No. 20-1177

In The
Supreme Court of the United States

NATIONAL MEDICAL IMAGING, LLC, et al.,

Petitioners,

v.

U.S. BANK N.A., et al.,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Third Circuit

BRIEF OF AMICI CURIAE THE HONORABLE JUDITH FITZGERALD (RET.), THE HONORABLE BRUCE MARKELL (RET.), THE HONORABLE EUGENE WEDOFF (RET.), AND A GROUP OF LAW PROFESSORS IN SUPPORT OF PETITIONERS

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INTEREST OF AMICI CURIAE[1]

The amici curiae, whose names are set forth on Appendix A, include retired bankruptcy judges, and law professors at various universities. All of the amici devote a substantial portion of their professional lives to researching, teaching and writing on bankruptcy law.

We write to address a critically important issue arising under federal bankruptcy law—namely, when may a bankruptcy court award punitive damages to an alleged debtor who has been wrongfully subjected to an involuntary bankruptcy petition, and the petition has been dismissed.

Our concerns are this: the filing of an involuntary petition against an alleged debtor has long been recognized as particularly pernicious and debilitating[2] and can result in a company losing control over management. Congress provided for safeguards against this harm by expressly providing for punitive damages where the petition was filed in bad faith, yet the courts have adopted a variety of inconsistent and varying legal standards for what "bad faith" means. The courts

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[1] Pursuant to this Court's Rule 37.2, the Petitioners and Respondents received timely notice of the intent to file and have consented to this *amici curiae* brief. Pursuant to Rule 37.6, *amici* affirm that no counsel for a party authored this brief in whole or in part, and that no person other than *amici* or their counsel contributed any money to fund its preparation or submission.

[2] The filing of an involuntary bankruptcy petition "can leave a permanent scar even if properly dismissed." *In re Dino's, Inc.*, 183 B.R. 779, 783 (S.D. Ohio 1995).

follow at least seven different tests for bad faith under Bankruptcy Code § 303.[3] This disarray has plagued the courts for at least twenty-five years,[4] and by itself warrants review by this Court.

The Third Circuit's decision exacerbated the disarray of holdings, both because it was wrong and because its holding runs counter to most other courts.[5] It affirmed the holding of the District Court that when an involuntary petition is dismissed as having been filed in bad faith, an additional finding of "malice or egregious conduct" is "required" in order to permit a court to award punitive damages. Malice, however, is not mentioned in § 303(i)(2) and there is no justification for adding a threshold requirement for awarding punitive damages under § 303(i)(2). The upshot of this decidedly subjective standard is to make evasion of any sanction too likely.

The insistence on a showing of malice, an entirely subjective standard, as a threshold requirement for punitive damages, is inimical to the goals of Congress to protect debtors from abusive involuntary petitions. It is at odds with both the earlier Third Circuit decision of *In re Forever Green Athletic Fields, Inc.*, 804 F.3d 328, 335 (3d Cir. 2015) as well as this Court's recent

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[3] All references are to 11 U.S.C. §§ 101 *et seq.* (the "Code").

[4] *See In re Dino's, Inc.*, 183 B.R. 779, 781 (S.D. Ohio 1995) noting that as early as 25 years ago the determination of the appropriate standard for bad faith had led to a "substantial ground for difference of opinion among the circuits. . . ."

[5] *See In re Anmuth Holdings, LLC*, 600 B.R. 168, 188 (Bankr. E.D.N.Y. 2019) (stating that most courts follow the totality test).

decision in *Taggart v. Lorenzen*, 139 S. Ct. 1795 (2019), emphasizing objective factors for sanctions for creditor misconduct.

We write to urge the Court to grant the petition for certiorari in order to provide needed guidance to the bankruptcy courts by requiring a uniform standard for "bad faith" to be applied under § 303(i)(2) and to expressly disavow the notion that "intentional malice" is a mandatory, threshold requirement for an award of punitive damages.

SUMMARY OF ARGUMENT

Section 303(i)(2) of the Code provides that a bankruptcy court may award compensatory or punitive damages once it determines that an involuntary bankruptcy was filed in bad faith. The statute requires nothing more. There is no reference to malice.

