HANDLING INVOLUNTARY BANKRUPTCIES: TOP TWENTY TIPS FOR PETITIONERS, JUDGES, ALLEGED DEBTORS, ASSIGNEES, SECURED CREDITORS AND TRUSTEES [i]

PART II – TEN TIPS FOR JUDGES, ALLEGED DEBTORS, ASSIGNEES, SECURED CREDITORS AND TRUSTEES

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Editor's Note: This is part two of a two-part series. The first part, which was published in the January/February 2003 issue of the Commercial Law Bulletin, presented ten tips for petitioners.

Introduction

Because involuntary cases are just a small percentage of bankruptcy cases as a whole, parties do not always realize that the administration of such cases differs in significant respects from the more familiar voluntary cases. The purpose of this article is to provide some pointers to those who occasionally practice in this area. This two-part series presents my top twenty tips for petitioners, judges, alleged debtors, assignees, secured creditors and trustees.

Tips for Judges

11. Wait Until The Return Date Before Setting A Status Or Ordering Relief

In an involuntary case the petitioning creditor must summon the debtor to answer the petition. More often than not, the summons is served by mail. Pursuant to Fed.R.Bank.P. 1011(b) & 9006(f) the debtor has 23 days to answer or otherwise plead after service by mail. Therefore, you should not set a status on the case or enter an order for relief at least until that amount of time has elapsed; otherwise, you will just be wasting the parties' time and your own.

In that regard it is useful to check the docket or court file to see if a proof of service has been filed. Oftentimes, service is not effected on the day the case is filed, so the time limitations discussed above may need to be further extended. In the absence of prompt proof of service by the petitioner, you should consider entering a show cause order why the case should not be dismissed for failure to prosecute it.

12. Make Sure The Summons Is Fresh

Fed.R.Bank.P. 1010 provides for service of involuntary petitions and allows for the petition and summons to be served by mail. The rule incorporates Fed.R.Bank.P.

7004(e), which mandates that the summons be deposited in the mail within 10 days of issuance. Because debtors in involuntary cases have been known to be elusive, it is not uncommon for the petitioner to encounter difficulty in effecting service. If the summons is mailed more than 10 days after issuance, it is stale and you should not enter an order for relief because *in personam* jurisdiction has not been obtained.

13. Do Not Authorize The Appointment Of A Gap Trustee Without A Bond

As noted in Tip #2 the petitioner may request the appointment of a trustee before the order for relief. In a chapter 7 case Fed.R.Bank.P. 2001(b) requires the court to condition the appointment on the petitioner's posting a bond to ensure payment of any judgment that may be entered against the petitioner pursuant to § 303(i). For example, the bond would cover debtor's damages should the court find that the petition was filed in bad faith. Note that the interim trustee's bond which protects creditors in case of defalcation of estate funds is entirely different and cannot serve for complying with Fed.R.Bank.P. 2001(b). Also note that the bond requirement applies only in chapter 7, not in chapter 11 cases.

14. State Reasons For Appointing A Gap Trustee And The Trustee's Duties

Typically, reasons for orders are stated in opinions, not in the orders themselves. An exception applicable to involuntary chapter 7 cases is provided by Fed.R.Bank.P. 2001(c), which provides that the "order directing the appointment of an interim trustee shall state the reason the appointment is necessary and shall specify the trustee's duties."

Because of the exceptional nature of this kind of order, the requirement is easily overlooked, but, of course, it should not be. Again, note that this requirement does not apply where the court authorizes the appointment of a chapter 11 trustee before the order for relief. Also note that whereas in chapter 7 cases the rule requires an explicit statement of the § 704 duties imposed on the "gap" trustee, the duties of a chapter 11 trustee authorized before the order for relief are as provided in § 1106.

Tips for Alleged Debtors

15. You Can't Act Like A DIP If You Aren't One

As the alleged debtor you are ordinarily free to act as if the involuntary bankruptcy petition had not been filed. *See* § 303(f). Of course, sometimes you might wish to have the bankruptcy court enter an order approving conduct you are considering, such as a sale of property or the retention of counsel. You should not make this request, nor should the court approve it if you do, because as the alleged debtor you wholly lack the power and authority to act like a trustee in bankruptcy or debtor in possession. Without any statutory basis for such a request, such a request must be denied.

16. You Should Consider Converting An Involuntary 7 To Chapter 11

An order for relief under chapter 7 is a business debtor's financial death knell. Unless your business is dead, you should consider converting a chapter 7 involuntary to chapter 11. Doing so will leave you in control of the business, at least for the time being, and, even if the business is not viable in the long term, you can influence, if not control, the manner of its eventual liquidation.

