No. _____

IN THE
SUPREME COURT OF THE UNITED STATES

QDOS, INC.,
Petitioner,
v.
MATTHEW HAYDEN, ET AL.,
Respondent.

On Petition for a Writ of Certiorari
To the United States Court of Appeals
For the Ninth Circuit

APPENDIX FOR PETITION FOR A WRIT OF CERTIORARI

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Appendix A

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

FILED
NOV 30 2020
MOLLY C. DWYER, CLERK
U.S. COURT OF APPEALS

In re: QDOS, INC.,
Debtor,

QDOS, INC.
Appellant,
v.

MATTHEW HAYDEN; et al.,
Appellees.

No. 19-60066
BAP No. 18-1301

MEMORANDUM*

Appeal from the Ninth Circuit
Bankruptcy Appellate Panel
Taylor, Faris, and Spraker, Bankruptcy Judges,
Presiding

* This disposition is not appropriate for publication and is not precedent except as provided by Ninth Circuit Rule 36-3.

Submitted November 18, 2020**
Pasadena, California

Before: RAWLINSON and HUNSAKER, Circuit Judges, and ENGLAND,*** District Judge.

QDOS, Inc. (QDOS) appeals an order of the Bankruptcy Appellate Panel (BAP) reversing the bankruptcy court's dismissal of the involuntary bankruptcy petition filed against QDOS and remanding for further proceedings.1 QDOS asserts that the BAP's order is a final, appealable order because it alters the status quo and the rights of the parties. We determine de novo whether we have jurisdiction to consider an appeal from the BAP and conclude that we lack jurisdiction in this case. *Gugliuzza v. FTC* (*In re Gugliuzza*), 852 F.3d 884, 889 (9th Cir. 2017).

Only BAP orders that alter the status quo and fix the "rights and obligations of the parties" are final, appealable orders. *Ritzen Grp., Inc. v. Jackson Masonry, LLC*, 140 S. Ct. 582, 588 (2020) (internal quotation and citation omitted). Orders remanding a case for additional substantive proceedings or "for further fact-finding will rarely have this degree of finality, unless the remand order is limited to ministerial tasks." *In re Gugliuzza*, 852 F.3d at 897.

The BAP remanded this matter for the bankruptcy court to conduct further proceedings on

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** The panel unanimously concludes this case is suitable for decision without oral argument. *See* Fed. R. App. P. 34(a)(2).

*** The Honorable Morrison C. England, Jr., United States District Judge for the Eastern District of California, sitting by designation.

key issues, including: (1) determining whether QDOS can establish that 11 U.S.C. § 303(b)(1)'s numerosity requirement applied: (2) allowing the petitioning creditors to conduct discovery; and (3) affording other creditors the opportunity to join the involuntary petition.

The BAP's decision may have altered the existing state of affairs by reversing the bankruptcy court's dismissal of the involuntary petition and remanding for further proceedings, but it did not "fix[] the rights and obligations of the parties" as is required for an order to be final under § 158(a). *Ritzen Grp., Inc.*, 140 S. Ct. at 588 (internal quotation and citation omitted). Therefore, we lack jurisdiction, and this appeal is

DISMISSED.

Appendix B
UNITED STATES BANKRUPTCY APPELLATE PANEL OF THE NINTH CIRCUIT

FILED
NOV 7 2019
SUSAN M. SPRAUL, CLERK
U.S. BKCY. APP. PANEL
OF THE NINTH CIRCUIT

In re: QDOS, INC., Debtor, MATTHEW HAYDEN; FELICE TERRIGNO; JIM MADDOX; CARL WIESE, as trustee for the Wiese Family Trust dated as of October 31, 2013. Appellants, v. QDOS, INC., Appellee.	BAP No. CC-18-1301-TaFS Bk. No. 8:18-bk-11997-MW OPINION

Argued and Submitted on September 26, 2019
at Pasadena, California
Filed – November 7, 2019
Appeal from the United States Bankruptcy Court for
the Central District of California

Honorable Mark S. Wallace, Bankruptcy Judge, Presiding

Appearances: Patrick Costello of Vectis Law Group argued for appellants; Damian Capozzola of The Law Offices of Damian D. Capozzola argued for appellee.

Before: TAYLOR, FARIS, and SPRAKER, Bankruptcy Judges.

TAYLOR, Bankruptcy Judge:

INTRODUCTION

Matthew Hayden, Felice Terrigno, Jim Maddox, and the Wiese Family Trust ("Petitioning Creditors") sought to place QDOS, Inc. ("QDOS") into an involuntary chapter 11 proceeding.[1] QDOS sought dismissal through a Civil Rule 12(b)(6) motion based on the assertion that none of the Petitioning Creditors were qualified to file the involuntary petition and, thus, the numerosity requirement of 11 U.S.C. § 303(b) was not met. The bankruptcy court recognized that the issue could not be resolved through a dismissal motion or other summary adjudication and held a trial. And because it determined that Mr. Terrigno was an investor, not a creditor, and because Mr. Maddox failed to appear, it agreed with QDOS and dismissed the petition.

Petitioning Creditors appeal. They do not dispute the disqualification of Mr. Terrigno. Nor do they adequately dispute the bankruptcy court's

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[1] Unless specified otherwise, all chapter and section references are to the Bankruptcy Code, 11 U.S.C. §§ 101–1532, all "Rule" references are to the Federal Rules of Bankruptcy Procedure, and all "Civil Rule" references are to the Federal Rules of Civil Procedure.

conclusion that Mr. Maddox failed to satisfy his burden of proof that he qualified as a petitioning creditor. All that said, we conclude that the bankruptcy court erred.

Under controlling Ninth Circuit law and the facts of this case, all creditors had the right to consider whether to join in the involuntary petition. But the bankruptcy court did not require QDOS to file an answer and the list of creditors required by Rule 1003(b) once it determined that triable issues existed. And it neither required Civil Rule 26 disclosures nor permitted discovery that would have otherwise allowed the Petitioning Creditors to give the required notice to creditors. The record reflects that QDOS's alleged 40 to 50 creditors had no reasonable opportunity to join in the involuntary petition. Dismissal based solely on an insufficiency in the number of petitioning creditors, thus, was error.

Therefore, we REVERSE and REMAND for further proceedings.

FACTS

In May 2018, Carl Wiese (as trustee of the Wiese Family Trust dated as of October 31, 2013), Matthew Hayden, and Felice Terrigno filed an involuntary chapter 11 petition against QDOS.[2] On the petition, they stated that each of their claims was for a loan.

QDOS moved to dismiss and requested § 303(i) damages; in the alternative, it sought abstention under § 305. It did not dispute the petition's

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[2] We exercise our discretion to take judicial notice of documents electronically filed in the bankruptcy case. *See Atwood v. Chase Manhattan Mortg. Co. (In re Atwood)*, 293 B.R. 227, 233 n.9 (9th Cir. BAP 2003).

allegation that it was not paying its debts as they came due; it focused solely on Mr. Terrigno and alleged that he did not hold a qualifying claim because he was an investor. It asserted that it had 12 or more claimholders, and, thus, the involuntary petition was not filed by three creditors as required by § 303(b).

Petitioning creditors opposed the motion. Among other things, they argued that the grounds for dismissal relied on disputed facts which could not be resolved on a Civil Rule 12(b)(6) motion to dismiss.

Two days before the hearing, the bankruptcy court issued a tentative ruling granting the motion because Mr. Terrigno was not a qualifying petitioner and, as a result, there were less than three qualifying petitioning creditors. It concluded that a Rule 1003(b) list was unnecessary because QDOS filed a motion instead of an answer.

