

1-1-2018

Equity or Inequality: Defining Bad Faith in Involuntary Bankruptcy

Carlos Wilder

Follow this and additional works at: <https://dc.suffolk.edu/jtaa-suffolk>



Part of the [Litigation Commons](#)

Recommended Citation

23 Suffolk J. Trial & App. Advoc. 164 (2017-2018)

This Notes is brought to you for free and open access by Digital Collections @ Suffolk. It has been accepted for inclusion in Suffolk Journal of Trial and Appellate Advocacy by an authorized editor of Digital Collections @ Suffolk. For more information, please contact dct@suffolk.edu.

EQUITY OR INEQUALITY?: DEFINING BAD FAITH IN INVOLUNTARY BANKRUPTCY

*“[W]hen we consider the rapid development of corporations as instrumentalities of the commercial and business world in the last few years, with the corresponding necessity of adapting legal principles to new and vary exigencies of this business, it is no solid objection to such a principle that it is modern, for the occasion for it could not sooner have arisen.”*¹

The United States Court of Appeals for the Third Circuit recently entered a judgment dismissing a creditor’s involuntary bankruptcy petition for bad faith, notwithstanding the creditor’s compliance with the standing requirements.² This new and impactful decision puts creditors in a hostile situation, as the already stringent requirements to filing an involuntary bankruptcy petition have been heightened.³ This holding does not come as a surprise, however.⁴ The Third Circuit’s decision follows a trend of decisions over the past few decades that have scrutinized creditors’ attempts to pull debtors into court to collect on their debts.⁵

The bankruptcy laws established in the United States have provided an outlet for creditors to seek repayment on the debts of unwilling debtors.⁶ Unlike the traditional voluntary bankruptcy route, where a debtor seeks to

¹ Sawyer v. Hoag, 84 U.S. 610, 620 (1873) (identifying importance of legal reform).

² See *In re Forever Green Athletic Fields, Inc.*, 804 F.3d 328, 336 (3d Cir. 2015) (holding involuntary bankruptcy petition dismissible at inception for bad faith).

³ See Barry M. Klayman, *A Cautionary Tale for Involuntary Bankruptcy Petitioners*, LAW360 (Oct. 26, 2015), <http://www.law360.com/articles/718749/a-cautionary-tale-for-involuntary-bankruptcy-petitioners> (noting Third Circuit ruling places another hurdle in front of creditors filing involuntary petitions).

⁴ See Norman N. Kinel, *When Not to File An Involuntary Bankruptcy Petition*, LAW360 (Feb. 22, 2016), <http://www.law360.com/articles/761250/when-not-to-file-an-involuntary-bankruptcy-petition> (outlining potential consequences in filing involuntary bankruptcy petition).

⁵ See Scott K. Brown, *Rolling in the Involuntary*, AM. BANKR. INST. J. (Nov. 2012), <https://www.lrrc.com/files/Uploads/Documents/Rolling%20in%20the%20Involuntary,%20by%20Scott%20Brown.pdf> (noting requirements to proceed safely with involuntary bankruptcy petition).

⁶ See Charles J. Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5, 16 (1995) (noting bankruptcy creditor remedy in early American history); Vern A. Countryman, *A History of American Bankruptcy Law*, 81 COM. L. J. 226, 228 (1976) (exhibiting early English model of bankruptcy focused on involuntary proceedings).

enter resolution of his debt situation with his creditors, the involuntary petition allows a creditor to force a debtor into bankruptcy, as long as the creditor follows strict guidelines set forth in the Bankruptcy Code.⁷ Even with the standing to bring a case, courts have probed creditors' attempts to file involuntary petitions, often dismissing the claims because the creditors allegedly acted in bad faith.⁸ These dismissals have been largely based on the Circuit Courts' varying interpretations of bad faith.⁹

Recent decisions have influenced bankruptcy laws to support the notion that involuntary bankruptcy petitions are too harsh a burden on debtors.¹⁰ As a result, courts have begun imposing harsh sanctions on attorneys and parties that allegedly file involuntary petitions in bad faith.¹¹ The Bankruptcy Code provides for sanctions and punitive damages to be imposed with respect to bad faith bankruptcies under 11 U.S.C. § 303(i), but the legislative history of the Bankruptcy Code does not provide a basis for

⁷ See Nicholas Gebelt, *Involuntary Bankruptcy: What Is It, and Why Would Anyone File One?* S. CAL. BANKR. LAW BLOG (Jan. 13, 2012), <http://www.southerncaliforniabankruptcylawblog.com/2012/01/13/involuntary-bankruptcy-what-is-it-and-why-would-anyone-file-one/> (explaining purpose of involuntary bankruptcy).

⁸ See James H. Haithcock III & Robert C. Goodrich Jr., *Bad News, Will Travel Fast: Third Circuit Imposes "Good Faith" Condition on Involuntary Bankruptcy Petitioners*, 2015 NO. 12 NORTON BANKR. L. ADVISER NEWSLETTER 1 (2015) (describing recent decision by Third Circuit imposing good faith filing requirement). "[A]s courts of equity, bankruptcy courts are equipped with the doctrine of good faith so that they can patrol the border between good and bad-faith filings." *Id.*; see also *In re Forever Green Athletic Fields, Inc.*, 804 F.3d 328, 334 (3d Cir. 2015) (holding bad faith filing provides basis for dismissing involuntary suit even when statutory criteria met).

⁹ See Collier on Bankruptcy ¶303.16 (Richard Levin & Henry J. Somme reds., 16th ed. 2017) LEXIS NEXIS (noting varying interpretations of bad faith courts employ in analysis). It seems that the purpose of these tests is to alert creditors to not push too hard on debtors. *Id.*; see also Isabella C. Lacayo, Note, *After the Dismissal of an Involuntary Bankruptcy Petition: Attorney's Fees Awards to Alleged Debtors*, 27 CARDOZO L. REV. 1949, 1954 (2006) (stating purpose of bankruptcy skewed towards debtor's recovery). "The goal of bankruptcy law is skewed towards providing debtors rather than creditors with remedies; therefore, the Code constructs many barriers to efforts by creditors to obtain involuntary relief." *Id.* at 1954.

¹⁰ See Timothy Bow, Article, Student Gallery, *Involuntary Petitions: Bad-Faith Motives and High Risks*, 31-7 AM. BANKR. INST. J. 52, 55 (2012) (noting involuntary petitions frequently used litigation tactic). "Involuntary petitions have frequently been used as a litigation tactic, a means to harass a debtor, a substitute for ordinary collection procedures or a means to wrest corporate control from a company's owners." *Id.* at 52.

¹¹ See *id.* at 53 (noting status of courts dealing with bad faith involuntary bankruptcies). "If the bankruptcy court finds that the involuntary petition was motivated by or is a product of bad faith, in addition to attorney's fees and costs, it may award—against any petitioner—damages proximately caused by such filing along with any punitive damages due to the debtor." *Id.* Among the cruel sanctions includes compensatory and punitive damages. See *In re John Richards Home Bldg. Co., L.L.C.*, 312 B.R. 849, 866 (Bankr. E.D. Mich. 2004) (noting Congress intended to deter filing involuntary petitions by inserting provision into Bankruptcy Code).

determining how those sanctions are assessed.¹² Instead, courts have developed their own interpretations of section 303(i) through the creation of several bad faith tests to measure the actions of creditors in filing involuntary petitions, which have been nothing shy of relentless.¹³ The imposition of these sanctions imposed by the bad faith tests are contrary to the forum that once endorsed a creditor-friendly system and have ultimately turned the tables on creditors' rights to remedy in the sphere of bankruptcy law.¹⁴

This article argues that a majority of the standards implemented in the Circuit Courts to evaluate whether an involuntary bankruptcy was filed in bad faith are improper in light of the legislative history of the Bankruptcy Code and the equitable nature of Bankruptcy.¹⁵ The article begins with a background on the history of bankruptcy in the United States.¹⁶ It will review how involuntary bankruptcy has served as a remedy for creditors in obtaining judgments on debtors' outstanding debts, as well as an introduction to bad faith in the context of § 303 involuntary petitions.¹⁷ The article will then discuss how the courts have come to shape the determination of bad faith in the context of creditors filing for involuntary bankruptcy.¹⁸ Next, an analysis of the inherent risks involved in filing an involuntary bankruptcy under each test follows.¹⁹ The article concludes that the totality of the circumstances test is the appropriate standard for determining bad faith in involuntary proceedings based on its equitable roots.²⁰ However, this article ultimately serves as a guide for navigating the consequences of filing an

¹² See *In re Bayshore Wire Products Corp.*, 209 F.3d 100, 105 (2d Cir. 2000) (noting courts take multiple approaches in determining bad faith because no set definition); see also *In re Wavelength, Inc.*, 61 B.R. 614, 619 (B.A.P. 9th Cir. 1986) (asserting "Bankruptcy Code does not define bad faith for purpose of awarding damages").

¹³ See e.g., *In re K.P. Enter.*, 135 B.R. 174, 179 n.14 (Bankr. D. Me. 1992) (providing improper use test); *In re Bayshore*, 209 F.3d at 107 (defining improper purpose test); *In re Wavelength*, 61 B.R. at 620 (laying out objective test); *In re Forever Green Athletic Fields, Inc.*, 804 F.3d at 338 (providing totality of the circumstances test).

¹⁴ See Adam Feibelman, *Involuntary Bankruptcy For American States*, 7 DUKE J. CONST. L. & PUB. POL'Y 81, 83-84 (2012) (stating several functions bankruptcy serves, including interests of creditors); see also Tabb, *supra* note 6, at 51 (noting early bankruptcy laws creditors remedy). "The 1800 Act was very similar to the 1732 English act, and also had many of the features of the Pennsylvania statute. It was purely a creditor's remedy. Only creditors, upon proof of the debtor's commission of an act of bankruptcy . . ." *Id.* at 14; Bow, *supra* note 10, at 52 (explaining involuntary bankruptcy sometimes litigation tactic to gain advantage). Involuntary petitions have been used to gain an advantage over debtors when other collection procedures can be sought. *Id.*

¹⁵ See *Infra*, Part V.

¹⁶ See *Infra*, Part I.

¹⁷ See *Infra*, Parts II-III.

¹⁸ See *Infra*, Part IV.

¹⁹ See *Infra*, Part V.

