INVOLUNTARY BANKRUPTCY:

WARNING BELLS SOUND!

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INTRODUCTION

"{A]ny petitioning creditor in any involuntary case should expect to pay the debtor's attorney's fees and cost if the petition is dismissed."[3]

If this quotation from a Florida case affirmed by the Eleventh Circuit does not cause a bold creditor to reconsider the filing of an involuntary petition, then perhaps three recent decisions might do so.

In *Wortley v. Chrispus Venture Capital , LLC (In re Global Energies, LLC)*, 763 F. 3d. 1341 (11th Cir. 2014), the Eleventh Circuit reversed both district and bankruptcy court orders denying, in effect, a motion to dismiss an involuntary filing as a bad faith filing. On remand, the bankruptcy court was directed to "conduct any hearings necessary in the exercise of all of its powers at law or in equity and issue appropriate orders or writs, including without limitation orders requiring an accounting and disgorgement, orders imposing sanctions, writs of garnishment and attachment, and the entry of judgments to ensure that [the petitioning creditors and their counsel] do not profit from their misconduct and abuse of the bankruptcy process." Id. at 1350. The only reason that it did not impose those remedies itself, the Eleventh Circuit said, was because those parties had not had "an appropriate hearing" before being sanctioned.

In *In re American Resource & Energy, LLC*, 513 B.R. 371 (Bankr. Ct. D. Minn. 2014), the court dismissed an involuntary chapter 7 petition by summary judgment motion after determining that (a) each of the three petitioning creditors failed to qualify under section 303(b)(1) of the Bankruptcy Code to file a bankruptcy petition because a "bona fide dispute"

[3] *Patraka v. Orlinsky*, No. 09-21903-CMA, slip op. at 6 (S. D. Fla. Dec. 8, 2009) (affirming the bankruptcy court's award of $96,500 in attorney's fees and $4,454.32 in costs where the court found no bad faith on the part of the petitioning creditor) *aff'd,* 417 Fed. Appx. 852 (11th Cir. 2011).

existed with respect to each of their putative claims when they filed the petition that commenced the case and (b) with the disqualification of those parties as petitioners, the joinder of a fourth creditor to the petition post-filing did not satisfy the debt threshold of section 303(b)(2) to allow that party to maintain the petition even if the putative debtor had fewer than twelve creditors in all. For want of a qualified petitioning creditor holding claims in a sufficient amount against the putative debtor, the petition, and the case as a whole, was dismissed. Although both sides had professed a desire for broad discovery, the court resolved the matter by summary judgment as it was "obvious" that disputes existed with respect to the petitioning claims. Clearly concerned about the potential for abuse with involuntary petitions, the court held that the claims of all three petitioners lacked "the solidity, the prima facie sheen of enforceability and consequent recovery, that §303(b)(1) requires to qualify as a petitioning creditor in involuntary bankruptcy."

A third case involved Miami businessperson Maury Rosenberg who obtained a $6.2 million jury award after a finding that an involuntary bankruptcy had been filed in bad faith.[4] The award included $5 million for punitive damages.

Obviously, the size of the Rosenberg award and the holdings in these other cases provide sobering examples for creditors. To the creditor or its lawyer, if the goal is to use an involuntary bankruptcy to damage or destroy a debtor's reputation, intimidate a debtor into a settlement, undermine the debtor's business, or obtain a disproportionate advantage over other creditor's position, or if the case is essentially a two-party dispute with other available remedies, then a loud warning bell should go off in your head. But even for "good faith" creditors, the "bona fide dispute" issues and numerosity concerns should give pause.

[4] At the time of writing this case is on appeal pending before the Eleventh Circuit, Case No. 14-14620.

INVOLUNTARY BANKRUPTCY PROCESS [5]

I. COMMENCEMENT OF AN INVOLUNTARY CASE

Most people who end up in bankruptcy, of course, do so by choosing to file. Often, the notion of a creditor filing an involuntary bankruptcy seems counter intuitive; after all, absent bankruptcy, there is no automatic stay to prevent a creditor's collection efforts. Rarely does a creditor get paid in full if a debtor files bankruptcy. Thus, involuntary cases make up only a small portion of the total number of bankruptcy cases that are filed each year.

The primary statutory provisions for an involuntary bankruptcy proceeding are found in Section 303 of the Bankruptcy Code, although other Bankruptcy Code sections, including sections 105, 109, 305, 330, 362, 363, 364, 502, 503, 507, 523, 549, and 1109, 1501, 1511, come into play. In addition, the Bankruptcy Rules, primarily rules 1002, 1003, 1044, 1010, 1011, 1013, 1018, 2001, and 9011 are applicable, as well as local bankruptcy rules.

As a threshold issue, section 303(a) provides "that [a]n involuntary case may be commenced only under chapter 7 or 11 of this title, and only against a person, except a farmer, a family farmer, or corporation that is not a moneyed, business, or commercial corporation, that may be a debtor under the chapter which such case is commenced."[6] In

[5] Unless otherwise specified, all section references are to Title 11 of the United States Code, 11 U.S.C. §101*, et seq.* (the "Bankruptcy Code" or the "Code").

[6] 11 U.S.C. §303(a). Some commentators have suggested that an involuntary chapter 11 case against an individual, in light of the changes to the Code made by BAPCPA, violates the Thirteenth Amendment's

addition, the person must either reside or have a domicile, a place of business, or property in the United States.[7]

Section 303(b) governs who may file an involuntary case and provides in part —

> An involuntary case against a person is commenced by the filing with the bankruptcy court of a petition under chapter 7[8] or 11 of this title—
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> (1) by three or more entities, each of which is either a holder of a claim against such person that is not contingent as to liability or the subject of a bona fide dispute as to liability or amount, or an indenture trustee representing such a holder, if such noncontingent, undisputed claims aggregate at least $15,325[9] more than the value of any lien on property of the debtor securing such claims held by the holders of such claims;
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> (2) if there are fewer than 12 such holders, excluding any employee or insider of such person and any transferee of a transfer that is voidable under section 544, 545, 547, 548, 549, or 724(a) of this title, by one or more of such holders that hold in the aggregate at least $15,325 of such claims;[10]

The burden of proving that the alleged debtor is subject to an involuntary case is on the petitioning creditors.[11] A petitioning creditor must have standing to file an involuntary

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prohibition against involuntary servitude, such discussion is beyond the scope of this material. *See, e.g.*, Keach, Robert J., "Dead Man Filing Redux: is the New Individual Chapter 11 Unconstitutional?," 13 Am. Bankr. Inst. L. Rev. 438, 500 (2005); 2 COLLIER ON BANKRUPTCY ¶ 303.03, at 310–311 (Alan N. Resnick & Henry J. Sommer eds., 16th ed.).

[7] 11 U.S.C. § 109(a). Section 109(a) is not jurisdictional and therefore, may be waived. 2 COLLIER ON BANKRUPTCY ¶ 303.02, at 303-9 (Alan N. Resnick & Henry J. Sommer eds.,16th ed.).