But then Mr. Maddox joined the involuntary petition; the bankruptcy court set a trial for two days later and directed each petitioning creditor to appear personally or risk removal from the list of petitioning creditors.

The next day, Petitioning Creditors' counsel filed a document stating that they were unable to appear on less than 48 hours notice for a variety of reasons. So, the bankruptcy court continued the trial. Its order limited the time for additional joinders to the petition to the following three weeks.

Six business days later, Petitioning Creditors filed an ex parte request for a telephonic conference on discovery matters because QDOS was unwilling to negotiate a workable document production schedule and refused to file a Rule 1003(b) list. QDOS opposed the ex parte request, and the bankruptcy court thereafter entered an order striking it.

An additional delay in the hearing occurred. And the bankruptcy court altered the consequences of a failure to appear at the hearing from being struck from the list of petitioning creditors to the striking of the non- appearing petitioning creditor's declaration.

At the eventual trial, Mr. Maddox did not appear.

The bankruptcy court then entered a combined memorandum decision and order. It found that QDOS had more than 12 creditors for § 303(b)(1) purposes. It concluded that Mr. Terrigno was not a qualifying petitioning creditor because he was an equity holder.[3] Next, it concluded that Mr. Maddox was not a qualifying petitioning creditor for two reasons: first, his claim was subject to a partial bona fide dispute; and second, he failed to appear at the hearing as ordered and, as a result, failed to meet his burden of proof that he was a qualifying petitioning creditor.

Petitioning Creditors timely appealed.

JURISDICTION

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[3] QDOS also argued that the Wiese Family Trust and Mr. Hayden were not appropriate petitioning creditors because it disputed that payment on their claims was required at the time of the involuntary petition. The bankruptcy court disagreed; it preliminarily determined that because liability and the amount owed were not in question, the Wiese Family Trust and Mr. Hayden qualified as petitioning creditors. But it also allowed for additional briefing. QDOS filed a document that agreed with the bankruptcy court's analysis but raised another issue; it argued that because these entities had the right to convert their claims to stock, they were contingent creditors and, thus, disqualified as petitioning creditors. The bankruptcy court has not decided this issue, and QDOS does not advance arguments related to the qualifications of the Wiese Family Trust and Mr. Hayden on appeal. Because resolution of this issue is irrelevant given the basis of our decision, we do not further consider this point.

The bankruptcy court had jurisdiction under 28 U.S.C. §§ 1334 and 157(b)(2)(A). We have jurisdiction under 28 U.S.C. § 158(a)(3).

ISSUE

Did the bankruptcy court err when it dismissed the involuntary petition?

STANDARD OF REVIEW

We review de novo whether a particular procedure satisfies due process. *Owens-Corning Fiberglass Corp. v. Ctr. Wholesale, Inc. (In re Ctr. Wholesale, Inc.)*, 759 F.2d 1440, 1445 (9th Cir. 1985); *Garner v. Shier (In re Garner)*, 246 B.R. 617, 619 (9th Cir. BAP 2000).

We review the bankruptcy court's conclusions of law de novo and its conclusions of fact for clear error. *Liberty Tool, & Mfg. v. Vortex Fishing Sys., Inc. (In re Vortex Fishing Sys., Inc.)*, 277 F.3d 1057, 1064 (9th Cir. 2002).

DISCUSSION

The Code overhauled the standards for involuntary bankruptcy as they existed under the former Bankruptcy Act of 1898; it relaxed them and allowed an involuntary bankruptcy at an earlier point in an entity's economic decline. *In re Kidwell*, 158 B.R. 203, 212–13 (Bankr. E.D. Cal. 1993). At the same time, it allowed for monetary remedies that counterbalanced this new liberality. *Id.* at 213. The Rules then established the procedures that a bankruptcy court must follow in balancing the important concerns extant when a party seeks the involuntary bankruptcy of an unwilling debtor. In sum, they require a speedy resolution and a full complement of due process.

A. The law governing involuntary petitions.

Section 303 authorizes the filing of an involuntary petition against a corporation. 11 U.S.C. § 303(a). When the petition is not contested, the bankruptcy court enters an order for relief, and the bankruptcy case proceeds. 11 U.S.C. § 303(h). But corporations can resist the involuntary petition, and the Code provides for standards and procedures that govern the resulting decisional process.

The Code requires that the involuntary debtor be in financial distress and that a sufficient number of undisputed creditors request involuntary relief. When an involuntary petition is contested, the petitioning creditors must show that the involuntary debtor is in actual financial distress; they may meet this requirement by establishing that the involuntary debtor is not paying its undisputed debts as they come due. 11 U.S.C. § 303(h)(1).[4] Petitioning creditors must also show that there is sufficient desire for an involuntary bankruptcy on the part of undisputed creditors; in a case with fewer than 12 creditors, a single qualified creditor suffices, but, where the debtor has a larger creditor body, three qualified creditors must petition for involuntary relief. 11 U.S.C. § 303(b)(1), (2). Petitioning creditors bear the burden of proof on both of these issues. *Cunningham v. Rothery (In re Rothery)*, 143 F.3d 546, 548 (9th Cir. 1998).

Joinder can remedy a deficiency in the number of petitioning creditors; and all creditors have the right to consider joinder where the involuntary debtor

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[4] Financial distress also may be demonstrated where, within the 120 days previous, a custodian was appointed for substantially all of the debtor's assets. 11 U.S.C. § 303(h)(2). No one argues that this section applies here.

is in economic distress. Where there are fewer than the three required petitioning creditors, the Code and Rules allow for Civil Rule 24(a)(1) joinder. 11 U.S.C. § 303(c); Fed. R. Bankr. P. 1018. Thus, joinder may remedy a defect in the number of petitioning creditors.

In deciding the issue before it, whether joinder could cure even a tainted initial petition, the *Kidwell* court emphasized that such joinder was a matter of right. 158 B.R. at 211. It further noted the importance of the right to join given that an involuntary petition may provide significant benefit to all creditors. *See id.* at 212. We agree; where an entity is in true economic distress, an involuntary filing may stop the race to the state courthouse and the dismemberment of a debtor through involuntary liens, level the playing field among unsecured creditors, and otherwise appropriately aid creditors.[5] Thus, the *Kidwell* court found that it is not permissible to deprive eligible creditors of their statutory right to join in the petition and then to dismiss for insufficiency in number of petitioners, even if an initial petitioning creditor misbehaved. *Id.* at 220.

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[5] QDOS's request for abstention as an alternative to dismissal of the involuntary petition evidences its fundamental misunderstanding of the purpose of a proper involuntary petition. It argued that because state court litigation was pending in connection with the initial Petitioning Creditors' claims, the involuntary bankruptcy was unnecessary and improper. But an involuntary filing does not necessarily remove the litigation from state court; the bankruptcy court may elect to allow the claim to be liquidated there. Instead, an involuntary case can help to achieve appropriate bankruptcy purposes. Reorganization or orderly liquidation may follow.

The *Kidwell* court made a compelling case for a requirement that all claimholders receive an opportunity to consider supporting an involuntary petition when the debtor is in financial distress even if there initially are too few petitioning creditors. And in *Vortex Fishing Systems*, the Ninth Circuit agreed.

