By Donald L. Swanson

Involuntary Bankruptcy: BAPCPA Amendment to § 303(b) Needs to Be Revoked

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Filing an involuntary bankruptcy petition as a petitioning creditor is a precarious action. The risks involved are intense, including potential liability for the debtor's costs, attorneys' fees, actual damages and punitive damages.[1] To qualify as an involuntary bankruptcy petitioner, under 11 U.S.C. § 303(b) a creditor's claim must not be subject to a "*bona fide* dispute."

Before 2005, a creditor could be disqualified under the *bona fide* dispute standard only if its entire claim was disputed: "To eliminate a creditor as an eligible petitioning creditor, the *bona fide* dispute must go to the entire claim. A *bona fide* dispute as to a portion of the petitioning creditor's claim does not disqualify that creditor from filing an involuntary case."[2]

This "entire claim" disqualification standard was difficult and threatening enough for petitioning creditors. However, in 2005, the standard got even tougher. Since 2005, a creditor is now ineligible to be an involuntary petitioner if *any portion of the creditor's claim* is disputed. A November 2023 bankruptcy opinion explained the post-2005 rule: "[A] dispute as to any portion of a claim, even if some dollar amount would be left undisputed, means there is a *bona fide* dispute," and the creditor is ineligible to be a petitioning creditor under § 303(b).[3] The 2005 change occurred by the addition of five words to § 303(b)(1) (emphasis added):

> (b) An 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 either a holder of a claim against such person that is not contingent as to liability or the subject of a *bona fide* dispute *as to liability or amount*....

This addition occurred as part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA). The design behind BAPCPA has been described as (1) "to deter people from pursuing bankruptcy by making filing for it more difficult and expensive, as well as less financially advantageous";[4] and (2) "to make filing for bankruptcy more difficult, more expensive and less financially advantageous for households."[5] BAPCPA's enactment succeeded in its purpose: A million fewer consumer bankruptcy filings occurred in the two years following BAPCPA than what would have otherwise been expected.[6] Consistent with the intention to reduce the number of bankruptcy filings, those five words were added to § 303(b) to make petitioning-creditor eligibility more difficult to achieve.

The addition of those five words created both an irony and a tension. On the one hand, involuntary bankruptcy is an effective creditor tool for addressing a debtor's existing and potential financial abuses (such as avoiding insider preferences and fraudulent transfers), as well as gaining bankruptcy protections (such as disclosure requirements), but on the other hand, BAPCPA views the very act of filing an involuntary bankruptcy petition as a potential abuse that might need to be prevented. It is fair to suggest that Congress, in its desire to decrease the number of bankruptcy filings through BAPCPA, may have overreacted and made involuntary petitioning creditor eligibility excessively stringent. For example, consider this vendor hypothetical under existing § 303(b)(1) language.

A vendor sells 100 items of its product to the debtor, and payment is now long past due. The vendor learns that the debtor is transferring assets to insiders without fair consideration, so the vendor accepts the invitation of two other creditors to join in an involuntary bankruptcy petition against the debtor.

Once the petition has been filed, the debtor argues that one of the vendor's 100 product items was defective — and therefore the vendor's claim is a *bona fide* dispute for § 303(b)(1) purposes. In response, the vendor could presumably waive its claim as to the allegedly defective item, amend the petition accordingly and still proceed.

Suppose that the debtor instead alleges that 90 of the vendor's 100 items are defective. The vendor feels sure that the defectiveness claim is without merit and does not want to waive its claim to the 90 items, but the

1 11 U.S.C. § 303(i).
2 *Collier on Bankruptcy*, Vol. 2, ¶ 303.03[2][b][iii], at 303-24 & 25 (15th ed.).
3 *In re Azteca, S.A.B. de C.V., et al.*, Case No. 23-10385, (Bankr. S.D.N.Y. Nov. 20, 2023), 2023 Bankr. LEXIS 2786.
4 Matthew Notowidigdo, "Assessing the Bankruptcy Law of 2005," Inst. for Policy Research, Northwestern Univ. (Dec. 16, 2019), *available at* ipr.northwestern.edu/news/2019/assessing-the-bankruptcy-law-of-2005.html (last visited July 23, 2024).
5 Steve Maas, "Bankruptcy Reform of 2005 Sharply Reduced Filings," *The Digest*, published by Nat'l Bureau of Econ. Research (Dec. 1, 2019).
6 *Id.*

vendor also does not want to run the risk of a trial. In this scenario, the vendor may effectively be left without the ability to file an involuntary bankruptcy under § 303(b)(1) as it currently exists, which appears to portray a problem without a viable solution.