[8] Thus, persons who are excluded from being debtors under chapter 7 by virtue of Section 109(b) of the Bankruptcy Code, which primarily excludes railroads, banks, insurance company and homestead associations, may not be placed in an involuntary chapter 7.

[9] Dollar amounts are subject to adjustments as provided for in section 104(a).

[10] 11 U.S.C. § 303(b)(1) and (2).

[11] *In re EM Equip., LLC*, 504 B.R. 8, 13 (Bankr. D. Conn. 2013)(The "[p]etitioning creditor[s] bear[s] the ultimate burden of proving that all statutory requirements of.... Section 303 have been met." *In re Palace*

petition; otherwise the bankruptcy court is without jurisdiction and the case will be dismissed.[12]

The process for filing an involuntary petition is relatively straightforward and is initiated by a petitioning creditor or creditors filing Official Form 5[13] against an eligible person.[14] Official Form 5 contains only three allegations to the Involuntary Petition—

> (1) Petitioner(s) are eligible to file this petition pursuant to 11 U.S.C. §303(b)[15]
>
> (2) The debtor is a person against whom an order for relief may be entered under title 11 of the United States code
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> (3) a. The debtor is generally not paying such debtor's debts as they become due, unless such debts are the subject of a bona fide dispute as to liability or amount;
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> or
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> b. Within 120 days preceding the filing of this petition, a custodian, other than a trustee receiver, or agent appointed or authorized to take charge

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Oriental Rugs, Inc., 193 B.R. 126, 128 (Bankr.D.Conn.1996). "Specifically, [the petitioning creditor] bear[s] the burden of establishing the 'jurisdictional' prerequisites of Section 303(b)." *Id.* Similarly, the petitioning creditor "bear[s] the ultimate burden of proving by a preponderance of the evidence that the Alleged Debtor is generally not paying its debts as such debts become due.").

[12] *In re Raymark Industries, Inc.*, 99 B.R. 298 (Bankr. E.D. Pa. 1989).

[13] *See also* Advisory Committing Notes to Official Form 5.

[14] Section 101(41) defines person quite broadly to include an individual, corporation or partnership, but excludes from the definition governmental units, unless they are acting in certain specified roles with respect to the alleged debtor's assets. In addition, Section 101(9) defines "corporation" in an expansive manner as well.

[15] Section 303(b) sets forth the prerequisites for commencing an involuntary petition. The Circuits are split on whether the requirements of §303(b) must be satisfied to convey subject matter jurisdiction over an involuntary case or whether, requirements are merely substantive matters which must be proved before petitioning creditors can prevail in involuntary proceedings. The Eleventh Circuit holds that the Bankruptcy Code's requirements for commencing an involuntary case are not subject matter jurisdiction in nature and therefore, can be waived. *In re Trusted Net Media Holdings, LLC*, 550 F.3d 1035 (2008).

> of less than substantially all of the property of the debtor for the purpose of enforcing a lien against such property, was appointed or took possession.

Since the term "debtor" is in the singular and the term "person" references "individual," an involuntary case should not be filed jointly against a husband and wife.[16] Although courts are split on whether the bankruptcy court lacks subject matter jurisdiction over an involuntary joint petition; some bankruptcy courts take the position that they can do nothing other than immediately dismiss the case,[17] while other courts have severed the case and allowed the involuntary to proceed. [18]

II. THE PARTIES— PETITIONING CREDITOR AND ALLEGED DEBTOR

The petitioning creditor must be an entity as defined in section 101(15), which includes a person, estate, trust, governmental unit, and United States Trustee.[19] A single petitioning creditor may file an involuntary case against the debtor unless the debtor has twelve (12) or more creditors, in which case the petitioning creditor needs at least two other creditors to join in the petition.[20] The sole petitioning creditor has the burden of

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[16] Section 302(a) provides:

> A joint case under a chapter of this title is commenced by filing with the bankruptcy court of a single petition under such chapter *by an individual that may be a debtor* under such chapter and such individual's spouse. (emphasis added)

[17] *In re Jones*, 112 B.R. 770 (Bankr.E.D. Va. 1990)(if the court does not have subject matter jurisdiction over joint involuntary case, a court has no choice but to dismiss the case).

[18] *In re Bowshier*, 313 B.R. 232 (Bankr. S.D. Ohio 2004)(concluding that section 303 requirements for filing of an involuntary petition are nonjurisdictional in nature and therefore, severed the involuntary proceedings against the joint debtors allowing the creditor to proceed against each debtor in separate bankruptcy cases).

[19] 11 U.S.C. §101(15).

[20] 11 U.S.C. §303(b)(2).

showing that an alleged debtor has less than twelve eligible creditors.[21] The creditor or creditors filing the involuntary petition must hold claims aggregating at least $15,325.[22]

For purposes of determining if, a debtor has 12 or more creditors, claims of employees of the debtor, claims of insiders of the debtor, and claims of recipients of transfers voidable under §§ 544 (trustee as a lien creditor and as successor to certain creditors and purchasers), 545 (statutory liens), 547 (preferences), 548 (fraudulent transfers), 549 (post-petition transfers) or 724(a) (penalty claims), are excluded.[23] In addition, petitioning creditor's claims that are barred by the statue limitations should not be considered.[24]

If the debtor believes an involuntary petition was filed with fewer then the requisite number of creditors, the debtor should file an answer as contemplated by section 303(d). When fewer than three creditors file an involuntary petition, the alleged debtor has the burden to raise the issue that it has more than 12 creditors by filing a list pursuant to Bankruptcy Rule 1003, after which the burden shifts back to the petitioning creditors. The fact that a debtor complies with Bankruptcy Rule 1003 is not an admission that the creditor's claim is not contingent as to liability or the subject of a bona fide dispute as to liability or amount.[25]

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[21] *Atlas Mach. & Iron Works, Inc. v. Bethlehem Steel Corp.* , 986 F2d. 709 (4th Cir. 1993).

[22] 11 U.S.C. §303(b)(1).

[23] 11 U.S.C. §303(b)(2).

[24] *In re F.R.P. Industries, Inc.* 73 B.R. 309 (Bankr. N.D. Fla. 1987).

[25] 2 COLLIER ON BANKRUPTCY ¶ 303.31, at 93–94 (Alan N. Resnick & Henry J. Sommer eds., 16th ed.).

If the debtor's answer to the Involuntary Petition asserts that there are twelve or more creditors, then pursuant to Fed. R. Bank. P 1003(b) a petitioning creditor should request a reasonable time within which to join at least two other creditors.[26] If the other creditors join, it is as if they were creditors from the commencement of the case, and the otherwise defective Involuntary Petition is considered cured.[27]

In order to have standing, the petitioning creditor(s) must either be a holder of a claim against the alleged debtor or an indentured trustee representing such holder.[28] The Bankruptcy Code defines "claim" as not only a right to money payment, but also a right to any equitable remedy for breach of performance.[29] Courts have held that for the statute of limitations defense to preclude a petitioning creditor's claim, it must be clear that the creditor's claim would be time barred without the resolution of substantial factual or legal questions.[30]

The claim against the alleged debtor cannot be contingent as to liability or the subject of a bona fide dispute as to liability or amount.[31] Although the term "contingent" is

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[26] Fed. R. Bank. P 1003(b).