²⁰ See *Infra*, Part V.

involuntary petition under each test, as well as the future of bankruptcy litigation.²¹

I. HISTORY OF BANKRUPTCY LAW IN AMERICA

Bankruptcy laws in colonial America were initially adopted from England's early bankruptcy laws, which encompassed merciless punishment for bankrupt debtors, permitting imprisonment for unpaid debts, the cutting of ligaments for fraudulent debtors, and in some circumstances death.²² The American laws did not impose these severe punishments as a consequence of insolvency, but rather served as a creditor's remedy, as cases were limited solely to the involuntary bankruptcy proceeding.²³ Because the government viewed the indebted as delinquent and unsavory, no remedies were available to protect them from creditors, which upset state legislators who could not relieve debtors without federal bankruptcy legislation.²⁴ Nevertheless, in the early nineteenth century, involuntary proceedings were limited primarily to the affairs arising from commerce, not the matters of individuals.²⁵

In the eighteenth century, the notion that bankruptcy should become a uniform law was predicated on the fact that bankruptcy was a creditor's remedy.²⁶ The framers of the Constitution supported government interjection in the affairs of bankruptcy in order to create a safeguard on creditors' ability to collect on their debts.²⁷ This principle was elicited in

²¹ See *Infra*, Part VI.

²² See Countryman, *supra* note 6, at 233 (describing system of early English bankruptcy law and imposition of harsh punishments on fraudulent debtors); see also, Jay Cohen, *The History of Imprisonment for Debt and its Relation to the Development of Discharge in Bankruptcy*, 3 J. LEGAL HIST. 153, 171 (1982) (examining history of imprisonment for debt and origins of bankruptcy in sixteenth century).

²³ See Countryman, *supra* note 6, at 228 (outlining history and model for bankruptcy in United States). "It was confined to merchants and provided for involuntary proceedings only on a creditors' petition filed in federal district court and alleging an act of bankruptcy." *Id.* In this time period, bankruptcy was not limited to debt, rather it also included concealing oneself from creditors, disposing of property in an attempt to avoid payment, and defrauding creditors. *Id.*

²⁴ See, Jeff Ferriell & Edward J. Janger, *Understanding Bankruptcy*, 135-36 (LEXIS NEXIS 2007) (2nd ed.) (outlining foundation of American bankruptcy law in history).

²⁵ See source cited *infra* note 50, at 16 (noting first bankruptcy laws applied to commercial parties, including merchants, bankers, and brokers).

²⁶ See Ferriell & Janger, *supra* note 24, at 135 (noting early bankruptcy laws utilized to protect creditors). "[Bankruptcy laws were] placed there, at least in part, at the behest of bankers concerned about their ability to collect debts in local courts." *Id.*

²⁷ See Stefan A. Riesenfeld, *Creditors' Remedies & Debtor's Protection* 1-7 (WEST PUBLISHING CO.) (4th ed. 1987) (noting bankruptcy primarily creditor's remedy). "Perhaps the most important and earliest innovation was the extension of the creditors' reach to the debtor's entire interest in land." *Id.* at 7.

diplomat, James Madison's Federalist No. 42: "The power of establishing uniform laws of bankruptcy is so intimately connected with the regulation of commerce, and will prevent so many frauds where the parties or their property may lie or be removed into different States, that the expediency of it seems not likely to be drawn into question."²⁸ Prior to the first federal bankruptcy law, states had built comprehensive insolvency laws in order to combat this concern; these laws governed the matters of debtors and creditors, but they did not provide for an easy method of apprehending a fraudulent debtor's repayment.²⁹ In fact, debt obligations in colonial America were difficult to collect on, as a majority of debts consisted of personal loans or mortgages, where individuals would pledge their property as collateral; and because debt collection varied from state to state, the lack of uniformity among jurisdictions ultimately placed restraints on collection remedies.³⁰

After years of inconsistency, Congress finally utilized their power to create a law on the subject of bankruptcies in 1800.³¹ This law was not significant, other than the fact that it was quickly repealed, based on debtor

²⁸ THE FEDERALIST NO. 42 (James Madison) (discussing classes of powers lodged into government, including regulation of commerce); see also Wasson & Thornhill, *The Bankruptcy Clause in the Federalist Papers*, BANKR. BLOG (Sept. 28, 2012), <https://wassonthornhill.com/the-bankruptcy-clause-in-the-federalist-papers/> (attempting to determine intent of Madison, including subject of bankruptcy in Federalist Papers). "Madison, at least, focused on how a uniform national bankruptcy law would help creditors by preventing debtors from hiding themselves or their assets in other states. This simply reflects the pro-creditor attitude of bankruptcy law during this period." *Id.*; F. Regis Noel, *A History of the Bankruptcy Law*, 5-6 (William S. Hein & Co., Inc. 2003) (discussing interrelation between concept of bankruptcy and its impact on United States Constitution).

²⁹ See Peter J. Coleman, *Debtors and Creditors in America: Insolvency, Imprisonment for Debt, and Bankruptcy 1607-1900*, 3-6 (BEARDBOOKS) (1999) (discussing issues and trends revolving around bankruptcy in colonial America). Coleman writes:

[I]t is an historical fact, that the early English statutes of bankruptcy did not provide for the discharge either of the debtor or of the person. Discharge is not mentioned, nor in any way provided for, until the 4th or 5th of Anne; that is, after the system of bankruptcy had been established almost two centuries.

Id.; see also *Sturges v. Crowninshield*, 17 U.S. (4 Wheat.) 122, 158-59 (1819) (discussing early-era collection remedies and history of bankruptcy law).

³⁰ See Coleman, *supra* note 29, at 3-4 (noting creditor difficulty in obtaining payment from debtors due to lack of uniformity); see also Cara O'Neill, *Your Home in Bankruptcy: The Homestead Exemption*, ALLLAW, <http://www.alllaw.com/articles/nolo/bankruptcy/homestead-exemption.html> (last visited Nov. 20, 2016) (explaining homestead exemption pertaining to individuals filing for bankruptcy). The homestead exemption simply determines the amount the creditor will get in a bankruptcy proceeding, based on the dollar amount that may be exempted pursuant to state law. *Id.*

³¹ See Charles J. Tabb, *The Historical Evolution of the Bankruptcy Discharge*, 65 AM. BANKR. L. J. 325, 343 (1991) (tracing development of bankruptcy laws in America).

and creditor concerns.³² In the 1820s, legislators attempted to push for the creation of another bankruptcy law stemming from economic concerns, as farmers and mechanics were rendered insolvent in the midst of unstable commodity prices.³³ However, these efforts were strongly opposed by southerners who believed that bankruptcy was unconstitutional.³⁴ Finally, at the brink of economic turmoil, the Bankruptcy Act of 1841 was eventually passed.³⁵

While the bankruptcy laws in the eighteenth century served to protect creditors from debtors escaping liability, many grew wary of the harsh consequences it imposed on commerce.³⁶ As a means of relegating the issue, legislative reform provided more protection for debtors—both individually and in commerce with the creation of the Bankruptcy Act of 1841.³⁷ For the first time, bankruptcy laws provided remedies for debtors to relieve themselves through a voluntary petition.³⁸ Despite the significance of this Act at the time, it quickly turned sour after “thousands of debtors were discharged, minimal dividends were paid to creditors, and administrative fees [remained] high.”³⁹

With the creation of a voluntary remedy available to debtors in the 1841 Act, the future of bankruptcy quickly changed from a creditor’s remedy, to a debtor’s solution to discharge.⁴⁰ Several amendments followed

³² See Countryman, *supra* note 6, at 228 (describing reasons for dissatisfaction with Bankruptcy Act of 1800). “Reasons for dissatisfaction with the measure were various: the difficulty of travel to federal courts, the extension of federal powers . . . the fact that dividends to creditors were very small because most debtors were already in jail . . .” *Id.*

³³ See Charles Warren, *Bankruptcy in United States History*, 26-27 (HARVARD UNIV. PRESS) (1935) (explaining negative effects of not having uniform bankruptcy law in place).

³⁴ See Tabb, *supra* note 6, at 51 (noting dissent from southerners in movement to create uniform bankruptcy law).

Throughout the 1820s attempts were made to pass a bill permitting voluntary bankruptcy for the direct relief of debtors, merchant and non-merchant alike. Yet throughout that period all such efforts were rebuffed by an alliance of southerners, who opposed any federal bankruptcy bill, and others who believed that voluntary bankruptcy was unconstitutional.

Id. at 16 (citations omitted).

³⁵ See *id.* (discussing history of 1841 Bankruptcy Act).

³⁶ See *id.* at 28 (noting uncertainty in involuntary bankruptcy and need for voluntary process for debtors to relieve debts).

³⁷ See Tabb, *supra* note 31, at 17 (describing creation of bankruptcy act).

³⁸ See Warren, *supra* note 33, at 229 (noting creation of voluntary petition).

³⁹ See Tabb, *supra* note 31, at 19 (describing failure of 1841 Act).

⁴⁰ See *id.* (explaining advantages of voluntary proceedings to debtor and restraints imposed upon creditors). “An important benefit of the Act to debtors, however was that it allowed debtors to elect the benefit of generous state exemption laws as an alternative to the federal scheme . . . the

the 1841 Act, including the 1867 Act that dropped the restriction on involuntary bankruptcy to merchants, and opened the door to the potential for involuntary petitions to be pursued against individuals.⁴¹ Further innovations in 1874 integrated composition agreements for debtors and in 1898, the United States held onto the longest piece of bankruptcy legislation until the Bankruptcy Reform Act in 1978.⁴²

By 1973, concerns arose amongst creditors and bankruptcy scholars regarding the set up of the bankruptcy laws initiated in 1898.⁴³ The 1898 Act called for specific acts of bankruptcy, as opposed to the debtor's failure to pay on their debts, as means of initiating the involuntary bankruptcy petition.⁴⁴ These acts were generally hard to prove and placed restraints on some creditors' ability to collect.⁴⁵ The Commission on Bankruptcy Laws

utilization of state exemption laws in federal bankruptcy cases has continued to the present." *Id.* at 20 (citation omitted).

⁴¹ See Countryman, *supra* note 6, at 228 (noting legislative changes in bankruptcy law throughout eighteenth century).