Purpose and History of § 303(b)

The purpose and history of § 303(b) shed light on this present situation.[7] The purpose of involuntary bankruptcy is to provide a method for creditors to protect their rights against debtors who are not meeting their debts.[8] Bankruptcy in general, and § 303 in particular, encourage group action by creditors and discourage a "race to the courthouse" by individual creditors for their separate benefit.[9] The Bankruptcy Code's initial version of § 303(b) did not contain a "*bona fide* dispute" limitation on creditor eligibility; the only such limitation was that the creditor's claim not be "contingent as to liability." Yet, even under that initial version, courts disagreed on whether a disputed claim would qualify as a basis for a petitioning creditor's eligibility.[10]

Congress then enacted the Bankruptcy Amendments and Federal Judgeship Act of 1984 (BAFJA) in response to the U.S. Supreme Court's 1982 *Northern Pipeline Construction Co v. Marathon Pipe Line Co*. decision.[11] The BAFJA added the "*bona fide* dispute" eligibility requirement to § 303(b)(1).[12] The legislative record for the "*bona fide* dispute" addition includes this explanation from Sen. Max Baucus (D-Mont.) about its purpose:

> Some courts have interpreted section 303's language ... as allowing the filing of involuntary petitions and the granting of involuntary relief even when the debtor's reason for not paying is a legitimate and good-faith dispute over his or her liability. This interpretation allows creditors to use the Bankruptcy Code as a club against debtors who have *bona fide* questions about their liability, but who would rather pay up than suffer the stigma of involuntary bankruptcy proceedings.
>
> My amendment would correct this problem. Under my amendment, the original filing of an involuntary petition could not be based on debts that are the subject of a good-faith dispute between the debtor and his or her creditors.[13]

Immediately following Sen. Baucus's statement, the Senate adopted his "*bona fide* dispute" amendment to § 303(b)(1).[14] President Ronald Reagan said in his statement at signing the BAFJA into law, "The bill ... remedies abuses by both debtors and creditors in consumer bankruptcy proceedings." The BAFJA's legislative history reflects that the primary purpose of § 303(b)(1)'s "*bona fide* dispute" requirement for creditor eligibility is to protect debtors from coercive creditors.[15]

Few Involuntary Cases

The incidence of involuntary bankruptcy filings is, actually, very low.[16] Bankruptcy began in 16th century England as an entirely involuntary procedure: Creditors initiated a bankruptcy proceeding by filing a complaint against their debtor. Debtors could not file for bankruptcy voluntarily in England or the U.S. until the mid-1800s, and American corporations could not file voluntarily until 1910.

Despite the late emergence of voluntary bankruptcy, it has come to utterly dominate modern American bankruptcy practice — at the expense of the involuntary process.[17] Today, involuntary bankruptcy plays almost no role in real-world practice except, perhaps, as an action available to creditors that they may threaten, but almost never exercise.[18] A 2020 study of involuntary bankruptcy filings from 2007-17 provides the following data:

Total Bankruptcy Petitions: 11,244,521
Total Involuntary Petitions: 5,512
Involuntary Petition Percentage: 0.05 percent.[19]

When the data focuses exclusively on bankruptcies with business debts, the numbers are dramatically less, but the percentage of involuntary cases is still less than half of 1 percent:

Bankruptcy Petitions with Business Debts: 238,906
Involuntary Petitions with Business Debts: 1,016
Involuntary Petition Percentage: 0.43 percent.[20]

The same study also reported that many of the involuntary bankruptcies filed from 2007-17 were filed by petitioners acting *pro se*. It is no surprise that an "overwhelming majority" of *pro se* involuntary cases are dismissed.[21] Thus, the study made this recommendation for improving involuntary bankruptcy law: "[A]n involuntary petition filed without an attorney's signature should not be placed on the court's docket or reported to credit bureaus and should not trigger the automatic stay. In short, bankruptcy law should ban *pro se* involuntary petitions."[22] Based on this evidence, it is hard to understand how Congress could conclude that involuntary bankruptcy filings are out of control and need to be limited, except for involuntary cases filed by *pro se* petitioners.

