SCHIAN WALKER, P.L.C.
1850 NORTH CENTRAL AVENUE, #900
PHOENIX, ARIZONA 85004-4531
TELEPHONE: (602) 277-1501
FACSIMILE: (602) 297-9633
E-MAIL: bkdocket@biz.law
CODY J. JESS, #025066
TYLER J. GRIM, #031300
Attorneys for Debtor/Defendant
Yomtov Scott Menaged

UNITED STATES BANKRUPTCY COURT

DISTRICT OF ARIZONA

In re: YOMTOV SCOTT MENAGED, Debtor.	Case No. 2:16-bk-04268-PS CHAPTER 7 Adversary No. 2:16-ap-00589
UNITED STATES TRUSTEE, Plaintiff, v. YOMTOV SCOTT MENAGED, Defendant.	**MOTION TO DISMISS UNITED STATES TRUSTEE'S COMPLAINT TO DENY DISCHARGEABILITY UNDER 11 U.S.C. § 727**

Pursuant to Federal Rule of Civil Procedure 12(b)(6), made applicable in these proceedings by Federal Rule of Bankruptcy Procedure 7012, Debtor/Defendant Yomtov "Scott" Menaged moves to dismiss the complaint initiating this adversary proceeding ("**Complaint**") [DE 1] filed by Ilene J. Lashinsky, the United States Trustee ("**UST**"), because the Complaint fails to state any claim upon which relief may be granted. While the Complaint is replete with supposed "facts" that allegedly support the UST's requested relief, the UST's failure to in any way marry those facts to the law torpedoes her Complaint. Accordingly, the Complaint – which seeks the extraordinary relief of denying Mr. Menaged his bankruptcy discharge – must be dismissed. This Motion to Dismiss is more fully

supported by the following Memorandum of Points and Authorities, Exhibits "1" through "13" attached hereto, and the entire relevant record in this adversary proceeding and the above-captioned administrative proceeding, Case No. 2:16-bk-04268 (the "**Administrative Case**").

MEMORANDUM OF POINTS AND AUTHORITIES

I. INTRODUCTION

Given the multifaceted nature of this case, a brief introduction of the parties and issues is appropriate. Mr. Menaged is 39 years old. Mr. Menaged did not graduate from high school and has no degrees, advanced training, certifications, or technical skills. Aside from menial labor, Mr. Menaged has been self-employed his entire life. Despite his lack of a formal education, in less than a decade, Mr. Menaged became one of the largest buyers and sellers of residential real estate in Arizona. In the early 2000s, Mr. Menaged attended a seminar on "fixing and flipping" homes. After losing money on his first fix-and-flip, but making over $100,000.00 on his second, Mr. Menaged was enthralled and, over the next several years –with generous financial assistance from his father – began buying, remodeling, and selling hundreds of houses in the Phoenix-metropolitan area.

Mr. Menaged typically purchased properties at foreclosure sales – often on the courthouse steps – with the combination of a small down payment (typically ten percent of the purchase price) and a loan from a "hard money," or asset-based, lender. Mr. Menaged would then hire a third-party contractor to rehabilitate the property. Given that a hard money, residential property loan typically matures within six months, in order to see a return on his investment, Mr. Menaged's properties would be quickly remodeled, marketed, and sold. In approximately 2008, Mr. Menaged, thorough his single-member limited liability companies, Arizona Home Foreclosures, LLC ("**Foreclosures**") and Easy Investments, LLC ("**Easy**"), began doing significant business with DenSco Investment Corporation ("**DenSco**").

DenSco was formed in 2002 by Denny J. Chittick, DenSco's president, vice-president, treasurer, and secretary. Prior to doing business with DenSco, Mr. Menaged and Mr. Chittick had formed a personal relationship due their time and experience in the residential real estate business. While Mr.

Menaged's and Mr. Chittick's business dealings began modestly, the collapse of the residential housing market after 2008, with the incumbent rise in foreclosure sales, caused their financial relationship to massively balloon. Foreclosures quickly became DenSco's largest borrower, and Mr. Menaged's reputation as a distressed real estate buyer grew to a national scale. In 2012, Mr. Menaged was approached by the Discovery Channel to star in a reality television show focused on the rehabilitation and sale of residential real estate. Mr. Menaged starred in the Discovery Channel's *Property Wars* for the next two years.

Between 2013 and 2015, DenSco made thousands of loans to Foreclosures totaling hundreds of millions of dollars.[1] Given his success in the housing market, Mr. Menaged also branched out into other businesses, including furniture and automobile sales, forming upwards of a dozen businesses related to those ventures. Through a combination of significant changes in the residential real estate market due to an upswing in the economy, the poor performance of Mr. Menaged's other businesses (economy-grade furniture and used cars), DenSco's grievously lax lending policies, and Mr. Menaged's crippling gambling addiction, by 2016, Mr. Menaged and his businesses were indebted to DenSco in excess of $30 million.

Spurred by threats from a Las Vegas casino over a six-figure gambling debt and recognizing that he was utterly unable to service his mountainous debt to DenSco[2] and other creditors, Mr. Menaged filed for bankruptcy protection. Overestimating his abilities, Mr. Menaged filed his bankruptcy case without the assistance of counsel. Given the significant debt owing to DenSco, by 2016, Mr. Chittick had become upset to the point of regularly speaking of suicide. Mr. Menaged, not wanting to further distress his friend, did not list DenSco as a creditor in his bankruptcy case. After his Chapter 7 trustee, Jill Ford (the "**Chapter 7 Trustee**"), actively became involved in Mr. Menaged's case, Mr. Menaged wisely

[1] It was not until 2014 that Mr. Menaged learned that the source of DenSco's funds was not Mr. Chittick (who told Mr. Menaged he had sold a successful technology company and was independently wealthy), but hundreds of investors in DenSco. Deposition Transcript of Rule 2004 Examination of Mr. Menaged at 201:22 – 202:5, attached hereto as Exhibit 1 (the "**Trustee 2004 Transcript**").

