

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF CALIFORNIA
325 West "F" Street, San Diego, California 92101-6991

In re: SEAN PAUL NEVETT & SHANNON LEE NEVETT, Debtors.	BANKRUPTCY NO. 15-07986-CL7
UNITED STATES TRUSTEE, Plaintiff.	ADVERSARY NO. 18-90038-CL
v. SEAN PAUL NEVETT, Defendant.	Name of Judge: Christopher B. Latham

ORDER GRANTING SUMMARY JUDGMENT AND DENYING DISCHARGE

IT IS HEREBY ORDERED as set forth on the continuation page(s) attached, numbered two (2) through seven (7).

DATED: August 8, 2019

Judge, United States Bankruptcy Court

The court has considered Plaintiff's motion for summary judgment, Defendant's opposition, Plaintiff's reply, the parties' arguments at the hearings on this matter, and the court's prior orders. For the following reasons, the court **grants** the motion.

Background

The parties are familiar with the facts of this case. And the court has issued two orders in the matter (ECF Nos. 29 & 54) with detailed factual recitations, which it fully incorporates here. The court thus provides an abbreviated summary.

On December 16, 2015, Defendant and his wife, Shannon Lee Nevett, filed a joint Chapter 7 petition (Case No. 15-07986-CL7). Of the total liabilities, their schedules disclosed $5,178,842 in prepetition loans made to Defendant and his business entities. *Id.* at ECF No. 1, pp. 5-6. Yet on the petition date, Debtors had only $9,933.49 in their bank accounts. As a result, Plaintiff initiated this adversary proceeding seeking to deny Defendant a discharge under §§ 727(a)(3) and (5) (ECF No. 1).[1] She says that Defendant did not preserve adequate records for, or satisfactorily explain, his disposition of these loans. She then moved for summary judgment on both causes of action (ECF No. 14).

Interim Order on Summary Judgment

Plaintiff's motion focused on five loans totaling $1,500,000. In opposition, Defendant produced some records explaining how he disposed of two loans, thus raising a genuine issue of material fact over the adequacy of his recordkeeping as to them. The court consequently denied summary judgment as to those funds.

But Defendant did not produce records for his disposition of the remaining three loans: (1) $25,000 from Deanne Gage; (2) $400,000 from Mitch Pullman; and (4) $500,000 from Heath Bell (the "Loans") (ECF No. 29). And the court agreed that without records of where the combined $925,000 went, Plaintiff could not ascertain Defendant's financial condition on the petition date. So the court concluded that Plaintiff had met her prima facie burden as to the § 727(a)(3) claim with respect to the Loans.

The court, however, also determined that Defendant raised a genuine issue of material fact in rebuttal. He argued that the Loans were too remote in time from the petition date such that his failure to preserve records was justified. The court concluded that the reasonable prepetition period was a factual issue to be tried. So it held the motion in abeyance and conducted an evidentiary hearing. *See In re Berg*, 532 B.R. 162, 165-66 (Bankr. S.D. Cal. 2015).

[1] Unless otherwise noted, all statutory citations are to the Bankruptcy Code, Title 11 of the United States Code. And all rule references are to the Federal Rules of Civil Procedure.

Factual Findings After Evidentiary Hearing

At the hearing, the parties presented documentary and testimonial evidence. Much of it focused on Debtor's sophistication and his explanation for his failure to preserve records. Ultimately, the court found that it was reasonable to look back roughly six years to determine Defendant's financial condition on the petition date. Thus, requiring Defendant to keep records for some six years is entirely warranted under the circumstances. With this conclusion in mind, the court then considered the Loans, which span four to six years prepetition.

The Gage Loan

Defendant claimed that he invested Ms. Gage's $25,000 in Hawaii Mona Protein Powder. But he provided no records evidencing this. His check register showed that the money was transferred to his Checkpoint business account. But that is the end of the trail. That being said, Defendant testified that he repaid roughly $23,000. And the court credited his testimony. So because the loan was small by comparison, and had been primarily repaid, the court determined that it was not unreasonable for Defendant not to have preserved records as to it.