Involuntary Bankruptcies Should Be Encouraged?

Moreover, the same study also argued that involuntary bankruptcy cases are not only a good thing ... they should be encouraged! Here is the argument:

> Evidence from both theory and practice suggests that the demise of involuntary bankruptcy has had significant social costs.... This Article [provides] a com-

7 *See generally* Steven J. Winkelman, "A Dispute over Bona Fide Disputes in Involuntary Bankruptcy Proceedings," *Univ. of Chicago Law Review*, Vol. 81: Issue 3, Article 10 (2014).
8 *Id.* at 1344 (citing *In re All Media Props. Inc.*, 5 Bankr. 126, 137 (Bankr. S.D. Tex. 1980); *In re Apache Trading Grp. Inc.*, 229 Bankr. 891, 894 (Bankr. S.D. Fla. 1999)).
9 *Id.* at 1344-45 (citing *Coral Petroleum Inc. v. Banque Paribas-London*, 797 F.2d 1351, 1355 (5th Cir. 1986), quoting Bankruptcy Law Revision, H.R. Rep No. 95-595, 95th Cong, 1st Sess. 177 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6138).
10 *Id.* at 1345-46, *see* fns.21-25.
11 458 U.S. 50 (1982).
12 *Id.* at 1347.
13 *Id.* at 1347-48.
14 *Id.* at 1348.
15 *Id.*
16 *See* Richard M. Hynes & Steven D. Walt, "Revitalizing Involuntary Bankruptcy," 105 *Iowa Law Review* 1127, at 1150-61 (2020).
17 *Id.* at 1128 (citing Max Radin, "The Nature of Bankruptcy", 89 *U. Pa. L. Rev.* 1, 3-4 (1940); Louis Edward Levinthal, "The Early History of English Bankruptcy," 67 *U. Pa. L. Rev.* 1, 14-15 (1919); W.J. Jones, "The Foundations of English Bankruptcy: Statutes and Commissions in the Early Modern Period," 69 *Transactions Am. Phil. Soc'y*, No. 3 (July 1979), at 25; John C. McCoid II, "The Origins of Voluntary Bankruptcy," 5 Bankr. Dev. J. 361, 361 n.4-5 (1988); Garrard Glenn, "The Law Governing Liquidation: As Pertaining to Corporations, Partnerships, Individuals, Decedents, Bankruptcy, Receivership, Reorganization," 136-40, 310 (1935)).
18 *Id.* at 1132.
19 *Id.* at 1152.
20 *Id.*
21 *Id.* at 1132.
22 *Id.*

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prehensive study of the previously vibrant practice of involuntary bankruptcy. Crucially, we find that early twentieth-century bankruptcy practice provided *de facto* incentives for involuntary petitions by rewarding filing attorneys with lucrative post-petition work. Such rewards helped overcome the collective-action problems that otherwise discourage creditors from filing.

The law of involuntary bankruptcy should look back to that past to find its future. We propose a number of reforms, including instituting a system of *de jure* "bankruptcy bounties" to encourage involuntary petitions that will revitalize involuntary bankruptcy and restore its rightful place in the law and theory of bankruptcy.[23]

23 *Id.* at 1127.

These views are at great variance with the supposed purpose of BAPCPA of tightening up eligibility for filing an involuntary bankruptcy petition as a way to prevent abuse.

Solution

There is an important difference between being coerced by a creditor whose entire claim is in *bona fide* dispute vs. being placed into involuntary bankruptcy by a creditor with a completely or mostly undisputed claim (even when a portion is disputed). In managing the tension between limiting the number of bankruptcy filings and providing an involuntary bankruptcy tool for creditors, BAPCPA's five-word addition to § 303(b)(1), "as to liability or amount," should simply be removed from that Bankruptcy Code provision. abi