[27] 11 U.S.C. §303(c).

[28] 11 U.S.C. §303(b)(1). *See e.g. In re James Plaza Joint Venture*, 67 B.R. 445, 446 (Bankr. S.D. Tex. 1986)(court determined that there was no written agreement between two of the petitioning creditors and the alleged debtor, thus they did not have a claim against the alleged debtor. Since the alleged debtor had more than 12 creditors, the requisite number of petitioners was three, and when the remaining petitioner was unable to obtain joinder of two creditors holding valid claims against the debtor, the case was dismissed).

[29] 11 U.S.C. §101 (5).

[30] *Bartmann v. Maverick Tube Corp.*, 853 F.2d 1540, 1544-45 (10th Cir. 1988)(for a statute of limitations defense to bar a petitioning creditor's claim in an involuntary petition, it must be clear that the creditor's claim would be barred, without the resolution of substantial factual or legal questions.)

[31] 11 U.S.C. §303(b)(1).

not defined in the Bankruptcy Code, contingent claims are those claims that become due only upon the occurrence of a future event which triggers the liability of the debtor to the creditor and such event was within the actual or presumed contemplation of the parties at the time the relationship was created.[32] Moreover, when in doubt as to the existence of claim, courts tend to find that the claim is contingent.[33] By way of example, rent payments under a written lease agreement are generally not contingent whereas the liability of the guarantor may be contingent unless the principal obligor is unable to satisfy the claim.[34] A judgment rendered by a court is generally sufficient to demonstrate that a claim is noncontingent.[35]

The petitioning creditor must serve the alleged debtor with a copy of the Involuntary Petition and a summons within seven (7) days following the issuance of the summons.[36] While the failure to timely serve the alleged debtor may cause an additional burden and expense in defending, Fed. R. Bank. P 7004(j) provides for another summons to be issued for service if service is not made upon the alleged debtor within 120 days after filing of the petition and the party on whose behalf such service was required cannot show good cause why the service was not made within that time period.[37]

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[32] *In re Wilbur*, 237 B.R. 203, 207 (Bankr. M.D. Fla. 1999).

[33] *In re Wilbur*, 237 B.R. 203, 207 (Bankr. M.D. Fla. 1999) citing *Siegel v. Federal Home Mortgage Corp.* (9th Cir. 1998).

[34] See eg. *Subway Equip. Leasing Corp. v. Sims (In re Sims)*, 994 F.2d 210 (5th Cir. 1993).

[35] *In re Wilbur*, 237 B.R. 203, 207 (Bankr. M.D. Fla. 1999)

[36] Fed. R. Bank. P 7004(e).

[37] See *generally*, *In re Usatch*, 155 B.R. 596 (Bankr. S.D. Fla. 1993).

As prescribed by Rule 12 Fed. R. Civ. P. the alleged debtor has twenty-one (21) days after service of the summons to file an answer or other responsive pleading.[38] In the event service of the involuntary petition is effectuated by publication on a party or partner not residing or found within the state in which the court sits, the court may prescribe the time for filing and serving the response.[39]

"The debtor, or general partner in a partnership debtor that did not join in the petition, may file an answer to the petition."[40] Rule 1013 of the Federal Rules of Bankruptcy Procedure provides that if involuntary petition is not timely opposed, as provided by Rule 1011, the court "on the next day, or soon thereafter as practicable, shall enter an order for the relief requested in the petition."[41] Notwithstanding the mandate of Bankruptcy Rule 1013(a) that the court determine the issues pertaining to a contested petition at the "earliest practicable time," for whatever reason gap periods have extended for as long as two years.[42] Therefore, what occurs during this time may considerably affect the alleged debtor's ability to continue business as usual.

III. WHAT HAPPENS BETWEEN PETITION DATE AND ANSWER- THE GAP PERIOD?

The period between the date of the involuntary filing and the date of the entry of order for relief is commonly referred to as the "gap period." The gap period has been

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[38] Fed. R. Bankr. P. 1011(b).

[39] *Id.*

[40] 11 U.S.C. §303(d).

[41] Fed. R. Bankr. P. 1013(b).

[42] *E.g., Wynn v. Eriksson, (In the Matter of R.C. Wynn)*, 889 F.2d 644 (5th Cir. 1989) (25 months lapsed between filing of involuntary petition and entry of order for relief).

described by some as the best of both worlds (voluntary vs. involuntary). On the one hand, the automatic stay goes into effect upon the filing of a petition under section 303, just as it does when a voluntary petition is filed.[43] On the other hand, section 363 does not apply during the gap period, which means that the debtor may continue to acquire or dispose of property as if the involuntary petition had not been filed.[44] However, section 303(f) gives the court power to restrict and limit a debtor's operations during the gap period.[45]

Where there is evidence that the debtor is likely to abscond with assets, waste property or sell goods for less than fair market value, the court may grant appropriate orders to control or limit the debtor's powers. In such a case, a petitioning creditor in an involuntary chapter 7 case may consider filing a motion for the appointment of an interim

[43] Section 362(a) provides that a petition filed under section … 303 of this title…operates as a stay.

[44] Section 303 (f) provides "except to the extent that the court orders otherwise, and until an order for relief in the case, any business of the debtor may continue to operate and the debtor may continue to use, acquire, or dispose of property as if an involuntary case concerning the debtor had not been commenced."

[45] *Id.*

trustee.[46] After notice and a hearing, the court may appoint an interim trustee if there is "an exceptionally strong need for doing so."[47]

While section 303(g) specifically provides for the appointment of an interim trustee in a chapter 7 case, courts have found authority to appoint a trustee in chapter 11 case by looking to section 1104(a), which is triggered by the commencement of a case rather than the entry of the order for relief.[48] The standards for appointing a trustee in an involuntary chapter 11 case, are for cause including gross mismanagement, dishonesty or fraud, or if the best interest of creditors as set forth in section 1104.[49]

The Bankruptcy Code provides only partial protection for gap creditors, including attorneys. Section 502(f) provides that claims of creditors that arise in ordinary course of business are determined as of the date the claim arose and allowed "the same as if such

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[46] Section 303(g) provides (emphasis added) –

> At any time after the commencement of an involuntary case under chapter 7 of this title but before an order for relief in the case, the court, on request of a party in interest, after notice to the debtor and a hearing, *and if necessary to preserve the property of the estate or to prevent loss to the estate*, may order the United States trustee to appoint an interim trustee under section 701 of this title to take possession of the property of the estate and to operate any business of the debtor. Before an order for relief, the debtor may regain possession of property in the possession of a trustee ordered appointed under this subsection if the debtor files such bond as the court requires, conditioned on the debtor's accounting for and delivering to the trustee, if there is an order for relief in the case, such property, or the value, as of the date the debtor regains possession, of such property.

