AMERICAN BANKRUPTCY INSTI

JOURNAL

Winter Leadership Conference Issue

Vol. XXI, No. 10 • Issues and Information for the Insolvency Professional • December/January 2003

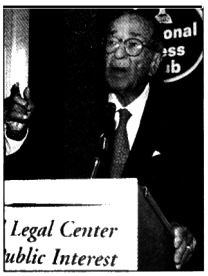
ABI Breaks 9,000-member Mark

Karen Ostad, Of Counsel in Lovells's New York office, has become ABI's 9,000th member. Ms. Ostad specializes in corporate restructuring and insolvency matters on behalf of financial institutions, investors and multinational corporations. As a member of Lovells, a large international law firm, Ms. Ostad advises clients in both domestic and multinational workouts and insolvencies. A 1988 graduate of New York Law School, Ms. Ostad is also a member of the American and International Bar Associations, INSOL and the Women's Insolvency and Restructuring Confederation. "I joined the ABI because of the quality of its membership and the relevancy of its publications, and I look forward to contributing to both," she said. ABI reached the 9,000-member mark just 19 months after passing 8,000 members, making ABI both the largest and fastest-growing insolvency organization in the world. ■

Karen Ostad

Judge Griffin B. Bell Highlights 2003 ASM

Former Attorney General Griffin B. Bell will be the keynote speaker during the 21st Annual Spring Meeting in Washington, D.C., April 10-13, 2003. Judge Bell has served with distinction under U.S. presidents of both parties for more than 40 years. He was named to the U.S. Court of Appeals for the Fifth Circuit in 1961 and served until he was confirmed as President Carter's Attorney General in 1977. His high-level appointments since 1981 include his recent service on Secretary Donald Rumsfeld's advisory committee on military tribunals. He is a senior partner at King & Spalding in both Atlanta and Washington, D.C. Judge Bell has written and spoken extensively on the asbestos litigation crisis; these lawsuits have driven more than 50 U.S. companies into bankruptcy. Judge Bell will speak on his prescription for reform of the tort and bankruptcy laws during his luncheon address on April 11. Make plans now to attend. ■



Hon. Griffin B. Bell

An Issue That Has Confounded Courts

Do Insiders Have Standing to File an Involuntary Petition in Small Cases?

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Since the enactment of not only the Bankruptcy Code but also the Bankruptcy Act, courts have struggled with the issue of whether, in cases involving 12 or less creditors, an insider has standing to file an involuntary petition. Few contemporary courts have addressed the issue in a published opinion. No consensus has emerged. This article briefly examines the differing approaches to the issue.

Henry M. Karwowski

Applicable Code Section

Section 303(b) of the Bankruptcy Code provides in relevant part:

> [a]n involuntary case against a person is commenced by the filing with the bankruptcy court of a petition under chapter 7 or 11 of this title—
>
> (1) by three or more entities, each of which is

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L.A.-area Members Salute ABI President

More than 100 Los Angeles-area members attended a reception at the Westin Century Plaza on Oct. 24 to honor ABI President **Andy Caine** (Pachulski, Stang, Ziehl, Young & Jones PC; Los Angeles). Several judges from the Central District of California, including current Chief Judge **Geraldine Mund**, incoming Chief Judge **Barry Russell** and Judge **Erithe Smith** (judicial chair of ABI's Bankruptcy Battleground West program) made short presentations. The event was sponsored by **Josefina Fernandez McEvoy** (McEvoy & Associates), **Dennis I. Simon** (Crossroads LLC) and **Michael L. Tuchin** (Klee, Tuchin, Bogdanoff & Stern). ABI Executive Director Samuel J. Gerdano provided an update on the status of the bankruptcy legislation. ■

Reception attendees (l-r): Sam Gerdano, Andy Caine, Hon. Geraldine Mund, Hon. Barry Russell, Hon. Erithe Smith, Richard M. Pachulski and Josefina Fernandez McEvoy.

On the Inside

Directory of Winter Conference Sponsors and Exhibitors

> either a holder of a claim against such person that is not contingent as to liability or the subject of a bona fide dispute, or an indenture trustee representing such a holder, if such claims aggregate at least $11,625 more than the value of any lien on property of the debtor securing such claims held by the holders of such claims;
> (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 §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 $11,625 of such claims.