[2] Mr. Menaged had personally guaranteed Foreclosures' obligations to DenSco.

hired counsel to assist him in his bankruptcy case. With the assistance of counsel, Mr. Menaged began making significant disclosures to the Chapter 7 Trustee and amendments to his bankruptcy filings, including – despite his concerns for Mr. Chittick's wellbeing – notifying Mr. Chittick and DenSco of Mr. Menaged's bankruptcy filing. Unfortunately, within days of receiving Mr. Menaged's notice of bankruptcy filing, Mr. Chittick took his own life.

Thereafter, Peter S. Davis (the "**Receiver**") was appointed as receiver to oversee DenSco's affairs, Case No. CV2016-014142, pending in Maricopa County Superior Court (the "**Receivership**"). Among other things, the Receiver and the Chapter 7 Trustee have agreed to place all of Mr. Menaged's furniture businesses (Mr. Menaged's only operating or semi-operating businesses and of which DenSco is a secured creditor) under the control of the Receiver in the Receivership. In addition to the UST, both the Receiver and the Chapter 7 Trustee have moved for and obtained orders directing Mr. Menaged to produce documents and sit for an oral examination.

In response, Mr. Menaged sat for the Receiver's deposition, the UST's deposition, and has, prior to the most recent production to the UST, produced to the Receiver, the Chapter 7 Trustee, and the UST over 4,000 pages of documents, including bank statements for approximately a dozen different bank accounts belonging to Mr. Menaged and his businesses for the last two years, tax returns, loan agreements, copies of canceled checks, reconciliation reports, and documents related to all of Mr. Menaged's real properties, vehicles, and other personal property, personal and business leases, has permitted the Chapter 7 Trustee to personally inspect all of his real properties, inventory his personal property, and take immediate possession of all of non-exempt real and personal property, all of which has been abandoned, sold, or is in the process of being sold for the benefit of Mr. Menaged's creditors. *See generally* docket in the Administrative Case.

As set forth above and more fully herein, Mr. Menaged's life and, by extension, his financial affairs, is not simple. The fact that Mr. Menaged's case is complex does not, however, entitle the UST to throw her hands up and declare that the intricacy of Mr. Menaged's case must mean that he has

abused the bankruptcy process and is not entitled to a discharge. "A claim for denial of discharge under § 727 is construed liberally and in favor of the discharge and strictly against a person objecting to the discharge." *Roberts v. Erhard (In re Roberts)*, 331 B.R. 876, 882 (B.A.P. 9th Cir. 2005) (citing *First Beverly Bank v. Adeeb (In re Adeeb)*, 787 F.2d 1339, 1342 (9th Cir. 1986)). Rendering all of one's debts nondischargeable is an extraordinary remedy that extracts a heavy toll on a debtor. As such, the law demands that the proponent of an action under 11 U.S.C. § 727 meet a weighty burden. Having not met that burden, the UST is not entitled to the extraordinary relief she seeks.

II. FACTUAL BACKGROUND

1. On April 20, 2016, Mr. Menaged filed for Chapter 7 bankruptcy protection *pro per*. *See* DE 1, Administrative Case.

2. On May 12, 2016, Mr. Menaged's case was dismissed for failure to file all required Official Forms as indicated by the Court. *See* DE 26, Administrative Case.

3. On June 2, 2016, Mr. Menaged's case was reinstated upon the urging of, among others, the Chapter 7 Trustee. *See* DE 37, Administrative Case.

4. On June 22, 2016, the Chapter 7 Trustee obtained an order pursuant to Bankruptcy Rule 2004 directing Mr. Menaged to, among other things, produce documents (the "**Chapter 7 Trustee 2004 Order**"). *See* DE 49, Administrative Case.

5. On or about July 8, 2016, Mr. Menaged retained the law firm of Schian Walker, P.L.C. to represent him in the Administrative Case.

6. On July 25, 2016, Mr. Menaged, through counsel, responded to the Chapter 7 Trustee 2004 Order pursuant to the letter attached hereto as Exhibit "2." Between July 25, 2016, and August 16, 2016, Mr. Menaged produced approximately 4,000 pages of documents to the Chapter 7 Trustee in response to the Chapter 7 Trustee 2004 Order. *See* August 16, 2016 letter to Steven D. Nemecek, Esq., attached hereto as Exhibit "3" (the "**Initial Production**").

7. In August and September, 2016, Mr. Menaged, with the assistance of counsel, made a

number of amendments to his bankruptcy filings, including, among others, his Petition, Schedules, Statement of Financial Affairs, Statement of Intention, Chapter 7 Means Test Calculation, and Master Mailing List. *See* DEs 88-95, 98, 102, and 135, Administrative Case.

8. On September 14, 2016, the UST obtained an order pursuant to Bankruptcy Rule 2004 directing Mr. Menaged to produce documents and sit for an oral examination (the "**UST 2004 Order**"). *See* DE 119, Administrative Case.

9. On September 26, 2016, Mr. Menaged, through counsel, wrote to the UST's counsel, Ms. Jennifer Giaimo, Esq., in response to the UST 2004 Order, offering to produce to the UST the Initial Production:

> Thank you for the call today – I appreciate it. As discussed, attached is the letter I sent Steve [Nemecek, Esq.]. If you think these documents would be helpful, I'd like to send you a disk with the documents for you to review, and for us to temporarily hold off on formally responding to the US Trustee's request for production. Once you've completed your review of the documents, we can then drill down on any other documents the US Trustee would like us to produce. After you've reviewed the letter, please let me know if you'd like to start with the documents noted therein.

See e-mail from undersigned counsel to Jennifer Giaimo, Esq., dated September 26, 2016, attached hereto as Exhibit "4."

10. Ms. Giaimo and undersigned counsel agreed that Mr. Menaged's deposition would be taken on November 3, 2016. *See id*.

11. Having not received a response to the offer produce to the Initial Production, on October 31, 2016, undersigned counsel inquired whether the November 3 deposition would be going forward in light of the fact that the UST had not accepted or rejected the September 26 offer regarding production. *See* e-mail from undersigned counsel to Jennifer Giaimo, Esq., dated October 31, 2016, attached hereto as Exhibit "5."

