UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of	:	
MARK A. SHEROD, f/d/b/a THE SHEROD COMPANY,	:	Case No. 89-2007-C H
Debtor.	:	Chapter 7
ROBERT D. TAHA,	:	
Plaintiff,	:	Adv. No. 89-0167
v.	:	
MARK A. SHEROD, f/d/b/a THE SHEROD COMPANY,	:	
Defendant.	:	

RULING ON COMPLAINT OBJECTING TO DISCHARGE OF DEBTOR

A trial was held on May 29, 1990, regarding the Trustee's objection to discharge. Robert D. Taha appeared as Trustee, and Gary R. Hassel appeared on behalf of Defendant. The parties presented a joint trial stipulation in which they agreed the case would be considered solely on documentary evidence submitted to the court. The parties waived any evidentiary objections and agreed the Court would determine the case based on the weight and sufficiency of the evidence submitted. The Court has taken the matter under advisement and considers it fully submitted.

This is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(j). The Court, upon review of the evidence submitted and applicable case law, now enters its findings and conclusions pursuant to Fed. R. Bankr. P. 7052.

FINDINGS OF FACT

1. Defendant, Mark A. Sherod, had been employed in the construction industry as a carpenter.

2. In 1986, Defendant began his own construction business, the Sherod Company. A quarterly tax return submitted in evidence reveals that at one time the Sherod Company employed at least 12 people.

3. In late summer of 1987, upon the recommendation of his pastor, Defendant hired Dave K. Rittman to handle the financial aspects of his business and to maintain company records.

4. Several months after hiring Rittman, Defendant authorized Rittman's signature on all Sherod Company accounts.

5. After hiring Rittman as business manager, Sherod noticed the company seemed to have trouble making ends meet despite the profit the company was making on its projects. There is no proof that Defendant took any action to review the company's records to determine whether company funds and records were being properly maintained.

6. In November 1988, a potential investor sought to have his accountants review Defendant's books. Rittman gathered financial information for Defendant to turn over to the auditors and then left on vacation. Rittman did not return to Defendant's employment. At that time Defendant

became very much aware of his company's poor financial situation and its lack of adequate financial data and records, but did not take any action to correct the status of the financial records.

7. Defendant filed for Chapter 7 relief on September 13, 1989.

8. Defendant's Statement of Financial Affairs for a Debtor Engaged in Business indicates no formal books and records were kept.

9. On November 24, 1989, Trustee Robert D. Taha, filed a complaint objecting to Debtor's discharge. The complaint alleges "Defendant has failed to keep or preserve books, records, documents, and papers from which his financial condition or business transactions might be ascertained."

10. Defendant filed an answer on December 14, 1989. Defendant denied that he failed to keep or preserve books, records, documents and papers from which his financial condition or business transactions might be ascertained. Defendant did admit "that his bookkeeping methods and practices have been historically inadequate to accurately monitor the business position of the Defendant."

CONCLUSIONS OF LAW

Bankruptcy Code §727(a) sets out ten non-exclusive grounds upon which the court can deny a debtor's discharge. 11 U.S.C. §727(a). An action brought under §727 is the most

serious non-criminal action a creditor can bring against a debtor in bankruptcy. In re Schermer, 59 B.R. 924, 924 (Bankr. W.D. Ky. 1986). Discharge under §727 "is the heart of the fresh start provisions of the bankruptcy law." In re Nye, 64 B.R. 759, 762 (Bankr. E.D.N.C. 1986) (quoting H.R. Rep. No. 595, 95th Cong. 1st Sess. 384 (1977), U.S. CODE CONG. & ADMIN. NEWS 1978, pp. 5787, 6340). Consequently, objections to discharge are construed liberally in favor of debtors and strictly against the objecting creditor. In re Schmit, 71 B.R. 587, 589-90 (Bankr. D. Minn. 1987); In re Usoskin, 56 B.R. 805, 813 (Bankr. E.D.N.Y. 1985). The burden of proof in objecting to discharge rests with the plaintiff. Fed.R.Bankr.P. 4005.

At issue is whether Defendant should be denied a discharge pursuant to 11 U.S.C. §727(a)(3). That section provides:

> (a) The court shall grant the debtor a discharge, unless--
>
> (3) the debtor has 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.

The parties have stipulated that there are only two issues in this case. The first issue is whether or not Defendant failed to keep or preserve books, records, documents and papers from which his financial condition or business transactions might be ascertained. The second issue concerns whether or not the Trustee in challenging Defendant's discharge pursuant to §727(a)(3) is required to show "bad faith or an intentional act or omission on the part of the defendant to frustrate creditors or the trustee in the administration of the estate." The court will address this latter issue first.