Vortex Fishing objected to an involuntary petition; it disputed the sufficiency in number of qualified petitioning creditors and also disputed that it was in economic distress. 277 F.3d at 1065, 1070–71. So, pending trial on both disputed issues, the bankruptcy court ordered it to submit a list of its creditors to the bankruptcy court, and the parties agreed that the list could not be released without a court order. *Id.* at 1070. The petitioning creditors did not ask for pre-trial release of the list. *Id.* At trial, the bankruptcy court found that the number of then-existing petitioning creditors was insufficient, but it also continued with the trial and determined that Vortex Fishing was generally paying its debts as they came due. *Id.* at 1063. It then dismissed the involuntary petition. *Id.*

On appeal, the petitioning creditors argued, based on Rule 1003(b), that the bankruptcy court should have notified all creditors of the involuntary petition, afforded them an opportunity to join, and only then dismissed the involuntary case. *Id.* at 1070. The Ninth Circuit rejected this argument.

It noted that generally when an alleged debtor answers a petition filed by fewer than three qualifying petitioners, asserts the § 303(b)(1) three-petitioning creditors requirement, and alleges that it has twelve or more creditors, the bankruptcy court "must assure that other creditors have a 'reasonable opportunity' to exercise their § 303(c) statutory power

to join as petitioners . . . ." *Id.* at 1071. But the Ninth Circuit concluded:

> We cannot say, in the face of Rule 1013(a) and of the omission of the appellants to ask that the creditor list be released, that the Bankruptcy Court abused its discretion when it proceeded to determine the merits of the contested involuntary petition—i.e. whether Vortex was generally paying its debts as they came due—without requiring specific notification of other creditors.

Id. at 1071–72.

Vortex Fishing, thus, underscores that all creditors must have a *reasonable opportunity* to join in an involuntary petition.[6] It was unnecessary there only because, in a consolidated hearing, the bankruptcy court correctly found that the involuntary

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[6] To that extent, § 303(j) and Rule 1017 are enlightening. Section 303(j) governs dismissal of an involuntary petition and requires notice to all creditors when dismissal follows petitioner motion, or petitioner and debtor consent, or is based on want of prosecution. 11 U.S.C. § 303(j). Rule 1017 provides that such dismissal cannot occur before a hearing and notice to all creditors pursuant to a list provided by the debtor or other knowledgeable entity. Fed. R. Bankr. P. 1017(a). The First Circuit BAP concluded in an unpublished decision that "Rule 1017 applies in the context of a motion to dismiss an involuntary petition for failure to obtain the requisite number of petitioning creditors." *Banco Popular de Puerto Rico v. Colon (In re Colon)*, BAP No. PR 07-053, 2008 WL 8664760, at *7 (1st Cir. BAP Nov. 21, 2008). As a result, § 303(j) and Rule 1017 supported its conclusion that a bankruptcy court erred when it dismissed an involuntary petition on an insufficient number of creditor's ground without "at least giving all creditors notice and the opportunity for a hearing." *Id.* at *8.

debtor was not in financial distress; joinder, thus, would have been a meaningless endeavor.

The decisional process in relation to a contested involuntary petition must be prompt but also consistent with Rule 1018 and the Civil Rules it incorporates. While the standards for allowance of an involuntary petition are clear, the procedure for making a qualification determination is more meandering.

An involuntary debtor may initially contest the involuntary petition through a Civil Rule 12(b)(6) motion, but where a trial is required for resolution it must answer and file the list required by Rule 1003(b). Rule 1011 provides that the debtor may contest an involuntary petition, and it expressly allows the alleged involuntary debtor to file a Civil Rule 12 motion before answering. Fed. R. Bankr. P. 1011(a), (b), and (c). Thus, Civil Rule 12(b)(6) applies in a contested involuntary situation just as it does generally; the motion challenges the sufficiency of the allegations in the involuntary petition and "may be based on either a 'lack of a cognizable legal theory' or 'the absence of sufficient facts alleged under a cognizable legal theory.' " *Johnson v. Riverside Healthcare Sys.*, 534 F.3d 1116, 1121 (9th Cir. 2008) (citation omitted). The court accepts factual allegations as true but disregards legal conclusions. *Ashcroft v. Iqbal*, 556 U.S. 662, 678–79 (2009). It then determines if the remaining factual allegations, construed in the light most favorable to the non-moving party's favor, state a facially plausible claim for relief. *Id.* at 679; *see also Bell Atl. Corp. v. Twombly*, 550 U.S. 544 (2007).

In many cases, a bankruptcy court will not be able to dismiss an involuntary case solely on a motion

to dismiss. If the petitioning creditors plausibly allege that they have met the standards, the motion must fail, and the involuntary debtor must answer.[7]

When an involuntary debtor files a Civil Rule 12(b)(6) motion in connection with a contested involuntary bankruptcy, Rule 1011 extends the time for the answer as permitted in Civil Rule 12(a). Fed. R. Bankr. P. 1011(c). Civil Rule 12(a) provides that where a court denies a Civil Rule 12(b) motion or postpones its determination until trial, the answer must be filed within 14 days of the court's action. Fed. R. Civ. P. 12(a)(4)(A). So, once a trial is required to resolve issues in a contested involuntary proceeding, the involuntary debtor must answer within 14 days.

And, if the debtor asserts that it has more than 12 creditors in its answer, it must comply with Rule 1003(b) and concurrently file the required creditor list. Fed. R. Bankr. P. 1003(b). Rule 1003(b) serves two purposes. It implements, in part, § 303(c)'s joinder provisions. *In re Vortex Fishing Sys., Inc.*, 277 F.3d at 1071. And it provides the mechanism by which an alleged debtor substantiates its assertion that it has more than 12 qualifying creditors and returns the burden to petitioning creditors. *In re Clignett*, 567 B.R. 583, 587 (Bankr. C.D. Cal. 2017) ("[A] debtor cannot merely state that [it] has more than twelve creditors in [its] motion to dismiss.").

In summary, if resolution of a contested involuntary proceeding requires a trial, there is no procedural path that allows the alleged involuntary

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[7] Rule 1018 also allows for summary judgment. But just as in ordinary civil litigation, the court may not grant summary judgment if genuine disputes of material fact exist or further discovery is warranted.

debtor to leap over the requirement that it answer and, if appropriate given its answer, file the creditor list mandated by Rule 1003(b). The mere fact that the involuntary debtor initiated its opposition through a Civil Rule 12(b)(6) motion delays, but does not invariably negate, the requirement of answer and creditor list.

The requirement that contested involuntary petitions be resolved quickly must be read in tandem with the fact that Civil Rule 26 governs the pre-trial process and that discovery is available under Civil Rules 7028 through 7037. Rule 1013(a) directs bankruptcy courts to "determine the issues of a contested petition at the earliest practicable time and forthwith enter an order for relief, dismiss the petition, or enter any other appropriate order." Fed. R. Bankr. P. 1013(a). The "earliest practicable time" is when the bankruptcy court has "sufficient information to resolve the conflict" before it. *Hayes v. Rewald (In re Bishop, Baldwin, Rewald, Dillingham & Wong, Inc.)*, 779 F.2d 471, 475 (9th Cir. 1985). Often the bankruptcy court will acquire this information at trial.

Where trial is required to adjudicate an involuntary petition, Rule 1018 incorporates many procedural Rules and expressly provides that references to adversary proceeding therein include a reference to a proceeding to contest an involuntary petition. Fed. R. Bankr. P. 1018. Several of the incorporated rules are critical to providing the parties with the information they need to either contest or defend the involuntary petition at trial.

