THIS OPINION IS NOT INTENDED FOR PUBLICATION

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

In re:	)	Case No. 02-17257
	)	
JOSEPH J. JACOBSON,	)	Chapter 7
	)	
Debtor.	)	Judge Pat E. Morgenstern-Clarren
	)	
	)	
ALAN J. TREINISH, TRUSTEE,	)	Adversary Proceeding No. 03-1044
	)	
Plaintiff,	)	
	)	
v.	)	
	)	
JOSEPH J. JACOBSON,	)	**MEMORANDUM OF OPINION**
	)	
Defendant.	)	

The chapter 7 trustee filed this complaint to deny a discharge to the debtor Joseph Jacobson under bankruptcy code § 727(a)(2)(A) (transferring property within one year of the bankruptcy filing with intent to hinder, delay, or defraud creditors) and/or bankruptcy code § 727(a)(5) (failure to explain satisfactorily a loss of assets). Mr. Jacobson filed a counterclaim requesting an award of his costs and attorney fees. For the reasons stated below, the debtor's discharge is denied and the trustee is granted judgment on his complaint and on the debtor's counterclaim.

JURISDICTION

Jurisdiction exists under 28 U.S.C. § 1334 and General Order No. 84 entered by the United States District Court for the Northern District of Ohio. This is a core proceeding under 28 U.S.C. § 157(b)(2)(J).

THE POSITIONS OF THE PARTIES

Bankruptcy code §§ 727(a)(2)(A) and 727(a)(5) provide:

> (a) The court shall grant the debtor a discharge, unless –
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> * * *
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> (2) the debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed –
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> (A) property of the debtor, within one year before the date of the filing of the petition[.]
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> * * *
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> (5) the debtor has failed to explain satisfactorily, before determination of denial of discharge under this paragraph, any loss of assets or deficiency of assets to meet the debtor's liabilities[.]

The trustee must prove his case by a preponderance of the evidence. *See Barclays/Am. Bus. Credit, Inc. v. Adams (In re Adams)*, 31 F.3d 389 (6th Cir. 1994). *See also* FED. R. BANKR P. 4005.

The trustee bases his § 727(a)(2)(A) case on these transfers made by the debtor within one year before he filed his bankruptcy petition, at a time when he was insolvent, and which he did not disclose in his bankruptcy schedules:

(1) $175,000.00 to an account in the name of his wife, Marilyn Jacobson;

(2) a 98% interest in a partnership to his son, Scott Jacobson; and

(3) cash transfers to these family members:

(A) $1,500.00 to his daughter, Laurie Ross;

(B) $11,568.00 to his son-in-law, Robert Ross;

(C) $1,251.39 to his son, Scott Jacobson; and

(D) $4,000.00 and $15,000.00 to his sister, Judy Fraberg.[1]

The debtor states that these were either transfers made on his doctor's orders, gifts, or transfers without value and denies that any transfer was made with the intent to hinder, delay, or defraud creditors.

The trustee's § 727(a)(5) case is based on the debtor's alleged failure to account satisfactorily for these funds:

(1) $2 million received by the debtor in 1996 when he sold his interest in Soft-Lite Manufacturing Co.;[2]

(2) $530,000.00 in IRA distributions in 2000 and 2001; and

(3) $500,000.00 drawn on an Ohio Savings Bank line of credit in 2001.

The debtor's explanation, which he argues is satisfactory, is that he lost the vast majority of the money through gambling and futures trading, activities he undertook as a result of his bipolar disorder. He also denies that he received an IRA distribution of this magnitude, although he stipulated to it before the trial. (Stip. 14).

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[1] The debtor argued in his closing statement that some of these transfers should not be considered because they were not specifically mentioned in the complaint. The complaint, however, stated that the trustee was relying on the transfers described in the complaint, "as well as other transfers which Plaintiff may not yet be aware of." (Docket 1 ¶ 15). The additional transfers were cited and discussed in the trustee's trial brief and addressed at trial without objection. (Docket 23). The additional transfers will, therefore, be treated as if they had been specifically raised in the complaint. *See* FED. R. BANKR. P. 7015 (incorporating FED. R. CIV. P. 15(b)).

[2] The company was apparently sold for $4 million, but the parties seemed to agree by the end of the hearing that $2 million of this belonged to non-debtor Marilyn Jacobson.