Certiorari should be granted to resolve the longstanding conflict over the meaning of bad faith as applied in § 303 of the Code. The circuit courts and lower courts are badly divided on the question of the legal standard for the award of damages (either compensatory or punitive) and have applied a "dizzying array of standards" with regard to awarding damages under § 303(i)(2). *In re Forever Green*, 804 F.3d 328, 335.

Despite this disarray, the correct legal test is the "totality of the circumstances test," set forth in *Forever*

Green.[6] The Third Circuit identified the key factors a court may consider in determining bad faith for dismissal under § 303, noting that Congress intended for bad faith to serve as a basis for both dismissal and damages under § 303. 804 F.3d at 334. The first three factors are objective factors, including whether the petitioning creditors were faithful to the statutory protections which serve as the gatekeepers to the filing of an involuntary petition. These "gatekeepers" include the requirement that the creditor holds a bona fide claim, that there are the required number of creditors, and that the debtor is generally not paying its debts.[7] These objective factors are based squarely on the express statutory requirements for a valid involuntary petition. Although subjective factors may be considered, the court did not remotely suggest that malice or any other subjective factor is a threshold requirement for either dismissal or damages.[8]

The Third Circuit disregarded entirely the objective factors utilized in *Forever Green*. In affirming the decision of the District Court it held that "something more" than bad faith is *required* for punitive damages.

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[6] "[T]he totality of the circumstances involves both the subjective and objective standards of bad faith. . . . This fluid analysis is the type of inspection that bankruptcy courts should be utilizing to accurately identify bad faith." Carlow Wilder, *Equity or Inequality?: Defining Bad Faith in Involuntary Bankruptcy*, 23 Suffolk J. Trial & App. Advoc. 164, 184 (2017-2018).

[7] 11 U.S.C. §§ 303(b)(1) and 303(h).

[8] In *Forever Green*, the court held that an involuntary petition could be dismissed under § 303(b) for bad faith, even if the statutory requirements were met.

"Punitive damages *require* more than bad faith, and 'are *only warranted* when the evidence shows that defendant acted with 'intentional malice' or that its conduct was 'particularly egregious'.' " App. 53 (emphasis added). This holding, that the threshold requirement for punitive damages is malice, was legal error.

The Third Circuit's decision also is at odds with this Court's recent decision in *Taggart* which held that the correct legal standard for a finding of contempt for disregarding a discharge order is generally an objective standard and overruled an earlier subjective standard. The same logic pertains here. The misconduct in filing an involuntary that justifies punitive damages should likewise primarily be an objective standard, such as a disregard of the filing requirements as occurred in this case, and should not depend solely on whether the petitioning creditor acted with malice—a decidedly subjective standard.

Certiorari should be granted because the issue is both timely and of critical importance. The involuntary petition is correctly "perceived as one of the most extreme remedies available to a creditor."[9] "The filing of an involuntary petition has devastating consequences for the putative debtor." *U.S. Bank, Nat'l Assoc. v. Rosenberg*, No. 18-1249, 741 F. App'x 887, 890 (3d Cir. 2018).

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[9] Isabella C. Lacayo, *After the Dismissal of an Involuntary Bankruptcy Petition: Attorney's Fees Awards to Alleged Debtors*, 27 Cardozo L. Rev. 1949, 1949-50 (2006).

This case is an ideal vehicle to resolve the question of the proper standard for bad faith, an issue that has been percolating for at least twenty-five years without resolution. The issue of whether malice is required was squarely presented below by U.S. Bank which insisted that malice is required to award punitive damages.[10] NMI disputed this. The lack of malice was the deciding factor in the District Court's refusal to award punitive damages.[11] Thus, the issue has been fully litigated and is ripe for judicial review by this Court.

ARGUMENT

I. THIS CASE PRESENTS AN OPPORTUNITY FOR THIS COURT TO RESOLVE THE CONFLICT ON THE LEGAL STANDARD FOR DAMAGES FOR FILING A BAD FAITH INVOLUNTARY PETITION.

A. There is widespread disarray of decisions on what constitutes bad faith, resulting in a loss of uniformity within the bankruptcy courts.