11 U.S.C. §303(b).

Section 101(31) defines the term "insider"; the definition varies depending on the status of the debtor. For instance, if the debtor is a corporation, insiders include directors, officers and general partners of the debtor. *See* §101(31)(B).

Courts Permitting an Involuntary Petition

A number of courts have interpreted §303(b) to allow an insider, or an employee or transferee, with which insiders are associated in subpart (b)(2), to file an involuntary petition in cases involving 12 or less creditors. *See Sipple v. Atwood (In re Atwood),* 124 B.R. 402, 405 n.2 (S.D. Ga. 1991) ("Petitioning creditors...qualify [to file an involuntary petition] even if their claim is voidable."); *In re Little Bldgs. Inc.,* 49 B.R. 889, 890-91 (Bankr. N.D. Ohio 1985) (denying debtor's motion to dismiss involuntary petition filed by insiders); *In re United Kitchen Assocs. Inc.,* 33 B.R. 214, 215 (Bankr. W.D. La. 1983) ("Under the plain meaning of 11 U.S.C. §303(b)(1) and (2), employees of the debtor may be petitioning creditors for involuntary bankruptcy of the debtor.").

Of these courts, only the *Little Bldgs.* court actually reviewed the language of the statute, and concomitantly, explained the basis for its decision. In denying a motion to dismiss an involuntary petition filed by certain officers, directors, employees or shareholders of the debtor, it found: "Although the [debtor] in this case has argued that the language of the involuntary provisions should be interpreted to mean that insiders must be excluded from the group of claimants eligible to file a petition, the language of the section states, with mathematic-like certainty, that the claims of insiders are excluded only from consideration in determining the number of an alleged debtor's creditors." *Little Bldgs.,* 49 B.R. at 890-91. "Insiders are still eligible," it held, "to initiate involuntary proceedings against the entity they are or were associated with." *Id.* at 891.

Courts Not Permitting an Involuntary Petition

A number of courts have reached the opposite conclusion: An insider, or employee or transferee, lacks standing to file an involuntary petition in cases with fewer than 12 creditors. *See In re Gills Creek Parkway Assocs. L.P.,* 194 B.R. 59, 62 (Bankr. D. S.C. 1995) (asserting in dicta that claims of employees, insiders and transferees of debtor are excluded from consideration in determination of single creditor's eligibility to file involuntary petition); *In re Runaway II Inc.,* 168 B.R. 193, 198 (Bankr. W.D. Mo. 1994) (dismissing case filed by insider); *In re Kenval Mktg. Corp.,* 38 B.R. 241, 244 (Bankr. E.D. Pa.) ("[C]reditors attempting to file under...§303(b)(2)...are precluded from successfully filing if they hold voidable preferences."), *reconsideration denied,* 40 B.R. 445 (Bankr. E.D. Pa. 1984); *In re Kreidler Import Corp.,* 4 B.R. 256, 259 (Bankr. D. Md. 1980) (rejecting "the construction advanced...that preferred creditors are not counted but are eligible to join in an involuntary petition").

Because it contains an extended analysis of the plain meaning of the applicable statute, *Runaway* is perhaps the most convincing authority for this proposition. The *Runaway* court noted that the phrase "such holders" appears twice in §303(b)(2). *See Runaway,* 168 B.R. at 196. "The first use of 'such holders,'" it found, "refers back to §303(b)(1) where a holder is 'a holder of a claim against such person that is not contingent as to liability or the subject of a bona fide dispute.'" *Id.* "However," it observed, "the first use of 'such holders' is immediately followed by language excluding employees, insiders and creditors holding avoidable transfers." *Id.* The court found that "[t]hese exclusions modify the phrase 'such holders' as it is used in subsection (b)(2)." *Id.* "The second use of 'such holders,'" it determined, "refers to the first use of the phrase in subsection (b)(2) and its exclusions" and "directly modifies the 'one or more' creditor language." *Id.*

