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### 1.0 Law & Legal CLE Credit – A/V Approval #1034425

Recording Date – January 10, 2017

Recording Availability – March 9, 2017

Meeting Location	Date	Time	Topic
King County Bar Association 1200 Fifth Avenue - Suite 700 Seattle, WA	<b>Tuesday, January 10, 2017</b>	12:00 PM to 1:15 PM	Everything You Ever Needed to Know About Involuntary Bankruptcies

#### AGENDA

- 12:00 PM** Introductions/Lunch
- 12:10 PM** Presentation: ‘Everything You Ever Needed to Know About Involuntary Bankruptcies’, by Ben Ellison, Cairncross & Hempelmann, P.S.; Don Bailey
- 1:15 PM** Evaluations & Adjourn

#### SPEAKER BIOGRAPHY:

**Ben Ellison, Cairncross & Hempelmann, P.S.** – Ben Ellison is of counsel at the law firm Cairncross & Hempelmann, P.S. Ben specializes in litigation-intensive bankruptcy matters, and has been practicing since 2004. He has a LL.M. in bankruptcy, formerly served as a term clerk for the Tacoma bankruptcy court, and is a former winner of the American Bankruptcy Institute student writing prize.

**Donald Bailey** – Donald Bailey is a graduate of Yale College (1973) and Cornell Law School (1978). At Cornell, he was a member of the Law Review and a research assistant to Professor Robert S. Summers. Mr. Bailey has practiced bankruptcy law in Seattle since 1983, representing debtors, creditors and trustees. From 1988 to 2015, he was a partner in the firm of Shafer & Bailey, concentrating on business bankruptcy and individual bankruptcies involving substantial legal issues. He continues that practice as a solo attorney. Mr. Bailey lectures frequently at continuing legal education seminars in the areas of business bankruptcy, pre-bankruptcy planning, and bankruptcy litigation. He is a past author of the bankruptcy section of the Washington Lawyer Practice Manual. He also helps to coach the Mock Trial Team for The Bush School.

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# Involuntary Bankruptcies: Facts and Stories from the Frontlines

By Don Bailey and Ben Ellison

# Overview

- This presentation presumes some familiarity with involuntary bankruptcies, including the underlying statutory and rules framework.
  - 11 U.S.C. § 303(a): *“An involuntary case may be commenced only under chapter 7 or 11 of this title, and only against a person, except a farmer, family farmer, or a corporation that is not a moneyed, business, or commercial corporation, that may be a debtor under the chapter under which such case is commenced”*
  - FRBP 1003, 1004, 1010, 1011, 1013, 1018
- Best way to think of involuntaries is initially not as a formal bankruptcy cases, but as expedited adversary proceedings: *“The court shall determine the issues of a contested petition at the earliest practicable time ...”* FRBP 1013(a).
- In the interim “gap” period while the *bona fides* of the filing are being determined, there is an automatic stay, but no bankruptcy estate.

# Background

- Involuntaries are the “original” form of bankruptcy, but are currently disfavored as they may constitute “involuntary” servitude. H. R. Rep. No. 95-595, at 120 (not permitted for Chapter 13). *See also In re MicroStructure Technologies*, Case No. 08-44074, ECF No. 76 at p. 4 (“*When an involuntary petition is dismissed on grounds other than the consent of the parties, and the debtor has not waived the right to judgment, a rebuttable presumption arises that reasonable fees and costs are authorized. ‘[A]ny petitioning creditor in an involuntary case . . . should expect to pay the debtor’s attorney’s fees and costs if the petition is dismissed.’ A rebuttable presumption exists that reasonable fees and costs are authorized in order ‘to reinforce the Idea’ that involuntary petitions “should not be lightly undertaken,’ and ‘to discourage inappropriate and frivolous filings.’ The petitioning creditor can overcome this presumption by establishing that factors exist under the totality of the circumstances that support the disallowance of fees.”*) *See also In re GNP Rly Inc.*, 11-40829, ECF No. 156.
- Involuntaries always seem like an act of desperation, where you have been pursuing some recalcitrant debtor for some time, to no success, you know or wonder if something is there, and you just want to press the button. It is a nuclear option, because by filing, you will have to share any recovery with all the other creditors.

