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Can I Be Held Liable as a Petitioning Creditor When an Involuntary Bankruptcy Is Dismissed?

Creditor's Rights Toolkit

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This article discusses the requirements to file an involuntary petition, the grounds on which the involuntary petition may be dismissed, and the types of liability that can be imposed on a petitioning creditor.

An involuntary bankruptcy can be a powerful tool in a creditor's arsenal. Involuntary bankruptcies are rarely filed, however, because of the significant risk of liability for the petitioning creditor if the case is dismissed. A creditor considering filing an involuntary bankruptcy must understand the requirements for filing involuntary bankruptcy cases, which are strictly construed and applied, and be mindful of the associated risks. This article discusses the requirements to file an involuntary petition, the grounds on which the involuntary petition may be dismissed and the types of liability that can be imposed on a petitioning creditor.

KEY ISSUES

WHAT ARE THE REQUIREMENTS FOR FILING AN INVOLUNTARY BANKRUPTCY?

The Bankruptcy Code sets forth the following minimum number of petitioning creditors. If a debtor has:

- More than 12 creditors holding qualified claims against the debtor, then three or more of these creditors holding in the aggregate at least $18,600 in eligible unsecured claims may file an involuntary case (§ 303(b)(1), Bankruptcy Code).
- Less than 12 creditors holding qualified claims against the debtor, then one or more of these creditors holding in the aggregate at least $18,600 in eligible unsecured claims may file an involuntary case (§ 303(b)(2), Bankruptcy Code).

While the literal requirements for filing an involuntary petition are simple enough, the mechanical application of the legal standards to a specific filing will not end the inquiry if the petitioning creditors file the petition in bad faith.

WHY WOULD THE PETITION BE DISMISSED?

The usual case of dismissal of an involuntary petition focuses on whether the requirements were met under the Bankruptcy Code (described above). Additionally, a petition might be dismissed if it was filed in bad faith. Certain courts have expanded this concept and have explained the petition must have also been filed in "good faith," which includes the existence of proper reasons, such as to avoid the preference of certain creditors or the dissipation of assets. Therefore, there must be an absence of "bad faith" factors, including ill will, a desire to

harass the debtor, to obtain a disproportionate or tactical advantage, or as a substitute for customary debt-collection procedures.

WHAT HAPPENS IF THE COURT DISMISSES MY PETITION?

The consequences of filing an involuntary bankruptcy can be serious for the company against which the petition was filed. Therefore, the Bankruptcy Code provides that if the court dismisses the petition other than by agreement of all petitioners and the debtor, the court may award costs or reasonable attorney's fees. If the petition is found to have been filed in bad faith, the court may also award damages proximately caused by the filing or punitive damages. This means that the petitioning creditor would have to pay for costs associated with any consequences caused by the filing, and even additional damages as punishment.

TAKEAWAY

Before deciding to file an involuntary petition, it is critical that a creditor, in consultation with experienced bankruptcy counsel, make a reasonable inquiry into the relevant facts and understand the risk associated with filing an involuntary petition. Because of the severe consequences recognized by the court, and the potential for a creditor to have to pay costs associated with the petition, including punitive damages, a creditor should carefully consider alternatives to filing an involuntary petition and should consider an involuntary petition is a "last resort."

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