12. Apparently believing that she had already responded to the offer, which she had not, Ms. Giaimo demanded that Mr. Menaged immediately produce the Initial Production, which Mr. Menaged

did the following day, November 1, 2016. *See id*.

13. On November 3, 2016, less than two days after receiving almost 4,000 pages of documents, Ms. Giaimo deposed Mr. Menaged.

14. Between November 4 and December 8, 2016, Ms. Giaimo and undersigned counsel met and conferred on a number of occasions regarding the scope of the UST 2004 Order. *See* e-mails between counsel, attached hereto as Exhibit "6." The UST ultimately agreed to refine a number of her document production requests. *See id*.

15. On December 14, 2016, the UST filed her Complaint.

16. On January 5, 2017, Mr. Menaged formally responded to the UST 2004 Order, producing an additional approximately 400 pages of documents to the UST. *See* DE 234, Administrative Case; *see also* Response to United States Trustee's Rule 2004 Request for Production of Documents (the "**Subsequent Production**"), attached hereto as Exhibit "7" (attachments not included).

III. LEGAL ARGUMENT

In *Bell Atl. Corp. v. Twombly*, 550 U.S. 544 (2007), the United States Supreme Court explained the minimum requirements a complaint must satisfy to avoid dismissal under Rule 12(b)(6):

> While a complaint attacked by a Rule 12(b)(6) motion to dismiss does not need detailed factual allegations, a plaintiff's obligation to provide 'grounds' of his 'entitle[ment] to relief' requires more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do . . . On a motion to dismiss, courts 'are not bound to accept as true a legal conclusion couched as a factual allegation.' Factual allegations must be enough to raise a right to relief above the speculative level . . . '[T]he pleading must contain something more . . . than . . . a statement of facts that merely creates a suspicion [of] a legally cognizable right of action', on the assumption that all the allegations in the complaint are true (even if doubtful in fact).

Id. at 555-56 (internal citations omitted).

"The court, thus, need not accept as true mere recitals of a claim's elements, supported by conclusory statements; and the plausibility of a claim is context-specific on review of which the court may draw on its judicial experience and common sense." *In re Vinh Chau*, ADV 12-01307-MKN, 2014

WL 643726, at *4 (B.A.P. 9th Cir. Feb. 19, 2014) (citing *Ashcroft v. Iqbal*, 556 U.S. 662, 678–79 (2009); *Moss v. U.S. Secret Service*, 572 F.3d 962, 969 (9th Cir. 2009) ("for a complaint to survive a motion to dismiss, the non-conclusory 'factual content,' and reasonable inferences from that content, must be plausibly suggestive of a claim entitling the plaintiff to relief.")). "Dismissal is appropriate if 'well-pleaded facts' do not allow the court to infer 'more than the mere possibility of misconduct.'" *Id*. (citing *Iqbal*, 556 U.S. at 679).

The UST alleges three different causes of action seeking to deny Mr. Menaged his discharge: (1) § 727(a)(2) (transfer or concealment with the intent to defraud); (2) § 727(a)(3) (concealing or failing to keep records); and (3) § 727(a)(4) (false oath). The UST bears the initial burden on all three of those causes of action. Fed. R. Bankr. P. 4005. Here, despite the UST's 102 paragraph, 24 page Complaint, the Court need only reference Counts I-III, which encompass a mere ***one and a half pages***, to deduce the deficiencies of the UST's Complaint. In each of the three counts in the Complaint, the UST merely ***incorporates by reference*** 89 paragraphs of alleged facts in support of the elements of the aforementioned claims. Not one single, specific fact is mentioned ***anywhere*** in the UST's claims for relief. As such, there are no facts tied to any of the elements of the UST's causes of action. The Complaint is based exclusively on "labels and conclusions, and a formulaic recitation of the elements of a cause of action." *Twombly*, 550 U.S. at 545. That, according to the Supreme Court, will not do. Accordingly, the Complaint must be dismissed.

A. <u>Count I (§ 727(a)(2) (transfer or concealment with the intent to defraud)) Must be Dismissed</u>.

i. The UST May Not Pursue a Finding that Mr. Menaged's Companies Were His Alter Egos as a Matter of Law.

The UST alleges that "[w]ithin one year before the Petition Date herein, [Mr. Menaged] transferred, removed and concealed [Mr. Menaged's] funds and property, including funds and property held in the name of alter ego Entities, with the intent to hinder, delay, or defraud [Mr. Menaged's]

creditors." Complaint at 22:23-27. While it is unclear which of the UST's 89 "factual" allegations allegedly support this conclusion, it appears that paragraphs 18-33, 34-72, and 84-89 of the Complaint are alleged in support of Count I.

A number of the UST's allegations stem from her mistaken belief that Mr. Menaged is the "alter ego" of his various housing, furniture, and automotive companies (collectively, the "**Companies**"). Initially, it is important to note that this is not a case where Mr. Menaged concealed ***his*** assets within the Companies in an effort to place those assets beyond the reach of his creditors, nor does the UST allege otherwise. *See generally* Complaint. What the UST does argue is that because Mr. Menaged is allegedly the alter ego of his Companies, various of those Companies' transactions with third parties are fraudulent as to Mr. Menaged's creditors (*id.*), and that because Mr. Menaged failed to make disclosures regarding his Companies' financial affairs on his – Mr. Menaged's – schedules and statements (*id*.), Mr. Menaged should be denied a discharge pursuant to § 727(a)(2).

The UST's alter ego allegations – largely the keystone supporting Count I – fail as a matter of law. First, what the UST seeks is essentially a reverse corporate veil pierce.

> Reverse piercing is a method of holding a corporation liable for the debts of a shareholder . . . When a court engages in reverse piercing, it imposes liability directly on a corporation. The idea of holding one entity liable for the debts of another flows from the traditional piercing theory, in which a shareholder is saddled with the debts of a corporation.