[47] *Id. In re Levin*, 2011 WL 1469004, at *2 (Bankr. S.D. Fla. Apr. 15, 2011)(The request for interim trustee is an extraordinary remedy which, should not be granted in absence of an exceptionally strong need for doing so.) citing, *In re R.S. Grist Co.,* 16 B.R. 872, 873 (S.D.Fla.1982).

[48] *In re Professional Accountants Referral Services, Inc.*, 142 B.R. 424 (Bankr. D.Colo. 1992)("This Court finds that the appointment of a trustee during the gap period—before an order for relief is entered—is authorized and proper under 11 U.S.C. §§ 1104(a)(1), 105 and, by analogy, 303(g).").

[49] 11 U.S.C. §1104(a).

claim had arisen before the date of the filing of the petition."[50] Allowed gap claims are given a third priority under section 507(a).[51] Since alleged debtors will want to retain bankruptcy counsel and bankruptcy counsel will want to be compensated for their services, "[a]ttorneys seeking to represent a debtor may be well served by seeking appointment as a professional during the gap period pursuant to section 363, thereby treating payments to counsel as outside the ordinary course."[52]

During the gap period, the alleged debtor may consent to the entry of an order for relief by filing a motion to convert the case to a voluntary case or dismiss. A debtor may file a motion to convert an involuntary case from chapter 7 to chapter 11 or chapter 13, in the case of an individual with regular income, under section 706(a).[53] Unlike an involuntary chapter 7, the debtor cannot unilaterally convert an involuntary chapter 11 case to chapter 7.[54] The effect of conversion from one chapter to another chapter constitutes the entry of an order for relief under the chapter to which the case is converted, but does not alter the date of commencement of the case.[55]

Assuming that the alleged debtor does not want to be in bankruptcy, an alleged debtor may argue that abstention is warranted under section 305(a)[56] in addition to

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[50] 11 U.S.C. §502 (f).

[51] 11 U.S.C. §507 (a)(3).

[52] 2 COLLIER ON BANKRUPTCY ¶ 303.25[2], at 85 (Alan N. Resnick & Henry J. Sommer eds., 16th ed.).

[53] 11 U.S.C. §706(a).

[54] 11 U.S.C. §1112(a)(2).

[55] 11 U.S.C. §348(a).

[56] Section 305(a) provides in pertinent part that–

seeking dismissal of the case. Courts that have construed §305(a)(1) generally agree that abstention to properly filed bankruptcy case is an extraordinary remedy, and that dismissals are appropriate only in situations where the court finds that both creditors and the debtor would be better served by dismissal.[57] Courts initially developed a three-factor test in determining whether to abstain based on the legislative history.[58] The factors considered in determining whether to abstain, are (1) petition was filed by a few recalcitrant creditors; (2) there is a state insolvency proceeding or an out-of-court arrangement pending; and (3) the dismissal is in the best interest of the debtor at all creditors.[59] Later cases considering abstention have expanded the factors to include:

> (1) economy and efficiency of administration;
>
> (2) whether another forum is available to protect the interests of both parties or there is already a pending proceeding in state court;
>
> (3) whether federal proceedings are necessary to reach a just and equitable solution;
>
> (4) whether there is an alternative means of achieving an equitable distribution of assets;

(a) The court, after notice and hearing, may dismiss a case under this title, or may suspend all proceedings in a case under this title, at any time if—
  (1) the interests of creditors and the debtor would be better served by such dismissal or suspension

[57] *See e.g. In re AMC Investors, LLC*, 406 B.R. 478, 487 (Bankr. D. Del. 2009); *In re NRG Energy, Inc.* 294 B.R.71 (Bankr. D. Minn. 2003).

[58] *In re Sun World Broadcasters, Inc*. 5 B.R. 719 (Bankr. M.D. Fla. 1980)("The House and Senate Reports on Section 305(a) relate that the court may dismiss or suspend if an arrangement is already being worked out by creditors and the debtor outside of court, the creditors' rights are not being prejudiced in the arrangement, and the involuntary case has been instituted "by a few recalcitrant creditors to provide a basis for future threats to extract full payment." House Report No. 95-595, 95th Congress, 1st Session (1977) 325; Senate Report No. 95-989, 95th Congress, 2nd Session (1978) 35, U.S.Code Cong. & Admin.News 1978, pp. 5787, 6281).

[59] *Id.*

> (5) whether the debtor and the creditors are able to work out a less expensive out-of-court arrangement which better serves all interests in the case;
>
> (6) whether a non-federal insolvency has proceeded so far in those proceedings that it would be costly and time consuming to start afresh with the federal bankruptcy process; and
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> (7) the purpose for which bankruptcy jurisdiction has been sought.[60]

A dismissal under 305(a) is a non-appealable order to a court of appeals, however it is reviewable by the district court. [61] While each case is fact specific, it appears that motions to abstain are typically granted when the involuntary petition is nothing more than a two-party dispute, especially where the petitioner can obtain adequate relief in a non—bankruptcy forum.[62]

IV. A SURVEY OF OFTEN LITIGATED ISSUES

Prior to the entry of an order for relief, some of the most frequently litigated issues are the number of petitioning creditors (discussed above), whether (1) the debtor is generally not paying its debts, (2) the petitioning creditor's claim is the subject of a bona fide, and (3) the involuntary petition was filed in bad faith.

Section 303(h) provides, after the trial on an involuntary petition,

> the court shall order relief against the debtor in an involuntary case under the chapter under which the petition was filed, only if—(1) the debtor is *generally not paying* such debtor's debts as

[60] *In re Paper I Partners, L.P.*, 283 B.R.661 (Bankr. S.D. N.Y. 2002)

[61] 11 U.S.C. §305(c).

[62] *In re Axl Industries, Inc.*,127 B.R. 482 (S.D. Fla. 1991).

such debts become due unless such debts are the *subject of a bona fide dispute* as to liability or amount.[63]

A. ALLEGED DEBTOR NOT PAYING DEBTS

Since the Bankruptcy Code does not define the term "generally not paying," courts have used a multi-factor test. Bona fide disputes as to liability and amount are excluded when considering "generally not paying." Most courts agree that the applicable date for determining whether an alleged debtor is generally not paying its debts is the date of filing the involuntary petition.[64] The factors courts have considered include focusing on (1) the number of unpaid claims, (2) the amount of the claims, (3) the materiality of nonpayment, (4) the overall conduct of the debtor's financial affairs, (5) the amount of delinquencies, and (6) the number of delinquencies.[65] No one factor should be more important than the others, instead which of the factors should take priority depends on the circumstances of each case.[66]

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[63] 11 U.S.C. § 303(h)(1)(emphasis added).

[64] 2 COLLIER ON BANKRUPTCY ¶ 303.31, at 93–94 (Alan N. Resnick & Henry J. Sommer eds., 16th ed.).