⁴² See Tabb, *supra* note 33, at 21 (describing innovations as bankruptcy law flourished). "The composition agreement, the forerunner of modern reorganization provisions, allowed the debtor to propose payment of a certain percentage of his debts over time in full discharge of those debts, while also keeping his property." *Id.*

⁴³ See Susan Block-Lieb, *Why Creditors File So Few Involuntary Petitions and Why the Number is Not Too Small*, 57 BROOK. L. REV. 803, 809-11(1991) (noting changes to standards for commencement of involuntary petition and difficulties in proving debtor insolvency). "If [a] debtor contested the [involuntary] filing, petitioning creditors were required to show that the debtor had committed an act of bankruptcy . . ." *Id.* at 809.

⁴⁴ See *id.* at 807-10 (identifying six required acts of bankruptcy). The requirements include:

The 1898 Act identified six different "acts of bankruptcy": (a) fraudulent transfers under Section 67 or 70 of the Act (concerning avoidance of certain statutory liens and other fraudulent transfers); (b) preferential transfers under Section 60a of the Act; (c) the failure to vacate a judicial lien in a timely manner, within the later of 30 days after imposition of the lien or 5 days before a scheduled judicial sale, if the debtor was insolvent during this period; (d) making a state law assignment for the benefit of creditors; (e) the appointment under state law of a receiver of property when the debtor was insolvent or unable to pay its debts; and (f) the admission in writing of an inability to pay debts and a willingness to be adjudicated bankrupt.

Id. at 809-10. See also Scott E. Blakely, *A Proper Purpose for Commencing an Involuntary Bankruptcy Petition: Preserving a Preference Action*, BLAKELEY, LLP (May 2, 2011, 10:25 PM), <http://www.blakeleyllp.com/content/2011/05/02/a-proper-purpose-for-commencing-an-involuntary-bankruptcy-petition-preserving-a-preference-action/> (last visited Jan. 16, 2018) (noting Congress' liberalization of standards pertaining to "acts of bankruptcy").

⁴⁵ See Block-Lieb, *supra* note 43, at 812-14 (noting ambiguity in 1898 Bankruptcy Act). "Because of these ambiguities, trials on contested involuntary petitions often dragged on for long periods of time at considerable expense to petitioning creditors and others." *Id.* at 813. "Not only was insolvency extremely difficult to prove, but the determinations as to whether the debtor had committed an act of bankruptcy and whether it was insolvent were questions of fact on which the debtor was entitled to a jury trial." *Id.* at 813.

proposed in 1973 “that a standard permitting the institution of an involuntary case when a debtor was unable to pay its current obligations be substituted for the ‘acts of bankruptcy.’”⁴⁶ The Commission reasoned that the stake creditors had in collecting on their debts was apparent and only aggressive creditors were able to take advantage of the laws that were in place.⁴⁷ These changes marked the inception of the Bankruptcy Act of 1978.⁴⁸

II. INVOLUNTARY PETITIONS

The Bankruptcy Act of 1978 was a turning point in federal bankruptcy law, as it replaced the law that had been in effect since 1898 and created the Bankruptcy Code, which continues to regulate bankruptcy law in the United States today.⁴⁹ This change also arrived as, arguably, the most debtor-friendly bankruptcy law.⁵⁰ When the 1978 law was enacted, Congress inserted § 303 into the Bankruptcy Code which provided the foundation for filing involuntary cases while also laying out the strict requirements to filing a petition.⁵¹ This change ultimately made it harder for

⁴⁶ See *id.* at 815 (noting standards Commission on Bankruptcy Laws attempted to adopt in furtherance of new amendments). “Others more broadly proposed improvements to the definition of the term insolvent.” *Id.*

⁴⁷ See *id.* (noting shifting purpose of early bankruptcy laws).

⁴⁸ See *id.* at 817-18 (noting Congress’ reactions to suggestions and enactment of 1978 Act). “Although Congress did not incorporate all of the Commission’s suggestions on this topic when it enacted the Bankruptcy Reform Act of 1978, it removed the ‘acts of bankruptcy’ as the standard of commencement of an involuntary case” *Id.*

⁴⁹ See *id.* at 32 (tracing creation of Bankruptcy Code).

⁵⁰ See Block-Lieb, *supra* note 43, at 32 (noting inception of Bankruptcy Code arguably most debtor-friendly); see also Margaret Howard, *Cases and Materials on Bankruptcy* (WEST PUBLISHING CO.) (5th ed. 2011) (noting bankruptcy law device for relief of overburdened debtors). Cf. Susan Block-Lieb, *supra* note 43, at 835 (recognizing Congress’s intent to provide protection for creditors by abolishing acts of bankruptcy).

First, it recognized that petitioning creditors had difficulty establishing their debtor’s insolvency, which often was an element under the “acts of bankruptcy.” More than just to simplify proof of the standard for commencement of an involuntary bankruptcy case, however, Congress also recognized that . . . [they should] encourage and facilitate earlier resort to [bankruptcy] relief and, . . . to increase dividends to creditors.

Id. at 835-36.

⁵¹ See 11 U.S.C. § 303 (2018) (laying statutory framework for filing involuntary petition). Scott E. Blakeley, *A Proper Purpose for Commencing an Involuntary Bankruptcy Petition: Preserving a Preference Action*, BLAKELEY, LLP, <http://www.blakeleyllp.com/content/2011/05/02/a-proper-purpose-for-commencing-an-involuntary-bankruptcy-petition-preserving-a-preference-action/> (last visited Jan. 16, 2018) (noting purpose of involuntary bankruptcy since its inception as equitable remedy). “The historic purpose of involuntary bankruptcy is to provide vendors with a means of assuring equal distribution

creditors to be able to reach debtors in collecting on unpaid debts even without the requirement of specific acts of bankruptcy, as was the case in earlier versions of the legislation.⁵²

The restraints imposed on creditors are memorialized in 11 U.S.C. § 303.⁵³ Under this section, creditors are granted the opportunity to file an involuntary petition under either Chapter 7 or 11 of the Bankruptcy Code to compel a debtor into court to pay on its debts.⁵⁴ The statute requires that the creditor file an involuntary petition that must then be served upon the involuntary debtor.⁵⁵ Once the debtor receives the petition, they will have an opportunity to defend against the action and argue that the creditor did not meet the specific requirements outlined in § 303.⁵⁶ Those requirements

of the debtor's assets. In addition to assuring an orderly liquidation and equal distribution of assets, an involuntary proceeding may benefit vendors . . . to recapture fraudulent conveyances . . ." *Id.*

⁵² See Tabb, *supra* note 31, at 32 (noting changes pertaining to debtors in 1978 reform act); see also Norman N. Kinel, *When Not to File An Involuntary Bankruptcy Petition*, LAW360 (Feb. 22, 2016, 11:14 AM), <http://www.law360.com/articles/761250/when-not-to-file-an-involuntary-bankruptcy-petition> (discussing harsh ruling against law firm attempting to force debtor into bankruptcy). "The bankruptcy court is not a collection agency,' bankruptcy is not a judgment enforcement device. Bankruptcy is a collective remedy, with the original purpose—which continues to this day—to address the needs and concerns of creditors with competing demands to debtors' limited assets . . ." *Id.* (quoting *In re Matthew M. Murray*, Case No. 14-10271 (Banker. S.D.N.Y. 2016)).

⁵³ See Bob Eisenbach, *Forced Into Bankruptcy: The Involuntary Bankruptcy Process*, IN THE (RED): THE BUSINESS BANKRUPTCY BLOG (May 24, 2012), <http://bankruptcy.cooley.com/2012/05/articles/business-bankruptcy-issues/forced-into-bankruptcy-the-involuntary-bankruptcy-process/> (articulating varying requirements for creditors to pursue the involuntary petition); see also Isabella C. Lacayo, Note, *After the Dismissal of an Involuntary Bankruptcy Petition: Attorney's Fees Awards to Alleged Debtors*, 27 CARDOZO L. REV. 1949, 1954 (2006) (outlining strict procedural requirements to filing involuntary petition).

⁵⁴ See 11 U.S.C. § 303 (2018) (outlining requirements of filing involuntary bankruptcy petition); see also Joe Lee, Bankruptcy Service Lawyers Edition Chapter 13: Code §§ 301-303 (July 2010) (discussing fact involuntary bankruptcy not achieved under Chapter XIII due to lack of willingness). Involuntary cases are also prohibited against farmers and municipalities because they make bad policies. *Id.* Moreover, an involuntary petition imposed against a municipality would conflict with the Tenth Amendment. *Id.*; Diane Davis, *Bad Faith Dooms Involuntary Bankruptcy Petition*, BLOOMBERG BNA (Oct. 27, 2015), <http://www.bna.com/bad-faith-dooms-n57982062791/> (noting most courts agree involuntary bankruptcies require good faith filing).

⁵⁵ See J. Kate Stickles & Patrick J. Reilley, *The Nuts & Bolts of Involuntary Bankruptcy*, 27-JUN AM. BANKR. INST. J. 30 (2008) (noting petition commences once filed and served upon debtor).

⁵⁶ See *id.* at 30 (outlining debtor's response to involuntary petition). "After an involuntary petition has been filed, the involuntary debtor has 20 days to file a responsive pleading." *Id.* Section 303(h) of the Code and Bankruptcy Rule 1013(b) are tantamount, in the sense that they both offer that the court must enter an order of relief when no response is rendered. *Id.* Stickles and Reilley write, "§303(h) provides that if the involuntary petition 'is not timely controverted, the court shall order relief against the debtor.'" *Id.* Furthermore, Rule 1013(b) requires that "[i]f no pleading or other defense to the petition is filed within the time provided . . . the court, on the next day, or as

include: the creditor's ability to file the petition,⁵⁷ the petitioning creditor must be a holder of a claim "that is not contingent as to liability or the subject of a bona fide dispute as to liability or amount,"⁵⁸ and the aggregate amount of claims must total \$15,775.⁵⁹

Creditors attempting to invoke the benefits of the involuntary petition must not only meet the stringent statutory requirements prior to making their case in court, but they must also tread lightly on the feet of the good faith filing requirement.⁶⁰ Unlike the debtor-friendly voluntary

soon thereafter as practicable, shall enter an order for the relief requested in the petition." *Id.* (alteration in original) (footnote omitted).