SEC v. Hickey, 322 F.3d 1123, 1130 (9th Cir. 2003). Arizona law does not recognize such a theory. *Jones v. Teilborg*, 151 Ariz. 240, 247, 727 P.2d 18, 25 (1986) ("[T]he doctrine of 'piercing the corporate veil' based on alter ego and fraud does not apply to claims asserted by corporate shareholders. This doctrine is only available to third parties who deal with the corporation.") (citations omitted); *In re Elegant Custom Homes, Inc.*, CV06-2574-PHX-DGC, 2007 WL 1412456, at *4 (D. Ariz. May 14, 2007), *aff'd sub nom. Dusharm v. Elegant Custom Homes, Inc.*, 302 Fed. Appx. 571 (9th Cir. 2008) ("'[g]enerally, the corporate veil is never pierced for the benefit of the corporation or its

stockholders' . . . [A]n Arizona corporation may not pierce its own veil.") (quoting 18 Am. Jur. 2d Corporations § 49 (2007)). Because the only plausible standing the UST ***might*** have to disregard the corporate separateness of the Companies is as the sole member of the Companies, *i.e.*, the UST believes she stands in Mr. Menaged's shoes, the UST's alter ego theory fails as a matter of law because such a claim is not cognizable under Arizona law.

Second, even if that theory were recognized in Arizona, alter ego and reverse veil piercing principles do not apply to § 727(a)(2)(A) causes of action. *Trivedi v. Levine*, 2014 WL 7187007 (Bankr. N.D. Ill. Dec. 16, 2014). In *Trivedi*, the Bankruptcy Court for the Northern District of Illinois provided a thorough analysis of the relevant jurisprudence, ultimately relying on the plain language of § 727(a)(2)(A) in determining that alter ego and reverse veil piercing are inapplicable to § 727(a)(2)(A) actions. The court in *Trivedi* noted that "***[S]ection 727(a)(2)(A) by its own terms applies only to 'property of the debtor,' not to property of a corporation owned or controlled by the debtor that a bankruptcy court may later deem to be the alter ego of the debtor. Congress chose this simple and direct language in § 727(a)(2)(A), and most courts have applied it as written."*** *Trivedi*, 2014 WL 7187007 at *5 (emphasis added) (collecting cases). The *Trivedi* court further explained that

> Congress created other remedies for dealing with fraudulent transfers, including §§ 548 and 544(b). 11 U.S.C. §§ 544(b), 548. Trustees may also pursue the assets of a corporation owned by a debtor under alter ego or reverse piercing theories in actions that do not involve denial of a discharge to the debtor. ***Expanding the reach of § 727(a)(2)(A) beyond the statutory language exposes debtors to the most serious consequence available under the Bankruptcy Code-denial of discharge-for failing to predict accurately how a bankruptcy court may apply alter ego or reverse piercing principles to his corporation. The court will interpret the statute as written to apply only to assets owned by the debtor.***

Id. at *5 (emphasis added).

The UST's wild allegation that, prior to filing for bankruptcy, Mr. Menaged should have engaged in a reverse veil piercing analysis, deduced that his and his Companies' assets were one in the same, and disclosed the universe of Mr. Menaged's Companies' financial affairs on his schedules and

statements, is entirely unsound. Nothing in the Bankruptcy Code or Rules requires a debtor to conduct such an effort. Mr. Menaged's Companies were validly formed under Arizona law. Those Companies have assets and liabilities separate and apart from Mr. Menaged. Those Companies have creditors, some of which are owed tens millions of dollars, and who dealt with those Companies as separate and apart from Mr. Menaged. It would have been illegal for Mr. Menaged to have collapsed all of those Companies into himself as part of his bankruptcy filing.

ii. The UST Does Not Have Standing to Purse § 523 Claims on DenSco's Behalf.

Certain of the UST's other allegations in support of Count I are likewise flawed, in that the UST appears to assert causes of action that do not belong to her in an effort to prop up her deficient Complaint. For example, the UST alleges that:

- "During the one year period before the Petition Date, [Mr. Menaged] misappropriated hard money loan funds received from Densco by using such funds for his own personal use." Complaint at ¶ 49.
- Within the year before the Petition Date, [Mr. Menaged] misappropriated funds that he received on behalf of the Alter Ego Real Estate Entities from Densco by using such funds to repay family loans, transferring funds to [Mr. Menaged's] family members and other entities including the Furniture Entities, and using such funds for personal expenditures including gambling in Las Vegas." Complaint at ¶ 50.
- "[Mr. Menaged] was aware from at least April 2014 when the Forbearance Agreement was executed through the Petition Date that Densco hard money loans were funded at least in part by money Densco received from individual investors." Complaint at ¶ 52.
- "[Mr. Menaged] was aware from at least February 2015 that [Mr. Chittick] was having a hard time paying the Densco investors." Complaint at ¶ 53.

The UST seems to conflate conduct giving rise to liability under § 523 with that which creates liability under § 727.[3] Simply put, the UST does not have standing to prosecute the Receiver's (who

[3] A cause of action pursuant to § 727 focuses on a debtor's acts and/or omissions vis-à-vis the ***debtor's*** or ***estate's*** property, while § 523's aim concerns debts, *i.e.*, ***property of another***, incurred through, for example, a debtor's fraud. The UST's complaint blurs these distinct concepts.

stands in DenSco's shoes) claims against Mr. Menaged under § 523. *See In re Jones*, 206 B.R. 355, 356 (Bankr. M.D. Pa. 1997) ("A trustee may not object to dischargeability under section 523(c), and therefore is not, under Bankruptcy Rule 4007(c), a 'party in interest' who is permitted to move for extensions of time in which creditors may object to dischargeability of specific debts.") (citing *Collier on Bankruptcy*, 15th Edition Revised, at page 523–113 at ¶ 523.26)). The Receiver is well-represented by counsel who will doubtlessly act to protect DenSco's interests vis-à-vis Mr. Menaged. Even if Mr. Menaged's debt to DenSco is not dischargeable under § 523 (which Mr. Menaged does not concede), nothing in § 727 suggests that the nondischargeability of a debtor's particular debt renders all of his debts nondischargeable.

iii. The "Transfers" of the Mustang and Bentley are Not Avoidable Transfers and Do Not Operate to Deny Mr. Menaged His Discharge.