[65] *In re Huggins*, 380 B.R. 75, 83 (Bankr. M.D. Fla. 2007)("The courts apply a flexible totality of the circumstances test in determining whether a debtor is "generally not paying" his debts, which focuses on the number of unpaid claims, the amount of the claims, the materiality of nonpayment and the overall conduct of the debtor's financial affairs.") *Also see*, *In re Concrete Pumping Serv.*, 943 F.2d 627, 630 (6th Cir.1991); *Fed. Fin. Co. v. DeKaron Corp.*, 261 B.R. 61, 64 (S.D.Fla.2001). *In re Tarletz*, 27 B.R. 787 (Bankr. D. Colo. 1983); *In re Systems Communications, Inc.*, 234 B.R. 145 (Bankr. M.D.Fla. 1999)("materiality of nonpayment of debts, the debts should be examined to determine whether there is a reasonable basis for the nonpayment... a failure to recognize that the creditors have agreed to a moratorium would be a failure to evaluate the basis for nonpayment or the materiality factor"). To determine whether an alleged debtor is "generally not paying" his debts as they become due, courts examine the matured and unpaid debt in context of its size in proportion to assets of the debtor, and its size in proportion to other debt. *In re Antar*, No. 12-13288-AJC, 2013 WL 1622217, at *3 (Bankr. S.D. Fla. Apr. 15, 2013)."

[66] *See e.g. In re Food Gallery at Valleybrook*, 222 B.R. 489 (Bankr. W.D. Penn. 1998).

Courts recognize it is more difficult for a single petitioning creditor to establish that an alleged debtor is generally not paying its debts as they become due, since the failure to pay one debt, without more, is not considered "general" nonpayment.[67] Although the plain language of Section 303(b) allows a single-creditor filing, some courts have carved out exceptions and found Section 303(h) is satisfied where special circumstances exist. Examples of special circumstances include: (i) the lack of an adequate remedy for the creditor pursuant to state or federal law if the order for relief is not granted; (ii) a showing of fraud, trick, artifice or sham by the debtor; or (iii) when the debtor has paid all of the small creditors, leaving only one large creditor.[68]

B. BONA FIDE DISPUTE

The primary purpose for disqualifying petitioning creditors when their claim is the subject of a bona fide dispute is to prevent them from using the threat of an involuntary petition to extort payment of their disputed claim or coerce the alleged debtor into a favorable settlement of their disputed claim.[69]

The term bona fide dispute is not defined in the code and its meaning has generated considerable litigation. The majority of courts have adopted an objective test for

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[67] Some courts early on appear to have adopted an almost per se rule that a single petitioning creditor is incapable of meeting the requirement of generality set forth in 11 U.S.C. §303(h)(1) thereby precluding an order for relief. *See, e.g., In re Nordbrock,* 772 F.2d 397, 399 (8th Cir.1985); *In re Smith,* 123 B.R. 423, 425 (Bankr.M.D.Fla.1990); *In re Gold Bond Corp.,* 98 B.R. 128, 129 (Bankr.D.R.I.1989). However, the trend has been for courts to carve out an exception based upon the totality of the circumstances with most courts rejecting the per se rule. *See* 2 COLLIER ON BANKRUPTCY ¶ 303.31[5], at 303-97 (Alan N. Resnick & Henry J. Sommer eds.,16th ed.).

[68] *See* 2 COLLIER ON BANKRUPTCY ¶ 303.31[5], at 303-98 (Alan N. Resnick & Henry J. Sommer eds.,16th ed.).

[69] *In re Ransome Grp. Investors I, LLLP*, 424 B.R. 547, 551 (Bankr. M.D. Fla. 2009) quoting *In re Rosenberg*, 414 B.R. 826, 845-46 (Bankr. S.D. Fla, 2009).

determining whether a bona fide dispute exists.[70] When applying this test, courts first determine whether there is an objective basis for either a legal or factual dispute as to the validity of the debt— the outcome of dispute need not be resolved, only the presence or absence of a dispute.[71] Whether a bona fide dispute exists in a particular case may be readily apparent in certain circumstances but not in others, thus it requires careful analysis of petitioning creditor's claim before filing an involuntary petition.[72]

Once a creditor establishes that its claim is not the subject of a bona fide dispute, the burden shifts to the alleged debtor to present evidence of a bona fide dispute.[73] While an alleged debtor may assert a counterclaim, such counterclaim does not render the

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[70] Courts adopting the objective test include the Second, Third, Fifth, Sixth, Seventh, Eighth and Tenth Circuits, although the actual articulation of the standard varies. The Bankruptcy Appellate Panel for the First Circuit has also adopted the objective approach, as has a bankruptcy court in the 11th Circuit. 2 COLLIER ON BANKRUPTCY ¶ 303.11[1], at 303–31 (Alan N. Resnick & Henry J. Sommer eds.,16th ed.) *Key Mechanical Inc. v. B D C 56 LLC*, (*In re BDC 56 LLC*), 330 F.3d 111, 50 C.B.C.2d 161 (2d Cir. 2003), *B.D.W. Assocs., Inc. v. Busy Beaver Bldg. Ctrs., Inc.*, 865 F.2d 65 (3d Cir. 1989), *Subway Equip. Leasing Corp. v Sims (In re Sims),* 994 F2d. 210, 29 C.B.C2d 443 (5th Cir. 1993), Riverview Trenton R. R. Co. v. DSC, Ltd. (DSC, Ltd.), 486 F.3d 940,944 (6th Cir. 2007)(bankruptcy court must determine if objective basis exists for either factual or legal dispute regarding the validity of the debt; genuine issue of material fact bearing on debtor's liability or meritorious contention regarding application of law to undisputed facts required dismissal, citing *In re* Eastown Auto Co., 215B.R. 960 (B.A.P. 6th Cir. 1998)), *In re Busick*, 831 F.2d 745, 17 C.B.C2d 788 (7th Cir. 1987), *In re Rimell*, 946 F.2d 1363 (8th Cir. 1991), *Bartmann v. Maverick Tube Corp.*, 853 F2d 1540, 19 C.B.C 2d 940 (10th Cir. 1988), *Metz v. Dilley* (*In re* Dilly) 55 C.B.C. 1287, 339 B.R.1 (B.A.P. 1st Vir. 2006)(relying on *Key Mechanical*, First Circuit has not decided what constitutes bona fide dispute but every circuit to address question has adopted objective standard which requires dismissal if there is either genuine issue of a material fact bearing on the debtor's liability or meritorious contention regarding application of law to undisputed facts), and *In re Bimini Island Air*, 370 B.R. 408 (Bankr. S.D. Fla. 2007).

[71] *In re Ransome Group Investors I, LLP*, 424 B.R. 547 (Bankr. M.D. Fla. 2009).

