

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

August Term, 2013

(Submitted: March 20, 2014 Decided: July 25, 2014)

Docket No. 13-1931

In re ALEXANDER KRAMER, III

BERGER & ASSOCIATES ATTORNEYS, P.C., BRADLEY IAN BERGER,
Plaintiffs–Appellants,

V.

ALEXANDER KRAN, III,
Defendant-Appellee.*

15 Before: STRAUB, SACK, and LOHIER, *Circuit Judges.*

16 The plaintiffs previously brought suit in state court against the debtor and
17 his law partner to recoup fees owed under a referral agreement between the
18 parties. In that action, the state court sanctioned the debtor and his partner for
19 discovery violations arising from their failure to keep and file certain records by
20 striking their answer. The parties eventually settled, and the debtor filed for
21 bankruptcy soon thereafter. The plaintiffs then filed this adversary proceeding
22 in the bankruptcy court, claiming that the deficient record-keeping which led to

* The Clerk of the Court is respectfully directed to amend the official caption to conform to the caption set forth above.

1 sanctions in state court also barred the debtor's discharge under 11 U.S.C.
2 § 727(a)(3). The bankruptcy court (Robert D. Drain, *Judge*) granted the debtor's
3 motion for summary judgment, and the district court (Kenneth M. Karas, *Judge*)
4 affirmed. Because we agree that the debtor was entitled to judgment as a matter
5 of law, the judgment of the district court is hereby

6 AFFIRMED.

7 RONALD COHEN, Wilmington, NC, for
8 Plaintiffs—Appellants.

9 BRUCE L. WEINER, Rosenberg Musso &
10 Weiner LLP, Brooklyn, NY, for Defendant—
11 Appellee.

12 SACK, *Circuit Judge*:
13 Bradley Ian Berger and his law firm, Berger & Associates Attorneys, P.C.,
14 brought suit against Alexander Kran, III, and his law partner in state court in
15 2004 for outstanding fees owed Berger and his firm (hereinafter referred to
16 collectively as "Berger") under a referral agreement between the parties. Because
17 Kran's partnership had failed to file certain documents with the New York State
18 Office of Court Administration as state law requires, Berger had difficulty
19 proving the amount of fees owed. This failure led to discovery sanctions in the
20 state court against the defendants and spurred the parties to settle. Soon

1 thereafter, Kran's partnership dissolved, his former partner died, and Kran filed
2 for Chapter 7 bankruptcy protection.

3 Berger filed an adversary proceeding against Kran in the bankruptcy court
4 contending that 11 U.S.C. § 727(a)(3), which bars discharge if a debtor
5 unjustifiably concealed, destroyed, or failed to preserve recorded information
6 "from which the debtor's financial condition or business transactions might be
7 ascertained," prevented Kran from obtaining bankruptcy relief. The bankruptcy
8 court (Robert D. Drain, *Judge*) granted Kran's motion for summary judgment, and
9 the district court (Kenneth M. Karas, *Judge*) affirmed. Because we conclude that
10 section 727(a)(3) does not bar discharge under the circumstances presented, we
11 affirm the judgment of the district court.

12 **BACKGROUND**

13 In 1992, David Davidson, a New York lawyer, concluded a referral
14 agreement with Berger. Berger would solicit plaintiffs in personal injury cases
15 through advertising and then refer them to Davidson, who would perform all of
16 the legal work and remit forty percent of the fees received to Berger. The
17 following year, Davidson formed a partnership with Kran under the name

1 Davidson & Kran. The partnership continued the arrangement with Berger until
2 sometime in 1996.

3 In 2004, Berger brought an action in New York state court against the firm
4 of Davidson & Kran and against Davidson and Kran individually to collect fees
5 due under the agreement. In the discovery phase of the litigation, Berger sought
6 documents related to the cases referred under the agreement. Although
7 Davidson and Kran supplied some of the requested information, they had either
8 lost or destroyed many of the relevant records. Still other records were never
9 created in the first place, even though state law required them to be filed with the
10 New York State Office of Court Administration. *See* N.Y. Comp. Codes R. &
11 Regs. tit. 22, §§ 603.7, 691.20.

12 Berger moved for discovery sanctions. Although Davidson and Kran
13 supplied additional responsive documents, the state court concluded that they
14 had willfully obstructed discovery, struck their answer to Berger's complaint,
15 and directed a trial on damages. At trial, Berger's expert testified that the
16 amount owed under the referral agreement exceeded \$2 million. Following trial,
17 the parties began settlement discussions, which culminated in May 2007 in a

1 consent judgment awarding Berger \$1.4 million in damages. After the judgment,
2 Davidson & Kran dissolved, and Davidson died soon thereafter.

