

NOT FOR COMMERCIAL PUBLICATION

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION



In re:)	Case No. 06-12196
)	
PATRICIA K. LEVY,)	Chapter 7
)	
Debtor.)	Judge Pat E. Morgenstern-Clarren
_____)	
)	
MARVIN A. SICHERMAN, TRUSTEE,)	Adversary Proceeding No. 06-2049
)	
Plaintiff,)	
)	
v.)	
)	<u>MEMORANDUM OF OPINION</u>
PATRICIA K. LEVY,)	(NOT FOR COMMERCIAL PUBLICATION)
)	
Defendant.)	

The chapter 7 trustee filed a complaint objecting to the debtor Patricia Levy’s discharge on the grounds that the debtor concealed assets, failed to keep adequate records, and made a false oath in connection with her bankruptcy. *See* 11 U.S.C. § 727(a)(2)(A), (a)(3), and (a)(4)(A). The debtor denies all allegations. For the reasons set forth below, judgment will be entered in favor of the trustee denying a discharge to the debtor under § 727(a)(3).

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).¹

¹ In the court’s view, the value of this opinion is solely to decide the dispute between the parties, rather than to add anything to the general bankruptcy jurisprudence. For that reason, the opinion is not intended for commercial publication.

FACTS²

I.

At trial, the chapter 7 trustee presented his case through cross-examination of the debtor, and the testimony of creditors Lilo Whittaker and Mary Bond, Natalie Nelson, attorney Thomas Frye, and his own testimony. The debtor presented her case through the testimony of Michael Leyde, her own testimony, and cross-examination. The court accepted into evidence exhibits offered by the parties separately, as well as their joint exhibits.

These findings of fact are based on that evidence and reflect the court's weighing of the evidence presented, 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." *In re The V Companies*, 274 B.R. 721, 726 (Bankr. N.D. Ohio 2002). *See* FED. R. BANKR. P. 7052 (incorporating FED. R. CIV. P. 52). 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] says with reference to the [issue at hand]. 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) (internal citation and quotation marks omitted.).

² The facts are limited to those necessary to decide the case under § 727(a)(3).

II.

The Debtor's Bankruptcy Filing and the Meeting of Creditors

The debtor filed her chapter 7 petition on June 1, 2006. She disclosed in her filing that she was a horse trainer and the sole shareholder of Majestic Acres, Inc., a business that offered horse boarding, training, riding lessons, and summer camp. The debtor listed two sources of monthly income: \$115.00 from government assistance and \$152.00 in food stamps. In her statement of financial affairs, she reported zero income in 2005 and 2006, with \$10,178.00 in income in 2004.

At the first meeting of creditors, *see* 11 U.S.C. § 341, the chapter 7 trustee asked for tax returns for the debtor and Majestic, as well as documentation about horse ownership and value. He adjourned the meeting to give the debtor time to provide this information. The debtor produced individual tax returns for 2003, 2004 and 2005, corporate returns for 2004 and 2005, and various documents related to the horses. Later, the trustee asked the debtor to produce additional financial records. The documents produced by the debtor are discussed below.

III.

The Debtor's Record Keeping

A. Record Keeping for Majestic

Majestic operated out of a horse barn and the debtor lived in a house near the barn. The customers paid for services either in cash, by check, or by barter. Payments by check or by cash were handed to the debtor or others who worked there. Whoever received the payment put it on the debtor's desk. The debtor deposited the checks into the Majestic bank account. For the most part, the cash was not deposited; instead, the debtor kept it in an envelope on the desk and used it for whatever bill needed to be paid, whether it was for the business or for herself personally.

The debtor admitted that she never kept any record of how much cash came in to the business and, although she had an accountant, she did not give that individual any information about the cash. The debtor testified that about 75% of the students paid by check and about 25% paid in cash.