Section 303(i)(2) of the Code states a court may award punitive damages in favor of an alleged debtor,

[10] "Punitive damages are available under § 303(i) only for malicious or egregious conduct." U.S. Bank's Second-Step Brief, Dkt. 62. p. 37.

[11] App. 6 and 61, *See also*, *id*. at notes 85 and 86, restating that misconduct does not justify punitive damages if it "does not demonstrate the level of egregiousness or maliciousness that would permit an award of punitive damages."

if the involuntary petition is dismissed, and the filing was in bad faith. This important protection, however, has been impeded by a significant number of divergent decisions from both the circuit courts and the lower courts, generating even an intra-circuit split among different panels on the Third Circuit. As noted by the Third Circuit, courts have applied a "dizzying array of standards, mostly with regard to post-dismissal damages under § 303(i)(2)." *Forever Green*, 804 F.3d at 335. A leading commentator suggests there are six, or possibly seven different tests utilized. 2 COLLIER ON BANKRUPTCY, ¶ 303.16. These tests, while sometimes overlapping, are often in conflict on key points. Some tests, "while capturing part of the inquiry, can miss key aspects of a situation." *Id.*

The circuit courts are split on the correct standard. The Third Circuit's controlling case, *In re Forever Green*, 804 F.3d at 334-35, adopted the 'totality of the circumstances' approach, which focuses on standards found in the plain language of § 303, and with some attention to subjective standards. The Third Circuit found that there was a unitary notion of "bad faith" that governed both the dismissal and the award of damages. 804 F.3d at 334.

A different panel from the Third Circuit, which issued the decisions below (App. 1 and 17), made passing mention of *Forever Green*, but disregarded the objective factors and looked solely to "malice" as the key requirement. The Sixth Circuit likewise cited the "totality" test for awarding damages under § 303(i) but then offered a less expansive test than *Forever Green.*

In re John Richards Homes Bldg. Co., L.L.C., 439 F.3d 248, 254-55 (6th Cir. 2006).

Other circuit courts do not rely on the totality test. The Fourth Circuit considers objective and subjective factors. *See Atlas Mach. & Iron Works, Inc. v. Bethlehem Steel Corp*., 986 F.2d 709, 716 (4th Cir. 1993) (affirming dismissal of involuntary under § 303(b) based on whether a reasonable person would have filed the petition and the creditor's motivation).

The Ninth Circuit has held that "§ 303(i)(2) expressly authorizes a stand-alone award of punitive damages . . . without limitation; the sole precondition is a showing of bad faith." *In re S. California Sunbelt Developers, Inc*., 608 F.3d 456, 465 (9th Cir. 2010), but without addressing the standards for bad faith.

However, the Bankruptcy Appellate Panel for the Ninth Circuit held that bad faith is an "objective test" that asks, "what a reasonable person would have believed." *In re Wavelength, Inc.*, 61 B.R. 614, 620 (B.A.P. 9th Cir. 1986) (citing *In re Grecian Heights Owners' Ass'n*, 27 B.R. 172, 173 (Bankr. D. Or. 1982) (bad faith is a factual question to be measured objectively)).

Other circuits have not resolved the meaning of bad faith for purposes of § 303(i)(2). *See*, *e.g.*, *In re Bayshore Wire Prod. Corp.*, 209 F.3d 100, 105-06 (2d Cir. 2000) (declining to choose among various tests); *General Trading Inc. v. Yale Materials Handling Corp.*, 119 F.3d 1485, 1502 (11th Cir. 1997) (declining to choose a correct approach to determine bad faith, but

not identifying "totality of the circumstances" as one of the possible tests).

Lower courts are also split over the standard. For example, within the Seventh Circuit there are at least four different tests utilized. *See In re Fox Island Square P'ship*, 106 B.R. 962, 967-68 (Bankr. N.D. Ill. 1989) (awarding punitive damages when petitioner failed to make a reasonable inquiry into debtor's debts and sought to delay a foreclosure, applying Rule 9011); *In re Mundo Custom Homes, Inc.*, 179 B.R. 566, 569-70 (Bankr. N.D. Ill. 1995) (applying totality test); *In re Paczesny*, 282 B.R. 646, 649 (Bankr. N.D. Ill. 2002) (applying objective test); *In re Better Care, Ltd.*, 97 B.R. 405, 409 (Bankr. N.D. Ill. 1989) (applying "nose test").