First, Rule 1018 incorporates Rule 7026 which makes the requirements of Civil Rule 26 applicable. *Id.* The initial notice requirements of Civil Rule 26

mandate pre-discovery disclosure of individuals likely to have relevant discoverable information and production of documents supporting claims or defenses. Fed. R. Civ. P. 26(a)(1)(A)(i) & (ii). Rule 1003(b) works in tandem with this requirement and, because it mandates the creditor list when the involuntary debtor answers, actually accelerates disclosure on this topic. But, even if Rule 1003(b) did not require early submission of the creditor list, there can be no doubt that a list of creditors or the provision of documents containing creditor information would be a required Civil Rule 26(a)(1)(A) disclosure where there is a dispute regarding the number of creditors.

Civil Rule 26 also affects the pace of resolution unless the bankruptcy court is immediately proactive. Rule 1018 allows for all typical discovery as it incorporates Civil Rules 7028 through 7037. Fed. R. Bankr. P. 1018. But such discovery cannot proceed until the parties confer as required by Civil Rule 26(f) or as otherwise agreed by the parties or ordered by the bankruptcy court. Fed. R. Civ. P. 26(d)(1). To achieve the prompt resolution required by Rule 1013(a), the bankruptcy court may establish a discovery schedule that removes the limitations imposed by Civil Rule 26(d)(1).

In short, Rule 1018 makes clear that resolution of a contested involuntary petition should proceed with the discovery and disclosures typical in an adversary proceeding, but Rule 1013(a) mandates that the process move speedily.

B. The bankruptcy court erred when it imposed § 303(b)(1)'s numerosity requirement, did not require an answer, failed to allow for appropriate discovery, and dismissed the case before allowing

appropriate notice and a meaningful opportunity for joinder to all creditors.

As noted, a Civil Rule 12(b)(6) motion assumes the truth of the allegations in the operative documents, here the involuntary petition. And the involuntary petition in this case does not allege that QDOS had 12 or more qualifying creditors. As a result, § 303(b)(1) does not facially apply and there only needed to be at least one qualifying petitioning creditor. The bankruptcy court correctly recognized that it could not resolve the issues without a trial.

The bankruptcy court, thus, accepted matters extrinsic to the pleadings.[8] In support of its assertion that it had more than 12 creditors, QDOS submitted Richard Gillam's, QDOS's CEO, declaration, which baldly stated: "QDOS, Inc. has twelve or more entities or individuals which would be classified as claimholders pursuant to 11 U.S.C. §§ 101(5), 303." At no time did QDOS provide additional information about its creditors. Petitioning Creditors argued to the bankruptcy court and on appeal that this generic statement is insufficient. We agree.

The bankruptcy court erred when it proceeded to trial without requiring QDOS to answer and file its Rule 1003(b) list. When Petitioning Creditors asked the bankruptcy court to enforce the Rule 1003(b) requirement, it declined to do so because, it reasoned, Rule 1003(b) applies to answers, not motions to dismiss. This reliance was misplaced.

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[8] The bankruptcy court stated at one point that it was converting the proceeding to a summary judgment, but we read this as shorthand. The bankruptcy court correctly determined that triable issues existed; thus, trial was required, and summary adjudication was impossible.

We acknowledge that some courts find a "gap" in the Rules related to Rule 1003(b). *In re Kidwell*, 158 B.R. at 209. Put simply, an alleged debtor is allowed to raise the defense of a failure to comply with the three-petitioner requirement by either a motion to dismiss under Civil Rule 12 or by an answer, but Rule 1003(b) only facially applies when the defense is raised by answer, not motion. *Id.* The "sensible solution", concluded *Kidwell*, is to apply the same procedure when the defense is raised by motion. *Id.* at 210. If there is a gap, we completely agree with *Kidwell*.

But if Rule 1011 is read in full and one recognizes that Rule 1018 treats contested involuntary petitions as adversary proceedings, there is no gap. Rule 1011 allows the filing of a Civil Rule 12 motion, but Rule 1018 incorporates Civil Rule 8 and requires the assertion of defenses through an answer when Civil Rule 12(b)(6) relief is not available. And Rule 1011(c) states that filing a Civil Rule 12 motion extends the time for filing a responsive pleading or answer. Finally, Civil Rule 12(a)(4)(A) provides that the answer is due 14 days after the court denies a Civil Rule 12(b)(6) motion or postpones disposition until after trial.

So here, once the bankruptcy court implicitly denied QDOS's Civil Rule 12(b)(6) motion and actually postponed decision until trial, QDOS was required to answer within 14 days and to accompany its answer with the list required by Rule 1003(b) as it asserted that it had more than 12 creditors.[9]

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[9] And, again, QDOS was also required to provide Civil Rule 26(a)(1) initial disclosures even before receiving a discovery

The bankruptcy court erred when it proceeded to trial and dismissed the involuntary petition without allowing Petitioning Creditors a reasonable opportunity for discovery. The bankruptcy court denied Petitioning Creditors any reasonable opportunity for discovery. First, discovery is generally inappropriate while a Civil Rule 12(b)(6) motion is pending. At some point, Petitioning Creditors informally attempted to confer with QDOS to obtain discovery; this conferral is required by Civil Rule 26(d)(1). QDOS was not cooperative. But the bankruptcy court penalized the Petitioning Creditors—it erroneously asserted that discovery should have commenced before it took any action on the pending Civil Rule 12(b)(6) motion, and it declined a request for a telephonic discovery conference six business days after it set the matter for trial. The bankruptcy court never relieved the parties from the requirements of Civil Rule 26(d)(1) or otherwise regulated discovery. And it limited the time for joinder in the petition to three weeks following its implicit denial of the motion to dismiss and its conclusion that a trial was necessary. The Petitioning Creditors could not obtain discovery allowing them to solicit joinders before the deadline for joinder passed unless the bankruptcy court shortened time; but it

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request. As these disclosures require the name and contact information for all parties with discoverable information and identification of all documents supporting all claims—here that more than 12 creditors existed—it is impossible to assume that QDOS's compliance with these rules would not have identified its creditors before trial if QDOS acted as required by Rule 1018. Fed. R. Civ. P. 26(a)(1)(A)(i)–(ii).

declined their requests for assistance in obtaining discovery.

We also acknowledge that in some regards the errors in relation to discovery may be harmless. The Petitioning Creditors dispute that QDOS has more than 12 creditors, but we have evidence in the record of 11 creditors exclusive of Mr. Terrigno and Mr. Maddox.[10] It seems likely that more exist. And QDOS should have provided the critical information as to the identity of creditors with the required answer or as an initial disclosure. Here the failure to allow discovery as allowed and conditioned by Rule 1018 merely compounded an existing problem. Petitioning Creditors could not remedy these defects through the discovery allowed by Rule 1018.

We acknowledge that the bankruptcy court correctly emphasized Rule 1013(a)'s requirement that bankruptcy courts decide the merits of a contested petition at the earliest practicable time. But Rule 1013(a) must be read in concert with Rule 1018. Rule 1013(a)'s expeditious trial requirement cannot negate Rule 1018 on the grounds that there is no time for discovery.

The bankruptcy court erred when it did not allow all creditors a meaningful opportunity to join in the involuntary petition. In this case, the bankruptcy court did not provide for reasonable notice to all of QDOS's creditors and, thus, it denied them their statutory right to join in the involuntary petition. The bankruptcy court intimated, at one point, that other creditors had a "reasonable opportunity" to join

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[10] Five creditors other than the Petitioning Creditors filed proofs of claim, and the Petitioning Creditors requested judicial notice of another four recent judgments against QDOS.

because the petition had been pending for more than five weeks on a public docket. The mere pendency of a bankruptcy petition, however, is not sufficient notice to creditors. *In re Vortex Fishing Sys., Inc.*, 277 F.3d at 1071 ("[Rule 1003(b)], which functions to provide an opportunity to moot a defense of insufficiency in the number of petitioners, is needed because all creditors do not necessarily receive notice of an involuntary case until there is an order for relief adjudicating the merits of the petition in favor of the petitioning creditors.").