⁵⁷ See 11 U.S.C. § 303(a) (outlining when involuntary case may commence). "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." *Id.*; See Eric J. Taube, *Involuntary Bankruptcy: Who May Be a Petitioning Creditor?*, 21 HOUS. L. REV. 339, 350 (1984) (Courts recently have allowed holders of "disputed but noncontingent claims to be counted as involuntary petitioning creditors.").

⁵⁸ See 11 U.S.C. § 303(b) (2018) (elucidating claim requirements for bringing involuntary petition against debtor). "An involuntary case may be commenced: . . . (1) by three or more entities, each of which is either a holder of a claim against such a person that is not contingent as to liability or amount or the subject of a bona fide dispute as to liability or amount, or an indenture trustee representing such a holder . . ." *Id.* This requirement is in place so that creditors will not use the Bankruptcy Code to force debtors into court when there may be a question as to the liability that is owed. *Id.*; see also Peter Spero, *Fraudulent Transfers, Prebankruptcy Planning and Exemptions* § 10:10 (Aug. 2016) (explaining bona fide dispute requirement for filing involuntary petition). The Bankruptcy Court for the Eastern District of Tennessee took the view that:

When all the events have occurred which allow a court to adjudicate a claim and determine whether or not payment should be made, there is no contingency concerning the claim itself, unless it is apparent, to a legal certainty, that petitioning creditor would be unable to obtain judgment against debtor upon adjudication of its claim.

In re Taylor & Assocs. L.P., 193 B.R. 465, 475 (Bankr. E.D. Tenn. 1996) (citations omitted); see also Steven J. Winkelman, Comment, *A Dispute Over Bona Fide Disputes in Involuntary Bankruptcy Proceedings*, 81 U. CHI. L. REV. 1341, 1352-53 (2014) (noting Congress' act in adding phrase "subject of a bona fide dispute" in § 303).

⁵⁹ See Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23, 29-30 (2005) (addressing new standards for voluntary petitions in bankruptcy with some amendments to § 303); see also Nathan L. Rudy, Note, *Robbing Your Rival's Piggybank: The Third Circuit Affirms Bad Faith Dismissals In Involuntary Bankruptcies After In Re Forever Green Athletic Fields, Inc.*, 61 VILL. L. REV. 705, 709 (2016) (eliciting standards required in order to file involuntary bankruptcy petition).

⁶⁰ See 11 U.S.C. § 303 (2018). The prerequisites include: the creditor proving that they may petition the debtor into court, determining whether the claim is subject to a bona fide dispute, and overcoming the burden of showing that the debtor is generally not paying their debts. *Id.*; see also David S. Kennedy, ET. AL, *The Involuntary Bankruptcy Process: A Study of the Relevant Statutory and Procedural Provisions and Related Matters*, 31 U. MEM. L. REV. 1, 7-8 (2000) (outlining three threshold issues arising in commencement of involuntary bankruptcy case); *Carolin Corp. v. Miller*,

bankruptcy, the creditors that file involuntary petitions are subject to the scrutiny of debtors proclaiming that they have filed their petition in bad faith.⁶¹ This characteristic can be explained by the perceived detriment an involuntary petition may put the debtor into in eyes of the courts, which has been the consistent view of the judiciary for the past few decades.⁶²

III. BAD FAITH FILINGS

The legislative history of § 303 has not provided context to the courts in determining whether a claim is, in fact, filed in bad faith.⁶³ Rather, the definition of bad faith is merely grounded in the Bankruptcy and the Circuit

886 F.2d 693, 694 (4th Cir. 1989) (holding bankruptcy court may dismiss petition for want of good faith).

⁶¹ See 11 U.S.C. § 303(i) (2018) (outlining provisions pertaining to bad faith filings in involuntary bankruptcy petitions). "If [a] court dismisses a petition under this section other than on consent of all petitioners and the debtor, and if the debtor does not waive the right to judgment under this subsection, the court may grant judgment—(1) against the petitions and in favor of the debtor for (A) costs or (B) a reasonable attorney's fee, or (2) against any petitioner that filed the petition in bad faith for—(A) any damages proximately caused by such filing or (B) punitive damages." *Id.*; see also *Lubow Machine Co. v. Bayshore Wire Prod. (In re Bayshore Wire Products Corp.)*, 209 F.3d 100, 105 (2d Cir. 2000) (stating determination of whether bad faith exists question of fact); Eric Snyder & Eloy Peral, *Involuntary Bankruptcy Petition: A Powerful Tool for Creditors*, NEW YORK LAW JOURNAL (June 13, 2016) <http://www.newyorklawjournal.com/id=1202759586005/Involuntary-Bankruptcy-Petition-A-Powerful-Tool-for-Creditors?slreturn=20160828161013> (noting involuntary petitions disfavored by courts). "An involuntary petition filed by a single qualified creditor draws greater scrutiny from the Bankruptcy Court out of concern that the courts will be used as collection agencies. In those situations, alleged debtors can rely on additional defenses with varying degrees of success depending upon the jurisdiction." *Id.*; David A. Samole & Lisa B. Keyfetz, *New Law, New Tools For Creditors: A Fresh Look at the Involuntary Bankruptcy Petition*, 16 BUS. L. TODAY 17 (2006) (highlighting involuntary bankruptcy issues). "Petitioning creditors can expect debtors to argue that the involuntary filing is improper because a creditor's motive, to limit the debtor's homestead, is an 'improper use' of the petition that constitutes 'bad faith.'" *Id.* at 20.

⁶² See Howard, *supra* note 50, at 43 (articulating strict requirements for involuntary petitions to protect debtors from precipitous filings); see also Brian W. Cashell, et. al., *Preliminary Observations on the Impact of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, CONGRESSIONAL RESEARCH SERVICE (Sept. 14, 2007) (elucidating bankruptcy filings from 2002 to 2007). The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) was created to make the bankruptcy code more favorable for creditors. *Id.* Nevertheless, the Congressional Research Service's findings concluded that bankruptcy filings accelerated post-enactment. *Id.*

⁶³ See H.R. Rep. No. 95-595 (1977), as reprinted in 1978 U.S.C.A.N., 5963 (6280-81) (attempting to lay foundation for bad faith). "Subsection (I) provides for costs, attorney's fees, and damages in certain circumstances. . . [to] discourage frivolous petitions as well as the more dangerous spiteful petitions, based on a desire to embarrass the debtor who may be a competitor of a petitioning creditor or to put the debtor out of business with good cause" *Id.*; see also *In re K.P. Enter.*, 135 B.R. 174, 179 (Bankr. D. Me. 1992) (noting Bankruptcy Code nor legislative history provides direction for courts in determining bad faith).

Courts' creation of varying bad faith tests.⁶⁴ At a basic level, most courts have come to the conclusion that bad faith is prevalent when a creditor attempts to gain an unfair advantage over a debtor or "[tries] to exert pressure on the debtor to pay [their] debts."⁶⁵ In the context of § 303, creditors act in bad faith when they file petitions to "collect on a personal debt, to gain an advantage in pending litigation, or to harass the debtor." Nevertheless, much of this is ascertained through courts' analysis of bad faith, which is ultimately out of the scope of the Bankruptcy Code.⁶⁶

"Whether a party acted in bad faith in filing an involuntary petition so as to warrant award of costs, fees and damages under 11 U.S.C.A. § 303(i)

⁶⁴ See *In re Wavelength, Inc.*, 61 B.R. 614, 617 (9th Cir. BAP 1986) (noting no ready definition of bad faith); see also Lawrence Ponoroff, *The Limits of Good Faith Analyses: Unraveling and Redefining Bad Faith in Involuntary Bankruptcy Proceedings*, 71 NEB. L. REV. 209, 212-13 (1992) (noting purpose of bad faith tests to protect against precipitous filings). "The concern was that unprincipled creditors would use or threaten use of involuntary bankruptcy, not when its invocation would increase value for the benefit of the common weal, but to serve a purpose or end unrelated to (or even at odds with) core bankruptcy policy." *Id.*; see Lawrence Ponoroff, *The Limits of Good Faith Analyses: Unraveling and Redefining Bad Faith in Involuntary Bankruptcy Proceedings*, 71 NEB. L. REV. 209, 290 (1992) (explaining bad faith tests vehicle to stop abuses of bankruptcy process). Ponoroff explains:

Bringing this distinction to bear on the present discussion, it can be said that both Bankruptcy Rule 9011 and the judicially-implied good faith filing requirement are intended to regulate and control "abuses" of the bankruptcy process. The history of each is deeply tinged by a profound concern for the damage done to the integrity of judicial process by the wrongful initiation of bankruptcy cases and associated missuses of the process.

Id. at 290.

⁶⁵ See Barry M. Klayman, *A Cautionary Tale for Involuntary Bankruptcy Petitioners*, LAW360 (Oct. 26, 2015, 12:23 PM) <http://www.law360.com/articles/718749/a-cautionary-tale-for-involuntary-bankruptcy-petitioners> (arguing Third Circuit's ruling in 2015 case imposes harsh penalties for involuntary petitioners); see also *In re Mylotte, David, & Fitzpatrick*, No. 07-11861BIF, 2007 WL 2033812 at *11 (E.D. Pa. Jul. 12, 2007) (outlining substantive definition of bad faith with respect to involuntary bankruptcy). As the court acknowledged,

Bad faith has been defined as The [sic] opposite of "good faith," generally implying or involving actual or constructive fraud, or a design to mislead or deceive another, or a neglect or refusal to fulfill some duty or some contractual obligation, not prompted by an honest mistake as to one's rights or duties, but by some interested or sinister motive. [The] [t]erm "bad faith" is not simply bad judgment but rather it implies the conscious doing of a wrong because of dishonest purpose or moral obliquity; it is different from the negative idea of negligence in that it contemplates a state of mind affirmatively operating with design or ill will.

Id. at *11 (citing *In re Elsinore Shore Associates*, 91 B.R. 238 (Bankr. D.N.J. 1988)).

