

CONSUMER BANKRUPTCY

Some Debtors Have Higher Duty to Keep Records

Businessman debtor denied discharge for failing to keep business records

By Craig D. Robins

As a consumer bankruptcy practitioner, I am often concerned with clients who fail to have sufficient paperwork to document their past finances. This often leads to the question - at what point can a consumer debtor be in jeopardy because he or she failed to keep financial documents?

I discussed this issue exactly four years ago when I reviewed an opinion by Judge Stong (Brooklyn), who held in that particular case that the debtor was entitled to a discharge even though she failed to keep a number of important financial documents. In that case the debtor had a good excuse for not being able to produce copies of bank and credit card statements.

However, a judge from the Bankruptcy Court for the Northern District of Ohio just addressed the same issue, although this time for a consumer with business debts, and determined that the debtor in that case was not entitled to a discharge.

In this month's column I'll discuss the recent Ohio decision and provide some insight as to when a consumer debtor can face difficulty for not having financial documents.

Businessman fails to keep documents

In the Ohio case, *In Re: Kim Wesley Michael*, no. 09-3258, (Bankr. N.D.Ohio 2010), the debtor, a businessman, had been involved in at least a dozen different business enterprises over a 30 year period, six of which he operated in the five-year pre-petition period.

Two of the businesses enabled the debtor to draw compensation in excess of \$100,000 per year. The debtor had various roles in these business ventures including sales manager, freelance graphic designer, insurance salesman and concert promoter.

When the debtor ultimately defaulted on some business obligations, he sought Chapter 7 relief.

At the time the debtor filed for bankruptcy relief, he was not employed, no longer involved in any part of his business venture, and had no income.

One particular creditor, who the debtor borrowed \$60,000 from for the purpose of financing his most recent business venture, filed an adversary proceeding objecting to discharge pursuant to Bankruptcy Code



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section 727(a)(3) for failure to keep adequate records.

As it turned out, the debtor failed to maintain any kind of records regarding his most recent business ventures, including the one for which the objecting creditor lent money. As such, the debtor had no check registers, accounting ledgers of any kind, or any other kind of financial records. In addition, the debtor hadn't filed tax returns for several years.

The bankruptcy court held the debtor to a much higher standard than the average consumer debtor because of his business experience. Thus, the judge determined that the debtor's inability to explain his financial affairs because he had not kept sufficient records warranted a denial of discharge.

In his decision, the judge explained some basic, but important principles. A bankruptcy discharge is an extraordinary remedy, and carries with it certain duties and obligations.

Only those debtors who are fully cooperative and honest are entitled to a dis-

charge. In that way, a debtor who receives benefits under the Bankruptcy Code must also accept its burdens, and one of them is to be fully transparent with all matters regarding financial affairs.

Bankruptcy Code requires debtors to maintain financial documents

Bankruptcy Code Section 727(a)(3) provides that the court can deny a debtor his discharge if the debtor failed to keep or preserve any recorded information, including books, documents, records and papers. If a party objecting to discharge under this provision can establish that the debtor failed to keep or preserve the necessary information, and can also demonstrate that the lack of financial records makes it impossible to ascertain the debtor's financial condition, then the objecting party has met its evidentiary burden.

The burden then shifts to the debtor who can still prevail and get a discharge if he can demonstrate that his failure to keep documents was justified under all circumstances of the case.

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Some debtors are held to higher standards than others

The court pointed out that a debtor with primarily consumer debts should not generally be held to the same standard as a debtor with mostly business debts. As such, issues of this sort must be reviewed on a case-by-case basis.

In this case, the court determined that it should examine the size, complexity and volume of a debtor's business to ascertain the sufficiency of the debtor's records. In addition, the court can consider the debtor's expertise, experience, sophistication and any other circumstances.

Here, the court observed that the debtor had considerable business experience and earned substantial sums of money from the business. Thus, the court inferred that the debtor's failure to produce any financial documents was because he was attempting to obfuscate his financial dealings.

The court also pointed out that the debtor's intent to hide or conceal information was irrelevant, nor was it necessary to show that the debtor intended to defraud a particular creditor or the trustee. Instead, the test for determining whether a debtor has adequately justified the lack of financial records is an objective one, focusing on whether others in like circumstances would ordinarily keep financial records.

Practical tips when clients don't have prior financial documents

If a client comes to you and presents a problematic scenario because of a lack of prior financial documents, does that mean you should turn down the case or advise against filing? Not necessarily.

No one can fault you for filing the case if you have sufficient documents to do your BAPCPA due diligence. However, if the debtor does not even have sufficient written information to enable you to answer the mandatory questions in the petition, perhaps you should turn down the case.

If a debtor with deficient past financial documents does file, then he can only get into trouble if the trustee or a creditor makes an issue of it. Then, even in a worse-case scenario, if the debtor's discharge is denied, he would likely be in the same position he was in prior to filing.

Note: Craig D. Robins, Esq., a regular columnist, is a Long Island bankruptcy lawyer who has represented thousands of consumer and business clients during the past 20 years. He has offices in Coram, Mastic, West Babylon, Patchogue, Commack, Woodbury and Valley Stream. (516) 496-0800. He can be reached at CraigR@CraigRobinsLaw.com. Visit his website: www.BankruptcyCanHelp.com and his Bankruptcy Blog www.LongIslandBankruptcyBlog.com.