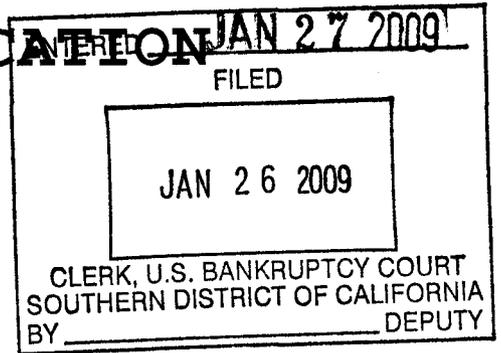


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12 UNITED STATES BANKRUPTCY COURT  
13 SOUTHERN DISTRICT OF CALIFORNIA

14 In re  
15 WILLIAM J. HERNANDEZ and  
16 JACQUELINE A. HERNANDEZ,  
17 Debtors.  
18 UNITED STATES TRUSTEE,  
19 Plaintiff,  
20 v.  
21 WILLIAM J. HERNANDEZ and  
22 JACQUELINE A. HERNANDEZ,  
23 Defendants.

Bankruptcy No. 06-03353-JM7  
Adversary No. 07-90319-JM7

MEMORANDUM DECISION

24 I

25 The United States Trustee ("Plaintiff") filed a complaint to deny  
26 the discharge of William Hernandez and Jacqueline Hernandez  
27 ("Debtors") under 11 U.S.C. § 727(a)(3) or (a)(5). After considering  
28 cross motions for summary judgment, the Court determined there  
remained genuine issues of material fact and the live testimony of the

1 Debtors was necessary to determine whether their records were adequate  
2 under the circumstances, or whether the Debtors had satisfactorily  
3 explained their loss of assets, or lack of assets to meet liabilities.  
4 The case was tried on August 20, 2008, and taken under submission.  
5 After reflection on the stipulated facts and the testimony of the  
6 Debtors during the trial, the Court agrees with the Plaintiff that the  
7 discharge should be denied in this case.

8  
9 II

10 FACTS

11 The parties submitted a detailed Pre-Trial Order which provided  
12 many stipulated facts relevant to this case. The Pre-Trial Order was  
13 entered by the Court before trial, and the stipulated facts included  
14 therein are hereby adopted as the Court's findings. In a nutshell,  
15 the Debtors obtained increases in their available credit lines and  
16 took cash advances of \$89,000 through their credit cards during the  
17 years 2004 and 2005. Their total unsecured debt is \$227,000,  
18 including \$120,550 which they incurred between May 2005 and October  
19 2005. Their bankruptcy schedules identified \$65,000 in assets, mainly  
20 consisting of a vehicle with no equity and \$45,000 in a retirement  
21 account. The Debtors first consulted with bankruptcy counsel in  
22 October 2005 and were advised to stop using their credit cards. They  
23 did so, and eventually filed a Chapter 7 petition on October 31, 2006.  
24 They pawned some of their assets in the year before filing.

25 The Debtors acknowledge that their record keeping is poor. As a  
26 defense, they explain that Mr. Hernandez abused prescription drugs  
27 because of a military injury he sustained during service in the first  
28 gulf war. He later turned to street drugs, such as crystal

1 methamphetamine. Mr. Hernandez lost his high paying job in car sales  
2 because of lower productivity due to the drug abuse. The drug abuse  
3 and financial stress caused Mrs. Hernandez to fall into depression and  
4 spend money gambling. The Debtors state that the cash advances were  
5 used for drugs, gambling and household expenses. There were times  
6 they lived apart during the period of drug use. Since 2005, they have  
7 sought some treatment for their problems. The Debtors provided the  
8 few documents they could locate; a smattering of random receipts,  
9 checks to Barona Casino and bank statements. They obtained letters  
10 from various casinos to document gambling losses, but these only  
11 supported a loss of \$6,902.70 for the three year period between  
12 January 1, 2004 and December 31, 2006.

13 The Plaintiff submitted declarations which include charts to  
14 illustrate the significant increase in unsecured debt during 2005, a  
15 lack of documentation to show what the funds were used for, and a long  
16 list of cash advances the Debtors obtained on many credit cards during  
17 2004 and 2005 (totaling \$89,224). The statement of affairs filed with  
18 the bankruptcy petition shows that their income was decreasing during  
19 that time (from \$68,143 in 2004, to \$48,316 in 2005 to about \$42,000  
20 in 2006). The credit applications by which they either obtained new  
21 credit cards or increased credit limits on existing cards represented  
22 their monthly income to be between \$6,000 - \$9,300.

23 Both of the Debtors testified during the trial. However, the  
24 testimony did not provide any additional specific details concerning  
25 the expenses for separate households, frequency of use or cost of  
26 drugs, or gambling losses in an amount anywhere near the amount of  
27 cash advances they withdrew during 2005.

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III

DISCUSSION

To prevail under Section 727, the Plaintiff must prove that the Debtors either:

(a) (3) 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;

OR

(a) (5) failed to explain satisfactorily, before determination of denial of discharge under this paragraph, any loss of assets or deficiency of assets to meet the debtors' liabilities.