The Pullman Loan

Mr. Pullman loaned Defendant $330,000 and then $70,000, for a combined total of $400,000. Defendant testified that he invested the entire sum into O'Quinn, LLC, a now defunct entity. He provided no records of this investment. But he did produce other documents contradicting his overall explanation. Promptly after the second installment, his check register shows nearly $28,000 in disbursements from the account. Although inconsistent, they are records nonetheless. Consequently, the court concluded that only the remaining $372,000 is unexplained.

The Bell Loan

The largest of the Loans was $500,000 from Heath Bell. Again, the written evidence contradicted Defendant's testimony about what he did with this money. He said he purchased 1 million shares in an enterprise called Location Based Technologies. He produced no records of this purchase. Instead, his check register shows $491,000 disbursed for, among other things, payments toward his credit card bills. Notwithstanding the inconsistency, the record exists. So only $9,000 of the Bell loan is deemed to be unexplained.

The court thus concluded that it was unreasonable for Defendant not to have preserved records explaining the disposition of $381,000 in loans from some six years prepetition. The court then resumed the summary judgment motion and took the matter under submission. *Id.*

Legal Standards

Summary Judgment

Rule 56 governs summary judgment motions. It applies in bankruptcy through Federal Rule of Bankruptcy Procedure 7056. To prevail on a motion for summary judgment under Rule 56, the movant must show: (1) that there is no genuine dispute as to any fact material to the underlying cause of action; and (2) that the movant is entitled to judgment as a matter of law. FED. R. CIV. P. 56(a). In determining whether to grant summary judgment, inferences drawn from the underlying facts must be viewed in the light most favorable to the nonmoving party. *Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986); *see also Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 255 (1986).

Section 727(a)(3)

Section 727(a)(3) provides for denial of discharge if "the debtor has concealed, destroyed, mutilated, falsified, or failed to keep or preserve any recorded information . . . 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). In the Ninth Circuit:

> The underlying purpose of this subsection is "to make discharge dependent on the debtor's true presentation of his financial affairs." *Caneva v. Sun Cmty. Operating Ltd. P'ship (In re Caneva)*, 550 F.3d 755, 761 (9th Cir. 2008). Even so, § 727(a)(3) "does not require absolute completeness in making or keeping records." *Id.* Instead, a debtor must only "present sufficient written evidence which will enable his creditors reasonably to ascertain his present financial condition and to follow his business transactions for a reasonable period in the past." *Id.* A debtor's "duty to keep records is measured by what is necessary to ascertain [his] financial status." *Moffett v. Union Bank*, 378 F.2d 10, 11 (9th Cir. 1967); *see also U.S. Trustee v. Hong Minh Tran (In re Hong Minh Tran)*, 464 B.R. 885, 893 (Bankr. S.D. Cal. 2012) (type of debtor, as well as debtor's sophistication, informs the bankruptcy court's determination).

In re Hussain, 508 B.R. 417, 423-24 (B.A.P. 9th Cir. 2014).

The creditor bears the initial burden of showing by a preponderance of the evidence: "(1) that the debtor failed to maintain and preserve adequate records, and (2) that such failure makes it impossible to ascertain the debtor's financial condition and material business transactions." *Hong Minh Tran*, 464 B.R. at 892 (citing *Lansdowne v. Cox (In re Cox)*, 41 F.3d 1294, 1296 (9th Cir. 1994)). But once the creditor establishes a prima facie § 727(a)(3) violation, "the burden shifts to the debtor who must justify the inadequacy or nonexistence of the records." *In re Hong Minh Tran*, 464 B.R. at 892 (citing *Caneva*, 550 F.3d at 761). Intent to defraud is not an element of a § 727(a)(3) objection to discharge. *See In re Bourget*, 176 B.R. 25, 28 (Bankr. C.D. Cal. 1994)

(first citing *In re Bailey*, 145 B.R. 919, 924 (Bankr. N.D. Ill. 1992); and then citing *In re Kinney*, 33 B.R. 594, 596 (Bankr. N.D. Ohio 1983)).