"Thus," the court concluded, "to file a petition under (b)(2), a creditor must hold a claim that is not contingent, subject to a bona fide dispute, nor be the claim of an employee, insider or transferee of an avoidable transfer." *Id.*

In reaching this conclusion, the *Runaway* court disagreed with the *Little Bldgs.* interpretation. It found that "the *Little Bldgs.* court looked only at the first use of the term 'such holders' in subsection (b)(2)" and that "[i]t did not analyze the second mention of the same term which appears after the exclusions." *Id.* Further, the *Runaway* court noted that, under the Bankruptcy Act, "[courts] held that creditor counting exclusions [now codified in §303(b)(2)] also affected the creditor's standing to file or join an involuntary petition," *Id.* at 196-97 (*quoting Stevens v. Nave-McCord Mercantile Co.,* 150 F. 71 (8th Cir. 1906)). Finally, it asserted that "[t]he exclusion of insiders from filing a petition makes sense from a policy perspective when, as here, the bankruptcy is the result of an internal struggle for corporate control." *Id.* at 198.

The court concluded: "When there are less than 12 creditors, employees, insiders and creditors receiving avoidable preferences cannot file an involuntary petition." *Id.*

Analysis

Plausible arguments can be raised in support of each approach. For instance, parties opposing the filing of an involuntary petition, such as the debtors themselves, can argue that, as noted in *Runaway,* the language of §303(b)(2) should be interpreted to disqualify insiders in cases involving less than 12 creditors. Moreover, these parties can cite cases in which courts construed the corresponding Bankruptcy Act provision in the same fashion. *See, e.g., Stevens,* 150 F. 71. Finally, these parties can emphasize the point, apparently not raised in any published opinion, that §303(b) contains a specific subpart authorizing the filing of an involuntary petition against a partnership by its general partners, *i.e.,* insiders. *See* 11 U.S.C. §303(b)(3); 11 U.S.C. §101(31)(C)(i) (defining general partner in debtor as insider where debtor is partnership). They can argue that if it had intended to allow all insiders, including corporate insiders, to file an involuntary petition, Congress could have easily included language to that effect in §303.

In contrast, insiders can argue that, as noted in *Little Bldgs.,* the exclusionary language in §303(b)(2) should be interpreted

to apply for counting purposes only. Further, they can emphasize that a consensus hardly existed among courts with respect to the issue of insiders' eligibility under the Act to file an involuntary petition; in fact, some courts found insiders eligible. *See, e.g., J.J.S. Co. v. Sacks (In re J.J.S. Co.),* 445 F.2d 138, 139 (7th Cir. 1971) ("While 11 U.S.C.A. §95(e)...excludes shareholders, officers and directors in the computation of the number of creditors of a bankrupt for the purposes of determining how many creditors must join in the petition, it does not serve to disqualify an officer, director or shareholder as a petitioning creditor."), *citing Winkleman v. Ogami,* 123 F.2d 78, 80 (9th Cir. 1941).

Yet another argument, apparently not raised in any published opinion, may carry the day. Transferees generally lack incentive to file an involuntary petition. *See In re Syke Mktg. Corp.,* 11 B.R. 891, 897 (Bankr. E.D.N.Y. 1981) ("[A] creditor who is being paid lacks an incentive to join [or file] an involuntary proceeding because of the risk that a portion of his claim would be sought as a preference by the trustee while the balance of his claim would be discharged in bankruptcy."). Although one can contemplate situations in which they may have selfish reasons to file an involuntary petition, *e.g.,* cases such as *Runaway* involving an internal struggle for control, insiders and employees generally also lack such incentive. *See Id.* ("Insiders who have become creditors of their businesses are deterred...from joining in [or filing] an involuntary petition."). Given this lack of incentive, one can argue that Congress could not possibly have intended that these parties should lack standing to file an involuntary petition. Indeed, it is for this very reason—lack of incentive—that these parties are excluded for counting purposes. *See Id.* at 897-98 (observing that Congress sought to avoid "collusion between the insolvent debtor and friendly creditors through which an involuntary petition might be defeated" and concluded, as a result, that "[t]hose who would be deterred from joining the effort to petition a debtor into bankruptcy...are not to be counted according to the dictates of §303(b)(2)"). ■