And while the bankruptcy court allowed Petitioning Creditors a limited opportunity to solicit additional creditors after it set the matter for hearing,[11] Petitioning Creditors had no list of creditors to solicit. Again, they had no Rule 1003(b) list, no initial disclosures, and no reasonable opportunity to conduct discovery. As a result, we conclude that the bankruptcy court erred when it dismissed the involuntary petition based on a § 303(b)(1) infirmity without affording other creditors an opportunity to join the involuntary petition through Rule 1003(b) notice or Petitioning Creditor solicitation.

Vortex Fishing Systems, Inc. does not stand for a contrary result. First, the alleged debtor filed a sealed list of creditors but the petitioning creditors never sought access to it and only raised Rule 1003(b) on appeal. Here, Petitioning Creditors have consistently sought access to a list of creditors or

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[11] The temporal limitation on the time for joinder (three additional weeks) also raises an issue. By statute, creditors can join an involuntary petition at any time before "the case is dismissed or relief is ordered." 11 U.S.C. § 303(c).

discovery on this topic. Second, the *Vortex Fishing* bankruptcy court determined the *merits* of the contested petition and concluded that Vortex Fishing *was* paying its debts as they came due. And the Ninth Circuit affirmed that finding. As a result, it was immaterial whether there was a sufficient number of petitioning creditors because, even if there were, entry of an order for relief would have been inappropriate. 11 U.S.C. § 303(h)(1). Here, the bankruptcy court made no findings about whether QDOS was paying its debts as they came due; QDOS effectively admitted that it was not.[12] Thus, it deprived creditors of the joinder right mandated by *Vortex Fishing*.

The only creditor information that Petitioning Creditors had as to the QDOS creditor body came from a declaration that came too late for solicitation

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[12] QDOS never disputed this point in its Civil Rule 12(b)(6) motion and when questioned on appeal side-stepped inquiry by saying that other creditors were working with it. Petitioning Creditors allege financial distress, and the claims docket in the involuntary case supports this conclusion. A few creditors found the case and filed claims; almost all evidence that QDOS was not regularly paying its debts. The IRS and Employment Development Department filed substantial claims for unpaid and delinquent tax obligations; these claims evidenced interest accruals, penalties, and tax liens. In the EDD's case, they alarmingly were filed on account of unpaid employee withholdings. Another claim evidenced a judgment and lien from 2017. AT&T filed a claim that evidenced arrearages, including some more than 90 days past due. And even more dispositive of a broad-based failure to pay debts as they come due and financial distress is a February 22, 2018 email from the QDOS principal that is attached to the Wiese Family Trust proof of claim. *See* Claim No. 6 at 13–15. The Petitioning Creditors also requested judicial notice of several recent judgments against QDOS.

and named no one, trial testimony that asserted that it had 40 to 50 creditors but did not name them, and information obtainable from the claims docket and litigation databases showing judgments against QDOS. Both Rule 1003(b) and Ninth Circuit authority require more, especially given that QDOS never argued that it was paying its undisputed debts as they came due.

C. The bankruptcy court did not err in concluding that Mr. Maddox was not entitled to be a petitioning creditor at that time.

The bankruptcy court concluded that Mr. Terrigno and Mr. Maddox did not qualify as petitioning creditors. On appeal, Petitioning Creditors only discuss Mr. Maddox's disqualification.

To be a petitioning creditor, an entity must hold a claim that is not contingent "as to liability or the subject of a bona fide dispute as to liability or amount . . . ." 11 U.S.C. § 303(b)(1). The bankruptcy court concluded that Mr. Maddox did not qualify as a petitioning creditor for two reasons: his claim was subject to a bona fide dispute as to the amount of the claim, and he did not appear in person at the trial. We start, and end, with the latter.[13]

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[13] The former reason is an unsettled area of law. Pre-BAPCPA, the Ninth Circuit had held that the undisputed portion of a debt could qualify under § 303(b)(1) as not subject to a bona fide dispute. *Focus Media, Inc. v. Nat'l Broad. Co. (In re Focus Media, Inc.)*, 378 F.3d 916, 926 (9th Cir. 2004). But in 2005 Congress amended § 303 and added the phrase "as to liability or amount" after "bona fide dispute." *In re Honolulu Affordable Hous. Partners, LLC*, No. 15-00146, 2015 WL 2203473, at *2 (Bankr. D. Haw. May 7, 2015) (Faris, J.). Some courts have found that the 2005 amendments overruled the Ninth Circuit's decisions.

Petitioning Creditors raise a variety of arguments on appeal. But, crucially, they conceded at oral argument that the record contains no explanation for Mr. Maddox's failure to appear. He just did not show up.

The bankruptcy court had the right to control the proceedings before it. QDOS disputed that Mr. Maddox properly qualified as a petitioning creditor; it had the right to cross-examine him. And, the bankruptcy court's amended scheduling order was clear about the consequences for non- appearance: the bankruptcy court would strike any and all declarations signed by that petitioning creditor. At issue, in the main, was whether Mr. Maddox held an undisputed claim. And the dispute centered on whether his loan was usurious. We acknowledge that Mr. Maddox filed a proof of claim that temporarily, and far from definitively, waived disputed interest. But the bankruptcy court and QDOS had every right to question him on this point. Thus, the bankruptcy

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E.g., id.; see Mont. Dep't of Revenue v. Blixseth, 581 B.R. 882, 898 (D. Nev. 2017) (citing cases). Two circuit courts have agreed with this line of reasoning. *Mont. Dep't of Revenue*, 581 B.R. at 898-89. But other bankruptcy courts (and *Collier*) have concluded otherwise. Id. at 899–900; 2 Collier on Bankruptcy ¶ 303.11[2] (Richard Levin & Henry J. Sommer eds. 16th ed. 2019).

Although neither we nor the Ninth Circuit have decided the matter, the Ninth Circuit heard oral argument on this issue and took the matter under submission on August 26, 2019. *See Mont. Dep't of Revnue v. Blixseth*, Case No. 18-15064, Dkt. No. 47 (submitting appeal after oral argument on August 26, 2019). Because the bankruptcy court excluded Mr. Maddox's claim for an alternate reason, and we affirm on that ground, we need not resolve this well-ventilated question.

court concluded that Mr. Maddox had not carried his burden of proof that he was a qualifying petitioning creditor. The bankruptcy court did not err in so deciding.[14]

CONCLUSION

Based on the foregoing, we REVERSE and REMAND for further proceedings.

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[14] We leave to the bankruptcy court's discretion, on remand, whether Mr. Maddox may revive his participation in the involuntary proceedings by, for instance, appearing at future hearings to testify or by affirmatively and absolutely waiving the disputed portions of his claim. See 2 Collier on Bankruptcy ¶ 303.11[2] ("Of course, as a practical matter, the prudent creditor will take the suggestion loudly whispered by some courts and simply assert the *un*disputed, *non*-contingent portion of its claim." (footnotes omitted)). Unless, of course, in the interim, the Ninth Circuit determines that he need not do so.