The privilege of a discharge is dependent on a true presentation of the Debtors' financial affairs. To establish a prima facie case, the Plaintiff must show that the Debtors failed to maintain and preserve adequate records and that such failure makes it impossible to ascertain their financial condition and material business transactions. In re Cox, 41 F.3d 1294, 1296 (9<sup>th</sup> Cir. 1994). Once the Plaintiff establishes a prima facie violation of § 727(a), the burden shifts to the Debtors to show that their lack of records was justified under the circumstances and to provide a satisfactory explanation for their dissipation of the cash advances. In re Caneva, 550 F.3d, 755 (9<sup>th</sup> Cir. 2008). In this case, the Debtors conceded at trial that the Plaintiff had established a prima facie case, and that the burden had shifted to them to provide a satisfactory explanation.

Debtors must provide direct or circumstantial evidence to show money was in fact lost gambling and not merely used as a ruse to evade

1 creditors and defend a denial of discharge. McBee v Silman, 512 F.2d  
2 504, 506 (5<sup>th</sup> Cir. 1975). Similarly, courts have held that the fact  
3 that a debtor spends money on illegal drugs does not relieve him of  
4 his duty to maintain required records, and that vague statements  
5 regarding a loss of assets through gambling, alcohol and prostitutes  
6 is not sufficient to satisfactorily explain a loss or deficiency of  
7 assets. In re Watson, 122 B.R. 476 (M.Ga. 1990); In re Dolin, 799  
8 F.2d 251, 253, (6<sup>th</sup> Cir. 1986); In re Johnson, 68 B.R. 193 (Or. 1986).

9 The Debtors contend that they provided reasonable explanations of  
10 the financial status and lack of records. They did not obtain large  
11 cash advances shortly before filing bankruptcy for which they have no  
12 explanation. The cash advances were obtained over a year before the  
13 filing and the Plaintiff did not provide evidence to show the  
14 bankruptcy schedules do not accurately portray their financial status.  
15 The Debtors argue they provided substantiation for many of the  
16 expenses on gambling, home improvements and living expenses, so they  
17 are more like the debtor in In re Luhman, 146 BR 163 (W. Pa. 1992),  
18 who was granted a discharge. The Debtors also beseech the Court to  
19 consider the insurmountable amount of unsecured debt they will face if  
20 their discharge is denied.

21 After considering the summary judgment motions, the Court ruled  
22 that the Debtors had supplied enough evidence to create a genuine  
23 issue of material fact on the relevant issues to proceed to trial.  
24 However, after providing them with an opportunity to supplement the  
25 limited documentary evidence with their oral testimony, the Court  
26 concludes that the Debtors have failed to meet the burden of proof  
27 which shifted to them to explain their lack of records and use of cash  
28 advances. The Court acknowledges it is unlikely the Debtors would

1 have receipts for the purchase of illegal drugs and that some gambling  
2 losses may not be documented by casinos. The Debtors are not  
3 operating a business nor do they have large investments to require the  
4 extent of records expected of someone such as the debtors in In re  
5 Caneva, supra or In re Dolin, supra. However, the Debtors were  
6 provided the chance to orally explain the expenditure of the money  
7 they received through cash advances on credit cards, and cash  
8 withdrawals from their accounts, and they simply did not provide  
9 enough information to find their explanation to be satisfactory. The  
10 Court accepts the fact that Mr. Hernandez used drugs and that both  
11 Debtors participated in gambling. However, their testimony consisted  
12 of general, unsubstantiated statements, and did not rise to the level  
13 of a satisfactory explanation. Engaging in legal gambling activities  
14 on occasion does not establish an "addiction." The Debtors failed to  
15 provide testimony of specific details to make the leap from occasional  
16 gambling to an addiction, to show any particular cost of maintaining  
17 separate households, or the extent of Mr. Hernandez's drug  
18 expenditures.

19 The Court recognizes that exceptions to discharge are to be  
20 applied narrowly, and appreciates the plight of the Debtors in facing  
21 a significant amount of unsecured debt. However, their testimony was  
22 not enough to overcome the prima facie case so thoroughly established  
23 by the Plaintiff.

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#### IV

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#### CONCLUSION

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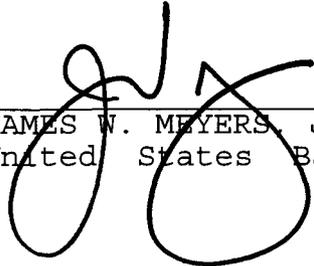
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The Plaintiff established a prima facie case to deny the Debtors' discharge under § 727(a)(3) and (a)(5). The Debtors failed to provide

1 a satisfactory explanation to justify their lack of records, or the  
2 loss or deficiency of assets to meet their liabilities. The Debtors  
3 discharge is denied. Counsel for the Plaintiff is directed to submit  
4 a proposed judgment within 14 days of entry of this Memorandum  
5 Decision.

6 Dated:

JAN 26 2009

  
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7 JAMES W. MEYERS, Judge  
8 United States Bankruptcy Court  
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