Another approach is the "improper purpose" test, which "focuses on whether the filing of the petition was motivated by ill will, malice or a desire to embarrass or harass the alleged debtor." *In re CNG Foods, LLC*, No. 16-43278, 2020 WL 4219679 at *11 (Bankr. E.D.N.Y. July 2020) (declining to decide which test governs).

The upshot of this disarray is that the courts lack adequate guidance and thus vacillate between standards. Congress is empowered to pass "uniform" laws on bankruptcy. U.S. Const. Art. I, § 8, cl. 4. This disarray runs counter to the goals of not having *geographic differences* in the application of bankruptcy law and thus warrants review.

B. The correct test for awarding punitive damages is the predominantly objective test set forth in *Forever Green*. This test is consistent with this Court's ruling in *Taggart v. Lorenzen*.

Despite the disarray among the courts, the correct legal standard was announced by the Third Circuit in *Forever Green*. The Third Circuit noted the dizzying array of standards and sought to resolve this question by holding that the proper legal standard for determining bad faith under § 303 is the "totality of the circumstances" test. 804 F.3d at 336. "Most of the courts . . . have adopted a totality of the circumstances test in which certain factors are to be considered." *In re Anmuth Holdings, LLC*, 600 B.R. 168 at 188.

Forever Green identifies both objective and subjective factors but specifically identified compliance with the statutory protections found in § 303—the "gatekeepers" which serve to prevent unlawful involuntary petitions, as occurred here.[12] The explicit statutory

[12] "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

standards for the filing of an involuntary petition include having the required number of petitioning creditors, § 303(b)(1); that the petitioners each hold a claim that is not subject to a bona fide dispute, *id.*; and that the debtor is generally not paying its debts as they come due, § 303(h). The courts have also held that a creditor is obligated to make a reasonable inquiry into the existence of these requirements.[13]

The "totality" test identifies key factors which are decidedly objective and true to Congressional intent. For example, punitive damages are warranted when a creditor is indifferent to its duty to investigate the number of creditors, or files a petition when its claim is subject to a bona fide dispute. "[I]f a petitioning creditor actually knows it has a bona fide dispute as to liability or amount with the debtor, that creditor's good faith can be challenged. If a single petitioning creditor knows that the debtor has more than eleven creditors, the filing can be challenged on the basis of bad faith." 2 COLLIER ON BANKRUPTCY, ¶ 300.16.

Had Congress intended to include a malice standard or a willfulness standard, it would have so stated. *See*, *e.g.*, 11 U.S.C. § 362(k) (requiring willfulness before damages can be awarded); and § 523(a)(6) (prohibiting the discharge of a debt for "willful and malicious

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customary debt-collection procedures; and the filing had suspicious timing." *Forever Green*, 804 F.3d at 336.

[13] "[The] courts consistently have stated that a 'lack of a due investigation' into the number of a debtor's creditors will result in a finding of bad faith." *In re Caucus*, 106 B.R. 890, 925 (Bankr. E.D. Va. 1989).

injury.") The omission is telling. "[I]t is generally presumed that Congress acts intentionally and purposely when it includes particular language in one section of a statute but omits it in another." *Chicago v. Environmental Defense Fund*, 511 U.S. 328, 338 (1994) (internal quotation marks omitted).

The use of an objective standard is far more consistent with this Court's ruling in *Taggart v. Lorenzen* which emphasized the need for objective standards for sanctioning creditor misconduct. This Court addressed whether a creditor who disregards the discharge order could be found in contempt and whether the standard to determine this was primarily objective or subjective. The Court emphasized that a subjective standard cannot be permitted to insulate a wrongdoer from sanction:

> This standard is generally an *objective* one. We have explained before that a party's subjective belief that she was complying with an order ordinarily will not insulate her from civil contempt if that belief was objectively unreasonable. As we said in *McComb v. Jacksonville Paper Co.*, 336 U.S. 187, 69 S.Ct. 497, 93 L.Ed. 599 (1949), "[t]he absence of willfulness does not relieve from civil contempt." *Id.*, at 191, 69 S.Ct. 497.
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> *Taggart*, 139 S. Ct. at 1802 (2019) (emphasis in original).

