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## CONSUMER BANKRUPTCY

### Recent Decision Summarizes Consumer Debtor's Obligation to Retain Documents and Explain Pre-Petition Loss of Assets

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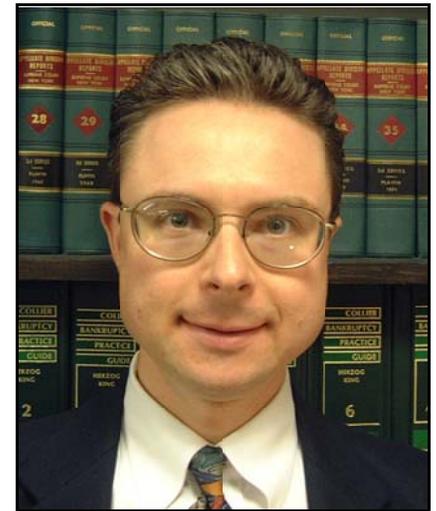
I was most intrigued when the Bankruptcy Court announced several months ago that it was going to make certain judicial opinions available on the E.C.F. website, and that they were going to do this at no charge as part of a policy of providing the public and the bar with information. Despite checking the site repeatedly, there have been very few reported decisions – less than ten to date. However, a few weeks ago I saw a decision issued by Judge Stong (Brooklyn) that was quite interesting.

That case contained a set of facts that became more and more fascinating as I read the decision. It also contained an excellent summary of the law regarding a consumer debtor's obligation to maintain documents and explain pre-petition financial transactions.

When I first started reading the 34-page memorandum decision (provided as an exact copy of the original in PDF format), I expected to

quickly skim the entire document and finish it within a minute. However, I found that it was written almost like a novel with an unexpected twist ending that initially kept me guessing as to who would prevail.

Ginger Young filed a Chapter 7 consumer petition in April 2004. Just five months later, the trustee, John S. Pereira, brought an adversary proceeding (Pereira v. Young, Adv. Pro. No. 04-1476-ess) in which he alleged five claims for relief. Essentially, he argued that the debtor, a paraprofessional employed by the N.Y.C. Department of Education, sold her single-family home just six months before filing, netting \$78,000, and that since the debtor could not account for where the money went, she should be denied a discharge. In addition, the debtor depleted \$62,000 in pension distributions in the year before filing and was barely able to account for



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where those proceeds went.

The trustee argued that under Code section 727(a)(3), the debtor's discharge should be denied because the debtor failed to keep or preserve recorded information; that under section 727(a)(4), the debtor knowingly withheld books and records relating to the debtor's financial affairs; and that under section 727(a)(5) the debtor was unable to satisfactorily explain the losses of assets. Judge Stong quickly pointed out that if the trustee succeeded under any one of these provisions, the debtor would not be entitled to a discharge.

The debtor denied the trustee's allegations. Although the trial started in June 2005, the parties agreed to postpone the trial in an

effort to reach a disposition through Court-referred mediation. When the parties were unable to reach a settlement over the course of almost a year, the trial was concluded in 2006, and this judicial opinion followed.

Half-way through the written decision, Judge Stong found that the documents that the debtor produced did not permit the trustee to determine the debtor's financial condition with completeness and accuracy. In particular, they did not enable the trustee to determine what the debtor did with the \$140,000 that she received from the sale of the house and from the pension distributions.

At this point, I thought for sure that the debtor was a dead duck. After all, I have witnessed trustees examining countless debtors (clients of other attorneys, of course) as to pre-petition loss of assets and the inability to produce satisfactory documents. These debtors would often come up with the flimsiest of excuses or no explanation whatsoever. In each case, it would merely be a question of time before the debtor's counsel would reach a settlement with the trustee, or in rare cases, the trustee would seek to bar the debtor's discharge, as here. I therefore wondered why there was such a lengthy decision in what seemed to be a slam-dunk case against the debtor. Furthermore, the Judge pointed out that since the trustee established his case, the burden shifted to the debtor.

The debtor claimed that her failure to keep adequate records was justified because she was the victim of physical and emotional domestic abuse by a boyfriend. I thought the debtor was grabbing for straws. She even brought in her therapist as an expert witness.

However, Judge Stong then addressed each of the trustee's claims carefully and methodically. She clarified each of the material elements necessary for the trustee to be successful and for the debtor to

adequately defend. In doing so, Judge Stong provided a thorough summary of the case law in this area. In the end, she found that even though the debtor was unable to produce documents or explain exactly where the money went, she was justified in doing so.

The reason was that her boyfriend engaged in extreme coercion and control, and the debtor was indeed a victim of domestic abuse. The debtor testified that the boyfriend repeatedly threatened her life. Essentially, the boyfriend stole her money. The debtor was so traumatized, which was supported by the testimony of her counselor, that it was reasonable to conclude that she could not maintain her papers. The debtor also had to move hurriedly, and had to discard most of her possessions in moving from a house to a small apartment. The judge found that discarding documents under these circumstances did not amount to intentional neglect or indifference to proper record keeping. The judge commented that the debtor's testimony was credible and that her courtroom demeanor evidenced the debtor's good faith.

Now for the legal principles. Two general starting points behind all bankruptcy issues such as this are that bankruptcy relief is a privilege, not a right, and should only inure to the benefit of the honest but unfortunate debtor; and the denial of a discharge is an extreme penalty and must be construed liberally in favor of the debtor.

If a trustee can demonstrate that a debtor failed to satisfactorily explain the loss of assets or the unavailability of documents, then the trustee has met his burden of proof in seeking to deny a debtor of the right to a discharge. However, this merely shifts the burden of proof to the debtor as to whether there is a satisfactory explanation. Here, the question in each instance becomes

one of reasonableness under the particular circumstances and whether the debtor's conduct was justified.

The bankruptcy court has broad discretion in determining what is reasonable. When it comes to the inability of a debtor who is in business to explain a loss of records, the court can look to a number of factors including: (1) whether the debtor was engaged in business, and if so, the complexity of the business; (2) the amount of the debtor's obligations; (3) whether the failure to keep records was due to the debtor's fault; (4) the debtor's education, experience and sophistication; (5) the customary business practices for record keeping in the debtor's type of business; (6) the extent of any egregious conduct on the debtor's part; and (7) the debtor's courtroom demeanor.

With regard to a consumer debtor, the standard is slightly different. Here, the issue of justification depends largely on what a normal, reasonable person would do under the circumstances. For example, a typical consumer debtor may discard credit card statements shortly after receiving them.

Another major factor the court considers is whether the debtor "knowingly and fraudulently" withheld information from the trustee.

Most cases seem to focus on whether the debtor's explanation was "satisfactory" -- a question of broad interpretation left up to the discretion of the court.

I urge you to check out this case and to look for other reported decisions in the future. When logging into E.C.F., just go to the tab for "Reports" and then click on "Written Decisions."

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