The debtor did not keep organized records of any of the income coming in to the business, whether in cash, by check, or as barter. For example, the only records she had of income from riding lessons consisted of informal and incomplete entries in a calendar, which just listed various first names next to time slots.³ Similarly, the only records of income from the summer camp consisted of camper's registration forms. Majestic also had a soft drink machine that was used frequently by barn visitors. The debtor's practice was to take cash from the machine when she needed it. There are few records relating to the income from that machine and what documents exist do not adequately account for the drinks that were sold.

The debtor kept incomplete records relating to income from boarding horses in 2003, 2004, and 2005. She had a handwritten chart with the names of horses on the left and the months of the year on the top.⁴ Some spots had an "x", others were blank, and some had an "x" with a circle around it. Other boxes had numbers in them. She testified that "x" meant "paid at that time", a circle meant cash, and a long line meant the horse moved. The document does not show the amount paid for each horse or the total amount Majestic received in any month or year.

The debtor frequently bartered for services that she needed either personally or for the business. Some people boarded their horses at Majestic without charge in exchange for

³ Pl. exh. 6.

⁴ Pl. exh. 31.

permitting their horses to be used for lessons, while others donated their time cleaning stalls or doing repair work in exchange for lessons or boarding. On the personal side, the debtor at times bartered boarding services for her house rent. The debtor did not keep any records of the barter transactions.

B. Records Relating to Income the Debtor Received from Majestic

The debtor paid numerous personal bills using the Majestic bank account. These included some rent, insurance and note payments on a house the debtor owned jointly with her ex-husband,⁵ gas,⁶ cable,⁷ electric,⁸ telephone,⁹ medical, and child support obligations, together with her daughter's high school and college expenses. She did not keep any record of how much income she received from Majestic in this fashion and her tax returns state that she had none.

The debtor admitted at trial that she failed to keep reasonable books and records. Testimony of others showed that she knew about this deficiency years before her bankruptcy filing. In late 2003, the debtor spoke with Lilo Whittaker, a client who had become a friend. The debtor told Whittaker that she wanted to make her business "legit." Whittaker, who ran her own business for 23 years, offered to help the debtor organize her finances and account for income and expenses. The debtor accepted the offer.

⁵ *See, for example*, pl. exh. 16-32 and 16-33.

⁶ Pl. exh. 16-30.

⁷ Pl. exh. 16-29.

⁸ Pl. exh. 16-31.

⁹ Pl. exh. 16-35.

Whittaker did two things. First, she put together a simple system to help the debtor keep track of Majestic's income from boarders, lessons, and other sources. She created a ledger with these columns: date, client name, lesson income, cash amount, check amount, board income, cash amount, check amount, and other income (to be described).¹⁰ Each person who gave a lesson or got payment was to record the information contemporaneously with the transaction. This ledger was not, however, ever fully utilized. Natalie Nelson, who worked at Majestic from about 2001 to February 2005, testified that she started to use the ledger in June 2004 and continued until she left. Almost all of the entries were made by Nelson, as the debtor rarely filled out the form. Nelson testified that toward the end of her employment, the debtor asked her to fill the form out in pencil rather than ink so that the debtor could erase entries and say the student was a "no show" if the debtor needed money. Nelson refused. The debtor paid Nelson in cash and Majestic did not issue a 1099 or a W-2 to Nelson.

Second, Whittaker created a document that listed expenses paid by Majestic and noted whether they were Majestic's expenses or the debtor's personal expenses.¹¹ The document, created from information provided by the debtor to Whittaker, showed that the debtor used the Majestic account to pay for her own electric/gas, water, phone, cable, and non-business payments to National City and Charter One. Whittaker concluded, and noted, that the debtor had a net profit from the business of \$10,570.64.

¹⁰ Pl. exh. 9.

¹¹ Pl. exh. 13.

In late 2004, Whittaker prepared a 2005 income projection for Majestic and gave it to the debtor with a note that said:¹²

Patt-if you want me to continue to do your books, you have to be honest with me. I can't help you if you continue to hide lesson income, board and training income. The figures show that you will make at least \$100,000 a year, combine that with lessons and trailering, leasing, and the added show fees you charge will make your business income close to \$170,000.