This Court in *Taggart* stated that a subjective standard provides an incentive for misconduct. Requiring a plaintiff to show "a difficult-to-prove state of mind" may lead creditors to violate the statute. *Taggart*, 139 S. Ct. at 1803. "We conclude the Court of Appeals erred in applying a subjective standard for civil contempt." *Id.* at 1804.

The *Taggart* Court noted that use of the objective standard did not mean that "subjective intent is always irrelevant"; like *Forever Green*, it described weighing evidence of a culpable state of mind. "Continuing and persistent violations" of the Code are properly considered in a finding of bad faith. *Id.* at 1802.

The same rule should pertain here; namely, the absence of malice should not relieve a creditor from sanctions for disregarding the key filing conditions of an involuntary petition. The grounds here are even more compelling than in *Taggart*. The Court in *Taggart* found there might be a basis for "fair ground of doubt" about the scope of the discharge order. *Id*. at 1799. But there is no such basis for any doubt about the lawful requirement for three petitioning creditors, nor holding an undisputed claim. The failure here was based on an admitted failure to do *any* investigation. App. 55 ("no one did"). It was more than "certainly improper" (App. 56), more an act of actionable indifference to the obligation to understand and comply with the law.

II. THE THIRD CIRCUIT'S SUBJECTIVE MALICE STANDARD FOR PUNITIVE DAMAGES WAS IN ERROR AND WILL FAIL TO ENSURE THAT DEBTORS ARE PROTECTED FROM ABUSIVE INVOLUNTARY PETITIONS.

A. The District Court erroneously utilized a subjective threshold test of malice as a requirement for awarding punitive damages.

The District Court committed legal error by applying the incorrect legal standard for an award of punitive damages. The court's ruling was as follows: "Punitive damages require more than bad faith, and 'are only warranted when the evidence shows that a defendant acted with 'intentional malice' or that its conduct was 'particularly egregious'.'" App. 53.

The District Court held that "[t]here are limited indicia of bad faith, which preclude any determination on that issue as a matter of law. . . ." App. 6. The Third Circuit agreed, stating the evidence relating to bad faith did not rise to the level of maliciousness that would warrant punitive damages. App. 56.

In affirming the District Court, the Third Circuit likewise agreed that there was a showing of bad faith: "[W]e are accepting, for the sake of argument that the creditors acted with some degree of bad faith." App. 8. Nevertheless, it held that Congress gave the court the power to "withhold an award [of punitive damages] in rare circumstances." App. 10.

The notion that "more than bad faith" is required, and that a court can disregard the finding of bad faith in "rare circumstances" is wholly unsupported by case law and was based entirely on dicta from *In re Reid*, 854 F.2d 156, 160 (7th Cir. 1988). *Reid*, however, did *not* address punitive damages,[14] cited no support for its "rare circumstances" statement, and did not even have the issue of bad faith before it, but only legal fees, which under § 303(i) does *not* require a showing of bad faith. No other court has cited this notion of "rare circumstances" justifying a departure from awarding punitive damages once there is a showing of bad faith. Finding "indicia of bad faith" fulfilled the explicit requirement of § 303(i) for punitive damages, and meant the question was now for the jury.

B. U.S. Bank engaged in continuing and persistent violations of the Code, thus demonstrating the requisite bad faith for punitive damages.

Had the Third Circuit applied the correct legal standard to the record below, it could not have affirmed the District Court's granting of summary judgment.

In *Taggart*, this Court held that a finding of bad faith may be inferred where there is evidence of "continuing and persistent violations" of a contempt order. 135 S. Ct. at 1802 (stating such conduct results in a

[14] "Appellant, however, have made no allegation of bad faith on the part of the creditors in this case." *In re Reid*, 854 F.2d at 160.

shift of the burden). The same rule should apply to violations of the Code's requirements. U.S. Bank's conduct could certainly have entitled a jury to find that it had engaged in continuing and persistent misconduct that constituted bad faith.