Lastly, the Trustee points to the purported fraudulent nature of certain transactions involving the sale of a 1965 Ford Mustang (the "**Mustang**")[4] and the "sale" of the Debtor's leasehold interest in a 2013 Bentley Continental GT Coupe (the "**Bentley**").[5] *See* Complaint at ¶¶ 62-72. As an initial matter,

[4] In January, 2013, the Debtor purchased the Mustang at auction with funds belonging to Easy. *See* US Bank cashier's checks, attached hereto as Exhibit "8"; *see also* Easy Bank statements evidencing payment for the Mustang, attached hereto as Exhibit "9." The Mustang was subsequently titled in Mr. Menaged's name. The Mustang, however, remained property of Easy, as Easy was the source of the consideration paid for the Mustang and, admittedly, should have been titled in Easy's name. Mr. Menaged subsequently sold the Mustang in February, 2016 and deposited the proceeds of the sale into Furniture and Electronic King, LLC's bank account. *See* Bill of Sale and check, attached hereto as Exhibit "10"; *see also* February, 2016 Furniture and Electronic King, LLC bank statement, attached hereto as Exhibit "11." The UST alleges that Mr. Menaged fraudulently concealed the proceeds of the Mustang sale from ***Mr. Menaged's*** creditors and failed to make said proceeds available to ***Mr. Menaged's*** creditors. Mr. Menaged, who provided no consideration for the purchase of the Mustang and who was never the equitable owner of the Mustang, had no right to the proceeds of the sale and, accordingly, no obligation to maintain the proceeds for distribution to ***his*** creditors. At best, Easy and/or Easy's creditors may have a claim against Furniture and Electronic King, LLC. The UST does not, however, have standing to assert such a claim and is not attempting to do so through the Complaint.

[5] As recognized by the UST, Mr. Menaged never had an ownership interest in the Bentley. Rather, Mr. Menaged maintained a leasehold interest in the Bentley. On November 26, 2015, Mr. Menaged entered into an agreement with his father, Joseph Menaged, whereby Mr. Menaged sold his interest in the Bentley to his father for $150,000.00, which amount was credited against the $5.5 million loan Joseph Menaged made to Foreclosures. *See* "Vehicle Sales Agreement," attached hereto as Exhibit "12." Pursuant to the terms of that agreement, the Debtor was to (a) continue making payments to the lessor; (b) pay off the lease and exercise the sale option on or before

both of these transactions were disclosed to the Chapter 7 Trustee with supporting documentation shortly after the Debtor retained undersigned counsel. *See* Ex. 1; e-mail dated August 26, 2016 from undersigned counsel to Steven D. Nemecek, Esq., attached hereto as Exhibit "13." After reviewing the documentation and analyzing those transactions, the Chapter 7 Trustee has, thus far, declined to prosecute avoidance actions related to either the sale of the Mustang or the "sale" of the Debtor's leasehold interest in the Bentley. There is good reason for the Chapter 7 Trustee's inaction: neither transaction rises to the level of an avoidable transfer, let alone a transfer of property with the intent to hinder, delay, or defraud a creditor as required by § 727(a)(2)(A).[6] Moreover, even if the Mustang and Bentley transactions are avoidable transfers, they do not, in and of themselves, operate as a basis to deny Mr. Menaged his discharge. Based on the foregoing, Count I must be dismissed.

B. Count II (§ 727(a)(3) (concealing or failing to keep records)) Must be Dismissed.

The UST alleges that "[Mr. Menaged] has failed to keep or preserve documents from which [Mr. Menaged's] financial condition and business transactions might be ascertained." Complaint at 23:11-13. Again, while it is unclear which of the UST's 89 "factual" allegations the UST believes support this conclusion, it appears that paragraphs 29, 54, 77-83, and 84-89 of the Complaint are alleged in support

---

November, 2016; and (c) deliver title to the Bentley to Joseph Menaged on or before November 30, 2016. *Id.* The lease currently expires on May 9, 2018.

[6] While the UST loudly crows about the Bentley transaction, she either ignores the facts related to that transaction or does not understand them. The estate was not in any way diminished by the Bentley transaction. Mr. Menaged does not yet own the Bentley, but he is obligated to make the payments on the Bentley lease. The only "transfer" that occurred as a result of Mr. Menaged's agreement with his father is the ***use*** of the Bentley, which is valueless to the estate. The estate's only interest in the Bentley is Mr. Menaged's ***leasehold*** interest. If Mr. Menaged ceased making payments to the lessor, the lessor would obtain stay relief and repossess the Bentley. In fact, that has actually happened. On January 9, 2017, the lessor, the Chapter 7 Trustee, and Mr. Menaged entered into a stipulation granting the lessor stay relief due to Mr. Menaged's nonpayment of the Bentley lease. *See* Administrative Case, DE 258. Surely the UST is not arguing that the estate will make the payments to the lessor so that Mr. Menaged's creditors can enjoy possession of the Bentley, or that the estate will exercise the option to buy the Bentley at the end of the lease for $85,000.00. If anything, Mr. Menaged's estate has been ***enriched*** by Mr. Menaged continuing to make payments to the lessor, both pre and postpetition. By continuing to make payments, Mr. Menaged has reduced the lessor's general unsecured claim in the event of a default. Moreover, by reducing Foreclosures' debt load by $150,000.00, the Bentley transaction ostensibly increased the value of Mr. Menaged's membership interest therein. In any event, the Bentley transaction is a red herring drug out in an effort to distract from the other deficiencies in the Complaint.

of Count II. Mr. Menaged recognizes that he has an affirmative duty to keep and preserve documentation that allows his creditors to ascertain his financial condition. *Caneva v. Sun Cmtys. Operating Ltd. P'ship (In re Caneva)*, 550 F.3d 755, 764 (9th Cir. 2008). A creditor objecting to discharge must "show (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" in order to present a *prima facie* case. *In re Cox*, 41 F.3d 1294, 1296 (9th Cir. 1994) (citing *Meridian Bank v. Alten*, 958 F.2d 1226, 1232 (3d Cir. 1992)) (emphasis added).