FACTS[3]

These findings of fact reflect the court's weighing of the evidence, including determining the credibility of the witnesses. In doing so, the court considered the witnesses' demeanor, the substance of the testimony, and the context in which the statements were made, recognizing that a transcript does not convey tone, attitude, body language or nuance of expression. *See* FED. R. BANKR. P. 7052 (incorporating FED. R. CIV. P. 52(a)). When the court finds that a witness's explanation was satisfactory or unsatisfactory, it is using this definition:

> The word satisfactory 'may mean reasonable, or it may mean that the Court, after having heard the excuse, the explanation, has that mental attitude which finds contentment in saying that he believes the explanation–he believes what the [witness] say[s] with reference to the [issue at hand]. He is satisfied. He no longer wonders. He is contented.'

United States v. Trogden (In re Trogden), 111 B.R. 655, 659 (Bankr. N.D. Ohio 1990) (discussing the issue in context of bankruptcy code § 727) (quoting *First Texas Savings Assoc., Inc. v. Reed*, 700 F.2d 986, 993 (5th Cir. 1983)).

* * * * *

The debtor Joseph Jacobson is an intelligent, college educated, financially sophisticated businessman who has a degree in accounting and worked as an accountant many years ago before he went into business. Over the last 25 years, he has owned interests in several businesses. He filed his bankruptcy on July 5, 2002. He was insolvent within the year before his bankruptcy filing. (Stip. ¶ 12). The debtor and his wife Marilyn Jacobson now live on his monthly disability

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[3] The trial was held on October 21, 2003. The trustee presented his case through the testimony of: (1) Joseph Jacobson, as if on cross-examination; (2) Scott Jacobson, as if on cross-examination; (3) Marilyn Jacobson, as if on cross-examination; (4) Stephen Kalette; and exhibits. Mr. Jacobson testified on his own behalf and called as witnesses Marilyn Jacobson and Brooke Wolf, M.D. He also introduced exhibits into evidence. In addition, the parties stipulated to some facts. (Docket 22).

payment of $1,750.00.[4] Mrs. Jacobson also recently started to teach part-time and contributes to the household income. The debtor testified that these funds are sufficient because their house is paid for and their children help with expenses.

I. The Debtor's Medical Condition

Brooke Wolf, M.D., a board certified psychiatrist, has been treating the debtor since March 6, 2002. The debtor had been treated by another physician before that date, but there was no testimony from that other physician.

Dr Wolf initially diagnosed the debtor with major depression based on his profoundly low mood, lack of interest in anything, inability to sleep, agitation, and overwhelming feelings of guilt. Dr. Wolf described the debtor as devastated because he lost an enormous amount of money after he retired. Because Dr. Wolf did not think that he was in any condition to handle money, she recommended that his wife handle their finances.

On March 20, 2002, the debtor was hospitalized after a serious suicide attempt.[5] His diagnosis expanded at that time to bipolar disorder with depression. Dr. Wolf explained that this is a severe psychotic illness with enormous mood swings not in sync with reality. The debtor has been on medication to treat this condition since March 2002. The debtor stated that it took about 6-8 weeks for the medicine to reach a therapeutic level. He acknowledged that at least by the time he filed his petition on July 5, 2002, neither the disorder nor the medication adversely affected his ability to tell the truth. He argues that the disorder fueled his need to gamble, which

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[4] The debtor did not explain why his schedules state that he does not have any income. There was no testimony as to why the debtor receives disability payments.

[5] Although the debtor stated that he was later hospitalized a second time during this same time frame, Dr. Wolf testified that he was only hospitalized once. The court finds Dr. Wolf's testimony to be credible.

led to his financial losses. The debtor gambled during the week through trading futures and on the weekend by betting on sports events.

II. The Debtor's Sports Gambling

The debtor gambled in Atlantic City and locally. In Cleveland, he dealt with bookies whose identities he did not know. He would call different numbers and place a bet on football games. An anonymous runner would later contact him to collect or pay on the bet. In 2002, the debtor was under pressure from the bookies to pay his "heavy debt." He responded by paying the debt down "substantially" before the bankruptcy filing. The debtor testified further that after he filed for bankruptcy, a runner told him that "they would handle" the remaining debt and he never heard from the bookies again.

The debtor did not offer evidence as to the time frame in which he started to gamble or the amount he still owed at the time of the bankruptcy filing. He did not quantify the amount of money that he lost gambling, other than one $60,000.00 payment made on about July 11, 2001. (Pl. Exh. 14). The debtor did not explain why bookies who had been pressuring him and threatening his family would stop demanding payment when they learned of his bankruptcy filing.[6] The debtor did not schedule any payments to bookies within 90 days of the filing or any debt owed to them at the time of filing.