The Pennsylvania district court dismissed the involuntary petition, finding that that "U.S. Bank was the only creditor. . . ." App. 36. Indeed, "on the petition date, the corporate good standing of the majority of the DVI entities had lapsed and had been administratively dissolved." App. 54. As the Circuit Court noted, "some of the . . . entities that were listed as creditors were no longer in business when the petition was filed." App. 11.

This failure to comply with the numerosity requirement was the result of no effort being made to comply with the Code's requirements for filing. The involuntary petition was signed on behalf of dissolved entities by Ms. Fox from Lyon Financial Services. This despite there having been no meeting of the directors or officers of the claimed co-filing entities before signing on their behalf. *In re Rosenberg*, 414 B.R. 826, 837 (Bankr. S.D. Fla. 2009), subsequently *aff'd*, 472 F. App'x 890 (11th Cir. 2012).

The petition filed by U.S. Bank failed to comport with any duty to make an objectively reasonable investigation before it filed. The Pennsylvania District Court found that "no one" did any investigation to determine the number of creditors (App. 55), and that the entire process of investigating and preparing the

petition constituted a "negligent and hasty approach." App. 54. Ms. Fox asserted "she personally did not do anything to determine whether NMI had more than 12 creditors, and that no one at Lyon did any due diligence and that she did not know if anyone performed any due diligence on this issue." App. 55, n.68. The Florida court also found that the "DVI entities and Ashland held contingent claims subject to a *bona fide* dispute." App. 36, n.6.

The District Court found that this conduct was "certainly improper," App. 56, but denied punitive damages solely because this improper conduct was not considered malicious. *Id.*

Malice was not required. The lack of due investigation is sufficient.[15] Further, the filing of an involuntary petition that contains improper assertion as to the number of creditors is a valid basis for punitive damages, without more. "Whether bad faith is determined by a subjective or objective test has been debated. . . . Under all approaches, however, a materially false statement in support of an involuntary petition constitutes bad faith for purposes of section 303(i)(2)." *In re Kidwell*, 158 B.R. 203, 217 (Bankr. E.D. Cal. 1993).

Likewise, the filing of a single creditor petition, as occurred in this case, is a practice that has been "condemned." *See In re Nordbrock*, 772 F.2d 397, 399, 400 (8th Cir. 1985) (calling single creditor involuntary petitions improper "absen[t] fraud or some special need

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[15] *See In re Caucus*, 106 B.R. 890, 925 (Bankr. E.D. Va. 1989).

for bankruptcy"). The Respondents engaged in exactly the kind of "bad faith" filing that has been found to justify both dismissal and an award of punitive damages.

Reversal is thus appropriate.

C. The Third Circuit's non-binding affirmation of the District Court's decision did not clarify that it was rejecting the requirement for malice.

The Third Circuit was well aware that the District Court's ruling was wrong and presumably knew it constituted an abuse of discretion. However, it failed to clarify the correct legal standard and to reject expressly the malice standard.

The Third Circuit's initial decision, issued in June 2020 (App. 17), affirmed the District Court and repeated the requirement for malice.[16] However, after a petition for rehearing *en banc* (Dkt. 92), the Third Circuit amended its decision in August 2020 and deleted the eight references to the word "malice," "malicious," "egregious" or "vengeful," previously found in the June Decision. App. 1. Nevertheless, it affirmed the decision of the District Court, noting that the decision "does not constitute binding precedent." App. 2 and App. 19.

The Third Circuit did little to cloak the notion that it had merely swapped the word "malice" for the phrase "not bad enough." It thus stated: "The District Court granted the creditors' motion for summary judgment

[16] App. 17.

on the punitive damages issue because it determined that NMI's proof of bad faith, even if accepted as true, was not sufficient to show that the creditors did anything *bad enough* to warrant an award of punitive damages." App. 9 (emphasis added).[17]

The "not bad enough" standard is no standard at all. The Third Circuit should have made clear that the "totality of the circumstances test" is the governing test for damages and that this test does not contain a requirement for a finding of malice. Because it found that there was a basis for bad faith, the question of punitive damages was then one for the jury to resolve.

III. THE PETITION FOR CERTIORARI SHOULD BE GRANTED BECAUSE THE NEED FOR AN OBJECTIVE AND UNIFORM STANDARD FOR PUNITIVE DAMAGES IS BOTH TIMELY AND IMPORTANT.