⁶⁶ See *In re Forever Green Athletic Fields, Inc.*, 804 F.3d 328, 336 (3d Cir. 2015) (elucidating what bad faith means in context of § 303 of Bankruptcy Code).

is a question of fact.”⁶⁷ Courts have established several grounds for finding that a petitioner has acted in bad faith.⁶⁸ These acts typically comport with the established bad faith tests and include threats made to other creditors and the withholding of pertinent facts with respect to the totality of the circumstances test, as an example.⁶⁹ Additional signs of bad faith include exhibiting personal malice,⁷⁰ using bankruptcy as vehicle to collect on debt when other remedies are available,⁷¹ and even when a petitioning creditor knows that they will not meet the stringent requirements set out in 11 U.S.C. §303, but they file anyway.⁷²

IV. STANDARDS FOR EVALUATING BAD FAITH

Courts have not only struggled to find a precise definition of bad faith but, rather a more important quandary has been the split among the

⁶⁷ See Lee, *supra* note 54, at 13-247 (explaining what constitutes bad faith in filing involuntary petition in bankruptcy); see also *Camelot, Inc. v. Hayden*, 30 B.R. 409, 411 (E.D. Tenn. 1983) (acknowledging bad faith question of fact); *In re Wavelength, Inc.*, 61 B.R. 614, 620 (B.A.P. 9th Cir. 1986) (noting bad faith question of fact).

⁶⁸ See Lee, *supra* note 54, at 13-245 to -246 (discussing various ways in which bad faith may exist in involuntary actions); see also FRIEDLAND, ET AL., *Commercial Bankruptcy Litigation* § 4:38: *Creditors' liability upon dismissal of the involuntary petition* (2nd ed. 2016) (noting some courts may find necessary to inquire on petitioner's potential motives in filing). “[S]ome cases have begun to expressly acknowledge that, in reaching a decision on the question of bad faith, it is not only proper but necessary for the court to inquire into and consider both a petitioners conduct and any possible ulterior motives in filing.” *Id.*

⁶⁹ See *In re John Richards Home Bldg. Co., L.L.C.*, 439 F.3d 248, 254 (6th Cir. 2006) (noting threats and withholding of pertinent facts clear examples of bad faith); see also Lee, *supra* note 54, at 13-245 (describing bad faith in involuntary bankruptcy proceedings); Brian A. Blum, *Bankruptcy and Debtor/Creditor* (ASPEN PUBLISHERS) (4th ed. 2006) (noting involuntary cases concerning threats and intimidation); 1-8 Lender Liability Law and Litigation § 8.08 (2017) (outlining risks associated with filing involuntary bankruptcy petition).

⁷⁰ See Lee, *supra* note 54, at 13-245 (noting ill will or malice linked to bad faith in involuntary bankruptcy proceedings); see also *In re Johnston Hawks Ltd.*, 72 B.R. 362, 366 (Bankr. D. Haw. 1987) (acknowledging bad faith exists where ill will, malice, or attempt to embarrass debtor occurs).

⁷¹ See Lee, *supra* note 54, at 13-245 (describing egregious conduct of creditors in seeking repayment); see also *In re Advance Press & Litho, Inc.*, 46 B.R. 700, 703 (Bankr. D. Colo. 1984) (noting bad faith exists when creditors use bankruptcy like debt collection device). “There is a second line of authority which looks to whether the creditor's actions were an improper use of the Bankruptcy Code as a substitute for customary collection procedures.” *Id.*

⁷² See Lee, *supra* note 54, at 13-245 (noting bad faith can exist when creditors attempt to file without meeting all requirements); see also *In re Paczensy*, 282 B.R. 646, 649 (Bankr. N.D. Ill. 2002) (acknowledging filing with knowledge creditor cannot meet requirements exhibits bad faith); *In re Meltzer*, 516 B.R. 504, 504 (Bankr. N.D. Ill. 2002) (noting bad faith can exist when creditor does not meet all requirements to file); *In re Daniel Paczesny*, 282 B.R. 646, 649 (Bankr. N.D. Ill. 2002). “Bad faith can be shown by a creditor filing an involuntary petition when it knows that it cannot meet the requirements of § 303(b)(1). *In re Daniel Paczesny*, 282 B.R. at 649.

Circuit courts as to how bad faith should be analyzed in the Bankruptcy Code.⁷³ The tests that have been circulating around the circuits include: the improper use, improper purpose, objective test, and the totality of the circumstances test.⁷⁴

The improper use test is an objective measure that examines bad faith by determining whether a petitioning creditor uses the involuntary petition as an attempt to gain a disproportionate advantage for itself, as opposed to seeking to collect debts in another forum.⁷⁵ This test was applied in *In re Better Care, Ltd.* where Akkeron and the accounting firm Evans, Marshall & Pease, P.C. (EMP) filed an involuntary petition against Better Care, Ltd.⁷⁶ The court found that in the midst of filing the petition, the creditors were colluding against Sarno, a co-owner of Better Care, in order to gain control of the debtor-entity and direct the flow of collections.⁷⁷ In conducting its bad faith analysis, the court found that the petitioning creditors improperly utilized the involuntary bankruptcy against the debtor in bad faith because their primary objective was contrary to the principles elicited in the Bankruptcy Code.⁷⁸

⁷³ See Lee, *supra* note 54, at 13-61 to -69 (elucidating varying tests circulating throughout circuits).

⁷⁴ See *id.* at 13-35 (laying out multiple bad faith tests circulating throughout circuit courts); see also *In re Revely*, 148 B.R. 398, 407-08 (Bankr. S.D.N.Y. 1992) (noting bad faith found in two different types of circumstances); *Commercial Bankruptcy Litigation* § 5.14, 5-82 (1990) ("It appears that bad faith may be found if either improper motivation or inadequate investigation is demonstrated."); Isabella C. Lacayo, Note, *After the Dismissal of an Involuntary Bankruptcy Petition: Attorney's Fees Awards to Alleged Debtors*, 27 CARDOZO L. REV. 1949, 1978 n.29 (2006) (outlining tests observed by courts in analyzing bad faith). "Different courts have used different standards when considering the existence of bad faith for a section 303(i)(2) award . . . [S]ome courts use an objective test which asks whether a reasonable person would have filed. Other courts look at the creditor's motives and conduct, thus, applying subjective standard. Still other courts combine both approaches and use a two part test." *Id.*; *In re Better Care, Ltd.*, 97 B.R. 405, 409 (Bankr. N.D. Ill. 1989). Some courts have also examined two other uncommon tests: (1) the nose test; and (2) the Rule 9011 test. *Id.* The nose test examines bad faith by employing the mantra: "if it smells like bad faith, then it's got to be bad faith." *Id.* On the other hand, the Rule 9011 test is employed similar to the improper use test, which involves an inquiry into whether motivations outside of scope of bankruptcy were the reason for the involuntary petition. *Id.* at 411.

⁷⁵ See *In re K.P. Enter.*, 135 B.R. 174, 179 n.14 (Bankr. D. Me. 1992) (discussing improper use test in context of bad faith).

⁷⁶ See *In re Better Care, Ltd.*, 97 B.R. 405, 405-06 (N.D. Ill. 1989) (discussing background transactions between petitioning creditors and debtor leading up to filing).

⁷⁷ See *id.* at 410-12 (discussing conduct surrounding bad faith filing). The court implicitly recognized that the goal of bankruptcy is to ensure creditors disputes are handled in an efficient manner through the priority system and that the petitioning creditors overstepped this boundary in filing for a non-bankruptcy purpose, thus applying the improper use test as a means for identifying the bad faith. *Id.* at 409-412.

⁷⁸ See *id.* at 412 (explaining non-bankruptcy objectives petitioning creditors sought to pursue through involuntary bankruptcy). The *Better Care* court acknowledged that the petitioning

On the other end of the spectrum, the improper purpose test is a subjective measure that examines bad faith by determining whether or not the involuntary filing was motivated by ill will, malice, or a desire to embarrass or harass the alleged debtor.⁷⁹ In *In re Cannon Express Corp.*,⁸⁰ the court applied this bad faith test to the involuntary petition brought by Bennett, Kincaid, and Pruss, all of whom were creditors to three separate trucking contracts.⁸¹ The court held that the actions of all three creditors, namely their failure to investigate the debtor's financial situation and whether it was paying debts timely, amounted to an improper purpose.⁸²

The objective test examines the involuntary filing based on what a reasonable person would have believed to be the best option for collecting debt.⁸³ This is the standard employed in *In re Wavelength, Inc.*, a case where two individuals, Jaffe and Edwards, filed an involuntary petition against Kronfeld in order to obtain an interest in the debtor's business by pressuring him to sell his shares to the two petitioning creditors.⁸⁴ It was evident to the court that these actions equated bad faith because a reasonable person in the shoes of Jaffe and Edwards would not have filed an involuntary petition in order to pressure another person into making a substantial business decision.⁸⁵

At the crux of these tests is the totality of the circumstances test, which is a combined test, consisting of both subjective and objective factors.⁸⁶ In employing a totality of the circumstances analysis, courts consider a myriad of factors, including, whether the petition was meritorious, the creditors made a reasonable inquiry into the relevant facts prior to filing,

creditors sought to achieve two objectives unrelated to the scope and purpose of bankruptcy: take control of the stream of payments to creditors; and gain control of Better Care, Ltd. *Id.*

⁷⁹ See *In re Bayshore*, 209 F.3d 102, 107 (2d Cir. 2000) (explaining improper purpose test); see also *In re Micr Toner Int'l. LLC*, Case No.: 2:16-BK-24024-ER, 2017 BANKR. LEXIS 530, at *1 (C.D. Cal. Feb. 24, 2017) (noting sanctions not imposed against already dissolved LLC). "The Court cannot enter judgment under §303(i) in favor of . . . a dissolved limited liability company." *Id.* at *22.

⁸⁰ 280 B.R. 450 (Bankr. W.D. Ark. 2002).

⁸¹ 280 B.R. 450, 455-56 (Bankr. W.D. Ark. 2002) (applying improper purpose test to petitioning creditor's actions).

⁸² See *id.* at 454-55 (noting petitioning creditors failed to review creditor's financial history and payment status in filing).

⁸³ See *In re Wavelength, Inc.*, 61 B.R. 614, 619-20 (B.A.P. 9th Cir. 1986) (interpreting bad faith under the objective test).

⁸⁴ See *id.* at 618-19 (noting actions of petitioning creditors constituted bad faith).