3 On August 22, 2008, Kran filed for bankruptcy protection under Chapter 7
4 of the Bankruptcy Code. After examining Kran and reviewing his financial
5 records, the Chapter 7 trustee concluded that Kran possessed no non-exempt
6 property that could be reduced to money for the benefit of his creditors. Report
7 of No Distribution, *In re Kran*, No. 08-23193-RDD (Bankr. S.D.N.Y. Nov. 18,
8 2008).¹

9 In December 2008, Berger brought an adversary proceeding seeking to
10 prevent the discharge of Kran's debts pursuant to section 727(a)(3). Kran moved
11 for summary judgment. Berger cross-moved, arguing that Kran's failure to
12 produce documents in the referral fee litigation had complicated Berger's efforts
13 to determine how much was owed under the referral agreement and had led him
14 to accept a settlement far below the amount he had sought in damages. Berger

¹ At the conclusion of a Chapter 7 bankruptcy case, the trustee must provide an accounting to the court, certifying that the case has been "fully administered." Fed. R. Bankr. P. 5009; 11 U.S.C. §§ 704(a)(1), (4) (setting out the duties of the trustee to investigate the financial condition of the debtor and collect and reduce to money all of the debtor's assets). Where, as here, the trustee concludes that no non-exempt property exists to be collected on behalf of creditors, he or she files a "No Asset" report or a "Report of No Distribution." See, e.g., *In re Magee*, 444 B.R. 254, 256 (Bankr. S.D.N.Y. 2011); *In re Cruz*, 254 B.R. 801, 803 (Bankr. S.D.N.Y. 2000).

1 argued that this alone justified denying Kran's discharge, whether or not the
2 record-keeping failures were temporally related to the bankruptcy.

3 The bankruptcy court denied Berger's motion and granted Kran's motion,
4 concluding that because the amount Berger was owed under the referral
5 agreement had been fixed by the parties' settlement agreement, the alleged
6 difficulty in determining damages was irrelevant. The bankruptcy court rejected
7 Berger's contention that section 727(a)(3) did not require a temporal relationship
8 between the alleged failure to preserve records and the bankruptcy. The court
9 concluded instead that the focus of a section 727(a)(3) action was appropriately
10 on the debtor's financial condition during the bankruptcy and his condition for a
11 reasonable period of time before the filing of the bankruptcy petition.

12 The district court affirmed, stating that Berger failed to allege—let alone
13 prove—that Kran's failure to keep the required records had any bearing on the
14 court's ability to ascertain whether he was capable of repaying his creditors. *In re*
15 *Kran*, 493 B.R. 398, 405-06 (S.D.N.Y. 2013). Berger appeals.

16 **DISCUSSION**

17 Under Federal Rule of Civil Procedure 56, applicable in adversary
18 proceedings pursuant to Federal Rule of Bankruptcy Procedure 7056, a court

1 "shall grant summary judgment if the movant shows that there is no genuine
2 dispute as to any material fact and the movant is entitled to judgment as a matter
3 of law." This Court "review[s] the bankruptcy court's findings of fact for clear
4 error and its conclusions of law *de novo*." *In re Cacioli*, 463 F.3d 229, 234 (2d Cir.
5 2006).

6 Berger argues that 11 U.S.C. § 727(a)(3) bars the discharge of Kran's debt.
7 Section 727(a)(3) states:

8 The court shall grant the debtor a discharge, unless . . . the debtor
9 has concealed, destroyed, mutilated, falsified, or failed to keep or
10 preserve any recorded information, including books, documents,
11 records, and papers, from which the debtor's financial condition or
12 business transactions might be ascertained, unless such act or failure
13 to act was justified under all of the circumstances of the case[.]

14 Berger argues that because Kran failed to keep required records relating to the
15 cases referred to him under their agreement, his financial condition could not be
16 ascertained and his debts should not have been discharged.

17 In a proceeding under section 727(a)(3), "[t]he initial burden lies with the
18 creditor to show that the debtor failed to keep and preserve any books or records
19 from which the debtor's financial condition or business transactions might be
20 ascertained." *In re Cacioli*, 463 F.3d at 235. We agree with the bankruptcy court

1 that the inquiry into the debtor's financial condition is limited to the span from a
2 reasonable period of time before the bankruptcy filing through the pendency of
3 the bankruptcy proceedings. We further conclude that Berger has not met his
4 burden to show that the missing records were necessary to ascertain Kran's
5 financial condition during this temporally limited period.

6 "[A] central purpose of the [Bankruptcy] Code" is to allow the "honest but
7 unfortunate debtor" to "reorder [his] affairs, make peace with [his] creditors, and
8 enjoy 'a new opportunity in life with a clear field for future effort, unhampered
9 by the pressure and discouragement of preexisting debt.'" *Grogan v. Garner*, 498
10 U.S. 279, 286-87 (1991) (quoting *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934)).