III. The Debtor's Futures Trading Activity

The debtor traded in futures through various accounts at Rosenthal Collins Group, LLC (Rosenthal) in Chicago. He introduced into evidence Rosenthal account statements in his name, as well as the names of JSL Investments and L&J Investments. The statements were introduced

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[6] While it would be nice to think that the bookies were honoring the automatic stay of 11 U.S.C. § 362, this does not seem likely given the nature of the enterprise.

essentially for two purposes: (1) to show wire transfers from Ohio Savings Bank into the JSL Investments and L&J Investment accounts; and (2) to show losses in the accounts.

IV. The Debtor's Business Interests

A. Soft-Lite Manufacturing Co.

The debtor and his wife owned an unspecified interest in this company.[7] They sold their interest in 1996 for $4 million, of which the debtor received $2 million.

B. Solon Athletic Club

The debtor was the sole shareholder of Solon Athletic Club, Inc., which was the general partner of the Solon Athletic Club Limited Partnership (Club). (Stip. 4). He was also one of the Club's limited partners. (Stip. 4, 5). In February 2002, the debtor, acting as sole shareholder of the corporation, gave notice to the limited partners that he intended to sell the Club's assets. Although at least one limited partner objected in writing, and fewer than the requisite number of partners provided written approval, the debtor proceeded with the sale. Fifteen limited partners promptly filed a state court lawsuit against the debtor for breach of contract, breach of fiduciary duties, and an accounting, alleging that there were numerous irregularities in the sale.[8] (Pl. Exh. 12).

The debtor received $175,000.00 from the sale proceeds. On March 7, 2002, he deposited this money into a bank account owned solely by his wife, Marilyn Jacobson. (Stip. 8).

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[7] The testimony suggested that Scott Jacobson and/or Lee Ross also owned interests in this company.

[8] This court lifted the automatic stay to permit the parties to go forward in state court with that lawsuit. *See* 11 U.S.C. § 362. This memorandum of opinion deals only with the debtor's disposition of the $175,000.00 he received from the sale and does not address the liability, if any, that the debtor has to the state court plaintiffs for entering into that transaction in the first place.

Mrs. Jacobson was not involved in the ownership or management of the Club and had no claim to the money. While the debtor said that Dr. Wolf "ordered" him to put this money into Mrs. Jacobson's account, the court credits Dr. Wolf's testimony that she was not aware of any particular pot of money; she simply recommended in general that he not handle money. The decision to place the money into Mrs. Jacobson's account was made by the Jacobsons, even though they did have a joint account. Despite having put the money into Mrs. Jacobson's account, the debtor continued to direct how the money was spent. By the time of the bankruptcy filing, the funds were gone.[9] The debtor did not disclose the $175,000.00 transfer in his bankruptcy filing.

C. JSL Investments

This is a partnership in which the debtor originally held a 99% interest and his son Scott Jacobson held 1%. JSL was (and apparently still is) an approved futures trader with Rosenthal. In January 2002, the debtor transferred 98% of the partnership interest to Scott Jacobson and retained a 1% interest. The only consideration the debtor received was $700.00. The debtor testified that his partnership interest was worthless at the time of the transfer. When questioned as to why the debtor did not just close the JSL trading account rather than transferring the interest if it was worthless, the debtor stated that his son wanted to keep the account open because it was easier than opening a new one. The debtor did not, however, provide information about why opening a new account would be difficult or why it would be more difficult than the actions they took to transfer and record the partnership changes. Without this information, the debtor's explanation for the transaction is unsatisfactory.

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[9] The disposition of the funds is discussed below.

Before the transfer, the debtor contributed "most" of the money to the trading account. After the transfer, Scott Jacobson put "most" of the money in. These numbers were not quantified. The debtor did not disclose the transfer or the retained interest in his schedules.

Although the debtor testified that he does not stay in touch with the business, he nevertheless signed the partnership's 2002 tax return as secretary. That return shows that in 2002 the partnership distributed $166,447.00 and had $11,054.00 in assets.

In June 2003, Scott Jacobson agreed that JSL would provide a car for the debtor. They decided on a 300 series BMW. The debtor negotiated for the car, ultimately agreeing on a three-year lease which JSL paid for in one $15,371.93 payment. Scott Jacobson paid the $15,371.93 with a Key Bank cashiers check in the name of Greg Ryb. Scott Jacobson testified that this account held some of his personal money and some of JSL's money. He claimed to hold the money in this way because First Merit had a judgment against him and "he was trying to get the funds together to settle with First Merit." The court notes that spending more than $15,000.00 on a BMW for an individual who allegedly plays little or no role in the business is inconsistent with an intention to save money to pay a creditor and for that reason did not believe Scott Jacobson's explanation for why these funds were held in a third-party's name, it being far more likely that he was hiding his assets (which is irrelevant to this opinion) and those of JSL (which is relevant because of the debtor's transfer and retained interest in the partnership).