⁸⁵ See *id.* at 620-21 (acknowledging application of objective test). The *Wavelength* court added that the debtor was not insolvent at the time the involuntary petition was filed which stands as further support the finding of bad faith. *Id.*

⁸⁶ See *In re Forever Green Athletic Fields, Inc.*, 804 F.3d 328, 336 (3d Cir. 2015) (explaining totality of circumstances test is compilation of factors).

and whether the petition is begin used as a tactical advantage, among other considerations.⁸⁷ In the case of *In re Forever Green Athletic Fields, Inc.*, the Third Circuit reviewed the findings of a Pennsylvania Bankruptcy Court, holding that its analysis of the circumstances surrounding the debtors' conduct in attempting evade arbitration of its claims, among other things, was sufficient to find a bad faith filing.⁸⁸

V. ADOPTING THE TOTALITY OF THE CIRCUMSTANCES TEST

Despite the placement of § 303(i) in the Bankruptcy Code as a foundation for identifying and evaluating bad faith, many courts remain at a rudimentary stage of development because they struggle to decide which test to apply or have only recently adopted a particular test in their respective jurisdiction.⁸⁹ Nevertheless, each bad faith test serves a unique function.⁹⁰ While neither Congress nor the Supreme Court supports adopting any of the furthered tests, litigators and creditors pursuing an involuntary petition against a debtor should understand the purpose and scope of each test, as important factors for ultimately determining the success or failure in both litigation and in the recovery of debts.⁹¹

A. Improper Use Test

The core premise of the improper use test is to detect whether an involuntary bankruptcy petition was filed for reasons other than as a vehicle for bad faith.⁹² In a nutshell, the test aims to examine the objective measures a creditor took in filing a petition to ensure that there was an appropriate

⁸⁷ See *id.* (expanding on totality of circumstances test).

⁸⁸ See *In re Forever Green Athletic Fields, Inc.*, 804 F.3d 328, 338 (3d Cir. 2015) (outlining lower court's analysis and convergence of varying factors).

⁸⁹ See *In re Wavelength, Inc.*, 61 B.R. 614, 620 (B.A.P. 9th Cir. 1986) (noting Congress provided no basis for determining bad faith). "The statutory language is that the petitioner must have 'filed the petition in bad faith' There is no statutory requirement that the bad faith must be directed toward anyone in particular." *Id.*; see also *In re Bayshore Wire Products Corp.*, 209 F.3d 100, 105 (2d Cir. 2000) (pointing to courts inconsistent application of bad faith tests). "Because bad faith is not defined in the bankruptcy code, and because there is no legislative history addressing the intended meaning of this language, courts have used different approaches to determine whether a petition was filed in bad faith." *Id.* (citing *General Trading Inc. v. Yale Materials Handling Corp.*, 119 F.3d 1485, 1501 (11th Cir. 1997)).

⁹⁰ See *Lee*, *supra* note 54, at 13-270 (noting varying standards in determining bad faith includes objective or subjective determinations).

⁹¹ See *In re Bayshore*, 209 F.3d at 105 (noting varying tests circuit courts utilize).

⁹² See *In re K.P. Enter.*, 135 B.R. 174, 179 n.14 (Bankr. D. Me. 1992) (acknowledging utilizing improper use test).

basis for pursuing it in the first place.⁹³ Courts have interpreted the analysis of this test to be limited to the actions the creditor took to file a petition, but only from an objective viewpoint.⁹⁴ In other words, the test strives to determine whether a filing creditor had knowledge of certain damaging information and used that information to file an involuntary bankruptcy in order to gain an edge on the debtor.⁹⁵

Consider the case of *In re Better Care, Ltd.*⁹⁶ where the petitioning creditors, Akkeron and Evans, Marshall & Pease ("EMP") forced Better Care and its co-owner into bankruptcy.⁹⁷ The court in this case found that both petitioning creditors filed their petition in bad faith under the improper use test on account of their perceived malevolent intentions.⁹⁸ More specifically, the court noted that both parties maliciously intended to ensure that Better Care would go out of business, as a result of past disputes between Akkeron and Sarno, the co-owners.⁹⁹ Furthermore, Akkeron's animosity with Sarno was not the sole motivating factor; rather, EMP encouraged an involuntary filing because Sarno had recently terminated the accounting firm's services.¹⁰⁰

While the Court pointed out a sufficient basis for dismissing and finding bad faith under the improper use test, it failed to consider several other aspects motivating the involuntary petition, many factors of which are elicited in the totality of the circumstances test.¹⁰¹ For one, the Court only mentions petitioning creditor's conduct, but ignores the factual basis for which the creditor's petition was actually filed.¹⁰² Instead of examining both the subjective and objective factors contributing to the filing, the *Better Care* court only took into account the petitioning creditors' perceived intent—such

⁹³ See *id.* (describing purpose of improper use test); see also *Lee*, *supra* note 54, at 13-249-50 (outlining issue of debt collection as motive for filing involuntary petitions).

⁹⁴ See *Lee*, *supra* note 54, at 13-270 (highlighting requirements and standards in applying objective test to set of facts).

⁹⁵ See *id.* at 13-247 (mentioning inappropriate uses of involuntary petition). "Involuntary bankruptcy petition is not substitute for customary collection procedures," and should not be used as a means to circumvent traditional methods of creditor collections. *Id.*

⁹⁶ 97 B.R. 405 (Bankr. N.D. Ill. 1989).

⁹⁷ 97 B.R. 405, 405 (N.D. Ill. 1989) (noting Bankruptcy Court Judge's findings of fact).

⁹⁸ See *id.* at 412 (holding petition filed in bad faith under improper use and improper purpose test).

⁹⁹ See *id.* (explaining facts of case).

¹⁰⁰ See *id.* (establishing two motivating factors in filing petition).

¹⁰¹ See *Lee*, *supra* note 54, at 13-245 (outlining several objective and subjective factors used in determination of bad faith).

¹⁰² See *In re Better Care*, 97 B.R. 405, 412 (Bankr. N.D. Ill. 1989) (holding bad faith established when creditors had malicious means to file).

an incomplete examination render the improper use test an insufficient means for recognizing bad faith.¹⁰³

B. Improper Purpose Test

Unlike the improper use test, the improper purpose test focuses primarily on the creditors' subjective intent in filing an involuntary petition.¹⁰⁴ The scope of analysis focuses only on discovering an individual creditor's knowledge at the time of filing, as well as any motivating factors that may have existed prior to filing such as, ill will, malice or an intention to harass the debtor.¹⁰⁵

In *In re Cannon Express Corp.*, the Court held that the creditor's involuntary petition was filed in bad faith and that their motivations in filing were contrary to the purpose of bankruptcy.¹⁰⁶ Three petitioners, Bennet, Kincaid, and Pruss were owed nearly \$1 million from a trucking service for three separate contracts dealing with the recruiting and hiring of international employees.¹⁰⁷ The Court noted that when the three determined that Cannon was not planning on paying its debts to the petitioners, they decided to file a bankruptcy petition in order to enforce the payment. The Court concluded that because the petitioners failed to research the debtors financial condition (to ultimately determine whether or not they were paying their debts as they became due), filed in anticipation of Cannon filing bankruptcy,¹⁰⁸ and because the petitioners did not follow the appropriate steps necessary prior

¹⁰³ See *id.* (noting improper use test standards employed). The Court noted that in the case at bar, "it is clear that the improper purpose test was met. There was ample testimony in the record that petitioners maliciously intended to shut down [the] business." *Id.*

¹⁰⁴ See Lee, *supra* note 54, at 13-270 (noting improper purpose test focuses on petitioning creditor's motivation for pursuing involuntary bankruptcy).

¹⁰⁵ See Lee, *supra* note 54, at 13-245 (signifying bad faith to mean creditor's ill will, malice, and improper use of Bankruptcy Code).

¹⁰⁶ See *In re Cannon Express Corp.*, 280 B.R. 450, 454-55 (Bankr. W.D. Ark. 2002) (noting parties' only motivation for filing involuntary petition to collect debt).

¹⁰⁷ See *id.* at 453 (reiterating facts of the case).

¹⁰⁸ See *id.* (explaining facts). The petitioning creditors believed that Cannon would enter voluntary bankruptcy and because they were unsecured creditors, they wanted to ensure that they would have a standing chance at receiving the debts owed to them, as an involuntary petition would override priority. *Id.* at 455-57. Nevertheless, the Court disputed this point stating, "[t]here is no basis in bankruptcy law to support Bennett's theory of priority skipping. If the involuntary petition was appropriate, any claims Petitioners had against Cannon would be entitled to the priorities established under § 507." *Id.* at 455.

to filing, as a reasonable person would, the petition was deemed filed in bad faith.¹⁰⁹

The Courts' analysis in finding the petitioner's bad faith in *Cannon* under the improper purpose test aligned with the analysis offered in other courts.¹¹⁰ The particular matter of inquiry here, however, is with the lack of objective and subjective factors that are prevalent to be able to identify bad faith in such a case.¹¹¹ The Court did examine a fair share of subjective factors in making their bad faith determination, but limited their objective factors to that of a reasonable person standing in the shoes of the petitioning creditor.¹¹² This one objective factor alone is not enough to identify and evaluate bad faith properly, and will be discussed further in the next section on the objective test.¹¹³

C. Objective Test

The objective test that is employed to identify bad faith is by far the narrowest in scope.¹¹⁴ This test attempts to make the difficult decision as to whether or not a reasonable person standing in the shoes of the creditor would have filed an involuntary petition.¹¹⁵ This test seems to get at the purpose of the improper use test, where the court will measure the objective motivations of the petitioning creditor in their bad faith determination.¹¹⁶

¹⁰⁹ See *id.* at 455-57. (elucidating bad faith filing based on failure to act as reasonable creditor would in situation). The Court also noted that while the petition was filed in bad faith for an improper purpose, they were unable to find that the petitioners exhibited any ill will, malice, or harassment, but for the actions of Pruss. *Id.*

¹¹⁰ See *In re Cannon Express Corp.*, 280 B.R. 450, 453-54 (Bankr. W.D. Ark. 2002) (outlining court's holding).

¹¹¹ See *id.* at 454 (Bankr. W.D. Ark. 2002) (criticizing creditors for failing to look at debtor's entire picture prior to filing petition). In its decision, the court pointed out that the creditors failed to look at the debtor's entire financial situation in applying the improper purpose test. *Id.* It seems that the court's decision to point this out forwards the idea that the improper purpose test does not do enough to advance the interests of both parties in identifying bad faith. *Id.*; see also *In re Forever Green Athletic Fields, Inc.*, 804 F.3d 328, 336 (3d Cir. 2015) (generally holding totality of circumstance best at finding bad faith because other tests insufficient).