A. The involuntary bankruptcy process remains prone to creditor abuse.

The concerns over creditor abuse of the involuntary bankruptcy process continue to this day[18] and

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[17] "[W]e are accepting for the sake of argument, that the creditors acted with some degree of bad faith." App. 8, n.4.

[18] Between 2010 and 2019 there were 2,587 involuntary petitions filed. https://www.uscourts.gov/sites/default/files/data_tables/jff_7.2_0930.2019.pdf. Involuntary petitions in major cases continue to this day. *See, e.g.*, *In re Navient Solutions*, Case No. 21-10249, filed in the Bankruptcy Court for the Southern District of New York, and raising many of the issues presented here. *See* Motion to Dismiss at Docket 14, filed on February 17, 2021.

arise in large measure from the statutory procedures that are unique to an involuntary petition as compared to a voluntary petition. The process is initiated by a simple printed form (*see* Forms 105 and 205), which then "commences" the case without any judicial involvement. (§ 303(a)). A summons will then be served on the debtor, which in turn triggers an expensive and time-consuming adversary proceeding,[19] places the assets of an operating company under the purview of the bankruptcy court (the bankruptcy estate is created upon commencement; § 541), and, upon motion, permits the court to appoint a trustee (§ 303(g)), thereby replacing management—precisely what U.S. Bank claimed it wanted here. App. 56

The filing of the involuntary affects those who have done business with the debtor. The automatic stay of § 362 is effective immediately, thus barring prepetition creditors from seeking to enforce their remedies or take other collective action. *See* § 362(a).

Its consequences are both large and often irreversible. Its harm does not vanish once done. And because damages "caused" by the filing may be hard to prove, the ability to obtain punitive damages may be the only recourse for a debtor, as well as the only true incentive to prevent widespread abuse.

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[19] *See* FED. R. BANKR. P. 1010 and 7001-87. An adversary proceeding contains many of the same procedures as a civil case and is commenced by the filing of a complaint and answer, and in which discovery is available.

B. The legislative history reflects Congressional intent to increase debtor protections from abusive involuntary petitions.

The first American bankruptcy law, adopted in 1800, was limited to creditor-initiated petitions against merchants (e.g., the involuntary bankruptcy case). It later became a part of the Bankruptcy Act of 1867,[20] which was later replaced by the Bankruptcy Act of 1898[21] (the "Act") which remained in effect until the Bankruptcy Reform Act of 1978 (the "Code").[22]

The frequent abuse of the involuntary process was soon noted. In a message to Congress in 1873, President Ulysses S. Grant urged eliminating the involuntary process, noting that the "involuntary bankruptcy operat[es] to increase the financial embarrassment of the country," and urged a process that would protect against "obdurate creditors" seeking "to frighten or force debtors into compliance with their wishes and into acts of other injustice to other creditors and to themselves."[23]

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[20] Act of March 2, 1867, ch. 176, 14 Stat. 517, repealed by Act of June 7, 1878, ch. 160, 20 Stat. 99.

[21] The Bankruptcy Act of 1898, ch. 541, 30 Stat. 544, remained in effect until it was repealed in 1978.

[22] The Bankruptcy Reform Act of 1978, 92 Stat. 2657, 11 U.S.C. §§ 101 *et seq.*, superseding the Bankruptcy Act of 1898.

[23] Ulysses S. Grant, Fifth Annual Message to the Senate and House of Representatives (Dec. 1, 1873) *in* THE AM. PRESIDENCY PROJECT, available at https://www.presidency.ucsb.edu/node/203743 (last visited Mar. 3, 2021). *Accord* H.R. Rep. No. 1674, pt. 2, at 2 (1892) (Conf. Rep.).

