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Bankruptcy--Failure to Keep Records as Grounds for Denial of Discharge

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BANKRUPTCY — FAILURE TO KEEP RECORDS AS GROUNDS FOR DENIAL OF DISCHARGE. — *P* appeals from an order granting a discharge in bankruptcy to *D*, a traveling salesman, on the ground that *D* had failed to keep or preserve books of account or records. *Held*, that *D*, who worked for another upon monthly commissions, was justified in not keeping books or preserving bank statements and cancelled checks after he examined them. *Baily v. Ballance.*[1]

The bankruptcy act, as most recently amended, provides: "The court shall grant the discharge unless satisfied that the bankrupt has . . . (2) destroyed, mutilated, falsified, concealed, or failed to keep or preserve books of account or records, from which his financial condition and business transactions might be ascertained, unless the court deems such acts or failure to have been justified under all the circumstances of the case; . . ."[2] The present act represents a restriction on the granting of discharges in that proof of failure to keep records "with intent to conceal" financial condition is no longer required to be proved to sustain an objection to the granting of the discharge.[3] Nor is it now required that failure to keep records should have been "in contemplation of bankruptcy" in order to deny a discharge.[4] Yet it may be noted that the bankrupt may now justify his absence of records by mitigating circumstances.

The bankruptcy court is lodged with reasonably wide discretion in respect to denying a discharge for failure to keep books.[5] The ordinary rule that the discharge is denied where the bankrupt has not kept books of record is thus softened by this discretionary power of the court which will not demand that they be kept where a normal person under like circumstances would not have kept them.[6] The nature and not the size of the bankrupt's enterprise is the principal yardstick for the necessity of keeping books and records.[7] The failure of a traveling salesman to keep books was justified in two similar cases[8] on the ground that the occupation

[1] 123 F. (2d) 352 (C. C. A. 4th, 1941).

[2] 52 STAT. 850, 11 U. S. C. A. § 32 (c 2) (1938).

[3] Bankruptcy act as amended, 44 STAT. 663, c. 406, § 6 (1926); 1 COLLIER, BANKRUPTCY (14th ed. 1940) 1325; Nix v. Sternberg, 38 F. (2d) 611 (C. C. A. 8th, 1930).

[4] Bankruptcy act as amended, 32 STAT. 797, c. 487, § 4 (1903).

[5] Hultman v. Tevis, 82 F. (2d) 940 (C. C. A. 9th, 1936); *In re* Wilson, 19 F. Supp. 807 (S. D. N. Y. 1937); Rosenberg v. Bloom, 99 F. (2d) 249 (C. C. A. 9th, 1938).

[6] *In re* Weismann, 1 F. Supp. 723 (S. D. N. Y. 1932).

[7] *In re* Popik, 18 F. Supp. 717 (E. D. N. Y. 1937).

[8] *In re* Neiderheiser, 45 F. (2d) 489 (C. C. A. 8th, 1930); *In re* Earl, 45 F. (2d) 492 (C. C. A. 8th, 1930).

was such that the bankrupt, who was not accustomed to keeping books, could not ordinarily be expected to keep them in view of the fact that he was working for another and was receiving a comparatively small salary. Similarly, failure to keep books was held to be justified for a country butcher[9], a plumber engaged in a small enterprise[10], a priest[11], a building contractor operating on a small scale[12], and an employee who worked for another.[13]

Further liberty exists in the form in which records may be kept. No particular form of accounting is required, and the fact that the bankrupt has used a crude or careless method of keeping books is not, alone, sufficient to deny the discharge.[14]

The section of the act involved in the instant case being for the protection of creditors, it does not seem improper to make the privilege of a discharge dependent upon reasonable care of the bankrupt in preserving and presenting sufficient records to enable creditors to ascertain the true status of the bankrupt's affairs.[15] The burden of proving justification of the failure to present records rests upon the bankrupt[16], and it is probably true that the salesman in the principal case could well justify his failure to keep books of record because of the nature of his business. But in view of the fact that books of record must be kept for a reasonable time when the nature of the business demands their preservation[17], it is submitted that the court should have considered more fully the fact that the bankrupt destroyed his bank statements and cancelled checks after he had examined them. Although this fact alone might not be enough to deny a discharge, it is worthy of judicial consideration. It is not an unreasonable man who keeps his cancelled checks for a reasonable time after their return to him. Failure to do so might, in some cases, be significant of an attempt to destroy evidence of a "nest egg" set aside by payment of checks to another

