

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

IN RE:

WILLIAM T. TAGG,
Debtor.

BK #89-20501-WHB
Chapter 7

COMMERCIAL BANK AND TRUST COMPANY,
Plaintiff,

v.

Adversary Proceeding
No. 89-0132

WILLIAM T. TAGG,
Defendant.

and

ROGER E. FAKES,
Plaintiff,

v.

Adversary Proceeding
No. 89-0133

WILLIAM T. TAGG,
Defendant

and

WILLIAM WALDREP, COMMERCIAL
BANK & TRUST COMPANY, and ROGER E. FAKES,

Plaintiffs,

v.

Adversary Proceeding
No. 89-0137

WILLIAM T. TAGG,
Defendant.

MEMORANDUM OPINION AND ORDER ON OBJECTION TO DISCHARGE

These three adversary proceedings were consolidated for the purpose of trying the issue of an objection to discharge, with the Court reserving the issues of determination of dischargeability of specific debt raised in adversary proceeding number 89-0132 and 89-0133. Because of the Court's ruling herein, it will be unnecessary to address further the complaints seeking determination of dischargeability of certain debts, the Court having concluded that the general discharge would be denied.

At issue in adversary proceeding number 89-0137, filed by the three named plaintiffs, was an objection to the general discharge under 11 U.S.C. §727(a)(3) which provides as follows:

(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;

CONCLUSIONS OF LAW

As this Court has previously observed in Walter C. Drake, Trustee v. Marshall Woodrow Chandler and wife, Opal Chandler, Case Number 86-10320-B, Adversary Proceeding Number 86-0142, in an opinion dated February 2, 1989:

"The record keeping requirement of §727(a)(3) is imposed to enable creditors to ascertain the true status of the debtor's affairs and to test the completeness of disclosure required for discharge. However, in accordance with the 'fresh start' policy of the Bankruptcy laws, it is to be construed liberally in favor of the debtor and strictly against the complaining creditor. See, In re Becker, 74 B.R. 233 (Bankr. E.D. Tenn. 1987).

Therefore, the Bankruptcy Court has wide discretion in determining whether a debtor should be denied discharge for failing to keep adequate records. See, e.g., In re Drenckhahn, 77 B.R. 697 (Bankr. D. Minn. 1987); In re Parker, 85 B.R. 384 (Bankr. E.D. Va. 1988). In determining whether a discharge should be denied pursuant to this section, the Court should consider all of the debtor's circumstances, including education, experience, sophistication, volume of business, and amount of credit extended. In re McCall, 76 B.R. 490 (Bankr. E.D. Pa. 1987).

To be entitled to a Chapter 7 discharge, a debtor's records need not be perfect, but must be kept in intelligent fashion, and must, at least,

reasonably allow for a reconstruction of the debtor's financial condition. In re Schultz, 71 B.R. 711 (Bankr. E.D. Pa. 1987)."

In its only treatment of §727(a)(3) under the Bankruptcy Code, the Sixth Circuit affirmed a bankruptcy court's denial of discharge under §727(a)(3), wherein the Bankruptcy Court found that the debtor's "creditors were unable to ascertain [the debtor's] financial condition and business transactions," and that other factors existed, including the debtor's lack of maintenance of "books, accounts or records of his own personal affairs." In re Dolin, 799 F. 2d 251, 253 (6th Cir. 1986). Further, in the Dolin case, the Sixth Circuit found no evidence that the debtor's "chemical dependency or compulsive gambling interfered with his ability to keep records." Id. This is significant in this case only because the Court, in discussing the Dolin debtor's alleged difficulty in keeping records, commented in footnote 1 that voluntary decisions which interfered with the maintaining of records would not be a justification for failure to keep records. Id.

