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Problems in the Code

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Courts Reverse Trend on Interpretation of § 303(b)(1)

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Section 303(b)(1) of the Bankruptcy Code governs a creditor's general eligibility to commence an involuntary bankruptcy case against a debtor that has 12 or more qualifying creditors.[1] To be eligible under § 303(b)(1), three or more petitioning creditors must each hold a claim that is noncontingent and not subject to a bona fide dispute as to liability or amount, and the aggregate of the petitioning creditors' qualifying claims must be unsecured by at least $15,325.

The requirement that a claim cannot be subject to a "bona fide dispute" was added to § 303(b)(1) in 1984.[2] Prior to the 1984 amendments, the disputed nature of a petitioning creditor's claim was not considered when evaluating the propriety of an involuntary petition. The amendment's purpose was to eliminate the previous common practice of granting involuntary petitions because a debtor was not paying its debts as they came due, without evaluating the debtor's reasons for failing to do so.[3]

Through the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), Congress added the phrase "as to liability or amount" following "bona fide dispute."[4] Before BAPCPA, there was little debate that a partially disputed claim did not disqualify a petitioning creditor, as long as the aggregate undisputed portion of the petitioning creditors' unsecured claims met the minimum statutory amount. However, the addition of "as to liability or amount" to § 303(b)(1) raised questions regarding a petitioning creditor's eligibility to commence a case if any portion of its claim is subject to a bona fide dispute.

One line of cases applies an "all-or-nothing" approach, finding that if any portion of a claim is subject to a bona fide dispute, the petitioning creditor is automatically disqualified. Another line of cases, and current emerging trend, reason that a claim can be partially disputed without impacting eligibility, as long as the aggregate undisputed portion of the petitioning creditors' unsecured claims totals at least $15,325.

The "All-or-Nothing" Approach

The seminal decision representing the all-or-nothing approach is *In re Euro-American Lodging Corp.*[5] In this case, the court noted that under pre-BAPCPA law, a dispute solely as to amount was not a bona fide dispute as to the entire claim under § 303(b)(1).[6] The court further noted that before BAPCPA, a dispute as to the amount gave rise to a bona fide dispute under the statute only if the dispute arose from the same transaction and netting the claims against the debtor brought the petitioning creditors below the threshold amount as required by § 303(b)(1).[7] The *Euro-American* court held that by adding the phrase "as to [the] liability or amount," Congress presumably intended to remove the second prong of the pre-BAPCPA test, thereby disqualifying a petitioning creditor if any amount of its claim arising from the same transaction is disputed.[8] At least seven other bankruptcy courts since *Euro-American*

1 Section 303(b)(2) incorporates the standard set forth in § 303(b)(1) in cases involving fewer than 12 such creditors, the only difference being that § 303(b)(1) requires at least three petitioning creditors and § 303(b)(2) only requires one.

2 *See In re DemirCo Holdings Inc.*, 2006 WL 1663237, at *3 (Bankr. C.D. Ill. June 9, 2006) (citing 130 Cong. Rec. S7618 (daily ed. June 19, 1984)).

3 *See In re Tikijian*, 76 B.R. 304, 313-14 (Bankr. S.D.N.Y. 1987) (citing S. 7618, 98th Cong. 2d Sess., June 19, 1984)). The 1984 amendments made a corresponding change to § 303(h)(1), directing entry of an order for relief only if the debtor is not paying its debts as they come due, unless such debts are subject to a bona fide dispute. *See In re Century/ML Cable Venture*, 294 B.R. 9, 32 (Bankr. S.D.N.Y. 2003).

4 *DemirCo*, 2006 WL 1663237, at *3.

5 357 B.R. 700 (Bankr. S.D.N.Y. 2007). *See also In re Hentges*, 351 B.R. 758 (Bankr. N.D. Okla. 2006), the first reported post-BAPCPA decision that adopted the "all-or-nothing" approach, did not expressly discuss the reasoning for its decision.

6 357 B.R. at 712 n.8.

7 *Id.* (citing *In re Focus Media Inc.*, 378 F.3d 916, 926 (9th Cir. 2004)).

8 *Id.* (citing 2 Alan N. Resnick and Henry J. Sommer, *Collier on Bankruptcy* ¶ 303.03[2][b] (15th rev. ed. 2006)).

have agreed.[9] Until recently, "all or nothing" was the clear majority approach, raising significant doubt about the viability of involuntary petitions.[10]

On Feb. 3, 2014, the Fifth Circuit issued the first circuit court opinion on the subject in *Dev. Co. v. Green Hills Dev Co. (In re Green Hills Dev. Co.)*, holding that in light of BAPCPA, a bona fide dispute as to the amount is now sufficient to deny a creditor standing to commence an involuntary case.[11] *Green Hills*, however, involved a related counterclaim raised by the debtor that had the potential to eliminate the creditor's entire claim.[12] The court did not specifically address the subject of this article: whether BAPCPA created an "all-or-nothing" test, under which a bona fide dispute as to any portion of a creditor's claim denies a creditor standing.