¹¹² See *In re Cannon Express Corp.*, 280 B.R. 450, 454 (Bankr. W.D. Ark. 2002) (noting holding based on objective factor of reasonable person).

¹¹³ See *In re Forever Green Athletic Fields, Inc.*, 804 F.3d at 336 (noting appropriate objective analysis requires analyzing multiple factors).

¹¹⁴ See *Lee, supra* note 54, at 13-244 (outlining objective test inquiry into bad faith in filing involuntary petition).

¹¹⁵ See *In re Wavelength, Inc.*, 61 B.R. 614, 620 (9th Cir. B.A.P. 1986) (noting purpose of objective test).

¹¹⁶ See *Lee, supra* note 54, at 13-244 (eliciting objective factors including whether petition justified after inquiry into facts and law).

The Court in *In re Wavelength, Inc.*, presents a fluid analysis of bad faith under the objective test.¹¹⁷ In that case, three individuals were the sole members of the board of directors of Wavelength: Edwards, Kronfeld, and Jaffe.¹¹⁸ In 1984, Wavelength elected Ron Goldberg to serve as the President and Chief Executive Officer of the corporation.¹¹⁹ Subsequently, Goldberg removed Kronfeld from the company despite the fact that he had a five-year employment contract with Wavelength.¹²⁰

Following Kronfeld's termination, the two remaining board members, Jaffe and Edwards filed a state court action to obtain judicial supervision to wind up the affairs of Wavelength.¹²¹ The Bankruptcy Court issued a temporary restraining order and removed Jaffe as a director on the board, relinquishing him of his powers as a director.¹²² Despite his lack of authority, Jaffe filed a voluntary bankruptcy petition on behalf of Wavelength, which eventually turned into an adversary proceeding against Jaffe, Edwards, and Kronfeld and the newly appointed director Tevrizian.¹²³

Upon further consideration, the court decided that the voluntary petition filed by Jaffe would be considered an involuntary petition since Jaffe did not have the legal authority to file on behalf of Wavelength.¹²⁴ Wavelength and Kronfeld issued findings of fact and conclusions of law and submitted a declaration for attorney's fees and punitive damages pursuant to § 303(i).¹²⁵ The Ninth Circuit Court held that, in determining bad faith under the objective test, both Jaffe and Edwards filed their petition in bad faith and subsequently awarded attorney's fees and damages.¹²⁶ Namely, the Court pointed out that Jaffe's filing without sufficient authority as a director, the subsequent signing of bankruptcy documents following the petition, coupled with Jaffe's intent to file a bankruptcy petition without putting the Court on

¹¹⁷ See 61 B.R. 614, 622 (9th Cir. B.A.P. 1986) (finding objective test appropriate for measuring bad faith in filing).

¹¹⁸ See *id.* at 616 (detailing composition of board).

¹¹⁹ See *id.* (acknowledging change in president).

¹²⁰ See *id.* (outlining removal of Kronfeld).

¹²¹ See *In re Wavelength*, 61 B.R. at 616-17 (9th Cir. B.A.P. 1986) (noting complaint to remove director).

¹²² See *id.* at 617.

¹²³ See *id.* (noting unethical actions purported by Jaffe and Edwards). The court also mentioned "that Jaffe and Edwards filed the Chapter 11 petition 'with the sole intent of pressuring Kronfeld into withdrawing from Debtor's business and selling his interest in Debtor to Jaffe and/or Edwards'; and that at the time Jaffe and Edwards filed the Chapter 11 petition, Wavelength was not insolvent." *Id.* at 618.

¹²⁴ See *In re Wavelength, Inc.*, 61 B.R. 614, 617 (9th Cir. B.A.P. 1986) (outlining facts).

¹²⁵ See *id.* at 617-18 (noting conduct and subsequent measures taken by Court).

¹²⁶ See *id.* at 621-22 (explaining reasoning for affirming attorneys' fees).

notice, amounted to bad faith.¹²⁷ The Court implicitly held that a reasonable person, given the circumstances, would not have filed the bankruptcy petition in this situation.¹²⁸

The objective test ultimately fails to show an accurate representation as to whether or not bad faith exists in the creditor's decision to file an involuntary petition because it is predicated on the whether a "reasonable person" can actually stand in the shoes of the creditor.¹²⁹ It is dubious to expect a reasonable person to gauge the hardships associated with a creditor collecting debt and to comprehend the time involved in adjudicating such matters.¹³⁰ To weigh this seemingly abstract concept against the weighing of the debtor's ability to pay their debts as they become due is the reason why this test falls short of depicting creditor's bad faith.¹³¹

D. Totality of the Circumstances Test

Finally, the totality of the circumstances test involves inquiries into both the subjective and objective standards of bad faith, by combining several of the factors considered in the three preceding tests.¹³² In the case noted at the inception of this Article, *In re Forever Green Athletic Fields*, the Court found, under the totality of the circumstances test, that the

¹²⁷ See *id.* at 617-19 (outlining Jaffe and Edward's bad faith under objective test).

¹²⁸ See *In re Wavelength, Inc.*, 61 B.R. 614, 620 (9th Cir. B.A.P. 1986) (acknowledging objective test is appropriate for determining bad faith). The *Wavelength* Court did not explicitly hold that the objective test was the proper test as a matter of law. *Id.* at 620.

¹²⁹ See *id.* (noting bad faith is a question of fact measured by reasonable person standard).

¹³⁰ See *In re Forever Green Athletic Fields, Inc.*, 804 F.3d 328, 336 (3d Cir. 2015) (discussing application of bad faith tests).

¹³¹ See Lee, *supra* note 54, at 13-270 (noting objective test's weaknesses).

¹³² See *In re Forever Green Athletic Fields, Inc.*, 804 F.3d 328, 336 (3d Cir. 2015) (describing details of totality of circumstances test and relation to other tests employed). As the court noted:

In conducting this fact-intensive review, courts may consider a number of factors, including, but not limited to, whether: the creditors satisfied the statutory criteria for filing the petition; the involuntary petition was meritorious; the creditors made a reasonable inquiry into the relevant facts and pertinent law before filing; there was evidence of preferential payments to certain creditors or of dissipation of the debtor's assets; the filing was motivated by ill will or a desire to harass; the petitioning creditors used the filing to obtain a disproportionate advantage for themselves rather than to protect against other creditors doing the same; the filing was used as a tactical advantage in pending actions; the filing was used as a substitute for customary debt-collection procedures; and the filing had suspicious timing.

Id. at 336. See also *In re Diamondhead Casino Corp.*, No. 15-11647(LSS), 2016 WL 3284674, at *16 (Bankr. D. Del. 2016) (noting totality of circumstances test comprised of factors from other bad faith tests).

petitioning creditors were found to have acted in bad faith and imposed harsh sanctions and a new rule stipulating that a petition can be dismissed for bad faith on its face.¹³³ This case began with a series of lawsuits between Keith Day, founder of Forever Green Athletic Fields, and Charles and Kelli Dawson, owners of Pro Green.¹³⁴ Forever Green initiated a suit against the Dawsons for diversion of corporate assets when the Dawsons worked for Forever Green.¹³⁵ Pro Green responded, and ultimately succeeded on their action against Forever Green for unpaid commission and wages.¹³⁶

After receiving their judgment, the Dawsons took action to ensure that they would receive their payment on the judgment in a timely manner.¹³⁷ First, the Dawsons attempted to terminate the arbitration process to force Forever Green into payment.¹³⁸ At the advice of counsel, they threatened to file an involuntary bankruptcy petition against Forever Green to force the money out of their pockets.¹³⁹ Upon the Third Circuit's review, the Court held that the Dawsons (Pro Green) had filed their petition in bad faith, noting that their intentions in filing were antithetical to the purpose of bankruptcy.¹⁴⁰ In conducting their analysis, the Court employed a totality of the circumstances test, identifying both subjective and objective factors that attributed to the bad faith filing.¹⁴¹

Notably, the Court examined the Dawsons' subjective intent in filing the petition, and utilized the objective measure of determining whether or not they examined and researched the situation prior to filing.¹⁴² The Court also investigated the Dawson's motivation to harass Forever Green and whether or not the petition was being used to obtain a tactical advantage.¹⁴³

¹³³ See *In re Forever Green Athletic Fields, Inc.*, 804 F.3d 328, 336 (3d Cir. 2015) (holding involuntary bankruptcy dismissed for bad faith).

¹³⁴ See *id.* at 330-31 (noting series of lawsuits filed between adversaries).

¹³⁵ See *id.* at 330 (explaining potential liability if damages awarded).

¹³⁶ See *id.* at 331 (stating judgment exceeds \$300,000).

¹³⁷ See *In re Forever Green Athletic Fields, Inc.*, 804 F.3d 328, 331 (3d Cir. 2015) (noting Dawsons' intent to obtain monies from judgment by any means). "With the consent judgment in hand, [Charles Dawson] intended to '[f]ind any available asset that Forever Green may have and try to use the lien to seize it.' . . . [Dawson testified] 'I'm going to use that judgment to levy any monies I can find anywhere, whether it be the arbitrator or anyone else.'" *Id.* at 331.

¹³⁸ See *id.* at 336 (noting hasty attempts to derail Forever Green's arbitration process).

¹³⁹ See *id.* at 331-34 (explaining facts). "Justifying this decision, Charles Dawson said that his counsel 'suggested the best way to get to [Forever Green's] assets would be involuntary bankruptcy.'" *Id.* at 331.

¹⁴⁰ See *id.* at 335-36. (explaining court's holding).

¹⁴¹ See *In re Forever Green Athletic Fields, Inc.*, 804 F.3d 328, 336 (3d Cir. 2015) (adopting totality of circumstances approach for identifying bad faith).

¹⁴² See *id.* at 336 (reviewing considerations for determining bad faith).

¹⁴³ See *id.* (analyzing intent and prospective motive for filing).