You need not consent to the entry of an order for relief under chapter 7 at all. Section 349(a) provides that simply by converting the involuntary chapter 7 petition to chapter 11 the order for relief under chapter 11 is effected. Section 349(e) provides you an additional bonus: conversion to chapter 11 terminates the service of any trustee and restores you to possession. One negative consequence of conversion is the Clerk's conversion fee and the U.S. Trustee quarterly fees that will apply until your case is closed. Another is that you cannot retain any professional that you owe money as of or before the order for relief, because that professional will not satisfy the disinterestedness test of § 327.

A Tip for Assignees

17. Know Your Rights And Duties Under § 543

As assignee for the benefit of creditors you liquidate a debtor's assets outside of bankruptcy and distribute the proceeds in accordance with the priorities of state and federal non-bankruptcy law. If you received the assignment within 120 days of the involuntary petition, the entry of the order for relief is automatic under § 303(h)(2). Furthermore, once you know the bankruptcy has been filed, you may not do anything to complete the assignment, even if the order for relief has yet to be entered, and may take only such action as is necessary to preserve the property under your control. *See* § 543(a).

Section 543 imposes other duties upon you, such as turning over the property to the trustee and filing an accounting of your administration, but these duties may be excused in whole or in part if the interests of creditors and, if the debtor is not insolvent, equity security holders, favor your continuing administration of the property. Therefore, you should strongly consider requesting such relief from the court, especially where you have completed a significant percentage of the assignment.

Note that if you are not excused from the turnover requirements of § 543, Fed.R.Bank.P. 6002 requires you to provide the court and U.S. Trustee a prompt accounting of your administration. You should request the court to approve your fees at the same time as you do the final account of your administration.

A Tip for Secured Creditors

18. You Are In The Catbird Seat, So Take Advantage Of It

Even though the filing of the involuntary case triggers the automatic stay of § 362, you are still in the catbird seat. You can move to lift the stay before the order for relief and the appointment of a trustee. Under Fed.R.Bank.P. 4001(a)(1) you need only serve the debtor and debtor's attorney, if there is one, and the U.S.Trustee, if so requested or ordered by the court pursuant to Fed.R.Bank.P. 2002(k). Technically, under Fed.R.Bank.P. 4001 you do not have to serve the petitioning creditors or their counsel, but it is unlikely any court would grant relief in the absence of such service.

Whether the involuntary case is a chapter 7 or 11, quick action on your part is likely to result in a situation where you can prevail on a default basis, since the debtor may not be prepared or willing to respond and no trustee may have been appointed. While the court may be reluctant to grant relief in this circumstance, you should strongly consider not waiving your right to a hearing in 30 days as provided by § 362(e). *See also* Tip #3 which you may be able to use to your advantage.

Tips For Trustees

19. Enforce Compliance By A Contempt Motion If Necessary

Once the order for relief is entered, Fed.R.Bank.P. 1007 requires the debtor to file the list of creditors, schedules and statement of affairs within 15 days. It is not uncommon for the debtor to either disregard this rule or unreasonably delay in complying with it, effectively frustrating the administration of the case.

As the trustee, you are the representative of the estate and should take steps to enforce compliance. If no order has been entered designating a specific individual as the one responsible for filing the papers on behalf of the debtor, you can request the court to make that designation under Fed.R.Bank.P 9001(5). Once the order is entered, you can enforce it through a contempt motion under Fed.R.Bank.P. 9020.

If the debtor or the debtor's designee has skipped the jurisdiction or it is otherwise impractical to follow the strategy suggested above, you can request the court to designate a petitioning creditor as the person to file the lists and schedules, or do it yourself. *See* Fed.R.Bank.P. 1007(k). While doing this task is not an attractive prospect, at least the cost of doing so is allowable as an administrative expense.

20. Anticipate A Trustee Election

In an involuntary case the creditors are almost by definition more organized and motivated than in a typical voluntary case. Even before filing the case the petitioners may have settled on the person they want to serve as trustee, and that person may not be you. Remember that Fed.R.Bank.P. 2006(d) prohibits you from soliciting proxies on your behalf, and that it is inadvisable for you to preside at the meeting of creditors or conduct the election yourself. If you suspect that an election will be called, advise the U.S. Trustee and request that a U.S. Trustee representative preside at the meeting and

conduct the election if one is requested. Finally, remember that you are the trustee until you aren't, and, therefore, have the responsibility for discharging the trustee's duties under § 704 as long as you serve.

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[i] The views expressed in this article are those of the author and do not necessarily represent the views of, and should not be attributed to, the United States Department of Justice or the United States Trustee Program. Contact the author at Richard.C.Friedman@usdoj.gov.

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