

# Considerations For The Filing Of Involuntary Bankruptcies

## PART III: EXAMPLES OF WHEN AND WHEN NOT TO FILE AN INVOLUNTARY PETITION

In Part I of this series we discussed the prerequisites necessary in order to file an involuntary petition. In Part II, we discussed the damages creditors could incur if they filed an involuntary petition under the wrong circumstances. In this final article of our three-part series, we will attempt to illustrate by example some good and bad cases for creditors to employ the involuntary petition as a collection strategy.

For our first example, imagine you, as a credit manager, have been pressing your buyer, Acme Products, Inc., for payment on a large outstanding balance for months. You may have received \$1,000 on account each month, but the outstanding sum, originally billed on a "30 days net" basis, is still quite large by comparison.

During your last collection phone call, you are informed that Acme Products no longer has the money to meet its payroll and has closed its doors. Since the filing of a Chapter 7 liquidation bankruptcy for a corporate debtor is usually a waste of time and energy, Acme has simply surrendered their collateral to its secured creditors and shut down its plant. Several unsecured creditors had filed collection lawsuits which are in various stages of litigation, but they now have little incentive to reduce their claims to judgment because there are no assets from which they can collect.

You later learn from your former contact at Acme—now a disgruntled former employee—that in the year prior to closing its doors, Acme management had seen to it that several large unsecured loans from its directors had been carefully repaid, thereby depleting the company's cash flow significantly and making trade creditors go begging.

What should you do? Immediately see a lawyer having expertise in bankruptcy. The filing of a Chapter 7 involuntary petition may allow a court appointed trustee to pursue the directors for all funds repaid to them by the debtor in the year prior to the petition date. These funds would then be available for distribution to trade creditors of the estate such as yourself. The recovery of such large preferential payments by the estate is a very good reason to file an involuntary petition.

But suppose all the facts recited above were the same except that you had no informant nor any other reason whatsoever to suspect that there were preferential transfers to insiders in the prior year. The expense of bringing an involuntary petition against a defunct corporation is not usually warranted absent such special information.

Sometimes creditors are willing to file an involuntary petition simply to get the opportunity to investigate the books of the defunct debtor because they suspect monkeyshines such as fraudulent conveyances, or merely preferential transfers of a size worth recovering, have occurred. So long as these creditors understand the rules of the game, are willing to advance the attendant expenses, and have expert counsel capable of doing the job for them, then such suspicions may constitute a good enough reason to file an involuntary for the debtor.

Another good example of when you might want to file an involuntary petition is when you know that a supposedly "secured" creditor which repossessed its collateral when the debtor closed its doors actually has problems with its documentation. The problem could be either lack of a valid security interest or failure to properly perfect that security interest. Such a secured claim can be avoided by a Chapter 7 trustee who can then recover the collateral or its value from the "secured" creditor for the benefit of general, unsecured creditors. Nothing gets a Chapter 7 trustee more excited than an opportunity to avoid a security interest claimed by a major creditor of the estate.

We hope these examples will at least keep alive in the back of your mind the possibility of using an involuntary petition as a collection strategy. In closing this three-part series, however, we must caution you once again to be careful in your choice of counsel when seeking help in such situations.

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