The facts here are strikingly similar to those in *In re Wright*, 364 B.R. 51, 68 (Bankr. D. Mont. 2007), *aff'd*, CV 07-053-GF-SEH, 2008 WL 160828 (D. Mont. Jan. 16, 2008), *aff'd sub nom. Olympic Coast Inv., Inc. v. Wright*, 340 Fed. Appx. 422 (9th Cir. 2009). There, Olympic Coast Investment, Inc. ("**Olympic**"), one of the debtors' (the "**Wrights**") creditors, objected to their discharge under §§ 727(a)(3), (a)(4)(A), and (a)(5). Olympic argued that the Wrights should be denied a discharge under § 727(a)(3) because, given the Wrights' vast real estate holdings and interests in businesses, the Wrights should have kept better records. *Id*. at 67. Prior to his retirement and bankruptcy filing, Mr. Wright owned an insurance business, various motels, commercial properties, apartment buildings, rental properties, raw land, 500 condominiums, and an interest in a health supplement business. *Id*. at 58-59.

The Wrights moved to dismiss Olympic's nondischarge complaint on the basis that, *inter alia*, their financial condition could be gleaned from the voluminous financial records they turned over to Olympic to review prior to Olympic initiating litigation. Before Olympic filed its complaint, the Wrights turned over 15 to 18 file cabinets full of documents to Olympic's counsel, who admitted that he had only reviewed such documents for a day and a half. *Id*. at 68. Moreover, despite Mr. Wright admitting that "he may have been a poor record keeper" (*id*.), there was no evidence to suggest that "he 'concealed, destroyed, mutilated, falsified, or failed to keep or preserve any recorded information which is necessary for denial of discharge under the language of § 727(a)(3).'" *Id*.

Recognizing that a debtor need not keep ***any*** books or records so long as their financial condition can be determined from available documents, the court dismissed Olympic's complaint in its entirety:

> A leading commentator notes that "even if no books whatever are kept, if the debtor's financial condition and business transactions can be ascertained from available records and memoranda, a discharge should be granted." 6 Collier on Bankruptcy, ¶ 727.03[3][c]. The evidence in the record shows that voluminous records filled at least 15 file cabinets of Wrights' business transactions and real estate transfers, spanning more than three decades, which were made available to [Olympic] . . . This lack of evidence weighs against [Olympic] as the party with the burden of proof.

Id. at 69–70, 80.

Here, there is no dispute that Mr. Menaged, recognizing the folly of filing his bankruptcy case *pro per*, retained counsel and immediately began cooperating with the Chapter 7 Trustee and making significant amendments to his schedules, statements, and other disclosures. Unlike the debtor in *In re Lopez*, 532 B.R. 140, 153–54 (Bankr. C.D. Cal. 2015) (denying discharge under § 727(a)(3) because, among other things, the debtor turned over no bank statements or canceled checks, but instead only turned over tax returns), Mr. Menaged promptly turned over in excess of 4,000 pages of documents to the Chapter 7 Trustee, granted the Chapter 7 Trustee immediate and unfettered access to all of his real and personal property, and began cooperating with the UST the minute she obtained the UST 2004 Order. The correspondence between undersigned counsel and counsel for the UST illustrate that, prior to deposing Mr. Menaged, the UST spent less than ***two days*** reviewing over 4,000 pages of documents that Mr. Menaged produced to her, including thousands of pages of bank statements for approximately a dozen bank accounts in Mr. Menaged's and his Companies' names. *See supra* at Section II, paragraphs 8-13. While not impossible, it is extremely unlikely that the UST analyzed all of those documents prior to filing her Complaint, and wholly unlikely that she did so before deposing Mr. Menaged. Had the UST actually reviewed the documents Mr. Menaged produced to her, she would have been able to more accurately determine Mr. Menaged's financial picture.

Mr. Menaged submits that his financial condition can be ascertained through the nearly 5,000 pages of documents he has produced to the UST – every single financial document in Mr. Menaged's possession, custody, or control – through both the Initial Production and Subsequent Production. With respect to the UST's allegation that Mr. Menaged failed to keep formal records for his Companies, including balance sheets, profit and loss statements, cash flow statements, *etc*., the UST fails to appreciate the fact that Mr. Menaged is the sole member of all of his businesses, which he established himself by filling out forms on the internet. As the documents Mr. Menaged produced to the UST make clear, save for the loans from DenSco, which was solely operated by Mr. Menaged's friend, Mr. Chittick, neither Mr. Menaged nor his Companies obtained significant loans from any institutional lenders. Accordingly, it is neither surprising, nor inappropriate, that the Debtor maintained his and his Companies' financial affairs in the manner in which the UST complains, *i.e*., largely by tracking their finances through their bank statements.

Moreover, despite the significant funds flowing through Foreclosures, Mr. Menaged is not an accountant, lawyer, or otherwise sophisticated businessperson. The UST's attempt to hold Mr. Menaged to the heightened standards for recordkeeping established in cases like *Meridian Bank v. Alten*, 958 F.2d 1226, 1231 (3rd Cir. 1992) (debtor was an attorney and real estate consultant and had been a consultant for and CEO of several enterprises) and *Tranche 1 (SVP–AMC), Inc. v. Relito Tan (In re Relito Tan)*, 350 B.R. 488 (Bankr. N.D. Cal. 2006), 350 B.R. 488, 496–97 (Bankr. N.D. Cal. 2006), *aff'd*, ADV. 00-04199, 2007 WL 7541007 (B.A.P. 9th Cir. Sept. 28, 2007) (debtor was a certified public accountant with interests and positions in numerous corporations) is unwarranted.