The "Partially Disputed" Approach

Like *Euro-American*, the lead case on the opposite side of the issue, *In re DemirCo Holdings Inc.*, was decided shortly after BAPCPA's enactment.[13] In rejecting the debtor's argument that BAPCPA's amendment to § 303(b)(1) requires a divergence from prior law, the *DemirCo* court first examined the history of the 1984 Bankruptcy Code amendments and found that adding the phrase "bona fide dispute" was intended to encompass disputes both as to the liability and amount, and that the 2005 amendments comport with that intent.[14] Absent legislative history in BAPCPA evidencing a clear intent to change the law, the court declined to infer a new requirement that a petitioning creditor's claim be fully liquidated by judgment.[15]

Building on this logic, a recent bankruptcy court decision, *In re Miller*,[16] explained that such a condition to petitioning creditor eligibility is contrary to the plain language of § 303(b)(1), which only requires that a "claim" be noncontingent and not subject to a bona fide dispute as to the liability or amount.[17] Without an express requirement in § 303(b)(1) that claims be fully liquidated, the *Miller* court concluded that legislative intent would not be served by automatically disqualifying claims that are partially disputed as to the amount.[18] Over the past year, the all-or-nothing approach has lost momentum in favor of the view that was articulated in *DemirCo*.[19] With this emerging trend, the number of decisions on the issue is virtually evenly split.

Equitable Considerations

If a court is presented with interpreting the phrase "as to liability or amount," debtors will argue that it evidences congressional intent to change pre-BAPCPA law. Petitioning creditors will contend that § 303(b)(1) was always intended to apply to disputes as to the liability and amount and that BAPCPA merely clarified prior legislative intent. Petitioning creditors could point to the absence of clear BAPCPA legislative history confirming an intention to change the law, as well as the absence of a requirement in § 303(b)(1) that a claim be fixed or liquidated. In distinguishing *Green Hills*, petitioning creditors could argue that the holding is limited to cases where the dispute as to the amount is sufficient to reduce the aggregate petitioning creditor claims below the threshold statutory amount, and that the case did not expressly adopt an all-or-nothing approach.

While the analysis may end there, bankruptcy courts, as courts of equity, can consider additional factors in deciding what approach to apply. A debtor may posit that involuntary bankruptcy conditions are intentionally difficult, and that disqualifying a creditor based on a dispute as to any portion of its claim is consistent with the policy of keeping creditors from bringing two-party disputes into bankruptcy court and potentially abusing the bankruptcy process. A debtor may also argue that asserting a disputed portion of a claim in an involuntary petition is done at the creditor's own peril.

Petitioning creditors opposing the all-or-nothing approach might contend that § 303(b) sufficiently protects debtors by requiring that at least $15,325 in aggregate unsecured claims not be subject to a bona fide dispute. Petitioning creditors could further argue that applying an all-or-nothing approach could result in a dismissal on a technicality, and that legitimate petitioning creditors should not be ousted from the bankruptcy court due to an accounting error or a minor dispute regarding a large claim. In addition, petitioning creditors could contend that a creditor might not be aware of a dispute regarding its claim until after the filing, rendering it impossible for creditors to decide whether to exclude the disputed portion of their claims to avoid dismissal.

Impact of Dismissal Premised on All-or-Nothing Approach

Cases interpreting amended § 303(b)(1) do not discuss the effects of dismissal based on the application of the all-or-nothing approach. Perhaps this is because only two cases adopting that approach actually dismissed the petition based solely on the court's interpretation of § 303(b)(1),[20] with the remaining cases adopting the approach in *dicta* or in support of an alternative ground for dismissal.[21] Even though case law to date is silent on the issue, considering the practical implications of such a dismissal places the debate into proper context.

As a threshold matter, if a debtor raises a partial-claim dispute in support of a dismissal, a petitioning creditor could amend its petition to eliminate the disputed portion of its claim prior to dismissal. If a case is ultimately dismissed solely because a small amount of a petitioning creditor's

9 *See In re Mountain Dairies Inc.*, 372 B.R. 623, 634 (Bankr. S.D.N.Y. 2007); *In re Reg'l Anesthesia Assocs. PC*, 360 B.R. 466, 469-70 (Bankr. W.D. Pa. 2007); *In re Excavation, Etc. LLC*, 2009 WL 1871682, at *2 (Bankr. D. Or. June 24, 2009); *In re Metro Cremo & Son Inc.*, 2008 WL 5158288, at *4 n.8 (Bankr. M.D. Pa. Sept. 29, 2008); *In re Rosenberg*, 414 B.R. 826, 845-46 (Bankr. S.D. Fla. 2009); *In re Skyworks Ventures Inc.*, 431 B.R. 573, 578 n.1 (Bankr. D.N.J. 2010); *In re Elverson*, 492 B.R. 831, 835 (Bankr. E.D. Pa. 2013).

