particularly galling to bankruptcy experts who argue that forfeiture may pay "equity" ahead of "debt."

Even if bankruptcy court is not the ideal forum for dishonest debtors, it may be the preferred forum for the fraudster's creditors, who may benefit from a collective enforcement proceeding, complete with strong arm powers, avoidance and recovery powers, and tools and traditions designed to maximize and equitably distribute value.

Several of the pieces in this Symposium explore in greater depth the mechanics, strategies and practical implications of bankruptcy law's distribution scheme, as it interacts with forfeiture proceedings. Kathy Phelps offers a detailed, step-by-step approach to claims allowance, disallowance and distribution in bankruptcy and receivership cases arising from Ponzi schemes and related frauds.[35] Professor Gabel explores the circumstances under which the trustee can and should "claw back" payments investors received before the fraudulent enterprise collapsed.[36] Sharon Weiss thoughtfully navigates through the myriad administrative, procedural and evidentiary hurdles that arise in these cases.[37] Judge Rhodes considers how grand jury evidence obtained in criminal prosecution might be made available in the bankruptcy case.[38] Judge Newsome advocates mediation and discusses circumstances in which it may be most beneficial in complex bankruptcy cases.[39] These,

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Under chapter 11, however, the plan proponent has fairly broad latitude to determine treatment, provided that dissenting creditors receive at least as much value as they would have received in a liquidation case, classification and voting requirements are satisfied, and all classes accept the plan by the requisite majorities. 11 U.S.C.A. § 1129(a) (Westlaw 2012). The plan may be confirmed even if an impaired class rejects, provided that a modified absolute priority rule is satisfied as to that class. 11 U.S.C.A. § 1129(b) (Westlaw 2012). (This discussion is necessarily somewhat simplified).

[35] Kathy Bazoian Phelps, *Handling Claims in Ponzi Scheme Bankruptcy and Receivership Cases*, 42 GOLDEN GATE U. L. REV. 567 (2012).

[36] Jessica D. Gabel, Isaac Asher & Mary Beth Byington, *The Collapse of Financial Fraud: Measuring Bankruptcy Avoidance Actions*, 42 GOLDEN GATE U. L. REV. 587 (2012).

[37] Sharon Z. Weiss, *Overcoming Administrative, Procedural and Evidentiary Hurdles in Ponzi Scheme Litigation*, 42 GOLDEN GATE U. L. REV. 641 (2012).

[38] Randall J. Newsome, *Mediating Disputes Arising Out of Troubled Companies – Do It Sooner Rather Than Later*, 42 GOLDEN GATE U. L. REV. 661 (2012).

[39] Steven Rhodes, *Obtaining the Release of Grand Jury Evidence In Ponzi Cases*, 42 GOLDEN GATE U. L. REV. 657 (2012).

together with the Articles by Gerald Munitz, Professor Rapoport and Professor Welling, mentioned earlier in this Article, provide academics, practitioners, and judges with a coherent guide to navigating the complex intersections of bankruptcy and forfeiture law.

INTEGRATING CRIMINAL LAW AND BANKRUPTCY LAW IN THE CASE OF FRAUD

When fraudulent financial schemes collapse, the same wrongdoer and the same assets may be treated under two parallel legal regimes. When this occurs, bankruptcy law and forfeiture law encounter each other, after centuries of evolution, with dim surprise and hazy recognition, like two old friends meeting at the intersection of the town in which they were born. The world they now inhabit, and they themselves, have undergone such change they barely know it, or each other, anymore.

This Symposium is a booth in the coffee shop of that town, where the old friends sit together with open minds seeking to re-familiarize themselves with each other, suspicious at first of how strange the other appears to have become, slowly coming to understand the path the other has followed, and ultimately marveling at how much they have in common. Although they wield different tools, they hold firmly to the same fundamental principles regarding financial fraud: the honest but unfortunate debtor should not be shackled for life; the dishonest cheat should pay; the victims should be compensated.

It is not enough to agree upon these principles, however. The restorative and distributive rules of both bankruptcy law and forfeiture law vest in highly developed statutes. Those statutes evolved from different sources, for different reasons, and are in many ways irreconcilable today. Consequently, it is incumbent upon those who practice and make policy in these areas to collaborate across disciplines to reconcile competing processes where possible, identify points of tension where necessary, and advocate for change where appropriate.