As discussed above, Mr. Menaged did not graduate from high school and has no specialized education or training, financial or otherwise. Mr. Menaged started all of the Companies – single member limited liability companies – by himself and ran them by himself. While, like the debtor in *In re Wright*, Mr. Menaged could have done a better job preparing and keeping records, the fact is, his and his Companies' financial condition can be ascertained from the documents he produced to the UST,

which inarguably include thousands of pages of bank statements, loan documents, information regarding Mr. Menaged's financial dealings with insiders and documents concerning Mr. Menaged's and his Companies' ownership and transfers of any and all significant real and personal property. In light of the foregoing, Count II must be dismissed.

C. Count III (§ 727(a)(3) (false oath)) Must be Dismissed.

The UST alleges that "[Mr. Menaged] knowingly and intentionally made false statements concerning material information under oath in this case." Complaint at 23:20-22. Yet again, while it is patently unclear which of the UST's 89 "factual" allegations the UST believes support this conclusion, it appears that paragraphs 73 through 76 of the Complaint are alleged in support of Count III.

First, the vast majority of the UST's allegations with respect to Count III are based upon the UST's flawed argument that the Companies are Mr. Menaged's alter ego and, as such, that Mr. Menaged should have made disclosures regarding the Companies' transactions (for example, the sale of the 1965 Ford Mustang). As explained above (*see supra* at III.A), the UST's reverse veil piercing argument fails as a matter of law. Accordingly, the Court should disregard any allegations in support of Count III based upon the UST's "alter ego" theory.

Second, the UST argues that the Court should draw a negative inference in regard to each question that Mr. Menaged refused to answer based on his assertion of his Fifth Amendment privilege against self-incrimination when the UST deposed Mr. Menaged. The UST places far too much emphasis on Mr. Menaged's invocation of the privilege. Any time Mr. Menaged invoked the privilege, it was in response to the UST's questions regarding Mr. Menaged's dealings with Mr. Chittick and DenSco, specifically where the UST zeroed in on the alleged fraudulent misrepresentations Mr. Menaged made to Mr. Chittick. *See, e.g.*, Complaint at ¶¶ 85-87.[7] Given the various issues surrounding

[7] The UST alleges that Mr. Menaged "invoked the Fifth Amendment privilege and refused to answer numerous questions that pertain directly to [Mr. Menaged's] financial condition, business transactions, knowledge, and intent." Complaint at ¶ 88. The UST is wrong. Mr. Menaged only invoked the privilege when the UST pressed him on matters related directly to DenSco or Mr. Chittick. That the UST fails to cite a single instance where Mr. Menaged invoked the privilege related to other matters affecting his financial condition is telling.

DenSco's loans, Mr. Menaged believed that it was appropriate to assert the privilege with respect to the UST's questions regarding those loans and the statements Mr. Menaged made to Mr. Chittick regarding the same. As the Bankruptcy Court for the Northern District of California explained, courts in civil proceedings are not permitted to draw an adverse inference if there is independent evidence regarding the fact(s) which the party refuses to testify:

> Notwithstanding the Fifth Amendment's language referencing compulsion to testify in a "criminal case," the privilege against self-incrimination can be invoked in a civil case. The Bankruptcy Code, 11 U.S.C. § 344, contemplates that this privilege can also be invoked in bankruptcy cases and adversary proceedings . . . When the privilege is invoked in a non-criminal case, the presiding court may, in its discretion, draw an adverse inference from the assertion. Whether an adverse inference should be drawn depends upon the facts of the case. ***No adverse inference may be drawn, however, "unless there is a substantial need for the information and there is not another less burdensome way of obtaining that information***." The Court must also "determine 'whether the value of presenting [the] evidence [is] substantially outweighed by the danger of unfair prejudice' to the party asserting the privilege." In addition, ***the Court is not permitted to draw an adverse inference if there is "independent evidence of the fact about which the party refuses to testify***."

In re Martinez, 500 B.R. 608, 615–16 (Bankr. N.D. Cal. 2013) (emphasis added) (citations omitted).

Here, nothing suggests that (1) there is substantial need for the information related to certain alleged misrepresentations Mr. Menaged made to Mr. Chittick; (2) that the UST cannot obtain that information from some other source; and (3) there is not independent evidence of the information the UST attempted to solicit from Mr. Menaged. All or nearly all of that information is in the hands of the Receiver – some of which he provided to the UST in anticipation of her deposition of Mr. Menaged. *See generally* Exhibit 1. Moreover, testimony the UST attempted to solicit from Mr. Menaged – his alleged misrepresentations to Mr. Chittick – is largely irrelevant vis-à-vis Mr. Menaged's financial affairs and disclosures in his bankruptcy case. Even at this early stage, the Court should not draw an adverse interest.

Third, a significant number of the UST's other allegations in support of Count III are focused on Mr. Menaged scheduling a number of assets, liabilities, and other disclosures as "unknown." *See, e.g.*,

Complaint at ¶ 74. Courts routinely hold that a debtor may not be denied his discharge solely because he was unsure of approximate figures at the time he made disclosures. For example, in *In re Relito Tan*, 350 B.R. 488, the court held that the debtor scheduling his interests in closely held corporations as "unknown," despite the fact that the debtor had valued the interests at almost $3.5 million shortly before his bankruptcy filing, did not support denial of discharge on grounds that, among other things, the debtor knowingly made a false oath in connection with his bankruptcy case:

> [I]t is difficult to place a value on a minority interest in a closely held corporation . . . Moreover, the failure to place a definite value on an interest that is disclosed is clearly less egregious that the failure to disclose the interest at all. Once an interest is disclosed, the trustee or a creditor may question the debtor further or search other sources of information regarding the value of the interest. If the asset is not disclosed at all, the asset will frequently escape the notice of interested parties. Similarly, placing a clearly too low value on the asset is also worse than valuing it as "unknown" since, in the absence of a "red flag" the trustee or a creditor may have no reason to investigate the value further. Valuing an interest as "unknown" invites further investigation.