In a case involving a similar debtor, in the sense that the debtor was investing funds on behalf of investors, the Bankruptcy Court for the Eastern District of Virginia denied discharge under §727(a)(3) when that debtor "handled funds belonging to other people without keeping any kind of accurate records or identifying individual accounts." In re Baxter, 96 B.R. 58, 61 (Bankr. E.D. Va. 1989). "More important for this action," the Baxter Court observed, the failure to keep records "prevented the debtor's creditors, as well as this Court, from being able to ascertain the debtor's financial condition." Id. The Baxter Court went on to observe that the underlying purpose of §727(a)(3) "is to make the privilege of discharge dependent upon a true presentation of the debtor's financial affairs." Id. at 60, quoting In re Tackett, 67 B.R. 354, 359 (Bankr. E.D. Tenn. 1986), citing In re Underhill, 82 F. 2d 258, 260 (2nd Cir. 1936), cert. denied, 299 U.S. 546, 57 S. Ct. 9, 81 L. Ed. 402 (1936).

In those situations where a debtor fails to keep records, the debtor must justify such a failure, and in the absence of a plausible justification, discharge should not be granted. In re Dias, 95 B.R. 419, 422 (Bankr. N.D. Texas 1988), citing In re McNamara, 89 B.R. 648, 653 (Bankr. N.D. Ohio 1988). In the Dias case, the debtor failed to keep any type of ledger, tax records, or records of expenses. This does not mean, however,

that a debtor is "required to maintain books and ledgers that would pass muster under generally accepted accounting principles. However, [a debtor] is obligated to maintain minimal financial records which would provide creditors with basic information regarding [the debtor's business or financial activity]." In re Dias, 95 B.R. at 422. Ultimately, as Dias observed, "since the debtor obtains the 'fresh start' with a discharge of debts, the debtor has the burden under §727(a)(3) to maintain and produce adequate financial records." Id. at 423.

In making a determination about the debtor's justification for failure to keep or produce records, as well as in evaluating the reasonableness of the records produced, Judge Clive W. Bare pointed to several factors, including the "education, experience and sophistication of the debtor; the volume of the debtor's business, the complexity of the debtor's business, the amount of credit extended to debtor in his business; and any other circumstances that should be considered in the interest of justice." In re Becker, 74 B.R. 233, 236 (Bankr. E.D. Tenn. 1987), citing Seidle v. Escobar, 53 B.R. 382, 384 (Bankr. S.D. Fla. 1985) quoting Milam v. Wilson, 33 B.R. 689, 692 (Bankr. M.D. Ga. 1983).

In summary, what the Becker case and its predecessors teach is that the Bankruptcy Court must look at the totality of the circumstances in evaluating whether the debtor maintained records and whether the amount of records and nature of records maintained were reasonable, and if the debtor failed to maintain adequate records, is the debtor's explanation a reasonably justified one.

FINDINGS OF FACT AND CONCLUSIONS OF LAW
AS APPLIED IN THE PRESENT CASE

The failure of a debtor to maintain adequate records is an obvious problem for creditors, such as in the present case, in that, among other things, it prevents the creditors from being able to evaluate whether they have other grounds to object to the debtor's discharge. Here, the objecting creditors asserted that they were unable to determine whether they should plead other sections under 11 U.S.C. §727(a) because of their inability to obtain records from the debtor.

A striking fact in this case is that the adversary proceeding objecting to discharge was filed on June 27, 1989. An answer was filed on August 2, 1989, which answer alleges that the debtor has "not been given a

full and fair opportunity to provide those records which are specifically needed by the plaintiffs. Given that opportunity, he believes that he will be able to account for each and every transaction and each and every document which would be germane to a complaint objecting to discharge." Further, in the answer, it is admitted that at the debtor's Rule 2004 examination, "the debtor indicated that he did not have in his personal possession some records from his previous transactions. However, he would allege that given a fair and full opportunity to provide these records, he would be able to do so." A pre-trial order was entered on August 22, 1989, setting this trial for November 16, 1989, and that pre-trial order provided that the discovery for all parties was to be complete by the trial date. Therefore, the defendant had notice from service of the complaint on him on July 10, 1989, of the issue presented concerning §727(a)(3). The defendant had obviously consulted with his attorney, who filed an answer on behalf of the defendant alleging that the defendant could produce records if given an opportunity. No deadline for production of documents was set in the pre-trial order. However, the debtor/defendant appeared at the trial on November 16 and testified that he did not yet have certain records, did not know that they were being requested, and that if given a further opportunity, he could produce them. In general, the Court found Mr. Tagg not to be credible in his testimony concerning books and records. The debtor exhibited a cavalier attitude in his testimony.