D. L&J Sales LLC

In January 2002, the debtor and his long-time business associate Lee Ross started this replacement window business. L&J Sales LLC obtained a $200,000.00 line of credit with Liberty Bank secured by a mortgage on commercial real estate on Krick Road in Bedford

Heights. (Pl. Exhs. 39, 40). The debtor testified that he owns 46% of that property; Lee Ross, Ross's wife, and his sister-in-law own the balance.

On January 14, 2002, the debtor wrote a $75,000.00 check to himself using the line of credit. He used some unquantified part of this money for the business and some to invest in trading futures. He also wrote these prepetition checks on the line of credit:

(1) $9,300.00 to himself, but he did not know what he used it for;

(2) $20,000.00 to Bralin Steel and Storage, a company in which Scott Jacobson owned an interest. The debtor described this as a loan, but did not explain any loan terms or what the loan was for; and

(3) $3,000.00 to Scott Jacobson, for unexplained reasons.

E. L&J Investments

The debtor and Lee Ross each owned a 50% interest in this company. The debtor testified that the company stopped operating in 2000. According to the debtor's own documentation, however, the company had an active Rosenthal trading account at least from August 2001 through June 2002. (Def. Exhs. D, NN through XX). The debtor did not list this asset in his schedules.

V. The Debtor's Borrowings

A. Life Insurance Policies

In the early 1990's, the debtor took out ten insurance policies on his life. The debtor owned nine of these policies, with his wife as the named beneficiary. Marilyn Jacobson owned the tenth policy which she put into a trust which named the debtor as the beneficiary. The annual premium was $28,795.00. (Pl. Exh. 29). The debtor estimated the total death benefit as in the range of a few million dollars. The debtor borrowed about $350,000.00 against the policies on an unspecified date to pay some of his Rosenthal trading losses.

As is usual in the insurance business, the company offered the debtor payment options ranging from monthly payments to an annual payment. From 1995 to 2002, the debtor chose to pay the premium annually. On January 21, 2002, the debtor paid $28,795.00, which paid his premium through January 2003. (Pl. Exh. 31). He also made a loan payment at that time. Presumably, in the ordinary course the debtor would not have received another premium bill for a year. At that point, however, the debtor switched to monthly payments so that in the five months before the bankruptcy filing, he paid $23,600.00[10] on the policies. This change in payment method from annual to monthly let the debtor build up payments on policies that benefitted his family.

B. Ohio Savings Bank

In June 2001, the debtor obtained a $500,000.00 line of credit from Ohio Savings Bank secured by a mortgage on real estate owned by the debtor and his wife in Florida. (Stip. 15; Pl. Exh. 32). He testified that he drew $200,000.00 down on the line and transferred the funds to Rosenthal. He lost most of this almost immediately, and the balance within two to three days. He also drew down $20,000.00 in a lump sum, but could not explain what he used it for. The debtor owed more than $500,000.00 on this obligation at the time of the bankruptcy filing. (Stip. 15).

C. First Merit Bank

There were few details about the debtor's interaction with First Merit. Marilyn Jacobson testified that her husband had borrowed money secured by a mortgage on "her house." It was not clear whether she was referring to the house in Cleveland or the house in Florida.

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[10] *See* plaintiff's exhibit 13 for entries reflecting payments made to Northwestern Mutual.

D. The Debtor's IRAs

The parties stipulated that in 2000 and 2001, the debtor received more than $530,000.00 in distributions from his individual retirement accounts. (Stip. 14). At trial, the debtor testified that he only received $37,000.00, but did not provide any explanation that would release him from the stipulation, nor did his counsel argue that the stipulation was incorrect. The stipulation, therefore, stands.

E. Lee Ross

In 2002, the debtor received $116,000.00 from Lee Ross. Although the debtor described it as a loan, there was no documentation.

VI. The Disposition of the $175,000.00

As noted above, the debtor deposited $175,000.00 into an account in Marilyn Jacobson's name. Between the March 7, 2002 deposit date and the July 5, 2002 filing date, Marilyn Jacobson paid these bills at the debtor's direction:

(1) $23,600.00 to Northwestern Mutual
This paid the premiums and loan interest on the ten life insurance policies;

(2) $13,500.00 to First Merit Bank;

(3) $10,500.00 to Ohio Savings Bank;

(4) $9,500.00 for real estate taxes and condominium fees for a house in Florida;

(5) $2,000.00 to Marilyn Jacobson's IRA;

(6) $80,000.00 to Liberty Bank;

(7) $2,174.00 for car lease payments and expenses for two cars, one used by Marilyn Jacobson and one used by the debtor's mother;

(8) $3,354.00 in payments on various credit cards in Marilyn Jacobson's name that had been used at least in part by the debtor;

(9) $3,200.00 to Stephen Hobt, the debtor's bankruptcy counsel; and

(10) $1,861.00 to Lee Ross for interest on an undocumented loan and unspecified expenses.