I cannot fabricate your financial papers for the government. I have already set you up with the proper government paperwork, all you have to do is record all of the cash and checks you get, they will be off set by the expenses. The difference is yours, but you must report it and pay tax, like every other business. We'll talk about this.

Lilo

C. The Debtor's Falling Out with Whittaker and Bond

In 2003, Whittaker agreed to help the debtor buy a truck to use at Majestic Acres.

Whittaker and a related company made the down payment and took out a bank loan to pay for the truck, with the debtor being responsible for making the monthly payments to the bank.

Whittaker also loaned money to the debtor in connection with her divorce, which was finalized in September 2004. In January 2005, Whittaker told the debtor that she needed to begin to repay the loans. The next month the debtor failed to make the bank payment and Whittaker took the truck back. The friendship deteriorated and Whittaker sued the debtor later that year.

Mary Bond met the debtor through a mutual friend who asked Bond to recommend a lawyer who could defend the lawsuit. Bond suggested attorney Thomas Frye and went with the debtor to a meeting with Frye. At that meeting, the debtor asked if Bond would let the debtor put some of her assets in Bond's name to protect them from a possible adverse judgment. Frye

¹² Pl. exh. 14-2.

advised Bond not to do that because it would be concealing the debtor's assets and Bond accepted Frye's advice. Eventually, and for reasons that were not explained, Bond paid Frye \$4,500.00 for the legal services he rendered to the debtor. In 2006, Bond severed her ties with Majestic and filed suit against the debtor.

D. The Debtor's September 2005 Accident

The debtor had a riding accident in September 2005 that resulted in an extended hospitalization and her inability to ride or drive for a year. There was no evidence that the debtor's record keeping was any different after the accident than it had been before.

THE POSITIONS OF THE PARTIES

The chapter 7 trustee argues that the debtor mingled her personal finances with those of Majestic Acres and failed to keep any records of cash transactions, as a result of which it is impossible to ascertain or reconstruct the debtor's financial condition. The debtor counters that she ran a small business as best as she could following her divorce and that she did not understand that she should have maintained certain records. She argues that the challenge to her discharge is driven by personal animosity on the part of Whittaker and Bond.

DISCUSSION

I.

An individual chapter 7 debtor is entitled to a discharge of debt, unless:

- (3) the debtor has concealed, destroyed, mutilated, falsified, or failed to keep or preserve any recorded information, including books, documents, records, and papers, from which the debtor's financial condition or business transactions might be ascertained, unless such act or failure to act was justified under all of the circumstances of the case[.]

11 U.S.C. § 727(a)(3). The United States trustee, as the party objecting to the discharge, must prove his case by a preponderance of the evidence. *See Barclays/American Business Credit, Inc. v. Adams (In re Adams)*, 31 F.3d 389, 393–94 (6th Cir. 1994).

The bankruptcy code does not require a debtor to keep meticulous records. Instead, § 727(a)(3) “requires the debtor to provide creditors ‘with enough information to ascertain the debtor’s financial condition and track [her] financial dealings with substantial completeness and accuracy for a reasonable period past to present.’” *Turoczy Bonding Co. v. Strbac (In re Strbac)*, 235 B.R. 880, 882 (B.A.P. 6th Cir. 1999) (quoting *In re Martin*, 141 B.R. 986, 995 (Bankr. N.D. Ill. 1992)). The determination regarding the adequacy of a debtor’s records is made on a case by case basis. *Dolin v. N. Petrochemical Co. (In re Dolin)*, 799 F.2d 251, 253 (6th Cir. 1986).

Relevant factors include, but are not limited to, the debtor’s sophistication, education, business experience, financial structure, and occupation. *In re Trogdon*, 111 B.R. at 658. If the trustee proves that the records are inadequate, the burden shifts to the debtor to establish any justification for the inadequacy. *In re Strbac*, 235 B.R. at 883. The ultimate burden of proof, however, is on the objecting party. *In re Adams*, 31 F.3d at 393–94.