§727(a)(3)--Intent Requirement

In his answer the Defendant claims that "without a showing of bad faith or an intentional act or omission on [his part] to frustrate creditors or the trustee in the administration of the estate," no cause exists for denying his discharge. This court rejects Defendant's argument and holds §727(a)(3) requires neither intent or bad faith to deny a discharge.

Until 1926 the statutory sections of the Bankruptcy Act from which §727(a)(3) of the Code is derived contained specific language requiring either a "fraudulent intent to conceal" or an "intent to conceal." See e.g. In re Brice, 102 F. 114, 115 (S.D. Iowa 1900) (failure to keep proper books is

not sufficient to deny discharge absent evidence of fraudulent intent to conceal). Removal of the "intent" language in 1926 was regarded as a material change which lessened the burden imposed upon objecting creditors. 4 Collier on Bankruptcy, ¶ 727.03[1] (1st ed. 1990); see also Nix v. Sternberg, 38 F.2d 611, 612 (8th Cir. 1930) (removal of burden of proving intent to conceal was significant change), cert. denied, 282 U.S. 838, 51 S.Ct. 20, 75 L.Ed. 744 (1930). Creditors are no longer required to prove intent when challenging a debtor's discharge pursuant to §727(a)(3). See In re Gross, 188 F.Supp. 324, 329 (N.D. Iowa 1960) (failure to preserve records is not excused because the bankrupt may have lacked intent to deceive), rev'd on other grounds sub nom. Gross v. Fidelity & Deposit Co. of Maryland, 302 F.2d 338 (8th Cir. 1962); 1 Norton Bankruptcy Law & Practice, §27.19 (1987) (§727(a)(3) does not require proof of intent to defraud).

Numerous courts in other jurisdictions have also concluded §727(a)(3) contains no intent requirement. See In re Graham, 111 B.R. 801, 806 (Bankr. E.D. Ark. 1990) (there is no intent requirement under §727(a)(3) only a reasonableness requirement); In re Rusnak, 110 B.R. 771, 775-76 (Bankr. W.D. Pa. 1990) (intent to conceal one's financial condition is not a necessary element to support denial of a discharge for failure to keep records); In re Minesal; 81 B.R. 477, 481 (Bankr. E.D. Wis. 1988) (intent is not a prerequisite element

under §727(a)(3)); In re Shapiro, 59 B.R. 844, 848 (Bankr. E.D.N.Y. 1986) (an intent to conceal information is not necessary to support a denial of discharge under §727(a)(3)); In re Brown, 56 B.R. 63, 66 (Bankr. D.N.H. 1985) (intent to conceal financial condition is not a necessary element to support denial of discharge for failure to keep records). Contra, Matter of Davison, 73 B.R. 726, 730 n. 23 (Bankr. W.D. Mo. 1987) (element of intent is necessary for §727(a)(3)).

§727(a)(3)--Sufficiency of Defendant's Records

Having determined that §727(a)(3) encompasses no intent requirement, this Court must now decide whether Defendant's records are sufficient. The purpose of §727(a)(3) is to ensure that dependable information is supplied to the trustee and to creditors upon which they can rely in tracing a debtor's financial history. In re Devine, 11 B.R. 487, 488 (Bankr. D. Mass. 1981). A trustee and creditors are entitled to complete and accurate information showing what property has passed through a debtor's hands in the period prior to his bankruptcy. Id; see also In re Schultz, 71 B.R. 711, 716 (Bankr. E.D. Pa. 1987).

Unlike other subsections of 11 U.S.C. §727, §727(a)(3) addresses pre-petition conduct and mandates that the failure to keep or preserve records will taint a debtor's request for

equitable relief in bankruptcy. See In re Johnson, 80 B.R. 953, 960 (Bankr. D. Minn. 1987), aff'd 101 B.R. 997 (D. Minn. 1988). Full financial disclosure is a condition precedent to the court's grant of a discharge. Broad Nat'l Bank v. Kadison, 26 B.R. 1015, 1018 (D.N.J. 1983). The production of records is a reasonable "quid pro quo" for a debtor's relief from substantially all of his financial obligations. In re Devine, 11 B.R. at 489.

A court has reasonably wide discretion in determining whether a debtor's records satisfy the statutory requirements of §727(a)(3). Shapiro, 59 B.R. at 848; Brown, 56 B.R. at 66. A debtor's records will be deemed adequate if they reflect the debtor's finances with a fair degree of accuracy and in a manner appropriate to the debtor's business. Shapiro, 59 B.R. at 848. A debtor's records need not be perfect, but must be kept in an intelligent fashion that will reqsonably allow for reconstruction of the debtor's financial condition. In re Dias, 95 B.R. 419, 422 (Bankr. N.D. Tex. 1988).