[9] Thompson v. Lamb, 263 Fed. 61 (C. C. A. 3d, 1920).
[10] *In re* Hatch, 43 F. (2d) 463 (D. Maine, 1930).
[11] *In re* Opava, 235 Fed. 779 (N. D. Iowa, 1916).
[12] *In re* Arnold, 228 Fed. 75 (D. N. J. 1915).
[13] *In re* McCrea, 161 Fed. 246 (C. C. A. 2d, 1908).
[14] *In re* Weiner, 28 F. (2d) 881 (D. Md. 1928); *In re* Russell, 52 (2d) 749 (D. N. H. 1931).
[15] "The purpose and intent of section 14b of the Bankruptcy Act [now section 14c (2)] is to make the privilege of discharge dependent on a true presentation of the debtor's financial affairs. It was never intended that a bankrupt, after failure, should be excused from his indebtedness without showing an honest effort to reflect his entire business and not a part merely." *In re* Underhill, 82 F. (2d) 258, 260 (C. C. A. 2d, 1936); Koufman v. Sheinwald, 83 F. (2d) 977 (C. C. A. 1st, 1936).
[16] *In re* Miller, 5 F. Supp. 913 (D. Md. 1934).
[17] *In re* Marino, 20 F. Supp. 741 (E. D. N. Y. 1937).

person against the day of an anticipated bankruptcy. While the principal case is probably sound on its facts and in its result, it nevertheless suggests the possibility of a transfer in fraud of creditors by immediate destruction of cancelled checks when they are the only available record in cases where production of other more formal records is not required of the bankrupt.

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BILLS AND NOTES — DISCHARGE — REACQUISITION BEFORE MATURITY BY ACCOMMODATION MAKER. — *D*, comaker with *P*, of a note for the latter's benefit, purchased it before maturity from the holder, and after maturity, exercised the confession of judgment provision in the note to obtain an Ohio judgment against *P*. *D* now brings action against *P* in West Virginia on the judgment, and P seeks to enjoin the prosecution of the action. *Held*, that a state is required to give full faith and credit to judgments recovered in a sister state only if such judgment is valid; and that a judgment rendered by a court of a sister state is not valid unless the court had jurisdiction; and that a judgment note confers jurisdiction of the person on the court only so long as the note remains a legal and subsisting obligation; and that the possession of a note by the accommodation maker at maturity in his own right was a discharge of the note, and so the note conferred no jurisdiction on the Ohio court. *Perkins v. Hall*.[1]

Under the Negotiable Instruments Law, "A negotiable instrument is discharged: . . . (5) When the principal debtor becomes the holder of the instrument at or after maturity in his own right."[2] Two problems immediately present themselves in the instant case. Is an accommodation maker a principal debtor under the act?[3] Did this accommodation maker become the holder of the instrument at or after maturity? The term principal detor is not defined by the act, though the person primarily liable is defined as the one who is by the terms of the instrument absolutely required to pay

[1] 17 S. E. (2d) 795 (W. Va. 1941).

[2] NEGOTIABLE INSTRUMENTS LAW § 119; OHIO GEN. CODE (Page, 1938) §8224; as amended, W. VA. REV. CODE (Michie, 1937) c. 46, art. 8, § 1.

[3] West Virginia has eliminated this question by substituting the term "person primarily liable" for "principal debtor". An accommodation maker is absolutely required to pay a note, and is clearly a primary party as defined by the act. W. VA. REV. CODE (Michie, 1937) c. 46, art, 8, § 1. *Accord*: Marshall County Bank v. Fonner, 113 W. Va. 451, 168 S. E. 375 (1933); Rouse v. Wooten, 140 N. C. 557, 53 S. E. 430 (1906).