10 *See generally* David B. Wheeler, "Involuntary Bankruptcy Petitions: Is § 303 Still a Viable Creditor Alternative," 29 *Am. Bankr. Inst. J.* 36 (November 2011).

11 741 F.3d 651, 657-58 (5th Cir. Feb. 3, 2014).

12 *Id.* at 653.

13 2006 WL 1663237.

14 *Id.* at *3.

15 *Id.*

16 489 B.R. 74 (Bankr. E.D. Tenn. 2013).

17 *Id.* at 82-83

18 *Id.*

19 *See In re Tucker*, 2010 WL 4823917, at *6 (Bankr. N.D. W.Va. Nov. 22, 2010); *In re Mountain Country Partners LLC*, 2012 WL 2394714, at *3 (Bankr. S.D. W.Va. June 25, 2012); *Miller*, 489 B.R. at 83; *In re Roselli*, 2013 WL 828304, at *9 (Bankr. W.D.N.C. March 6, 2013); *Wishgard LLC v. Southeast Services LLC (In re Wishgard LLC)*, 2013 WL 1774707, at *5 (Bankr. W.D. Pa. April 25, 2013); *In re Fustolo*, 503 B.R. 206, 221-23 (Bankr. D. Mass. 2013); *In re EM Equipment LLC*, 504 B.R. 8, 18 (Bankr. D. Conn. 2013). In addition, a leading bankruptcy treatise, on which the *Euro-American* court relied, shifted its viewpoint in favor of the emerging approach. *See* 2 Alan N. Resnick and Henry J. Sommer, *Collier on Bankruptcy* ¶ 303.11[2] (16th ed. 2013) (questioning "all-or-nothing" approach).

20 *See Hentges*, 351 B.R. 758; *Excavation*, 2009 WL 1871682.

21 *See In re Mountain Dairies*, 372 B.R. 623; *Reg'l Anesthesia*, 360 B.R. 466; *Metro Cremo*, 2008 WL 5158288; *Rosenberg*, 414 B.R. 826; *Skyworks Ventures*,431 B.R. 573; *Elverson*, 492 B.R. 831.

claim is disputed, nothing in the Bankruptcy Code precludes the involuntary case from being refiled. In a refiled petition, the previously disqualified petitioning creditor could list only the undisputed portion of its claim, thereby insulating the case from dismissal on all-or-nothing grounds. This apparent right to refile the involuntary petition might lead a debtor to question what it gains from a dismissal, other than a potential damages award under § 303(i).

While it may seem somewhat pointless, at first glance, for a debtor to obtain a dismissal based solely on the all-or-nothing approach, a strategic advantage could be gained. For example, a dismissal could buy more time for the debtor to operate outside the jurisdiction of the bankruptcy court. This could provide the debtor with an opportunity to start paying its debts as they come due, which could bar a subsequent involuntary petition under § 303(h)(1). It could also give the debtor a chance to settle with some or all of its creditors. An "all-or-nothing" approach-based dismissal could permit a debtor to commence a voluntary bankruptcy case in an alternative venue if the debtor believes that it could gain a strategic advantage in doing so. In addition, it is possible that some petitioning creditors might lose interest and decide not to support the lead petitioning creditor's continuing efforts. These potential strategic advantages could lead the debtor to challenge the eligibility of a petitioning creditor based on a small dispute as to the creditor's claim, despite the fact that the involuntary petition is otherwise proper and could theoretically be refiled.

Conclusion

Given the frequency of litigation over the interpretation of § 303(b)(1), a clarifying amendment to the Bankruptcy Code is warranted. If Congress intended to change the law, as the cases adopting the all-or-nothing approach have held, the word "any" should be added before "amount." This would confirm that a bona fide dispute as to any amount listed on the petition disqualifies a petitioning creditor. On the other hand, if Congress did not intend to change pre-BAPCPA law, the following phrase should be added to the end of § 303(b)(1): "excluding the portion of such noncontingent, undisputed claims that are subject to a bona fide dispute as to liability or amount." This addition would clarify that a partial claim dispute does not automatically disqualify the petitioning creditor and render the involuntary petition defective in cases where disqualification reduces the number of petitioning creditors below the number required by statute. abi

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