[72] *See, e.g. In re Food Gallery at Valleybrook*, 222 B.R. 480 (Bankr. W.D. Penn. 1998)(bona fide dispute existed as to proper rate of interest on petitioning creditor's claim, and as to proper method for amortizing principal amount of the debtor's obligation to creditor, but such dispute did not render creditor's entire claim subject to a bona fide dispute); *In re BDC 56 LLC*, 330 F.3d 111 (2d Cir. 2003)(bona fide dispute existed where creditors right to payment had not matured at the time of filing the involuntary petition).

[73] *In re Rimell,* 946 F.2d 1363, 1365 (8th Cir.1991). *See also In re Manhattan Industries, Inc.,* 224 B.R. 195, 200 (Bankr.M.D.Fla.1997); *In re Apache Trading Group, Inc.,* 210 B.R. 869, 871 (Bankr.S.D.Fla.1997); *In re Audio Visual Workshop, Inc.,* 211 B.R. 154, 158 (Bankr.S.D.N.Y.1997); and *In re Gutfran,* 210 B.R. 672, 673 (Bankr.D.Conn.1997).

petitioning creditor's claim the subject of a bona fide dispute.[74] A claim against the petitioning creditor may not be asserted in the answer, except for the purpose of defeating the petition.[75] Counterclaims may be asserted to reduce either the dollar amount of the claim or the number of creditors below the statutory minimum for involuntary relief.[76]

Generally, an unappealed, unstayed final judgment is not subject to a bona fide dispute.[77] Some courts have held that if the claimant establishes that its claim is well-grounded and that no defenses have been asserted in response to the creditor's claim, the claim may not be subject to a bona fide dispute.[78]

C. BAD FAITH

While Section 303(b) does not explicitly state that an involuntary must be filed in good faith, it is generally agreed that involuntary filings must be in good faith.[79] The failure to file an involuntary bankruptcy in good faith may result in an alleged debtor being awarded damages, including punitive damages, under Section 303(i)(2). Because "bad faith" is not defined in the Code and there is no legislative history addressing the intended meaning of this language, courts have used different approaches to determine whether an

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[74] *In re Atwood*, 124 B.R. 402 (S.D. Ga. 1991).

[75] Fed.R. Bankr.P. 1011(d).

[76] *Georgia Jewelers, Inc. v. Bulova Watch Co.*, 302 F2d.362 (5th Cir 1962) *see also Harris v. Capehart–Farnsworth Corp.,* 225 F.2d 268, 270 (8th Cir.1955)(permitting the debtor to establish set-offs and counterclaims to challenge the standing of a petitioning creditor's claim).

[77] *In re Manhattan Industries, Inc.,* 224 B.R. 195 (Bankr. M.D. Fla. 1997).

[78] *In re Audio Visual Workshop, Inc.* ,211 B.R. 154 (Bankr. S.D.N.Y. 1997).

[79] *In re Richard Homes Building Co.,* 291 B.R.727, 30 (Bankr. E.D.Mich 2003)("[t]there is a presumption of good faith in favor of the petitioning creditor, and thus the alleged debtor has the burden of proving bad faith.")

involuntary was filed in bad faith. Whether or not a petitioning creditor acted in bad faith is principally a question of fact. Tests applied to resolve the factual question of bad faith have been categorized as the (1) improper purpose test; (2) improper use test; and (3) Rule 9011 test,[80] (4) the objective test; (5) the subjective test; and (6) the totality of the circumstances test, which combines the improper purpose and improper use tests.[81] "One court, considering the pertinent tests, has described the essence of the exercise as applying the nose test. Nosing about for bad faith, the fact-finder should attempt to ensure first, that it sniffs all the right places and, second, that it doesn't put its nose where it doesn't belong."[82]

In *Wortley*, the Eleventh Circuit discussed each the first three tests, leaving open which of them would apply in this Circuit. 763 F. 3d at 1349-1350. Each of these tests, the improper purpose test, the improper use test, and the Rule 9011 test, involves close attention to the facts and will almost always justify the alleged debtor who defends on these grounds in engaging in discovery.

The "improper purpose" test finds bad faith based upon the petitioner's improper motivation for filing the petition.[83] Cases under this line of reasoning have emphasized

[80] *General Trading v. Yale Materials Handling Corp.*, 119 F.3d 1485 (11th Cir. 1997).

[81] *In re K.P. Enter.*, 135 B.R. 174 (Bankr. D. Me. 1992).

[82] *Id.* at 179.

[83] *Id.*

that the involuntary petition was motivated by ill will, malice or for the purpose of harassing the debtor. [84]

The "improper use" test looks at whether petitioning creditor's conduct uses the involuntary bankruptcy proceeding in an attempt to obtain a disproportionate advantage for itself, rather than to protect against other creditors obtaining disproportionate advantages, particularly when the petitioner could have advanced its own interests in a different forum.[85] Examples include treating the bankruptcy process as if it were the creditors own private collection agency or using the bankruptcy to acquire control over the corporation.

The "Rule 9011 test" combines the "objective test" and the "subjective test," thus has a significant objective requirement bearing on the legal justification of a claim or defense plus a reasonable inquiry into the facts and the law.[86] In addition to requiring an objective inquiry, the Rule 9011 test requires a subjective inquiry as well— the bankruptcy proceeding cannot have been interposed for an improper purpose, "such as to harass, to cause delay, or to increase the cost of litigation." [87] The "objective test" essentially asks the question whether or not a reasonable person would have filed the involuntary under the

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[84] *See, e.g. In re Camelot, Inc.,* 25 B.R. 861 (Bankr. E.D. Tenn.,1982)(bad faith where petitioning creditors were not even creditors of the debtor and where the motivation for filing an involuntary petition was to "spitefully forestall the dissolution of a the debtor corporation" and to frustrate results in the state court proceeding); *Adell v. John Richards Homes Bldg Co.* (*In re John Richards Homes Bldg Co.*), 439 F.3d 248 (6th Cir. 2006)

[85] *In re F.R.P. Industries, Inc.,* 73 B.R. 309 (Bankr. N.D. Fla. 1987)(Prior to initiating the involuntary, the primary petitioning creditor made no effort to avail himself of collection remedies but rather used the involuntary petition as an attempt at a hostile takeover, which the court found constituted bad faith.)

[86] *General Trading,* 119 F.3d at 1502.

[87] *Id.*

same circumstances. [88] The "subjective test" is almost identical to the "improper purpose test" in that they both look to the subjective motivation and the objective reasonableness of the petitioning creditors. [89]

The findings of bad faith under the above referenced tests often overlap. For example, where an improper use of the bankruptcy process is alleged, such as to harass, destroy, embarrass, or punish the debtor, such motivation is also a bad faith finding under the "subjective test" as well. Since a finding of bad faith is very fact intensive, a good starting point in advising a potential petitioning creditor is to determine if it passes the "smell test."[90] Obviously, where a convicted felon used the privilege of filing involuntary petitions to harass the judge and prosecutor of his case were filed in bad faith. [91]

V. COMPENSATORY AWARDS AFTER DISMISSAL

The mere filing of an involuntary petition can be very damaging to an alleged debtor, including the inability to get new credit, discontinuance of supply sources except on a cash basis, and a general deterioration of the debtor's business reputation or personal financial reputation. To offset the damage to an alleged debtor, the Bankruptcy Code includes a provision to recover costs and attorney's fees, and in the case of a bad faith filing, damages proximately caused by filing the involuntary petition and punitive damages.[92] It

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[88] *In re Ballato*, 252 B.R. 553, 558 (Bankr. M.D. Fla. 2000).