Appendix C
UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF CALIFORNIA
SANTA ANA DIVISION

FILED & ENTERED
OCT 31 2018
CLERK U.S. BANKRUPTCY COURT
Central District of California
BY bolte DEPUTY CLERK

In re: QDOS, Inc Debtor(s).	Case No.: 8:18-bk-11997-MW CHAPTER 11 **MEMORANDUM DECISION AND ORDER** Hearing Date: October 17, 2018 Time: 9:00 a.m. Courtroom: 6C

Damian D. Capozzola, Esq. and Timothy R. Laquer, Esq. of Law Offices of Damian D. Capozzola for Debtor and Movant QDOS, Inc.

Patrick M. Costello, Esq. of Vectis Law for Petitioning Creditors.

WALLACE, J.

This matter is before the Court on a corporate debtor's motion to dismiss an involuntary chapter 11 petition filed against it by three, and later four, alleged creditors. The Court has subject matter jurisdiction over this proceeding pursuant to 28 U.S.C. § 1334 and General Order 13-05, filed July 1, 2013, of the United States District Court for the Central District of California. This is a core proceeding under 28 U.S.C. § 157(b)(2)(A).

FACTUAL BACKGROUND AND PROCEDURAL HISTORY

Petitioning creditors Carl Wiese, as trustee of the Wiese Family Trust dated as of October 31, 2013 ("Mr. Wiese"), Felice Terrigno ("Mr. Tarragon") and Matthew Hayden ("Mr. Hayden") (collectively, Mr. Wiese, Mr. Tarragon and Mr. Hayden shall be referred to as the "Original Petitioning Creditors") filed an involuntary chapter 11 petition against QDOS, Inc. (aka Desksite) ("QDOS") on May 31, 2018. QDOS filed a Notice of Motion and Motion to Dismiss Involuntary Petition and Request for Costs, Fees and Damages (Docket No. 7) on June 22, 2018 (the "Motion") pursuant to Federal Rule of Bankruptcy Procedure 1011 (incorporating by reference Federal Rule of Civil Procedure 12 and more particularly Rule 12(b)). In the Motion, QDOS contests the involuntary petition on the grounds that (1) the Original Petitioning Creditors fail to qualify under 11 U.S.C. § 303(b)(1) as the kind of creditors who are entitled to file an involuntary petition and (2) the involuntary petition was filed in bad faith.

The Motion was set for hearing on August 8, 2018 at 9:00 a.m. In advance of the hearing, the Court published a tentative ruling to grant the Motion and dismiss the case on the ground that Mr. Terrigno was not a qualified petitioning creditor and, therefore, that too few qualified petitioning creditors existed to support the petition. At approximately 1:00 p.m. on August 6, 2018, less than 48 hours prior to the scheduled hearing, alleged creditor Jim Maddox filed a Joinder in Involuntary Petition, Docket No. 27, thereby joining in the involuntary petition against QDOS. (Mr. Maddox together with the Original Petitioning Creditors shall be referred to as the "Petitioning Creditors.")

In view of this development, the Court continued the hearing on the Motion to August 10, 2018 at 10:00 a.m. and ordered that it be an evidentiary hearing in the nature of a trial and that the Petitioning Creditors personally appear at such hearing. Counsel for the Petitioning Creditors complained in a letter to the Court dated August 9, 2018 (Docket No. 38) that Mr. Terrigno, Mr. Maddox and Mr. Wiese were all out of state and unavailable to attend on August 10. Based upon the unavailability of all Petitioning Creditors except Mr. Hayden, the Court continued the evidentiary hearing for a period of one month to September 10, 2018 and again ordered all Petitioning Creditors to attend the September 10 hearing in person and be subject to cross-examination. (Based upon supplemental pleadings filed by the parties and evidence actually introduced, the Court deems the pleadings to conform to the evidence and proof and therefore treats the Motion as addressing itself to the Petitioning

Creditors and not merely the Original Petitioning Creditors.)

Following the rescheduling of the evidentiary hearing to September 10, 2018, Mr. Terrigno filed a Supplemental Declaration of Felice Terrigno Re Motion to Dismiss, Docket No. 48, filed August 22, 2018, alleging various reasons why he should qualify as a petitioning creditor and also informing the Court that, notwithstanding the Court's order, he would not be appearing at or attending the September 10, 2018 evidentiary hearing. Mr. Maddox filed a similar declaration (Docket No. 49, filed August 23, 2018), advising that he too would not be attending the September 10 evidentiary hearing.

Mr. Terrigno and Mr. Maddox each failed to appear at the evidentiary hearing with respect to the Motion on September 10, 2018. However, due to certain unfortunate ambiguities in the Court order setting the evidentiary hearing, counsel for QDOS appeared at one time and counsel for the Petitioning Creditors appeared at a different time, leading the Court to continue the evidentiary hearing once again, this time to October 17, 2018. Once again, each Petitioning Creditor was ordered to appear at the hearing so that he might be cross-examined by QDOS's counsel regarding the contents of declarations made by him allegedly supporting the contention that he was a qualified petitioning creditor under applicable bankruptcy law.

The Court had previously ordered that if a Petitioning Creditor failed to appear at the October 17, 2018 evidentiary hearing, any and all declarations filed by such Petitioning Creditor would be stricken. For a third time, Mr. Maddox failed to appear after being ordered to do so by this Court. In a transparent

effort to avoid the effect of the striking of Mr. Maddox's declarations, Mr. Maddox filed Proof of Claim 7-1 on September 26, 2018. In this cagily-drafted document, Mr. Maddox does not actually assert how much he is owed by QDOS; he merely states that he is owed "not less than $220,000.00." He also asserts in the Proof of Claim that he has eliminated any claim for interest. (QDOS had previously argued that the loan Mr. Maddox made to QDOS was usurious and that therefore the claim was in bona fide dispute.) By reason of Mr. Maddox's failure to appear for a third time at an evidentiary hearing after being ordered to do so by this Court, the Court determines that QDOS's due process rights were violated and that QDOS was prejudiced by its inability to cross-examine Mr. Maddox under oath regarding his claim and his alleged status as a qualified petitioning creditor.

REQUIREMENTS FOR A VALID INVOLUNTARY BANKRUPTCY PETITION

11 U.S.C. § 303(b)(1) provides in relevant part that "[a]n involuntary case against a person is commenced by the filing with the bankruptcy court of a petition under chapter 7 or 11 of this title — (1) by three or more entities, each of which is . . . a holder of a claim against such person that is not contingent as to liability **or the subject of a bona fide dispute as to liability or amount** . . . if such noncontingent, undisputed claims aggregate at least $15,775 more than the value of any lien on property of the debtor securing such claims held by the holders of such claims." (Boldfaced type added by the Court.)

11 U.S.C. § 303(b)(2) sets forth a separate rule that governs when there are fewer than 12 such holders. At the evidentiary hearing, Richard Gillam

("Mr. Gillam"), QDOS's chief executive officer, testified that QDOS has between 40 and 50 creditors holding undisputed claims.[1] Thus, 11 U.S.C. § 303(b)(2) is inapplicable here.

Petitioning Creditors bear the burden of proving all the statutory requirement elements of 11 U.S.C. § 303(b)(1). If they meet this burden, the burden of proof then shifts to the alleged debtor to show that there is a dispute as to a material fact. If there is a genuine issue of material fact that bears upon the debtor's liability or amount of the claim, then the petition must be dismissed. *Laxmi Jewel Inc. v. C&C Jewelry Mfg., Inc. (In re C&C Jewelry Mfg., Inc.)*, BAP Nos. CC-08-1190-HMoMk, CC-08-1267-HMoMk, 2009 Bankr. LEXIS 4517 at *21-22 (B.A.P. 9th Cir., April 14, 2009) (unpublished but cited for persuasive value).