Overall, the multi-faceted analysis portrayed in the case delineated several of the objective and subjective factors that were examined in several of the other tests.¹⁴⁴ This fluid analysis is the type of inspection the bankruptcy courts should be utilizing to accurately identify bad faith.¹⁴⁵ The *Forever Green* court could have ended their analysis after finding the underlying motives behind the Dawson's intent to file a bankruptcy petition, but they instead chose to apply a holistic review of the situation, which shed light on the objective factors that could have made or disturbed their conclusion.¹⁴⁶ The universal process of identifying multiple factors to attribute to bad faith findings assists other courts in avoiding harmful error.¹⁴⁷

With varying standards used to assign sanctions for improperly filed involuntary bankruptcy petitions, the Bankruptcy Courts' bifurcated decisions and interpretations of § 303(i) leave open the question of which standard should be applied.¹⁴⁸ In the process of accurately evaluating the potential for misconduct on behalf of the creditor, courts should employ a process that is both flexible and achievable in order to satisfy the interests of both parties in order to prevent improperly imposed sanctions.¹⁴⁹ Ultimately, the totality of the circumstances test should be adopted because it brings together subjective and objective factors for an evaluation that adequately identifies bad faith and serves the interests of both the debtor and the creditor.¹⁵⁰

¹⁴⁴ See *id.* at 336-37 (outlining factors used in determining bad faith coupled with creditor's specific acts of bad faith).

¹⁴⁵ See *id.* at 336 (noting totality of circumstances test most suitable for finding bad faith). "This standard is most suitable for evaluating the myriad of ways in which creditors filing an involuntary petition could act in bad faith. It also is the same standard we apply when reviewing allegations that a debtor filed a voluntary petition in bad faith." *Id.*

¹⁴⁶ See *In re Forever Green Athletic Fields, Inc.*, 804 F.3d 328, 338 (3d Cir. 2015) (utilizing both subjective and objective factors to determine actions constituted bad faith).

¹⁴⁷ See *id.* at 336 (prioritizing totality of circumstances test best for identifying bad faith). "In conducting this fact intensive review, courts may consider a number of factors, including . . . reasonable inquiry into the relevant facts and pertinent law before filing; . . . evidence of preferential payments . . ." *Id.*

¹⁴⁸ See Rudy, *supra* note 59 at 710. (explaining application of bad faith tests is left open to courts). "Congress did not define what constitutes bad faith; consequently, bankruptcy and circuit 'courts have developed different tests to determine' what equates to bad faith." *Id.* (citations omitted).

¹⁴⁹ See *In re Better Care, Ltd.*, 97 B.R. 405, 408 (Bankr. N.D. Ill. 1989) (highlighting legislative history regarding § 303 promotes flexible approach). "Congress intended the test to be applied with flexibility so as not to limit or restrict the involuntary process." *Id.*

¹⁵⁰ See *In re Smith*, 243 B.R. 169, 190 (Bankr. N.D. Ga. 1999) (noting flexible test required to determine whether debtor properly paying debts); see also *In re Molen Drilling Co., Inc.*, 68 B.R. 840, 846 (Bankr. D. Mont. 1987) (clarifying totality of circumstances test appropriate measure of determining bad faith under § 303(i)); *In re Grecian Heights Owners' Ass'n*, 27 B.R. 172, 173 (Bankr. D. Or. 1982) (exclaiming purely subjective test does not aide in determination of bad faith).

VI. INHERENT RISKS INVOLVED IN FILING INVOLUNTARY BANKRUPTCY

While the totality of the circumstances test is the dominant means of discovering bad faith, creditors and attorneys should be aware of the potential consequences involved in filing an involuntary petition against a debtor.¹⁵¹ Under 11 U.S.C. § 303(i), petitioning creditors and their attorneys may subject themselves to costs, attorney's fees, damages proximately caused by the petition, and punitive damages if a court finds that they filed an involuntary petition in bad faith.¹⁵² Furthermore, after the 2015 ruling in *In Re Forever Green Athletic Fields*, bankruptcy attorneys practicing and filing petitions in the Third Circuit will face greater hurdles than those in any other jurisdiction.¹⁵³ Considering the harsh consequences that may accompany the involuntary filing, litigators should be on alert and weigh the costs and benefits of filing on behalf of a creditor.¹⁵⁴

"Under a purely subjective test the court herein would be unable to find that [the petitioning creditor] acted in bad faith." *Id.*

¹⁵¹ See Blum, *supra* note 69, at 208 (outlining danger of involuntary bankruptcy). A court can award costs and attorney's fees if the petition is dismissed, unless dismissal is granted under the consent of all of the creditors to the case. *Id.*

¹⁵² See 11 U.S.C. § 303(i) (2018) (outlining sanctions against creditors if court finds involuntary petition filed in bad faith); see also 1-8 Lender Liability Law and Litigation § 8.08 (2017) (noting risks associated with filing bad faith petition). "Few courts have awarded costs and attorney fees without a showing of bad faith. Thus, a debtor seeking to recover against petitioning creditors must, for all practical purposes, show the extraordinary or excessive nature of its costs, fees, or damages." *Id.*; Diane Davis, *Bad Faith Dooms Involuntary Bankruptcy Petition*, BLOOMBERG BNA (Oct. 27, 2015), <http://www.bna.com/bad-faith-dooms-n57982062791/> (explaining harsh consequences of filing involuntary bankruptcy following *Forever Green* case); Barry M. Klayman, *Third Circuit Affirms Bad Faith Involuntary Bankruptcy Dismissal, Increasing Risk of Punitive Damages*, COZEN O'CONNOR (Oct. 20, 2015), <https://www.cozen.com/news-resources/publications/2015/3rd-circuit-affirms-bad-faith-involuntary-bankruptcy-dismissal-increasing-risk-of-punitive-damages> (noting potential risk of punitive damages accompanying Third Circuit ruling).

¹⁵³ See *In re Forever Green Athletic Fields, Inc.*, 804 F.3d 328, 328 (3d Cir. 2015) (holding involuntary petition dismissible for bad faith despite meeting relief requirements).

¹⁵⁴ See Bow, *supra* note 10, at 53 (outlining risks of filing involuntary bankruptcy on behalf of creditors). "If the bankruptcy court finds that the involuntary petition was motivated by or is a product of bad faith, in addition to attorney's fees and costs, it may award—against any petitioner—damages proximately caused by such filings along with any punitive damages due to the debtor." *Id.* "Even if the potentially enormous sanctions do not deter a petitioning creditor, they should be aware that a sanction levied by a bankruptcy court for an involuntary petition in bad faith may be held nondischargeable under 11 U.S.C. § 523(a)(6) if the petitioning creditor seeks to simply discharge the fine by subsequently filing its own bankruptcy." *Id.*

Petitioning creditors forcing debtors into bankruptcy also face a multitude risks.¹⁵⁵ As an initial matter, the easiest way for a creditor to avoid sanctions is to comply with the statutory requirements of § 303 in petitioning for an adequate amount of debt and ensuring that there is no dispute as to the liability owed to the creditor.¹⁵⁶ Furthermore, creditors and their attorneys should look past the standing requirements of § 303 and engage in intensive fact finding to determine whether their involuntary bankruptcy is not usurping other creditors' collection attempts or other proceedings relevant to the debt, otherwise both the creditor and the attorney can be subjected to penalties and sanctions.¹⁵⁷ In the end, depending on which circuit the creditor files an involuntary petition in, it may not be worth the cost of the litigation and the potential for other fees that may be imposed.¹⁵⁸

Involuntary bankruptcy was once a widely accepted and utilized tool for creditors to collect on obligations. With reform and measures to protect debtors that opportunity has now been diminished, forcing creditors to either attempt to perfect their interest or wait until the debtor voluntarily enters bankruptcy and limit their opportunity to collect. Now, creditors risk more than their unsecured interest in attempting to file bankruptcy. The divide among the circuit courts has only made matters worse for creditors—potentially supporting findings of bad faith without proper consideration of

¹⁵⁵ See Stickles & Reilley, *supra* note 55, at 31 (noting recovery of expenses and attorney's fees in involuntary bankruptcy); see also Barry Klayman, *A Cautionary Tale For Involuntary Bankruptcy Petitioners*, LAW360 (Oct. 26, 2015) <http://www.law360.com/articles/718749/a-cautionary-tale-for-involuntary-bankruptcy-petitioners> (describing harsh consequences following *Forever Green*, including sanctions and fees); Thomas Piney, *Involuntary Bankruptcy Petitions – Use With Caution*, WHITE & WILLIAMS LLP (Oct. 29, 2015), <http://www.whiteandwilliams.com/resources-alerts-Involuntary-Bankruptcy-Petitions-Use-With-Caution.html> (outlining risks and consequences of filing involuntary petition).

¹⁵⁶ See Rudy, *supra* note 59, at 709-11 (noting varying requirements for petitioning creditors under § 303).

¹⁵⁷ See 1-8 Lender Liability Law and Litigation § 8.08 (2017) (noting counsel's liability in assisting petitioning creditor in filing involuntary bankruptcy). "In addition to potential penalties and sanctions against a client under Section 303(i), counsel who assist in the filing of an involuntary petition . . . may be required by the court to satisfy personally the excess costs, expenses and attorney's fees" *Id.* (citing 28 U.S.C. § 1927). The statutory language of § 303(i) supports the proposition that attorney's fees should be assessed against petitioning creditors jointly and severally and that awards of damages for bad faith may lead to joint and several liability. *Id.*; see also Bow, *supra* note 10, at 53 (emphasizing creditor and attorney jointly liable if found filed petition in bad faith).

¹⁵⁸ See Block-Lieb, *supra* note 43, at 844-46 (noting preferences for non-judicial resolutions). "Creditors may prefer not to pursue their coercive collection remedies because they stand to gain little from litigation with the debtor." *Id.* "Moreover, creditors of an individual debtor rarely have anything to gain from the commencement of an involuntary bankruptcy case because the filing of a petition is a particularly ineffective means of coercing repayment of an individual debtor's obligations." *Id.* at 846.

the creditor's situation. While the courts will continue to utilize their individual tests for determining bad faith without guidance from Congress, the totality of the circumstances test should be adopted universally to protect both the interests of debtors and creditors.

Nevertheless, creditors and their attorneys should be wary of the potential consequences that may arise with filing for involuntary bankruptcy. Without taking the appropriate steps to ensure that all other collection routes have been utilized and that they fully meet the requirements under § 303, creditors will find themselves subjected to harsh penalties and sanctions for their collection efforts if found to be improperly accorded with the rules in the bankruptcy code.

Carlos Wilder