11 For this reason, we have described section 727, which requires the denial of
12 discharge under certain enumerated circumstances, as "impos[ing] an extreme
13 penalty for wrongdoing, which must be construed strictly against those who
14 object to the debtor's discharge and liberally in favor of the bankrupt." *In re*
15 *Cacioli*, 463 F.3d at 234 (quoting *State Bank of India v. Chalasani (In re Chalasani)*, 92
16 F.3d 1300, 1310 (2d Cir. 1996)) (internal quotation marks omitted).

17 We have long been of the view that, although the Code "make[s] the
18 privilege of discharge dependent on a true presentation of the debtor's financial

1 affairs[,] . . . it is intended" only "that there be available written evidence made
2 and preserved from which the present financial condition of the bankrupt, and
3 his business transactions for a reasonable period in the past may be ascertained."
4 *In re Underhill*, 82 F.2d 258, 260 (2d Cir. 1936) (construing a precursor to modern
5 11 U.S.C. § 727(a)(3)). In light of the admonition to construe section 727 "liberally
6 in favor of the bankrupt," *In re Chalasani*, 92 F.3d at 1310, we see no reason to
7 depart from the established principle that the "financial affairs" which a debtor
8 must adequately document are his circumstances during the pendency of the
9 bankruptcy proceedings and those obtaining "for a reasonable period" prior to
10 the filing of the bankruptcy petition. *In re Underhill*, 82 F.2d at 260.

11 Berger has failed to show that the facts of this case fall within the scope of
12 section 727(a)(3). He provided no evidence establishing either that Kran failed to
13 keep records such that his financial condition or business transactions could not
14 be ascertained during the pendency of the proceedings or for a reasonable time
15 before, or that Berger or the Trustee were impeded in determining whether Kran
16 had other assets that could be used to pay his creditors. Indeed, Kran provided
17 the bankruptcy court with sufficient documentation to permit the trustee in this
18 case to file a Report of No Distribution.

1 Berger's oral argument before the bankruptcy court underscores the
2 insufficiency of his showing. When asked whether he alleged that it was
3 impossible to "discern existing accounts receivable or existing income of the
4 debtor as of the petition date," Berger's attorney answered that "it's quite possible
5 there are still some outstanding cases that were referred from my client," but
6 admitted that "that goes back a few years" to 2007, before Kran's partnership
7 dissolved. Transcript of Oral Argument at 10–12, *Berger & Assocs. Attorneys v.*
8 *Kran*, No. 08-08428 (RDD) (Bankr. S.D.N.Y. Mar. 22, 2011). And when asked to
9 explain how Kran's "omissions preclude[d] the ascertainment of [his] financial
10 condition," *id.* at 23, counsel eventually offered that "the fact that we don't have
11 the records means that we couldn't trace the cash," *id.* at 24, an allegation not
12 made in his summary judgment papers. None of these explanations brings
13 Kran's record-keeping failures within the scope of section 727(a)(3). We therefore
14 conclude that Berger has not met his initial burden under the statute.

15 Finally, we reject Berger's contention that our ruling permits Kran to evade
16 his "legal and ethical duties." Appellant's Br. at 23. Section 727(a) bars from
17 relief a debtor whose misconduct threatens to undermine the just and orderly
18 administration of his bankruptcy, *In re Chalasani*, 92 F.3d at 1311 (explaining that

1 the statute "is directed toward protecting the integrity of the bankruptcy
2 system")²; it does not exist to police the debtor's legal and ethical obligations
3 more generally. We will not apply the "extreme penalty" of denying discharge,
4 *id. at 1310*, to failings so clearly unconnected with the bankruptcy proceeding,
5 especially when the New York courts have already sanctioned Kran for his
6 failure to keep legally required documents.

7 **CONCLUSION**

8 For the foregoing reasons, the judgment of the district court is AFFIRMED.

² Like section 727(a)(3), the other paragraphs of section 727(a) punish actions that hamper the Trustee's ability to collect and distribute non-exempt assets on behalf of creditors. *See* 11 U.S.C. § 727(a)(2) (barring discharge where a debtor "has transferred, removed, destroyed, mutilated, or concealed" property of the debtor or the bankruptcy estate "with intent to hinder, delay, or defraud"); *id.* § 727(a)(4) (barring discharge for certain kinds of debtor fraud "in or in connection with the case"); *id.* § 727(a)(5) (barring discharge for failure "to explain satisfactorily . . . any loss of assets or deficiency of assets"); *id.* § 727(a)(6) (barring discharge if the debtor refuses, "in the case," to obey a court order or, under certain circumstances, to testify).