(Pl. Exh. 13).

This totals $149,689.00. The rest of the money was spent on credit card payments, house repairs and maintenance for two houses, groceries, dry cleaning, gifts, eating out, entertaining, personal care, and the like.

VII. Other Transfers made by the Debtor in the Year before the Filing

The debtor made these additional transfers during the one year look back period:

(1) $1,251.39 to Scott Jacobson, for unexplained reasons. The debtor did not disclose this transfer. (Pl. Exh. 18).

(2) two checks for $4,000.00 and $15,000.00 to his sister Judy Fraberg. (Pl. Exhs. 19, 21).

The debtor testified that Ms. Fraberg gave him money to invest on her behalf in trading futures. He lost all of the money. Despite that, Ms. Fraberg asked for her money back and he complied. He did not disclose these transfers on his schedules.

(3) On an unstated date, the debtor paid $31,000.00 to Lee Ross as partial repayment of the undocumented $116,000.00 loan. He did not disclose this transfer on his schedules.

DISCUSSION

11 U.S.C. § 727(a)(2)

The trustee asks that the debtor be denied a discharge under § 727(a)(2)(A). Under that section, the trustee must prove that: (1) the debtor (or his authorized agent) transferred, removed, destroyed, mutilated, or concealed his property; (2) with actual intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of the property; and (3) did so within one year before the bankruptcy filing. 11 U.S.C. § 727(a)(2)(A). *See Gold v. Guttman (In re*

Guttman), 237 B.R. 643, 647-48 (Bankr. E.D. Mich. 1999) (citing *Am. Gen. Fin., Inc. v. Burnside (In re Burnside)*, 209 B.R. 867 (Bankr. N.D. Ohio 1997)). The debtor does not dispute that the transfers at issue came within the one year before the bankruptcy. The other two elements are disputed.

First, § 727(a)(2)(A) requires proof that the debtor transferred or concealed his property. The term transfer in this context means "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property." *Martin v. Bajgar (In re Bajgar)*, 104 F.3d 495, 498 (1st Cir. 1997) (citing the 11 U.S.C. § 101(54) definition of "transfer"). Omitting information from bankruptcy schedules has been construed as a concealment occurring both before and after the bankruptcy filing for purposes of §§ 727(a)(2)(A) and (B). See *Hunter v. Sowers (In re Sowers),* 229 B.R. 151, 156-57 (Bankr. N.D. Ohio 1998); *Cobb v. Hadley (In re Hadley),*70 B.R. 51, 53 (Bankr. D. Kan. 1987). Maintaining a bank account in someone else's name may also constitute concealment under § 727(a)(2). *See Roudebush v. Sharp (In re Sharp)*, 244 B.R. 889 (Bankr. E.D. Mich. 2000) (finding that a debtor's failure to disclose a bank account held in his father's name was a concealment intended to hinder and delay creditors).

The second element the trustee must prove is the debtor's subjective intent to hinder, delay or defraud. *Keeney v. Smith (In re Keeney)*, 227 F.3d 679, 683 (6th Cir. 2000). "Because direct evidence of a debtor's intent usually will be unavailable, it may be inferred from the circumstances surrounding his objectionable conduct." *In re Krehl*, 86 F.3d 737, 743 (7th Cir. 1996). *See also Keeney*, 227 F.3d at 684. The intent to defraud can be inferred when these badges of fraud are present:

(1) the lack or inadequacy of consideration;

(2) the family, friendship, or close associate relationship between the parties;

(3) the retention of possession, benefit, or use of the property in question;

(4) the financial condition of the party sought to be charged both before and after the transaction in question;

(5) the existence or cumulative effect of a pattern or series of transactions or course of conduct after the incurring of debt, onset of financial difficulties, or pendency or threat of suits by creditors; and

(6) the general chronology of the events and transactions under inquiry.