The testimony of the defendant established that from January, 1987, forward in his business of trading in the futures market, under a sole proprietorship known as Tagg Trading, he only had eight or nine customers. Yet, the debtor had virtually no records to substantiate what had happened with those investors' funds. The plaintiffs had obtained, through the defendant's banks, copies of bank statements and some cancelled checks. The defendant had no segregated banking accounts in which he maintained his clients' funds. Rather, the defendant commingled in his accounts the funds of various clients, loans from relatives, transfers from other bank accounts to cover insufficient funds, and personal transactions. The incompleteness of the debtor's records is illustrated by the fact that the debtor testified that he had invested all of his client's funds; however, the bank records available and introduced into evidence demonstrated that this was not always so. For example, in exhibit 5 (being a summary of the debtor's various bank accounts in portions of

1987 and 1988), it is clear that on August 14, 1987, the debtor opened a First Tennessee account with a \$30,000.00 check, which he testified was obtained from Mr. Jack Belz for investment purposes. On August 17, from that account, the debtor paid Paine, Webber, \$25,000.00, which appeared to be the Belz money. While the debtor testified that he was certain that the money was placed into investments, the First Tennessee account reflects that of the \$5,000.00 remaining, substantial payments were made in the next several days for non-investment items, often purely personal expenditures. The debtor never supplied testimony or evidence of where the balance of the Belz money was invested. A similar pattern is reflected for other investments in the exhibits.

The debtor testified that he understood that he acted in a fiduciary capacity, but then stated that "most of the money can be accounted for and that he was 'pretty sure' that he could provide records," concluding that it was no problem for him to provide records. The debtor admitted that he kept no ledgers on each investor, and no records were produced to the Court to demonstrate that the debtor could account for the disbursement of funds he had obtained from his clients or investors. The debtor testified that statements from the various investment or clearing houses would show the income from the various investments; however, the records that the debtor produced at trial, and which he had not shown to opposing counsel prior to the trial, were incomplete and inconclusive as to how the debtor had invested his clients' funds.

In substance, the debtor's explanation was that his investments were poor and that he had lost his clients' money on most if not all occasions. And while it certainly may be true that the debtor was a poor investor for his clients, the debtor nevertheless has an obligation under §727(a)(3) to account for both income and losses. Both the debtor's sparse records and the debtor's testimony failed to explain what had happened to various individual's funds.

In view of the fact that the debtor had very few clients, and operated over a short period of time in 1987 and 1988, there clearly was no undue burden for the debtor to maintain minimal records that would show where each client's funds were invested, what happened to those funds, and to otherwise show the debtor's financial transactions.

The nature of the debtor's bank records introduced into evidence demonstrate a commingling of funds, payment of personal expenditures, and a general disregard for any fiduciary responsibility to his clients. In fact, most of the accounts operated in an overdraft position. For example, the Commercial Bank and Trust account was in substantial overdraft almost its entire existence. The same is true for the First City Federal Savings Bank account. There is some evidence that the debtor was utilizing funds from one account to cover checks written from other accounts, and while the Court does not need to conclude that the debtor was kiting checks, nevertheless, the nature of the records indicate that the debtor was engaging in a pattern of use of client's funds in an inappropriate manner. Clearly, the debtor failed to keep records of his accounts, and it could be concluded that the debtor knowingly failed to keep records in order to cover up the true nature of his transactions. The debtor also often engaged in cash transactions, making cash deposits, withdrawing cash and, as he admitted, "always trying to cover checks he had written."

As further evidence of the debtor's failure to keep records, the debtor obtained a loan from the Commercial Bank and Trust for \$25,000.00, used those funds to open an account on September 24, 1987, in that bank, and immediately withdrew, in cash, the \$25,000.00. The debtor testified that he obtained this loan to buy computer equipment, but the evidence is that he only purchased, at most, \$3,000.00 to \$5,000.00 worth of equipment. On the same date as the withdrawal of \$25,000.00 from the Commercial Bank and Trust, the debtor made a deposit in that amount in his First Tennessee account, and the debtor could not explain adequately what had happened to that deposit.

