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Chapter 8 Humor

By Scott K. Brown

Rolling in the Involuntary[1]

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Two summers ago, I was minding my own business doing all the things that normal bankruptcy lawyers do when all of a sudden, a cold-calling business needed help with an involuntary bankruptcy filing. Since that date, I have been involved in exactly three involuntary filings in one form or another. That is enough to qualify me as cynical and sarcastic—the exact qualifications of a Chapter 8 Humor columnist.

Involuntary bankruptcies sends chills up my spine because of 11 U.S.C. § 303(i): "[T]hou and thine lawyer shalt pay massive fees and damages if thou screw up the involuntary filing." I have quoted that statute exactly 1,000 times when I am asked to represent the poor, oppressed (involuntary) debtor that was just on the verge of paying off its creditors but for the ill-timed involuntary filing, or I am fighting the impulse to file an involuntary on behalf of a creditor. Indeed, there are a lot of pitfalls in an involuntary filing, including the following:

1. *Filing an involuntary on behalf of a creditor who holds a claim that is "not contingent as to liability or amount or is the subject of a bona fide dispute as to liability or amount."*[2] It does not matter how rock-solid a claim may be, an involuntary debtor is required by the "involuntary debtor's code of conduct" (hereinafter the "involuntary code"...not to be confused with the Bankruptcy Code) to object to an involuntary filing on this basis. Yes, I have even seen an involuntary debtor object to a claim that was based on a final (nonappealable) judgment, even though unstayed final judgments *per se* establish that there is no *bona fide* dispute as to a debt.[3]

2. *Filing an involuntary when you are unsure how many "holders" of claims there are against the involuntary debtor.* While there may be times that it is perfectly acceptable to "shoot first and ask questions later"—like a discovery dispute[4]—an involuntary is not one of those times. A safe way to avoid this problem is to do a debtor's exam *before* filing an involuntary. Of course, pursuant to the aforementioned involuntary code, an admission before an involuntary is filed does not mean that the facts and recollections won't change after an involuntary is filed.[5]

3. *Deciding to wait until* after *a petition is filed to find out how many other creditors exist and/or which ones are willing to join the petition.* While the Bankruptcy Code (§ 303(c)) and Rules (1003(b)) contemplate creditors joining a petition *after* it is filed, you do not want to encounter any surprises that turn you or your client into the debtors under § 303(i).

4. *Insiders*.[6] I don't even want to go there. Although there is a definition for "insiders," it is voluminous and turns into an even longer definition if you have to look at the meaning of "affiliate." And, of course, most courts hold that the "statutory" definition of insiders is really just a starting point and can mean much, much more for what are creatively called "nonstatutory" insiders.[7]

5. *Have you adequately investigated whether the "involuntary debtor" is paying undisputed debtors as their debts "generally" come due?*[8] Despite using a concise word like "generally," the drafters of § 303(h) probably could have done us all a favor and either omitted that word altogether or defined it in § 101.[9] Again, in the history of bankruptcy there

1 I'd like to thank Grammy-winning British recording artist Adele for inspiring this headline based on her hit "Rolling in the Deep," and I hope she's still popular come November 2012 when this column is published.

2 *See* § 303(b)(1).

3 *See, e.g., In re Marciano*, 446 B.R. 407, 422-27 (Bankr. C.D. Cal. 2010); *In re Ransome Group Investors I LLLP*, 424 B.R. 547 (Bankr. M.D. Fla. 2009); *In re Euro-American Lodging Corp.*, 357 B.R. 700 (Bankr. S.D.N.Y. 2007); 2 *Collier on Bankruptcy* ¶ 303.11[1], at 303-32 (16th ed. 2011).

4 Yes, this is an ill-timed joke. I'm just seeing if you are paying attention.

5 I could swear I have read a case where an involuntary debtor tried this, but I can't find it anymore. The two associates at my firm who worked on the § 303 cases with me disclaim any recollection of such a case.

6 *See* § 303(b)(2).

7 *Wilson v. Huffman (In re Missionary Baptist Foundation of America Inc.)*, 712 F.2d 206, 210 (9th Cir. 1983). Fortunately, the word "means" (used in the "affiliate" definition) precludes the creation of "nonstatutory" affiliates. *See id.*

8 *See* § 303(h).

9 *See, e.g.*, 11 U.S.C. § 101(19B) (Congress is making effort to define term such as "family fisherman with *regular* annual income") (emphasis added).

has never been (that I know of, and I've been doing this since 2000) a time when an involuntary debtor conceded that it was not generally paying its debts as they came due or—this is probably more common—it could/would have been paying them had it not been for the tortious and egregious conduct of the petitioning creditors. If you represent the involuntary debtor, also remember that it is usually not enough to suddenly "get religion" after an involuntary filing and start paying off the old debts.[10]

6. *Don't act in "bad faith."* Pursuant to the "involuntary code," the phrase "bad faith" must be uttered by an involuntary debtor's lawyer at least 15 times per hearing, if not more, depending on the length of the hearing and the judge's temperament. Fortunately for them, neither "bad" nor "bad faith" is not defined in the Bankruptcy Code, so no one can tell him or her to stop saying those words in the case. Instead, one usually has to look at a list (which is neither all-inclusive nor all-exclusive) of about 25 different factors that really just mean that "bad faith" is never tried in a case until the very end and can still prevent a successful attempt at an "order for relief," even if all of the other requirements of § 303 are met.[11]

