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INVOLUNTARY BANKRUPTCIES: THE BASICS AND RECENT DEVELOPMENTS

Involuntary petitions are remedies with serious consequences for the debtor but also carry substantial risks for the petitioning creditors. The authors provide an overview of the basic statutory requirements and rules on involuntary petitions. They then turn to recent developments, discussing the "all-or-nothing" approach to claims, bad faith dismissals, abstention, and awards of attorneys' fees, costs, and damages. They conclude with a discussion of the difficulties creditors face during the gap period between the filing of the petition and the order for relief.

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An involuntary bankruptcy may simultaneously be a particularly risky venture and an extraordinarily game-changing arrow in a creditor's quiver. Bankruptcy courts across the country carefully scrutinize involuntary bankruptcies because they are often extreme remedies with serious consequences to the alleged debtor, including loss of credit standing, inability to transfer assets and carry on business affairs as usual, and public embarrassment.[1] And with this high level of scrutiny comes teeth: Courts are authorized to, and may, levy compensatory and punitive damages against petitioning creditors when they file involuntary petitions in bad faith.[2]

Although filing an involuntary petition is an extreme remedy, it is sometimes a necessary one. Involuntary bankruptcies serve as a useful creditor collection tool to ensure equality of distribution of a debtor's assets. They may preserve assets from further dissipation and provide for their orderly liquidation by a bankruptcy trustee, especially in situations where management is conflicted, has fraudulently transferred assets, or is otherwise wasting value for the creditor body. Given the high-stakes litigation involved in involuntary bankruptcies and the balance that the Bankruptcy Code attempts to strike with competing policies, it is unsurprising that less

[1] *In re Smith*, 243 B.R. 169, 174 (Bankr. N.D. Ga. 1999) (quoting *In re Reid*, 773 F.2d 945, 946 (7th Cir. 1985)). *See also In re Landmark Distribs., Inc.*, 189 B.R. 290, 306 (Bankr. D.N.J. 1995) (quoting *In re McDonald Trucking Co*., 76 B.R. 513, 516 (Bankr. W.D. Pa. 1987)).

[2] 11 U.S.C. § 303(i).

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