The Ninth Circuit has stated that § 727(a)(3) "places an affirmative duty on the debtor to create books and records accurately documenting his business affairs." *Caneva*, 550 F.3d at 762 (quoting *Peterson v. Scott (In re Scott)*, 172 F.3d 959, 969 (7th Cir. 1999)). And when a debtor is sophisticated and has carried on a business involving substantial assets, "creditors have an expectation of greater and better record keeping." *Id.* (quoting *Scott*, 172 F.3d at 970). Further, "[j]ustification for [a] bankrupt's failure to keep or preserve books or records will depend on . . . whether others in like circumstances would ordinarily keep them." *Cox*, 41 F.3d at 1299 (quoting *In re Russo*, 3 B.R. 28, 34 (Bankr. E.D.N.Y. 1980)); *see also In re Harmon*, Bankr. Nos. 91-10288-B, 91-1047, 1992 Bankr. LEXIS 96, at *13 (Bankr. W.D. Tenn. Jan. 10, 1992) (finding that a court must consider reasons for failure to keep records "on a case-by-case basis" and should include factors such as the debtor's education, the sophistication of debtor's business experience, the size and complexity of debtor's business, the debtor's personal financial structure, and "any other special circumstances that may exist.").

Similarly,

> In evaluating the reasonableness of records, the Court must undertake a case by case determination. The records required for a business, as opposed to those required for a person in the conduct of day-to-day life, may be entirely different. And the Court should take into consideration the sophistication of the debtor and the type of transactions in which the debtor engaged. For the average person, who is not engaged in sophisticated financial transactions and, instead, acts only as a consumer, tax records, wage records, bank records and credit card records may suffice.

Hong Minh Tran, 464 B.R. at 893.

Section 727(a)(5)

The court may deny a debtor's discharge under § 727(a)(5) if "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." 11 U.S.C. § 727(a)(5). In the Ninth Circuit,

> To establish a prima facie case under § 727(a)(5), the objector to discharge must demonstrate that: (1) [the] debtor at one time, not too remote from the bankruptcy petition date, owned identifiable assets; (2) on the date the bankruptcy petition was filed or order of relief granted, the debtor no longer owned the assets; and (3) the bankruptcy pleadings or statement of affairs do not reflect an adequate explanation for the disposition of the assets.

In re Hazelrigg, BAP No. WW-13-1230-TaDJu, 2013 Bankr. LEXIS 4962, at *14 (B.A.P. 9th Cir. Nov. 19, 2013) (citing *Retz v. Samson (In re Retz)*, 606 F.3d 1189, 1205 (9th Cir. 2010)). In addition,

> Under section 727(a)(5) after a creditor makes a *prima facie* showing that an asset existed, but that neither it nor its proceeds can be located, the burden shifts to the debtor to provide a satisfactory explanation for the missing asset. *Comerica Bank v. Bressler (In re Bressler)*, 321 B.R. 412, 417 (Bankr. E.D. Mich. 2005). A debtor's failure to offer a satisfactory explanation may be a sufficient ground for denial of discharge under section 727(a)(5). *In re Devers*, 759 F.2d at 754.

Hong Minh Tran, 464 B.R. at 893 (emphasis in original); *see also In re Kahn*, Bankr. Nos. 10-12306-CL7, 10-90636-CL, 2013 Bankr. LEXIS 4749, at *40 (Bankr. S.D. Cal. Sep. 30, 2013). An explanation is satisfactory when it "say[s] what actually happened to the assets and [is] believable . . . Section 727(a)(5) does not require that the explanation itself be meritorious, or that the loss or other disposition of assets be proper; it only requires that the explanation satisfactorily account for the disposition." *In re Chu*, 511 B.R. 681, 687 (Bankr. D. Haw. 2014) (quoting *In re Bodenstein*, 168 B.R. 23, 33 (Bankr. E.D.N.Y. 1994)). But where a debtor lacks reasonable records or supporting third party evidence, he defeats a § 727(a)(5) objection to discharge only if his story, standing alone, is satisfactory. *Hong Minh Tran*, 464 B.R. at 894. Whether a debtor has offered a satisfactory explanation is a question of fact for the court. *Retz*, 606 F.3d at 1205.