Despite the many fights that ensue after an involuntary is filed, the cold hard fact of the matter is that the debtor must endure the jaws of the vicious animal known as the "gap period" while it tries to swim to safety. Actually, the word "vicious," as modified by the word "jaws," is a bit of an overstatement. After all, § 303(f) says that a debtor "may continue to operate, and...may continue to use or dispose of property as if an involuntary case concerning the debtor had not been commenced." Of course, what § 303(f) does not cite is all of the other Bankruptcy Code provisions that quietly refer to § 303, like (for example) that super, duper, really extremely broad definition of "property of the estate" under § 541.[12] Once the "estate" word applies to the "involuntary" debtor's property, all sorts of Bankruptcy Code tentacles emerge.[13]

This, of course, can be divined from the legislative history for § 303, although you have to dig really hard to find it and then add a touch of liberal interpretation: "You may have an involuntary bankruptcy mark on your forehead, but don't worry—you can, if you are really diligent and have a lot of cash to spend on attorneys for discovery, trial and almost certain appeals [if you win], possibly win back your dignity and pride...or at least some cash."

Meanwhile, an involuntary debtor may show up at the office one day to find a "gap period" trustee sipping a Coke from the fridge and flipping through the files that were left too long in the "to be shredded" pile. Worse yet, once a trustee is appointed, the chances of overturning an order for relief on appeal have dropped from approximately 1 percent to zero. Within the last year or so, two appellate courts have held that once a trustee is appointed in an involuntary case, the debtor (corporation) cannot appeal an order for relief entered against it. The Tenth Circuit Court of Appeals said that "following the appointment of a trustee in a corporate Chapter 7 bankruptcy, the corporation's former managers are not authorized to bring the corporation's appeal—even if that appeal contests the very initiation of the bankruptcy itself. There is no equitable exception to this rule, nor is there a distinction between voluntary and involuntary debtors."[14]

So how does an oppressed involuntary debtor (and its now-sweating—and usually unpaid—counsel) avoid such a dire result? Request (and obtain) a stay of the order appointing the trustee or have "persons aggrieved"—members, shareholders and so forth—join in the opposition to an involuntary petition or the appointment of a trustee.[15]

Or, perhaps this might work, too: Pay the debts.[16] abi

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10 *See In re Bishop, Rewald, Dillingham & Wong Inc.*, 779 F.2d 471, 475 (9th Cir. 1985) ("The 'generally not paying' test is to be applied as of the date of filing of the involuntary petition."); *see also In re H.I.J.R. Props. Denver*, 115 B.R. 275, 277 n.2 (D. Col. 1990) (because test is applied as of petition filing, concluding that post-petition payments of delinquent accounts are irrelevant); *In re Win-Sum Sports Inc.*, 14 B.R. 389, 392-93 (Bankr. D. Conn. 1981) (same); *In re All Media Props Inc.*, 5 B.R. 126, 144-45 (Bankr. S.D. Tex. 1980) (same); *cf., In re B.D. Int'l Discount Corp.*, 701 F.2d 1071, 1076 n.9 (2d Cir. 1983) (recognizing that statutory language is ambiguous).

11 *Basin Elec. Power Co-op v. Midwest Processing Co.*, 47 B.R. 903, 909-10 (D. N.D. 1984) (reversing bankruptcy court for failure to dismiss involuntary petition that was filed in bad faith for ulterior motives); *In re Bicoastal Holding Co.*, 402 B.R. 916, 919 (Bankr. M.D. Fla. 2009) (dismissing bad-faith involuntary chapter 7 petition, collecting cases); *In re Accident Claims Determination Corp.*, 146 B.R. 64, 67-68 (Bankr. E.D.N.Y. 1992) (same).

12 *See* 11 U.S.C. § 541(a) ("The commencement of a case under section 301, 302 *or 303*...creates an estate.") (emphasis added).

13 *See* C.R. "Chip" Bowles, Jr., "The ABI Chapter 11 Fee Study: Moving Forward Analysis," at 20-26, www.abiworld.org/committees/newsletters/profcomp/vol5num2/Fee.pdf.

14 *In re C.W. Mining Co.*, 636 F.3d 1257, 1265 (10th Cir. 2011); *see also South Edge LLC v. JPMorgan Chase Bank NA*, 2011 WL 1626567 (D. Nev. 2011) (following *C.W. Mining* in chapter 11 case even where appeal was filed after order appointing the trustee, but before trustee was appointed). Don't forget that *C.W. Mining* is famous for another holding relevant to involuntaries: Counsel for a debtor that is subject to a chapter 11 involuntary petition must be employed (and compensated) by the court during the gap period. *In re C.W. Mining Co.*, 440 B.R. 878 (Bankr. D. Utah 2010); *but cf. In re Grabill Corp.*, 113 B.R. 966, 974-75 (Bankr. N.D. Ill. 1990) (fee payment during gap period reviewable under § 329 only); *see also* Bankruptcy Rule 2017(a). If you are interested in this issue, and you should be if you ever represent an involuntary debtor, review the article cited in fn. 14.

15 *See South Edge*, 2011 WL 1626567 at *7-8.

16 Occasionally, a bankruptcy court will abstain from or dismiss an involuntary bankruptcy under § 305, even if all of the requirements of § 303 have been met, but this column is already long enough, so I'll save that topic for another day.