A. The Status of Mr. Terrigno as a Qualified Petitioning Creditor.

Two sets of subscription documents were transmitted to Mr. Terrigno with respect to his investment in QDOS: subscription documents for the purchase of QDOS common stock[2] and subscription documents (a Participation Agreement) for the making of a loan to QDOS.[3] Mr. Terrigno executed the QDOS common stock subscription agreement, thereby making a $60,000 investment in QDOS common stock, and returned it to QDOS.[4]

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[1] Reporter's Transcript ("R.T.") at 97-98.

[2] Exhibit 30.

[3] Exhibit U.

[4] Exhibit 29

Mr. Terrigno testified that he thought he was making a loan to QDOS when he executed subscription documents, not buying common stock.[5] The Court determines that such testimony is not credible. Mr. Terrigno is a graduate of West Point and has a graduate degree in Business from Rice University. The Court concludes that Mr. Terrigno knew exactly what he was buying when he sent in his $60,000 – and even if he did not, the fact of the matter is that he bought common stock, not a QDOS promissory note.

Petitioning Creditors make much of the fact that Mr. Gillam later sent Mr. Terrigno an email on February 27, 2018 stating that "there is zero debate nor question on our side that you're owed $60k."[6] However, Mr. Gillam testified that he prepared the February 27 email in haste, without actually checking the QDOS records to see if Mr. Terrigno was a creditor ora shareholder and taking him at his word that he was a creditor.[7] The Court finds Mr. Gillam's testimony credible in this regard, noting that the emails show that there is only a 54 minute timespan between the transmission of Mr. Terrigno's email inquiry and Mr. Gillam's email reply.

The Court concludes that Mr. Terrigno is not a qualified petitioning creditor under 11 U.S.C. § 303(b)(1) because he holds an interest, namely, QDOS common stock, not a claim.

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[5] R.T. at 47.

[6] Exhibit P at its Exhibit B.

[7] R.T. at 107-110.

B. The Status of Mr. Maddox as a Qualified Petitioning Creditor.

Unlike the case of Mr. Terrigno, there is no question that Mr. Maddox is a creditor, not an interest holder. Rather, the dispute between QDOS and the Petitioning Creditors revolves around whether Mr. Maddox holds an undisputed claim or, alternatively, a claim that is "the subject of a bona fide dispute as to liability or amount . . ." within the meaning of 11 U.S.C. § 303(b)(1). QDOS contends that the loan made by Mr. Maddox is usurious, and therefore that the interest charges on the loan cannot be lawfully collected under California law. Petitioning Creditors argue that even if the loan is usurious, only interest is cancelled, not principal, and the principal portion of the loan is not subject to any bona fide dispute as to liability or amount.

Although the plain language of the statute (i.e., 11 U.S.C. § 303(b)(1)) as well as the legislative history is about as clear as it can possibly be, a surprising number of courts, both before and after the enactment of the BAPCPA amendments to section 303(b)(1) – and the *Collier on Bankruptcy* treatise – have reached the conclusion that a claim that is partially disputed as to amount – as the Maddox claim is here – is somehow not a claim that is "the subject of a bona fide dispute as to liability or amount . . ." within the meaning of 11 U.S.C. § 303(b)(1).[8]

If a claim is disputed as to liability, then the entire amount of the claim is disputed.[9] If a claim is

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[8] See 2 *Collier on Bankruptcy* ¶ 303.11[2] and cases cited therein.

[9] If 11 U.S.C. § 303(b)(1) had not used the words "or amount," it might be plausible to contend that a claim where liability was

disputed as to "amount," this implies that less than the entire amount is disputed. If the rule were otherwise – that is, if the entire amount had to be disputed to make the claim disputed as to amount – then the word "amount" in the statute would be redundant because it would mean the same thing as "liability." In construing a statute, a federal court is obliged to give effect, if possible, to every word Congress used. *Reiter v. Sonotone Corp.*, 442 U.S. 330, 339 (1979); *Lyon v. Chase Bank United States, N.A.*, 656 F.3d 877, 890 (9th Cir. 2011) (emphasis added). This is best done by interpreting a dispute as to liability as a dispute over the entirety of the claim and a dispute as to amount as a dispute only over a portion of the claim.

Additionally, the legislative history shows that from the inception, Congress intended that a bona fide dispute as to either liability or the amount of a claim be sufficient to disqualify the creditor holding such claim from qualifying as a petitioning creditor in an involuntary case. Senator Max Baucus made the following statement found in the Congressional Record with respect to 1984 amendments to the Bankruptcy Code of 1978:

> Mr. President, my amendment is designed to correct what I perceive to be an unintended inequity in the law of involuntary bankruptcies

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disputed as to only a portion of the claim is a claim disputed as to liability. The addition of the words "or amount" would seem to justify – for purposes of avoiding the assignment of the same meaning to different terms – treating a dispute as to liability as a dispute over the entirety of the claim (i.e., the entire amount) and a dispute as to amount as a dispute over a portion of the claim.

> . . . The problem can be explained simply. Some courts have interpreted section 303's language on a debtor's general failure to pay debts as allowing the filing of involuntary petitions and the granting of involuntary relief even when the debtor's reason for not paying is a legitimate and good faith dispute over his or her liability. This interpretation allows creditors to use the Bankruptcy Code as a club against the debtors who have bona fide questions about their liability, but who would rather pay up than suffer the usual stigma of involuntary bankruptcy proceedings. My amendment would correct this problem. Under my amendment, the original filing of an involuntary petition could not be based on debts that are the subject of a good-faith dispute between the debtor and his or her creditors. In the same vein, the granting of an order of relief could not be premised solely on the failure of a debtor to pay debts that were legitimately contested as to liability or amount. I believe that this amendment, although a simply [sic] one, is necessary to protect the rights of debtors and to prevent the misuse of the bankruptcy system as a tool of coercion.[10] (Underscoring added by the Court.)

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[10] *Bankruptcy Reform Amendments: A Legislative History of the Bankruptcy Amendments and Federal Judgeship Act of 1984, Public Law 98-353* (1992), D. Bernard, E.M. Wypinski Reams, A.N. Resnick, *downloaded from* https://heinonline.org/HOL/Print?collection=leghis&handle=hein.bank/banrefam0010&id=646.

Thus, from at least the time of the 1984 amendments to the Bankruptcy Code, it was or should have been clear from the legislative history quoted above that a legitimate dispute as to either liability or amount ("amount" meaning something less than the full amount of the claim, because a dispute as to the full amount of a claim is a dispute as to liability) was sufficient to disqualify a claim holder from being a petitioning creditor. Certain courts did not reach this result and determined that a holder of a partially disputed claim could still qualify as a petitioning creditor. If any further proof were needed to show that this conclusion was incorrect, such proof came in the form of the BAPCPA amendments to section 303, which added the words "as to liability or amount" to the statute. Nevertheless, some courts persist in reading the words "or amount" out of the statute despite the illogic of this interpretation.[11]

The magnitude of a particular dispute is not necessarily related to whether such dispute is over liability or amount. If the magnitude of a dispute is proportional to the amount of dollars at stake, a dispute over whether the amount of the claim should be $50 million or $150 million is of greater magnitude

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[11] *See* 2 *Collier on Bankruptcy* ¶ 303.11[2] and cases cited in footnote 34. It might be argued that a $100,000 claim that is only disputed as to $1,000 should not be treated as a claim subject to a bona fide dispute because that would elevate form over substance. However, it would equally elevate form over substance to treat a $100,000 claim that is disputed as to $99,000 as a claim that is not subject to a bona fide dispute. Finally, there is nothing in either the language of the statute or the legislative history providing support for the notion that a dispute as to amount must rise to either an absolute or a relative level before a bona fide dispute can be found to exist.

than a dispute over liability with respect to a $10,000 claim. Everything else being equal, and assuming each creditor would like to use the bankruptcy system as a tool of coercion, the creditor holding the $50 million/$150 million claim would seem to have a greater incentive to join an involuntary petition than the creditor holding the $10,000 claim. It is folly to believe that a debtor automatically has more to fear being pushed into bankruptcy by a creditor holding a claim disputed as to liability than from a creditor whose claim is disputed as to amount.