The overwhelming weight of the evidence showed that the debtor (1) commingled her personal income and debts with those of Majestic; and (2) failed to keep any records of cash taken in by Majestic and used by the debtor for personal expenses. The starting point for the analysis is the Majestic record-keeping because that business is the source of the debtor’s income, outside of government assistance. Majestic, under the debtor’s direction, failed to keep any records of cash income. As the debtor admitted that cash accounted for 25% of Majestic’s income, this is a material omission. Majestic also failed to keep adequate records of amounts paid by it to the debtor or on the debtor’s behalf for her personal expenses. Looking at the

receiving side of those transactions, the debtor failed to keep adequate records on her own behalf of any amounts received by her or on her behalf from Majestic. In sum, the debtor clearly had income from Majestic, but failed to keep records reflecting it. The debtor herself admits that she did not keep reasonable records. The burden now shifts to the debtor to justify the inadequacy.

The debtor did not provide satisfactory evidence to justify her inadequate record keeping. She testified generally about an injury in September 2005 that affected her memory. This is not a satisfactory explanation for the failure to keep records because the evidence showed that the debtor's record keeping, or lack thereof, was the same both before and after the accident. The debtor additionally testified about her difficult divorce. Again, however, there was no satisfactory evidence establishing a link between the divorce and the failure to keep records. The evidence showed that Lilo Whittaker tried to help the debtor with her record keeping *after* the divorce and the debtor, without explanation, either failed to implement the systems suggested by Whittaker or discontinued them. The debtor also argued that she was unsophisticated and did the best she could under the circumstances. The evidence showed otherwise. The debtor is an intelligent woman who knew that her records were inadequate and yet failed to take reasonable steps to correct the problem. On this point, the debtor not only had Whittaker's operational suggestions, but she also had an accountant who she could have consulted for guidance, but apparently did not. Finally, the debtor argued that the problems arose because of her failed friendships with Bond and Whittaker. The falling outs may account for why those creditors have pursued claims in this case, but it does not explain or justify why the debtor failed to maintain adequate records.

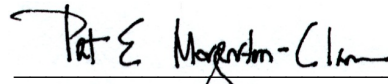
There is no way that the trustee can, from reviewing the information provided, ascertain the debtor's financial situation and understand her financial dealings for a reasonable period of

time before the filing. The debtor failed to provide a justification for the abysmal state of her records. As a result, the trustee met his burden of proving that the debtor's discharge should be denied.

In light of this disposition, it is not necessary to address the trustee's arguments under § 727(a)(2)(A) and (a)(4)(A).

CONCLUSION

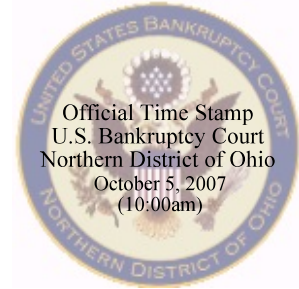
For the reasons stated, the chapter 7 trustee met his burden of proof under 11 U.S.C. § 727(a)(3) and the debtor's discharge will be denied. The court will enter a separate judgment reflecting this decision.



Pat E. Morgenstern-Clarren
United States Bankruptcy Judge

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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION



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PATRICIA K. LEVY,)	Chapter 7
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Debtor.)	Judge Pat E. Morgenstern-Clarren
_____)	
)	
MARVIN A. SICHERMAN, TRUSTEE,)	Adversary Proceeding No. 06-2049
)	
Plaintiff,)	
)	
v.)	
)	JUDGMENT
PATRICIA K. LEVY,)	(NOT FOR COMMERCIAL PUBLICATION)
)	
Defendant.)	

For the reasons stated in the memorandum of opinion entered this same date, the plaintiff trustee is granted judgment on the complaint and the debtor defendant is denied a discharge pursuant to 11 U.S.C. § 727(a)(3).

IT IS SO ORDERED.

A handwritten signature in black ink that reads 'Pat E. Morgenstern-Clarren'.

Pat E. Morgenstern-Clarren
United States Bankruptcy Judge