Whether a failure to keep records will be justifiable is a question of fact to be determined in each instance according to the particular circumstances of the case. Rusnak, 11 B.R. at 776. What is required of the debtor is that he take such steps as ordinary and fair dealing and common caution dictate to enable the creditors to learn what he did with his estate. Id.

In determining if a debtor's records are sufficient, a court should consider the following factors: the complexity and volume of a debtor's business; the amount of a debtor's obligations; whether a debtor's failure to keep or preserve books and records was due to the debtor's fault; a debtor's education, business experience and sophistication; the customary business practices for record keeping in the debtor's type of business and the degree of accuracy disclosed by the debtor's existing books and records. Minesal, 81 B.R. at 481.

The record in this case reveals that in addition to the schedules required to be filed in a bankruptcy case, Defendant has submitted the following documents for consideration by the court:

1) Defendant's 4-page letter (dated January 18, 1990) to his attorney explaining his financial condition and lack of business records.
2) Loan documents which represent notes payable to Brenton National Bank from May-August 1988.
3) An August 10, 1989 Brenton National Bank statement which reflects no credits or debits and a balance of 70 cents.
4) Four duplicates of West Bank records--all of which appear to be blank.
5) Employer's quarterly federal tax returns for the

quarters ending March 31, 1988 and June 30, 1988.

6) A four-page document dated May 11, 1988, entitled "Summary of Collateral."

7) A list of personal withdrawals Defendant made from company funds between September 1, 1987 and August 31, 1988.

8) An accounts payable summary for November 1988 and a copy of an unsigned W-3 tax statement.

9) Copies of bills for attorney fees and correspondence regarding litigation.

10) Thirty-one pages which consist of notes payable to East Des Moines National Bank from June-November 1988.

Noticeably absent from Defendant's records is information regarding accounts receivable during the company's three-year existence prior to the filing of bankruptcy. Apparently no general ledgers were kept and none of the records reveal the costs incurred or revenues realized from Defendant's separate construction projects. Neither checkbook registers nor canceled checks were submitted to show how company funds were applied. Only one balance statement and one summary of accounts receivable were submitted and they provide no meaningful insight regarding Defendant's financial transactions. Likewise, the few tax records provided by Defendant are insufficient to be of assistance in this matter.

The purpose of §727(a)(3) is to enable a trustee or creditors to ascertain "the true status" of a debtor's affairs." Matter of Ellison, 34 B.R. 120, 123 (Bankr. M.D. Ga. 1983). Defendant's records are woefully inadequate to achieve this purpose.

Defendant's letter to his counsel (submitted as an exhibit in this case) suggests his inability to produce records is justified by his reliance on Dave Rittman, his business manager, to prepare and maintain business records. As a general rule, a debtor's duty to preserve business records is not a delegable duty and reliance on an agent to keep business records is not a justification under §727(a)(3). 4 Collier on Bankruptcy, ¶727.03[2] (1st ed. 1990); see also In re Levine, 107 B.R. 781, 784 (Bankr. S.D. Fla. 1989) (debtor as a matter of law is responsible for keeping accurate business records and the duty is not delegable); Matter of Escobar, 53 B.R. 382, 385 (Bankr. S.D. Fla. 1985) (same). But see In re Zell, 108 B.R. 615, 628 (Bankr. S.D. Ohio 1989) (debtor's heavy reliance on bookkeeper to document transactions was mitigating factor in determining debtor had not failed to keep sufficient records).

While business realities may necessitate the delegation of some business functions including record keeping, a defendant may not abdicate his duty to provide oversight and

to ensure that his agents are maintaining necessary business records. Defendant failed to offer any explanation for failing to oversee Mr. Rittman and verifying that business records were prepared and preserved. Furthermore, Defendant's delegation of record keeping to Dave Rittman does not explain the absence of business records prior to Rittman's employment in late summer 1987, nor after his termination of employment in November 1988.

Defendant has failed to keep or preserve records from which his financial condition or business transactions might be ascertained. Defendant has not offered sufficient justification for failing to keep those records and his discharge must be denied pursuant to 11 U.S.C. §727(a)(3).

ORDER

IT IS HEREBY ORDERED that Defendant's discharge must be denied for failing to keep or preserve records pursuant to 11 U.S.C. 727(a)(3).

Dated this __2nd_____ day of November, 1990.

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Russell J. Hill
U.S. Bankruptcy Judge