On an even more basic level, the proposition "a partially disputed claim is a disputed claim" is not only true, it is necessarily true. Its truth is not contingent on anything, and it would be contradictory to deny that a partially disputed claim is nonetheless a disputed claim. The word "dispute" includes within it various degrees, just like the term "bald." If a creditor sent a debtor an invoice for $1,000, and the debtor wrote back that he owed only $600, it is properly said that the invoice is in dispute. Equally true, it would be palpably false to state under these circumstances that the invoice is not in dispute. Only under the rarest of circumstances does the resolution of legal questions involve an inquiry into the philosophical concept of necessary truth, yet this is one of those rare instances because of various pre-BAPCPA and post-BAPCPA cases holding contrary to the plain meaning rule, legislative history, statutory interpretation principles and logic that a partially disputed claim is not "a claim . . . that is . . . the subject of a bona fide dispute as to . . . amount."

For these reasons, the Court concludes that a dispute as to a portion of a claim can be a bona fide dispute as to liability or amount. The Court therefore

follows the decisions of other courts reaching a similar conclusion. *Laxmi Jewel Inc. v. C&C Jewelry Mfg., Inc. (In re C&C Jewelry Mfg., Inc.), supra*;[12] *In re Rosenberg*, 414 B.R. 826, 845-46 (Bankr. S.D. Fla. 2009); *Reg'l Anesthesia Assocs. PC v. PHN Physician Servs. (In re Reg'l Anesthesia Assocs. PC)*, 360 B.R. 466, 470 (Bankr. W.D. Pa. 2007);[13] *In re Euro-American Lodging Corp.*, 357 B.R. 700, 712 (Bankr. S.D.N.Y. 2007). *See also* 2 *Collier on Bankruptcy* ¶ 303.11[2] at footnote 32 and cases cited therein.

The next issue facing the Court is whether a bona fide dispute exists as to the Maddox claim. In order for a bona fide dispute to exist, the alleged debtor must do more than just disagree with the amount of the claim. Rather, the court must determine whether there is "an objective basis for either a factual or legal dispute as to the validity of the debt." *In re Vortex Fishing Sys., Inc.*, 277 F.3d 1057, 1064 (9th Cir. 2002). The court need not "evaluate the potential outcome of a dispute" but must "determine whether there are facts that give rise to a legitimate dispute over whether money is owed, or, in certain cases, how much." *Laxmi Jewel*

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[12] "The Ninth Circuit has not yet interpreted the new language of § 303(b) and (h); however, other courts have held that an objective legitimate dispute as to an amount owed on a petitioning creditor's claim is sufficient to demonstrate a bona fide dispute and forestall a petitioning creditor from maintaining an involuntary petition under § 303(b)." 2009 Bankr. LEXIS 4517 at *18-19.

[13] "As a result of the [BAPCPA] amendment, any dispute regarding the amount that arises from the same transaction and is directly related to the underlying claim should render the claim subject to a bona fide dispute."

Inc. v. C&C Jewelry Mfg., Inc. (In re C&C Jewelry Mfg., Inc.), supra, 2009 Bankr. LEXIS 4517 at *21 (quoting *Vortex*).

The Maddox claim is based upon a promissory note with a principal amount of $250,000 and carrying a "loan fee" of $25,000.[14] The loan's term is six months, so the effective per annum interest rate is 20 percent. California's Constitution prohibits commercial loans with rates in excess of 10 percent. California Constitution, Article XV, Section 1.

Petitioning Creditors argue that the "loan fee" is not interest – even though, if it is not interest, there is no other interest required to be paid under the promissory note – and that there are various exceptions to the usury law that apply to this particular loan. Petitioning creditors have not made a sufficient showing that either of these arguments carries the day. QDOS has cited California state case authority indicating that loan fees are permitted when they are "reasonable amount[s] for incidental services, expenses or risk additional to lawful interest," *Klett v. Security Acceptance Co.*, 38 Cal. 2d 770, 787 (1952) (underscoring added), and Petitioning Creditors have in no way shown what "incidental services, expenses or risk" would render a $25,000 loan fee reasonable on a six-month $250,000 loan. Nor have they shown what exceptions to the usury law would apply in this case. Clearly, the underlying facts here give rise to a legitimate dispute over how much money is owed.

The Court holds that a bona fide dispute exists as to the amount of the Maddox claim, and therefore

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[14] Exhibit Q at its Exhibit A.

that Mr. Maddox is not qualified to be a petitioning creditor in this case.

As an alternative holding, the Court determines that Mr. Maddox's Proof of Claim will not be taken into account in determining whether he has a claim for purposes of being a qualifying petitioning creditor. The basis for not taking Mr. Maddox's Proof of Claim into account is twofold: (1) his repeated violations this Court's orders requiring him to appear. despite two re-schedulings of the evidentiary hearing, and (2) violation of QDOS's due process rights to examine him concerning the declarations and Proof of Claim that he filed, especially in a situation where the Proof of Claim does not affirmatively state a sum certain owed but instead cagily states "not less than $220,000." In a nutshell, Mr. Maddox cannot be permitted to disobey multiple Court orders requiring his appearance at an evidentiary hearing, consistently dodge cross-examination on pleadings he filed in support of the contention that he is a qualified creditor and still qualify as a petitioning creditor. There being no probative evidence of Mr. Maddox's claim – all his declarations having been stricken and his proof of claim not being taken into account – Petitioning Creditors have failed to meet their burden of proof and therefore the Court determines on these alternative grounds that Mr. Maddox is not qualified to be a petitioning creditor in this case.

C. Other Issues in the Case.

With the elimination of Mr. Terrigno and Mr. Maddox as qualifying petitioning creditors, only two alleged petitioning creditors remain, namely, Mr. Wiese and Mr. Hayden. This is not a sufficient number to satisfy the three-creditor rule of 11 U.S.C. § 303(b)(1). Accordingly, the Court does not need to

reach, and does not reach, the issues of whether Messrs. Wiese and Hayden are qualifying petitioning creditors and whether the involuntary petition was filed in bad faith.

CONCLUSION

The Court grants the parties' requests for judicial notice relating to the Motion.

The Court grants Debtor's Motion. The involuntary petition against QDOS is dismissed with prejudice for the reasons stated above. Pursuant to 11 U.S.C. § 303(i)(1), the Court sets a hearing on January 28, 2019 at 2:00 p.m. on the issue of whether the Court should grant judgment against Mr. Wiese, Mr. Hayden, Mr. Terrigno and Mr. Maddox and in favor of QDOS for reasonable attorneys' fees and costs incurred by QDOS in connection with this involuntary petition proceeding. In that connection, QDOS's brief is due on or before November 30, 2018; Petitioning Creditors' brief is due December 31, 2018; and QDOS's reply is due January 14, 2019.

IT IS SO ORDERED.

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Date: October 31, 2018

s/ Mark S. Wallace
Mark S Wallace
United States Bankruptcy
Judge