At one point, the debtor said that he had ledgers of funds that he had repaid to some investors, but he did not have them with him. It is incredible that a debtor, faced with an objection to discharge under §727(a)(3), and knowing of that issue for months in advance of the trial, would come into court on the day of the trial with no records and still testify that he had the records or could obtain them if given more time. This debtor had ample opportunity to produce all records available to him and yet he failed either to make the effort, to obtain the records from other parties, or to otherwise explain his actions. Rather, the debtor's attitude in Court was that he was willing for the plaintiffs to obtain records. In other words, the debtor

attempted to shift the burden from himself to the objecting parties to produce records. While a party objecting to discharge has the burden of proving the elements under §727(a),¹ the debtor has the burden under §727(a)(3), as observed previously, to maintain records.

As observed, the debtor had commingled accounts. He testified that the Union Planters and First Tennessee accounts were intended to be Tagg Trading Company accounts. Yet, those accounts contained evidence that payments were made from them on personal expenditures, family expenditures, and other non-business transactions.

This debtor also failed to maintain tax return records. The debtor testified that he had filed his 1986 return but had not yet filed a 1987 or 1988 return. He then later stated that those returns were complete, but "not quite ready to go." Yet, the debtor also testified that his activities were fairly limited in 1987 and 1988 and that he did not need an accountant or bookkeeper in those years.

While the debtor's testimony on occasion was confusing, the underlying theme was that the debtor attempted to evade his entire responsibility to maintain records, account to his creditors, and justify his actions. Both the creditors and the Court are frustrated in their efforts to evaluate a debtor's financial activities when such incomplete records are kept, as in this case.

This debtor operated on a very limited basis, with few customers, most of whom were known to him personally, and the debtor engaged in speculative financial activities and investments, with his clients' money; yet, this debtor testified as if he had no awareness of his obligation to maintain even minimal records. This debtor testified that he did not keep records from some of the trading houses he dealt with, since it was unnecessary to do so. This debtor attempted to explain or to justify his client's losses by stating that they were aware he would be trading in futures where there was a tremendous risk. However, trading in speculative investments does not reduce a debtor's obligation to maintain records. Common sense would say that such a

¹ See Bankruptcy Rule 4005.

debtor would have an increased obligation to maintain records that would clearly show losses and track the use of all client's funds.

The debtor also attempted to defend by saying that his investors had never asked for records prior to the bankruptcy. Again, this is no excuse to the mandate of the Bankruptcy Code that the debtor maintain records. Once the debtor chooses the forum of the bankruptcy court and seeks bankruptcy discharge relief, the debtor must comply with the requirements of the Bankruptcy Code. This debtor has failed to comply with those requirements.

From all of the evidence, including the testimony of the debtor and other witnesses, and all exhibits, this Court finds and concludes that this debtor failed to maintain even minimal records and that clearly the debtor failed to keep adequate records to comply with §727(a)(3). The Court therefore concludes that this debtor must be denied a general discharge under §727(a)(3). This holding obviates the necessity to consider the other adversary proceedings seeking a determination of dischargeability of debt. Since the underlying discharge is denied as to all creditors, no creditor need have a determination that his or her individual debt is non-dischargeable. These creditors may pursue their nonbankruptcy law remedies against this debtor.

IT IS THEREFORE ORDERED that the debtor's general discharge is denied pursuant to §727(a)(3), and

IT IS FURTHER ORDERED that adversary proceedings numbers 89-0132 and 89-0133 are dismissed as being moot, the general discharge having been denied.

Pursuant to Bankruptcy Rule 4006, the Clerk of this Court will give notice to all creditors that the general discharge of §727 is denied.

SO ORDERED THIS 19th day of January, 1989.

WILLIAM HOUSTON BROWN
UNITED STATES BANKRUPTCY JUDGE

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