THE ARROW

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Considerations for the Filing Of Involuntary Bankruptcies

PART II: SOME REASONS WHY YOU MAY NOT WANT TO FILE AN INVOLUNTARY PETITION.

All too often, a creditor/client may favor pushing its debtor into an involuntary bankruptcy as a means to punish the debtor for a trail of repeated broken promises in regard to payment. Some creditors even threaten their more recalcitrant debtors with this drastic action in an effort to simply strike fear into their hearts.

As pointed out in Part I in our series on involuntary petitions, however, certain prerequisites must be met before any creditor or creditors may file an involuntary petition. The purpose of this part is to explain what can happen when an involuntary petition is filed when it should not have been.

An experienced creditor's counsel will advise his or her client that should a debtor successfully oppose the involuntary petition filed against it — that is, if the debtor's opposition to the involuntary petition results in its dismissal — the court may grant judgment against the initiating creditor or creditors in favor of the debtor for (1) the debtor's costs, (2) the debtor's reasonable attorney fees, and (3) any damages proximately caused by a court appointed trustee taking possession of the debtor's property.

That third element of damages deserves some comment. If creditors believe a debtor is committing waste, then they frequently want the court to appoint a trustee to step in and take charge of the debtor's operation while they await entry of an Order of Relief. Remember, there is a twenty-day "gap" wherein the debtor may go on with business as usual while the time period for it to oppose the involuntary petition filed by its creditors is running. If waste has been committed or is feared, then creditors might very well push for the appointment of a trustee on an emergency basis during that gap. Appointment of an interim trustee when it is necessary to preserve the property of the estate or prevent loss to the estate is provided for in 11 U.S.C. Section 303(g). Imagine what damages could be caused by the appointment of someone not knowledgeable about the debtor's business who nevertheless must operate it while the properness of the involuntary petition is litigated.

Once an involuntary petition is dismissed by the court for the petitioning creditors' failure to establish the prerequisites discussed in last month's article — that is, the debtor is generally not paying its debts as they become due, or that a custodian has been appointed within 120 days prior to the petition's filing to take charge of substantially all of the property of the debtor – the court may then go on to make an additional finding that the original involuntary petition was filed by the petitioning creditors in bad faith. If such a finding of bad faith is made, the court can hold petitioning creditors liable for any damages proximately caused by the petition's filing, and also punitive damages.

What kind of damages could be proximately caused by the filing of an involuntary petition? They are easy enough to imagine. No doubt a debtor would claim damage to credit, loss of business, loss of its suppliers, etc., etc., etc. Only the imagination of the debtor and its lawyers would limit the amount of damages claimed. Of course, the very thought of punitive damages is scary and needs no illustrations.

One example of a bad faith filing might be the use of the involuntary petition as a means by a single creditor to club the debtor into payment of a disputed account. Such a procedure is, of course, very dangerous in view of the statutory penalties.

Next month, in Part III of this series, we will discuss examples of when to file an involuntary petition as well as other examples of when not to file. As a final caution for this month, however, we advise that involuntary bankruptcy petitions are rare enough phenomena that a creditor considering one is well advised to seek the counsel of an experienced creditors' attorney who is well versed not only in general

bankruptcy law, but also in the specifics of the involuntary bankruptcy statute and rules.