Salomon v. Kaiser (In re Kaiser), 722 F.2d 1574, 1582-83 (2d Cir. 1983) (citing *In re May*, 12 B.R. 618, 627 (Bankr. N.D. Fla. 1980). *See also Stevenson v. Cutler (In re Cutler)*, 291 B.R. 718, 723 (Bankr. E.D. Mich. 2003). "The transfer of property by [a] debtor to his spouse while insolvent, while retaining the use and enjoyment of the property, is a classic badge of fraud." *In re Kaiser*, 722 F.2d at 1583. Also, an actual intent to hinder or delay, even if it is not fraudulent, is sufficient to support a denial of discharge. *See Cuervo v. Snell (In re Snell),* 240 B.R. 728, 730 (Bankr. S.D. Ohio 1999) (citing *Huntington Nat'l Bank v. Schwartzman (In re Schwartzman)*, 63 B.R. 348, 360 (Bankr. S.D. Ohio 1986)). *See also In re Adams*, 31 F.3d at 394 ("The bankruptcy court's finding of intentional delay or hindrance under this section is amply supported by the evidence, and we affirm the denial of discharge on those grounds.").

In this case, the debtor made several transfers to family members in the year before his bankruptcy, at a time when he was insolvent, and for inadequate consideration. The largest was the $175,000.00 deposit to Marilyn Jacobson's account. Although the debtor deposited the funds into his wife's account, he continued to control how the funds were spent. He then failed to

disclose the transfer. As the $175,000.00 was the major source of the debtor's income for the March to July time frame, it is extremely unlikely that the debtor forgot that he made this transfer. And in fact, he does not offer any explanation for the omission.

Mrs. Jacobson suggested in testimony that the transfer could not have been to defraud creditors because the majority of the funds went to pay creditors. This is too narrow a view of the issue. The debtor directed payment from the account in ways that benefitted certain creditors, some of which also had claims against his wife or his long-time business partner, Lee Ross. Some payments also directly benefitted his wife, such as the $2,000.00 deposit into her IRA. He also used these funds to make insurance payments for his wife's benefit, after he had changed the payment method to accelerate the amounts paid. At the bankruptcy filing, he then exempted these policies from his bankruptcy estate. *See* 11 U.S.C. § 522. Converting non-exempt property (cash) into exempt property (insurance policies) is not necessarily a problem standing alone. Here, however, the debtor took these steps as part of a series of transactions that worked to benefit family and friends.

The debtor also made other significant transfers of cash and business interests to family members without consideration. One notable undisclosed transfer was of 98% of the debtor's interest in JSL. The debtor testified that the interest was worthless and that he received $700.00 for the transfer. This position as to value is not supported by the record. In the year 2002, the partnership had about $11,000.00 in assets and distributed more than $166,447.00 none of which apparently went to the debtor despite his retained interest. The next year, however, JSL entered into a luxury car lease for the debtor, without any kind of reasonable explanation. These factors weigh in favor of finding that the debtor's interest did have value and was transferred without adequate consideration. And they also show that even the 1% retained by the debtor had some

value. Additionally, the debtor should have disclosed both the transfer and the retained interest. The failure to do so is another badge of fraud.

The debtor also transferred cash to his son, daughter-in-law, son-in-law, and sister without a satisfactory explanation for doing so. As one example, he gave his sister $19,000.00 although based on his testimony he did not owe her this money. He also transferred $20,000.00 to his son's company Bralin Steel without any documentation or satisfactory explanation for doing so in the month before his bankruptcy filing.

In sum, in late 2001 and early 2002, at a time when the debtor was insolvent and creditors were demanding payment, he transferred assets to or for the benefit of family and friends without adequate consideration and then failed to disclose the transfers. Under these circumstances, the court infers the existence of intent to defraud.

Before reaching this conclusion, however, the court has considered the debtor's mental health issues. He undoubtedly had bipolar disorder in March 2002. The court finds that the disorder either created or increased the debtor's need to gamble during his manic phase. This condition explains why the debtor got into debt (at least in part), but it does not explain why he transferred his assets as he did. There was no testimony that the bipolar disorder itself caused the debtor to make the challenged transfers to family members and friends. While the debtor's psychiatrist advised him not to handle money, she certainly didn't advise him to give away money to family members or to favor creditors who also had claims against the debtor's wife or long-time business partner. Nor did she advise him to conceal transfers on his bankruptcy schedules. The debtor does not claim that the disorder prevented him from telling the truth in his schedules. He simply did not offer any explanation, much less a satisfactory one, for why he did not list the $175,000.00 transfer. Nor does he explain the failure to disclose the other transfers at

issue. While the bipolar disorder is a serious health issue, it does not negate the fraud finding under the facts of this case.

The debtor's discharge is, therefore, denied under § 727(a)(2)(A).