Under the Code, it is now well-established that the goal of the involuntary process is to permit a collective remedy among many creditors, and *not* to permit the use of the bankruptcy court as a "rented battlefield" for a single creditor, as occurred in this case.[24]

Congress amended § 303 four times, generally providing for greater protection against creditor abuse. In 1984, Congress amended §§ 303(b)(1) and (h)(1) to add the words "subject [of] a bona fide dispute."[25] "[T]he primary purpose of the addition of the bona fide dispute language was to prevent creditors from using involuntary bankruptcy as a club to coerce a debtor to pay debts as to which the debtor, in good faith, had legitimate defenses."[26] In 1986, Congress amended § 303(i)(1) by removing the right to recover damage caused by a trustee then found in § 303(i)(1), but retaining the right to all actual and punitive damages if bad faith is found under § 303(i)(2).[27] In 1994, Congress amended §§ 303(b)(1) and (2) to increase the aggregate amount of claims required from $5,000

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[24] *In re Murray*, 543 B.R. 484, 493 (Bankr. S.D.N.Y. 2016), *aff'd*, 565 B.R. 527 (S.D.N.Y. 2017), *aff'd*, 900 F.3d 53 (2d Cir. 2018).

[25] *See* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 330.

[26] *See* S. 7618, 98th Cong. 2d Sess., June 19, 1984. *In re Tikijian*, 76 B.R. 304, 314 (Bankr. S.D.N.Y. 1987).

[27] *See* Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, 100 Stat. 3088.

to $10,000.[28] Finally, in 2005, Congress amended § 303(b)(1) to add "as to liability or amount" to modify the phrase "bona fide dispute."[29]

C. Judicial and academic commentary confirms the need for a meaningful sanction for bad faith involuntary petitions.

Despite the statutory protections against improper petitions, case law demonstrates that there is a continuing need for enforceable sanctions to protect against the serious and devasting problems that arise from the misuse of the involuntary bankruptcy process.

The courts have frequently noted this abuse: "[I]nvoluntary bankruptcy petitions have serious consequences [for] the alleged debtor, such as loss of credit standing, inability to transfer assets and carry on business affairs, and public embarrassment." *In re Murray*, 900 F.3d 53, 59 (2d Cir. 2018). "The filing of an involuntary petition is considered an 'extreme remedy' with serious consequences to alleged debtors and creditors." *In re CNG Foods LLC*, 2020 WL 4219679 at * 23. Further, "[A] sham involuntary filing may be highly prejudicial to the debtor (e.g., damaging debtor's reputation) and may be used by creditors as an improper bargaining tactic." *Id.* at * 24. "An allegation of bankruptcy is

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[28] *See* Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. 4106.

[29] *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23.

a charge that ought not to be made lightly. It usually chills the alleged debtor's credit and his sources of supply. It can scare away his customers. It leaves a permanent scar, even if promptly dismissed." *In re SBA Factors of Miami, Inc.*, 13 B.R. 99, 101 (Bankr. S.D. Fla. 1981).

The academic literature and studies confirm that the involuntary process has been frequently abused by over-aggressive creditors and that the need for punitive damages based on an objective standard remains high.[30]

Because of the risk to the alleged debtor, the Code provides that punitive damages may be awarded regardless of whether there is proof of actual damages. *In re Anmuth Holdings*, 600 B.R. at 202. *See In re S. California Sunbelt Developers, Inc.*, 608 F.3d 456, 465 (9th Cir. 2010).

Absent punitive damages there may be no meaningful relief for wrongful filings. Punitive damages are awarded to deter abusive actions by future creditors. *In re Grecian Heights Owners' Ass'n*, 27 B.R. 172, 173 (Bankr. D. Or. 1982). These goals cannot be served if

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[30] *See* Richard M. Hynes & Steven D. Walt, *Revitalizing Involuntary Bankruptcy*, 105 Iowa L. Rev. 1127 (2020) (discussing the opportunities for attorneys acting in their own interest to abuse the involuntary bankruptcy system); *see also* Amir Shachmur, *The Consequences of a Relic's Codification: The Dubious Case for Bad Faith Dismissals of Involuntary Bankruptcy Petitions*, 26 AM. BANKR. INST. L. REV. 115, 148 (2018) ("By giving creditors the ability to bring a debtor into bankruptcy, Congress created a power that could be abused.").

creditors can readily escape sanction by showing no malice, even when the record shows a careless disregard of the statutory requirements for a filing.

CONCLUSION

Accordingly, we respectfully submit that this Court grant the petition for certiorari.

March 5, 2021

Respectfully submitted,

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