# Reasons to File

- If there is a recent settlement with other creditors or a judgment is about to be entered against it, the involuntary starts the clock on recovering preferences. Certainly gets the attention of the debtor if he or she has been lacking focus up until then.
- Cost-effective way to have a Chapter 7 Trustee recover insider transfers (fraudulent conveyances). Use debtor's assets to litigate against debtor.
- Means for arresting Ponzi schemes.
- Way for minority shareholder-owners to “authorize” bankruptcy filing (shareholder deadlock).
- Mechanism to stop receivership or foreclosure sale.
- Prevent filing of larger cases in Delaware.
- Cathartic way to settle score publicly.
  - Possible abuse (Tift)

# The Downside: Threats of Sanctions

- Attorney's fees and other damages in the bankruptcy proceeding. 11 U.S.C. § 303(i).
- Attorney fees on appeal when involuntary petition is dismissed. *Compare DVI Receivables XIV, LLC v. Rosenberg (In re Rosenberg)*, 779 F.3d 1254 (11th Cir. Fla. 2015) (attorneys fees for appeal available under Bankruptcy Code § 303(i)(1) and also for prosecution of bad-faith claim under Bankruptcy Code §303(i)(2)) with *Higgins v. Vortex Fishing Sys. (In re Vortex Fishing Sys.)*, 379 F.3d 701 (9th Cir. Ariz. 2004) (FRAP 38 is the sole authority for award of attorney fees on appeal, requiring a showing of a frivolous appeal). At the same time, the Ninth Circuit recognizes that fee-shifting statutes such as Bankruptcy Code §303(i) generally shift fees for the entire litigation. *Orange Blossom Ltd. P'ship v. S. Cal. Sunbelt Developers, Inc. (In re S. Cal. Sunbelt Developers, Inc.)*, 608 F.3d (9th Cir. Cal. 2010).

# Considerations after Filing

- Options after petition is filed
  - Dispute that all petitioning creditors have claims that are sufficient in terms of certainty or amount by either denying through an answer or a motion to dismiss.
    - Move to abstain
    - Threaten to seek sanctions
    - Move to require bond
    - Negotiate “exit” by satisfying judgments.
    - How much does a fully contested involuntary cost (motion to dismiss, discovery, and trial)?
  - Consent to the bankruptcy, consider converting to Chapter 11.
    - Then face a Scheduling Order and a series of Orders to Show Cause



# Statistics

- Approximately 1/10 of 1% of cases are involuntaries— between 2 and 16 discrete cases per year in the Western District of Washington.
- How long does an involuntary take ?
- Typically involve non-bankruptcy counsel or no counsel and infrequently conflicting briefing.
- What percent of involuntaries “consensually” become bankruptcies?
- What percent of involuntaries “non-consensually” become bankruptcies?
- What percent of involuntaries are ultimately dismissed?
- What percent of involuntaries are dismissed? Are there ever trials?

# Key cases: 2016, 2015, 2014

- 16-44918                      *Stetson Ridge Partners LLC*
  - *Motion to dismiss for bad faith/lack of capacity (ECF No. 7)*
- 16-10800                      *Elumwood Associates LP*
  - *Insider filing, trustee appointed, petitioning creditors' fees paid*
- 15-10673                      *Veterans Pride Coffee Inc.*
  - *Motion to dismiss for lack of bona fide claims (fully litigated, oral ruling granting dismissal, ECF No. 9, 14, 19)*
- 14-14641                      *Cordon Selections*
  - *Motion for abstention due to pending receivership (completely briefed, and oral ruling: ECF Nos. 9, 21, 27); contested motion to convert from 7 to 11 (ECF Nos. 36, 44, 45, 46, 49)*

# Key cases: 2013, 2012

- 13-11334            *Express Transport*
  - Motion to abstain provisionally granted (ECF Nos. 19 & 34).
- 13-44600           *Ronald Tate*
  - Motion to settle and dismiss (ECF No. 76)
- 13-20756           *Thomas Chin*
  - Filed trial briefs (ECF Nos. 12 & 15)
- 12-12200           *Koeun H Inc*
  - Objection to Motion for Administrative Priority for Fees (ECF No. 9)

# Key cases: 2011, 2010

- 11-40829      *GNP Rly Inc*
  - *Motion to file a bond (ECF Nos. 21, 29)*
- 10-14343      *InMediaRes Productions LLC*
  - *Briefing on timing of filing answer (ECF No. 14)*
- 10-46535      *Susan Buratto and Stan Buratto*
  - *Briefing on improper joinder (ECF Nos. 14, 15, 20)*

# Additional Reading

- *The Involuntary Bankruptcy Petition: The World's Worst Debt Collection Device?* Brad Godshall and Peter Gilhuly, *Business Lawyer*; Aug98, Vol. 53 Issue 4, p.1315.
- *Creditors, Beware: Bankruptcy Code Authorizes Broad Award of Attorneys Fees upon Dismissal of Involuntary Petition*, Michael Friedman and Clay Roberts, *ABI Journal* April 201 and 6 at page 48.
- *Involuntary Judgment Creditors Beware: 1st Circuit Peeks Behind State Court Judgment for Bona Fide Dispute*, Jeremy Fischer and Julia Pitney, *ABI Journal* May 2016 at page 30.
- *When Is a Claim in “Bona Fide Dispute” under § 303(b)?*, David Jennis and Kathleen DiSanto, *ABI Journal* October 2016 at page 30.
- *Ron Bennett cases*, 12-12203, 12-12242

# Conclusion