11 U.S.C. § 727(a)(5)

The trustee also asks that the debtor's discharge be denied under § 727(a)(5) which provides for the denial of a debtor's discharge where he has failed to satisfactorily explain a deficiency of assets. The trustee bears the initial burden of introducing evidence of the disappearance of substantial assets or of unusual transactions. *See Solomon v. Barman (In re Barman)*, 244 B.R. 896, 900 (Bankr. E.D. Mich. 2000). This section "is broad enough to include any unexplained disappearance or shortage of assets." *Id.* (citing *Chalik v. Moorefield (In re Chalik)*, 748 F.2d 616 (11th Cir. 1984)). The debtor must then provide a satisfactory explanation. "[A] satisfactory explanation 'must consist of more than . . . vague, indefinite, and uncorroborated' assertions by the debtor." *In re D'Agnese*, 86 F.3d 732, 734 (7th Cir. 1996) (quoting *Baum v. Earl Millikin, Inc.*, 359 F.2d 811, 814 (7th Cir. 1966)). To quote again from the *Trogden* case: "The word satisfactory 'may mean that the Court . . . has the mental attitude which finds contentment in saying that he believes the explanation – he believes what the bankrupt says with reference to the disappearance or shortage. He is satisfied. He no longer wonders. He is contented." *United States v. Trogdon (In re Trogdon)*, 111 B.R. 655, 659 (Bankr. N.D. Ohio 1990) (quoting *First Texas Savings Assoc., Inc. v. Reed*, 700 F.2d 986, 993 (5th Cir. 1983)). The trustee has the ultimate burden of proof.

The trustee presented evidence that the debtor received $2 million in 1996 from the sale of a business and about $530,000.00 in IRA distributions in 2001 and 2002. (Stip. 14). He also proved that the debtor borrowed $116,000.00 from Lee Ross in 2001 and repaid only $31,000.00.

And in 2001 and 2002, the debtor drew $500,000.00 from the Ohio Savings Bank account and more than $84,000.00 from the Liberty Bank line of credit. He also borrowed $350,000.00 against life insurance policies. By the time of the bankruptcy filing, the debtor essentially had nothing left in his name. The trustee undoubtedly met his initial burden of proving that the debtor had funds that disappeared. The burden then shifted to the debtor to provide a satisfactory explanation for what happened to the money.

The debtor's explanation is that he (1) used some of the money for living expenses; and (2) lost most of it through gambling (casinos and bookies) and trading futures. With respect to the first category, the debtor undoubtedly did spend some of the money on living expenses. He did not, however, provide evidence of those expenses, other than in the few months before the bankruptcy filing, or of the financial contributions if any made by Marilyn Jacobson to those expenses. (Since she had her own $2 million from the sale, it is not unreasonable to think that she might have contributed to household expenses as well. In any event, she did not testify to the contrary). Absent a more detailed explanation of the debtor's household expenses, the court finds that these expenses do not satisfactorily explain what happened to the money or any significant part of it.

The second category is gambling and futures trading. "Illegal activities [as betting with bookies may be] in themselves do not operate as a bar to discharge." *Hutzelman v. Luhman (In re Luhman)*, 146 B.R. 163, 165 (Bankr. W.D. Pa. 1992) (citations omitted). At the same time, the debtor cannot hide behind the fact that an activity is illegal to explain an inability to trace the money. In *Dolin v. Northern Petrochemical Co.*, the Sixth Circuit Court of Appeals reviewed a case in which the bankruptcy court denied the debtor a discharge under § 727(a)(5), among other sections. *See Dolin v. Northern Petrochemical Co. (In re Dolin)*, 799 F.2d 251 (6th Cir. 1986).

The debtor argued that his drug addiction and compulsive gambling provided a satisfactory explanation for how he spent the $500,000.00 at issue. The Sixth Circuit disagreed, holding that:

> [The debtor] could only allege that he had used the [$500,000.00] to support his cocaine habit and to gamble. The actual expenditures, to whom and when made, are unknown. We recognize that [the debtor] would not want to keep records of his cocaine purchases and gambling because the drug purchases were illegal and the gambling may have been illegal. The mere fact that a debtor has spent money illegally does not satisfactorily explain the debtor's deficiency of assets. In particular, we hold that neither [the debtor's] chemical dependency nor his compulsive gambling satisfactorily explain his deficiency of assets.

Id. at 253.

In this case, the gambling losses fall into two categories: casino gambling and gambling through bookies. The debtor testified that he lost more than $200,000.00 at a casino, but he did not provide any information about when and where such a loss allegedly occurred. With respect to the losses to bookies, the $60,000.00 check in July 2001 is the only detail the debtor provided as to the amount of his losses. The debtor's income tax returns for 2001 show gambling gains of $4,000.00 and losses of only $6,000.00. (Pl. Exh. 38). Also, the debtor stated in his bankruptcy petition that he had no losses from gambling in the year before he filed his case. (Pl. Exh. 1, Statement of Financial Affairs ¶ 8). Given the inconsistent information and the lack of detail, this explanation does not satisfactorily account for the money.