The bankruptcy court has wide discretion in determining whether an explanation is satisfactory to defeat a § 727(a)(5) objection. *See In re Thompson*, BAP No. CC-08-1264-MoMkH, 2009 Bankr. LEXIS 4530, at *15-16 (B.A.P. 9th Cir. Apr. 20, 2009). Indeed, § 727(a)(5) "is broadly drawn and gives the bankruptcy court broad power to decline to grant a discharge in bankruptcy when the debtor does not adequately explain a shortage, loss, or disappearance of assets." *Id.* at *14. But "vague, indefinite, and uncorroborated explanations are unsatisfactory." *Id.* at *15.

Legal Discussion and Analysis

With the factual findings and outcome of the evidentiary hearing in hand, the court now returns to Plaintiff's summary judgment motion.

Section 727(a)(3)

"Although denial of discharge issues are usually construed generously in favor of the debtor, a bankruptcy discharge is a privilege that is dependent upon a true presentation of a debtor's financial affairs." *In re Morgan*, BAP No. WW-05-1372-KDMc, 2006 Bankr. LEXIS 4900, at *7-8 (B.A.P. 9th Cir. Sept. 13, 2006) (citing *Cox*, 904 F.2d at 1401).

The court previously determined that Plaintiff met her prima facie burden on her § 727(a)(3) claim as to the combined $925,000 from Ms. Gage, Mr. Pullman, and Mr. Bell: Defendant failed to maintain and preserve records supporting his alleged disposition of these funds. And it is certainly

a sum large enough that, without such records, Defendant's petition-date financial condition and material business transactions could not be understood. The burden then shifted to Defendant to justify this failure.

The court has determined that it was unreasonable for Defendant not to preserve records for $381,000 in loans extended some six years prepetition. Roughly six years is thus not too remote in time for § 727(a)(3)'s purposes in this case. Consequently, the court now finds that Defendant has not rebutted the prima facie showing with respect to the $381,000 from Mr. Pullman and Mr. Bell. This conclusion is based in large part on Defendant's education, sophistication, and the size and complexity of the transactions in question. *See In re Tan*, BAP No. NC-06-1372-RSD, 2007 Bankr. LEXIS 4858, at *46-47 (B.A.P. 9th Cir. Sep. 28, 2007); *Hong Minh Tran*, 464 B.R. at 893.

Importantly, Defendant is a financially sophisticated and highly educated individual. He held Series 7 and 24 licenses as a stock broker, and a real estate license (ECF No. 1, p. 10). He also formed several consulting and investment companies of which he was the sole shareholder, director, and officer. *Id.* at pp. 10-12. In these various roles he maintained detailed books and records. *Id.* He admitted that he ran "a complicated investment business for many years with many transactions" (ECF No. 44, p. 2). Further, he brokered numerous complex transactions, often taking equity as compensation. He handled large sums of money, including $5 to $7 million in debt. And he personally prepared the promissory notes for each of the Loans under scrutiny, evidencing his understanding of the need to record the transactions.

These loans were consequently not too remote temporally. And Defendant did not justify his failure to keep the records in question. *Cf. In re Sfadia*, BAP No. CC-06-1176-MaBPa, 2007 Bankr. LEXIS 4933, at *33 (B.A.P. 9th Cir. Sep. 5, 2007) ("Debtor proffers no plausible argument for the propositions, necessary for him to prevail, that it is reasonable to sell a business having several hundred thousand dollars' worth of inventory for over a million dollars, with a hundred thousand dollars or more still owing, on an oral agreement and without keeping any records whatsoever, or that it is justifiable to leave whatever records there were with the purchaser."). Since Defendant has not rebutted Plaintiff's prima facie case, then, the court grants her summary judgment on the § 727(a)(3) claim.

Section 727(a)(5)

Because the court is awarding Plaintiff judgment on her §727(a)(3) cause, Defendant will be denied a discharge. So it need not reach the merits of the remaining §727(a)(5) claim. A separate judgment will issue.

Conclusion

For the foregoing reasons, the court **grants** Plaintiff summary judgment on her § 727(a)(3) claim and **denies** Defendant a discharge in his bankruptcy case.

IT IS SO ORDERED.

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