[89] *Id.*

[90] To quote Judge Ray, "The filing of an abusive involuntary petition is odious." *In re Loe*, 2007 WL 997581 (S.D. Fla. March 29, 2007).

[91] *See e.g. In re Davis,* 278 B.R. 429, 431 (Bankr. W.D. Mich. 2002).

[92] 11 U.S.C. §303(i).

is generally recognized that any award for fees, costs, damages proximately caused by the filing, or punitive damages, is entirely within the discretion of the trial judge,[93] with the trial judge having considerable discretion in deciding to award fees and costs under 11 U.S.C. §303(i)(1).[94] The standard of review of the bankruptcy court's orders granting fees and costs is abuse of discretion.[95]

The court may award costs and attorney's fees under if (1) the court dismissed the involuntary petition; (2) the dismissal must be other than on the consent of all petitioners and the debtor; and (3) the debtor must not waive its right to recovery under the statute.[96]

As a prerequisite to an award under section 303(i), the alleged debtor and creditors must not have consented to dismissing the petition, thus what constitutes consent? The majority of courts appear to hold that the debtor's consent to dismissal while expressly preserving the debtor's rights under section 303(i), does not constitute consent within the

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[93] *In re Rosenberg*, No. 09-13196-BKC-AJC, 2012 WL 3990725, at *5 (Bankr. S.D. Fla. Sept. 11, 2012) *aff'd sub nom. DVI Receivables XIV, LLC v. Rosenberg*, 500 B.R. 174 (S.D. Fla. 2013) quoting *In re Macke Intern. Trade, Inc.*, 370 B.R. 236, 249 (9th Cir.BAP2007)("[B]ecause of the potential adverse impact on the debtor and the need to encourage discretion in filing such cases, unsuccessful involuntary petitioners should routinely expect to pay the debtor's legal expenses arising from the involuntary filing.").

[94] *In re Reid*, 854 F.2d 156, 160 (7th Cir. 1988)("Because Congress specifically distinguished between good and bad faith petitions with respect to damages, but not in determining when the court should make a § 303(i) award, it may not have intended bad faith to be relevant to the award decision itself. Conceivably, Congress' focus was on the well-being of the debtor, which is not necessarily a function of the petitioning creditors' state of mind. This position, however, is difficult to reconcile with Congress' decision to authorize additional remedies when a petition is filed in bad faith. The more plausible reading of the provision is that Congress believed that an involuntary petition filed in bad faith was sufficiently offensive to justify an additional recovery, but chose to reserve to the court the power to withhold an award in certain rare circumstances. Accordingly, we believe that the presence or absence of bad faith will inform the exercise of the district court's discretion under § 303(i).").

[95] *In re Westwood Cmty. Two Ass'n, Inc.* ,2006 WL 940647 *(11th Cir. 2006)(" the award or denial of attorney's fees and cost in bankruptcy cases is reviewed for an abuse of discretion, and underlying findings of fact are reviewed for clear error").

[96] § 303(i)(l).

meaning section 303(i).[97] At least one court has held that "the dismissal of the underlying petition by consent of the sole petitioner and the debtor extinguishes any claim under 11 U.S.C. § 303(i)."[98] In that case, the debtor and creditor jointly moved to dismiss under section 303(j).[99]

The majority of courts determining whether to award fees and costs under 11 Section 303(i)(1) and damages under Section 303(i)(2) to the debtor have adopted "totality of the circumstances" test. The factors considered by the courts include (1) the merits of the involuntary petition; (2) the conduct of the debtor; (3) the reasonableness of the actions taken by the petitioning creditors; and (4) the motivations and objectives behind the filing.[100]

"The majority rule is that there is a presumption in favor of awarding costs and reasonable attorney's fees under § 303(i)(l)."[101] This presumption is intended to

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[97] *See e.g. In re R. Eric Peterson Const. Co., Inc.*, 951 F.2d 1175 (10th Cir. 1991)("A more passive statement of nonopposition to the creditors' motion to dismiss the petition should not indicate consent, at least where, as here, the debtor simultaneously manifests its intention to seek damages under section 303(i)."); *In re Tichy Elec. Co.*, 332 B.R. 364, 375 (Bankr. N.D. Iowa 2005)(concluding that debtor did not consent to dismissal within the meaning of § 303(i) where debtor did not waive its right to claim under that section); In re Jett, 206 B.R. 407, 409 (Bankr. E.D.Va. 1997)(holding that "petitioning creditor's nonopposition to dismissal is not consent under the statute where the debtor seeks damages which are opposed by the creditor"); *In re Kelton Motors Inc.*, 121 B.R. 166, 186-87 (Bankr. D. Vt. 1990)("The preservation of a right to a judgment subsumes any consent.")

[98] *In re Int'l Mobile Adver. Corp.*, 117 B.R. 154, 155 (Bankr. E.D. Pa. 1990).

[99] *Id.* Section 303(j) provides—

> Only after notice to all creditors and a hearing may the court dismiss a petition filed under this section—
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> (1) on the motion of a petitioner;
> (2) on consent of all petitioners and the debtor; or
> (3) for want of prosecution.

[100] *In re Scrap Metal Buyers of Tampa, Inc.* 253 B.R. 103 (M.D. Fla. 2000).

[101] *In re Rosenberg*, 2012 WL 3990725, at *1 (Bankr. S.D. Fla. Sept. 11, 2012) *aff'd sub nom. DVI Receivables XIV, LLC v. Rosenberg*, 500 B.R. 174 (S.D. Fla. 2013)

discourage frivolous involuntary petition and protect debtors from having to defend against frivolous petitions.[102] Courts take the position that because of the adverse effect on the alleged debtor, involuntary petitioners should routinely "expect to pay" the debtor's legal expenses so that petitioning creditors will use discretion in filing involuntary cases.[103] An award for costs and attorney's fees under section 303(i)(1) does not require a showing of bad faith by the alleged debtor.[104] As one bankruptcy court explained, "Congress intended for the 'losing creditors to pay for the burden they…created.'"[105]

The best example of an "expect to pay" award for attorney's fees and cost is *In re Orlinsky*.[106] In *Orlinsky*, the petitioning creditor sued the alleged debtor in state court and obtained a $6 million judgment, which the alleged debtor appealed without a supersedeas bond.[107] While on appeal, the petitioning creditor attempted to execute on the judgment, but with no success as the alleged debtor had transferred assets to third parties.[108] The petitioning creditor then filed an involuntary bankruptcy against the alleged debtor.[109]

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[102] *In re Scrap Metal Buyers of Tampa, Inc.* 233 B.R. 162 (Bankr. M.D. Fla. 1999).