The other loss category is futures trading. Futures trading is a speculative activity and it is certainly theoretically possible for one to lose a large amount of money in a short period of time. Such losses should, however, be relatively easy to prove through the trading records. Here, the debtor claims to have lost $3.2 million trading futures at Rosenthal and Smith Barney.

The debtor did not provide any detail of the alleged Smith Barney losses and absent that information the court does not find that to be a satisfactory explanation. The Rosenthal claim is more complicated. The debtor had losses in his Rosenthal account, but the account

documentation raises as many questions as it answers. The documentation does not go back to 1996, the year the debtor received the $2 million. The documentation for more recent years is incomplete. The statements provided are not self-explanatory and although the debtor testified that he understood them, he did not provide a narrative that traced the funds in and out of the account.

The debtor also presented account statements from other Rosenthal accounts in the name of JSL Investments and L&J Investments that he felt related to his losses. He did not, however, analyze the total amount of money he put into these third-party accounts, the amount of losses he incurred, or any gains; in other words, he did not account for how the money went into and out of his hands into these other accounts. He also did not provide a satisfactory explanation for what input other individuals had into the two partnership accounts that he claims help to show his losses. Moreover, the 2002 year-end Rosenthal statements do not match the debtor's 2002 federal income tax return information. The debtor did not provide any bank account records that might have shown money in and money out to support the gambling and futures trading loss claim. In short, the information provided by the debtor is incomplete, inconsistent, and insufficient.

The court does not expect a debtor to be able to account for every dollar, but the debtor here provided only vague, general explanations for how he spent more than $3 million. Although the court has carefully reviewed the documentation provided and the testimony, it is not up to the court to attempt to reconstruct the debtor's financial history; that is the debtor's obligation. As found above, the debtor proved that he has bipolar disorder that caused him to need to gamble. He satisfied that need by gambling at casinos and with bookies, as well as through trading futures. This is only step one in the analysis, however. The debtor is obligated to explain where

the money went in sufficient detail that the court is not left wondering what happened to his considerable assets. In this case, the court is not satisfied from the evidence provided that the debtor has accounted for the millions of dollars he had by pointing to money lost through trading and/or gambling. Again, there was no evidence that the disorder prevented the debtor from keeping track of his activities. And, in fact, the debtor must have kept some accounting because he claimed gambling gains and losses on his 2001 income tax returns. The court continues to wonder where all of that money really went, particularly in light of the debtor's numerous undisclosed transfers to and for the benefit of family and friends during the year before the filing. *See In re Trogden*. The debtor's discharge is, therefore, denied under this section as well.

THE DEBTOR'S COUNTERCLAIM

The debtor argued that the trustee was not substantially justified in bringing this action against the debtor and requested an award of his costs and fees on that basis. As the trustee was justified in pursuing this matter and has prevailed, the trustee is granted judgment on the debtor's counterclaim.

CONCLUSION

For the reasons stated, the debtor's discharge is denied. A separate judgment will be entered in accordance with this memorandum of opinion.

Date: 8 Dec 2003

Pat E. Morgenstern-Clarren
United States Bankruptcy Judge

Served by mail on: Robert Barr, Esq.
Stephen Hobt, Esq.

By: Joyce L. Gordon, Secretary

Date: 12/8/03

THIS OPINION IS NOT INTENDED
FOR PUBLICATION

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

In re:	)	Case No. 02-17257
	)	
JOSEPH J. JACOBSON,	)	Chapter 7
	)	
Debtor.	)	Judge Pat E. Morgenstern-Clarren
	)	
	)	
ALAN J. TREINISH, TRUSTEE,	)	Adversary Proceeding No. 03-1044
	)	
Plaintiff,	)	
	)	
v.	)	
	)	
JOSEPH J. JACOBSON,	)	**JUDGMENT**
	)	
Defendant.	)	

For the reasons stated in the memorandum of opinion filed this same date, judgment is entered on the complaint in favor of the chapter 7 trustee and the debor is denied a discharge under 11 U.S.C. §§ 727(a)(2)(A) and 727(a)(5). Judgment is also entered in favor of the trustee on the debtor-defendant's counterclaim.

IT IS SO ORDERED.

Date: 8 December 2003

Pat E. Morgenstern-Clarren
United States Bankruptcy Judge

Served by mail on: Robert Barr, Esq.
Stephen Hobt, Esq.

By: Joyce L. Gordon, Secretary
Date: 12/8/03