Id. at 493; *see also In re Kong*, ADV 2:12-01007-BR, 2014 WL 1426631, at *6 (B.A.P. 9th Cir. Apr. 14, 2014) ("Not knowing the value of [debtor's closely held business] and listing it as 'unknown' was not the same as concealing an ownership interest in it, which is required for a claim under § 727(a)(2)(A).").

Likewise, bankruptcy courts will not deny a debtor's discharge simply because they list as "unknown" their income for the three years prior to filing for bankruptcy (*In re Knowling*, ADV 10-03298-RLD, 2011 WL 5024298, at *4 (Bankr. D. Or. Oct. 20, 2011) (dismissing United States Trustee's §727 complaint based upon same)). That Mr. Menaged did not know the precise value of his closely-held Companies, the exact amount DenSco was owed, or the approximate amount of income he received from his Companies' operations,[8] is not a basis to deny Mr. Menaged his discharge under § 727(a)(4).

[8] Part of Mr. Menaged's inability to disclose the precise amount of income he received between 2014 and 2016 is that he rarely took a salary on account of operating the Companies and, instead, had the Companies pay certain of his expenses. This is borne out in the bank statements provided to the UST in the Initial Production. Curiously, on the one hand, the UST chastises Mr. Menaged for disclosing his total income as "unknown," and on the other, takes him to task for not disclosing the "true amount" of income he received by virtue of the Companies having paid certain of Mr. Menaged's personal expenses. *Compare* Complaint at ¶ 74(h) *with* ¶ 74(i).

The fact is, Mr. Menaged ***disclosed*** all of his assets, liabilities, and financial information. That the UST does not like the way he made those disclosures, or believes that Mr. Menaged should have disregarded the corporate separateness between him and his Companies fails to illustrate that Mr. Menaged knowingly and fraudulently made a false oath or account.

Finally, the UST takes issue with the alleged deficiencies in Mr. Menaged's schedules and statements. The UST alleges that

> In his November 2016 Deposition, the Defendant testified that before filling out the information in his bankruptcy Schedules and SOFA, he did not carefully review his records to ensure that he properly listed all of the debts that he owed to creditors as of the Petition Date. During that deposition, the Defendant also testified that he was not sure if certain items on his amended bankruptcy pleadings were correct.

Complaint at ¶ 73. Disappointingly, the UST seriously misrepresents Mr. Menaged's testimony.

Mr. Menaged testified that, in filling out his ***original*** filings, he rushed through preparing them:

> Q: But you – when you prepared your bankruptcy schedules, you did go through your own records to make sure that you listed all debts that are – for which you are liable; correct?
>
> A: When I prepared my bankruptcy Statement, I went on line, I paid $19, I put as much information as I could. I wanted to rush through it . . .

Trustee 2004 Transcript at 37:20 – 38:2. Mr. Menaged also testified that he believed his amended schedules and statements were scrupulously accurate:

> Q: Okay. So, sitting here today, are you confident that your most recent Amended Schedules reflect all of your assets?
>
> A: Absolutely.

Id. at 88:12-15.

The law in the Ninth Circuit for nearly the last 30 years is that amendment of schedules is liberally allowed. *See, e.g.*, *In re Michael*, 163 F.3d 526, 529 (9th Cir. 1998) ("No court approval is

required for an amendment, which is liberally allowed.") (citations omitted). As set forth above, Mr. Menaged failed to appreciate the significance of his bankruptcy filing, which he accomplished on his own. In fact, Mr. Menaged failed to even claim any exemptions in his original schedules. *See* Administrative Case, DE 10. Once the Chapter 7 Trustee advised Mr. Menaged of the significance of the deficiencies contained in his filings, Mr. Menaged promptly hired counsel and began making significant amendments and disclosures. While Mr. Menaged admitted that his original schedules were deficient, he also testified that his amended schedules and statements fully and accurately disclose all of his assets and liabilities. Based upon the foregoing, Count III must be dismissed.

IV. CONCLUSION

Some bankruptcy cases are more complicated than others. Mr. Menaged fully recognizes and appreciates that his case is near the far end of that spectrum. He understands that he has myriad issues with respect to his dealings with Mr. Chittick and DenSco. He comprehends that he did not fully appreciate the responsibilities attendant to debtors and would-be debtors, including fully and accurately disclosing all of his assets and liabilities when he filed for bankruptcy protection.

All of that being said, Mr. Menaged has sincerely attempted to atone for his shortcomings in this bankruptcy case by, among other things, wholly amending his bankruptcy schedules and statements, allowing the Chapter 7 Trustee complete and unfettered access to all of his assets and financial affairs, and producing every single document in his possession, custody, and/or control in any way related to his financial condition to both the Chapter 7 Trustee and UST. Moreover, despite him not being obligated to do so, Mr. Menaged has subpoenaed documents in an effort to more completely paint his financial picture in this bankruptcy case. Mr. Menaged has worked freely and openly with the Chapter 7 Trustee and the UST in an effort to explain his financial affairs.

Instead of delving into the copious amount of documents Mr. Menaged produced – an admittedly time-consuming and arduous task – the UST chose to unload mountains of unfounded and legally-flawed theories on Mr. Menaged hoping that the Court will not look beyond the salaciousness of the

UST's allegations to determine the veracity of the UST's claims. Mr. Menaged deserves better; all debtors do. Based on the foregoing, Mr. Menaged respectfully requests that the Court dismiss the UST's Complaint in its entirety and grant Mr. Menaged such other relief as the Court deems appropriate.

DATED this 17th day of January, 2017.

SCHIAN WALKER, P.L.C.

By /s/ CODY J. JESS, #025066
Cody J. Jess
Tyler J. Grim
Attorneys for Debtor/Defendant Yomtov Scott Menaged

COPY of the foregoing
e-mailed this 17th day
of January, 2017, to:

Jennifer A. Giaimo, Esq.
U.S. Trustee's Office
230 North First Avenue, #204
Phoenix, Arizona 85003-1706
jennifer.a.giaimo@usdoj.gov

/s/ JULIE LARSEN