[103] *Id.* quoting *In re Macke Intern. Trade, Inc.,* 370 B.R.236, 249 (9th Cir. BAP 2007)("[B]ecause of the potential adverse impact on the debtor and the need to encourage discretion in filing such cases, unsuccessful involuntary petitioners should routinely expect to pay the debtor's legal expenses arising from the involuntary filing."]

[104] *In re Mundo Custom Homes, Inc.*, 179 B.R. 566 (Bankr. N.D. Ill. 1995).

[105] *In re Atwood*, 1993 WL 13005093 at *5(Bankr. S.D. Ga. April 20, 1993)(quoting *In re Advance Press and Litho, Inc.*, 46 B.R. 700, 702)(Bankr. D. Colo. 1984)).

[106] *Patraka v. Orlinsky*, No. 09-21903-CMA, slip op.at 6 (citing *Higgins v. Vortex Fishing Systems, Inc.*, 379 F.3d 701, 707 (9th Cir. 2004)(Affirming a bankruptcy court's award of $96,500 in attorney's fees and $4,454.32 in costs where there was no finding of bad faith) *aff'd,* 417 Fed. Appx. 852 (11th Cir. 2011).

[107] *Id.*

[108] *Id.*

[109] *Id.*

During the pendency of the bankruptcy case, the state court judgment was reversed.[110] The bankruptcy court, *sua sponte* dismissed the bankruptcy proceeding at which point the alleged debtor sought to recover costs and attorney's fees pursuant to section 303(i)(1).[111] Judge Mark went on to say "I'm not finding that it was bad faith…but in choosing to pursue additional rights with the judgment on appeal,…(petitioning creditor) should have known that dismissal of the petition was inevitable if you lost the appeal, and that an award of fees and costs was a very substantial risk if the appeal was lost and the petition was dismissed."[112] The bankruptcy court awarded $96,500 in fees and $4,454.32 in costs, which the petitioning creditor appealed. Both the District Court for the Southern District Florida and the Eleventh Circuit Court of Appeals affirmed.

Moreover, in the case of an involuntary petition filed in bad faith, the court may award compensatory damages caused by such filing and/or punitive damages. [113] The determination of bad faith for purposes of section 303(i) is the same as determining bad faith more generally under section 303, which was discussed above. After a finding of bad faith, petitioning creditors have attempted to raise as a defense that the filing of the involuntary was on the advice of counsel. Since the plain meaning of section 303(i)(1), only provides for an award against petitioners, most courts reject this defense.[114] However,

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[110] *Id.*

[111] *Id.*

[112] *Id.* at *6

[113] 11 U.S.C. §303(i)(2).

[114] *In re Rosenberg*, No. 09-13196-BKC-AJC, 2012 WL 1021724, at *3 (Bankr. S.D. Fla. Mar. 26, 2012)("The vast majority of courts interpreting this fee-shifting provision have followed these common-sense canons of judicial interpretation to hold that Section 303(i) does not permit an alleged debtor to bring claims against the petitioning creditors' counsel. *See e.g., Walden v. Bright Products, Inc.,* 787 F.2d 174 (5th Cir.1986); *In re*

while reluctant, courts have imposed sanctions against attorneys if the situation presents an abuse. [115]

Just when a petitioning creditor thought it couldn't get any worse, a petitioning creditor was surprised to find that damages arising out of his bad faith filing against an alleged debtor were nondischargeable pursuant to section 523 (a)(6)— willful and malicious injury by the debtor to another, when he filed his own bankruptcy.[116]

In addition, the bankruptcy court has the authority to award fees and costs incurred in defending an appeal from the bankruptcy court's decision to dismiss an involuntary case.[117]

VI. CREDITORS THINK TWICE

With so much at stake, petitioning creditors should carefully consider their options before filing an involuntary bankruptcy. At minimum a petitioning creditor should consider obtaining a credit report, run a lien search, determine if the alleged debtor is

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Glannon, 245 B.R. 882, 892–893 (D.Kan.2000); *In re Advanced Press & Litho, Inc.,* 46 B.R. 700, 706 (D.Colo.1984); *In re Merrifield Town Center Ltd. Partnership,* 2010 WL 5015006 *5 (Bankr.E.D.Va.2010); *In re Squillante,* 259 B.R. 548, 554 n. 7 (Bankr.D.Conn.2001); *In re International* Mobile *Advertising Corp.,* 117 B.R. 154, 158 (Bankr.E.D.Pa.1990); and *In re Ramsden,* 17 B.R. 59, 61 (Bankr.D.Ga.1981)").

[115] *See* 2 COLLIER ON BANKRUPTCY ¶ 303.33, at 112–113 (Alan N. Resnick & Henry J. Sommer eds., 16th ed.). Examples include—examples include, filing an involuntary petition for the sole purpose of collecting the debt; filing an involuntary per petition within without inquiring as the number of creditors the debtor had; filing an involuntary petition for the purpose of stalling foreclosure, filing an involuntary petition when the petitioning creditor has no claim against the debtor, filing an involuntary petition without adequately researching investigating the basis for filing, facilitating the filing of an involuntary case in opposing a motion for stay relief for the purpose of improper delay.

[116] *In re Antonini*, 2012 WL112978 *12 (S.D. Fla. Jan. 12, 2012).

[117] *In re Rosenberg*, 2012 WL 3990725, at *1 (Bankr. S.D. Fla. Sept. 11, 2012) *aff'd sub nom. DVI Receivables XIV, LLC v. Rosenberg*, 500 B.R. 174 (S.D. Fla. 2013)

being sued by any other creditors, send a written demand for payment, and wait to file an involuntary until after an alleged debtor has filed an answer in pending litigation or competed discovery in aid of execution of a judgment.

If the possibility that the petitioning creditor may be held financially responsible for alleged debtor's costs, attorney's fees and if it is determined that the petition was filed in bad faith, damages, and possibly putative damages, then why would a petitioning creditor consider filing an involuntary petition? A petitioning creditor may consider filing if the alleged debtor is—

(a) squandering assets or is grossly incompetent;

(b) statute of limitations on chapter 5 causes of action;

(c)transferring unsecured assets to a third party for less than reasonably equivalent values;

(d) transferring assets to creditors for forgiveness of debt, thus leaving insufficient funds to pay other creditors;

(e) transferring assets to a related company;

(f) only paying debts that have been guaranteed by its principles;

(h) is only paying debts owed to other "insiders;"

(i) is engaged in fraudulent activities (e.g., Ponzi scheme); or

(j) a bankruptcy filing is imminent but in a jurisdiction that will make it cost prohibitive. As we recently saw when a group of second-lien bondholders of Caesars Entertainment Corp. filed an involuntary Chapter 11 in Delaware, which was shortly followed by the operating company filing a voluntary petition in Illinois.