11 USC § 303
11 USC § 305
11 USC § 723
Involuntary

In Re M. Wood Enterprises — District Ct. # 99-6053-HO
Bankruptcy Ct. # 697-62839-aer7

7/21/99 Hogan (affirming Radcliffe) Unpublished*
(No written underlying bankruptcy court opinion)

An involuntary Chapter 7 petition was filed against a partnership by its sole creditor.[1] After intially granting the involuntary petition and ordering relief, the court then dismissed the case on its own motion.

On Appeal: Affirmed: A sole creditor may only maintain an involunary petition if it can establish either: 1) that the debtor has failed to meet repeated demands and the creditor cannot obtain adequate relief in a nonbankruptcy forum, or 2) there are special circumstances such as fraud, trick, or scam being perpetrated by the debtor which evidences the creditor's need for bankruptcy relief. An additional factor which may favor dismissal of an involuntary petition is a lack of assets held by the debtor which could be administered for the creditor's benefit. The above standards are derived from 11 U.S.C. § 305.

Creditor did not argue factor #2 above. Instead it argued 11 § 723 gave the Ch. 7 trustee rights it would not have outside of bankruptcy. The District Court (as did the bankruptcy court) disagreed, holding a trustee's rights under § 723 are derivative of the creditors' rights under nonbankruptcy law. Because it was conceded there were no other assets in the estate, the bankruptcy court did not abuse its discretion in dismissing the case.[2]

*On occasion the Court will decide to publish an opinion after its initial entry (and after submission of this summary). Please check for possible publication in WESTLAW, West's Bankruptcy Reporter, etc.

E99-17(10)

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[1]In a prior Ch. 11 proceeding filed by a general partner of the debtor, the judgment creditor had made claim against the partner for the amount of the judgment. The bankruptcy court held the partner had no liability because it had not been made a party to the creditor's suit in which it obtained the judgment.

[2]Based on District Court authority which came down after the bankruptcy court's ruling in the Ch. 11 case, the Court noted that the judgment creditor may pursue the general partners in state court to the extent that the Partnership could not satisfy the judgment.

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF OREGON

In re:	
M. WOOD ENTERPRISES, a partnership,	Bankr. : 97-62839 aer 7
Debtor.	Case No. 99-6053-HO
	ORDER

Creditor, Resource Recovery Group, Inc., appeals from the order dismissing an involuntary Chapter 7 petition it filed against M. Wood Enterprises (the Partnership).

STANDARD

The bankruptcy court's findings of fact shall not be set aside unless clearly erroneous. Fed. R. Bankr. P. § 8013. Issues of law are reviewed *de novo*. U.S. v. Horowitz, 756 F.2d 1400, 1403 (9th Cir. 1985).

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FACTUAL BACKGROUND

Milton R. Wood is a general partner of the Partnership. On December 18, 1992, the Partnership entered into a contract with Resource Recovery to log a stand of timber. In the fall of 1993, the Partnership filed an action in Lincoln County Circuit Court alleging that Resource Recovery had breached the contract. Resource Recovery counterclaimed for breach against the Partnership only and did not join any of the partners. In the summer of 1995, the circuit court entered judgment in favor of Resource Recovery and against the Partnership in the amount of $324,058.48 along with attorneys' fees and interest. The Partnership appealed.

Milton Wood filed a Chapter 11 petition on October 23, 1995. Wood disclosed his interest in the Partnership and listed the state court judgment as a disputed claim. Resource Recovery participated in the Wood bankruptcy and moved to dismiss the Chapter 11, arguing Wood's liability for the state court judgment against the Partnership. Resource Recovery also litigated Wood's liability through the bankruptcy proof-of-claims process asserting a claim against Wood for the judgment. Wood moved for summary judgment contending that he was not personally bound by the state court judgment. Resource Recovery opposed the motion and argued that the Partnership never had any assets and that Wood never contributed any assets to the Partnership.

Prior to ruling on the summary judgment motion, the bankruptcy

court granted Resource Recovery relief from the stay to seek a modification from the state court to find that the Partnership did not exist and to hold Wood personally liable. The Lincoln County Circuit Court entered an order rejecting Resource Recovery's motion entirely. Resource Recovery did not appeal the state court's order.

In light of the state court order, the Chapter 11 court granted Wood's summary judgment motion and held that the state court judgment did not bind Wood. Thus, the Chapter 11 court disallowed Resource Recovery's claim because it sought a judgment against the Partnership in state court only and did not join any of the individual partners.[1] The Chapter 11 court confirmed Wood's Chapter 11 plan.[2] Resource Recovery did not appeal the final order of the Chapter 11 court and Wood substantially performed his Chapter 11 plan.

Resource Recovery then initiated the involuntary Chapter 7 bankruptcy against the Partnership. The Partnership moved to

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[1]The Chapter 11 court applied the "all or none rule" and interpreted Oregon law to allow the creditor to obtain only one judgment. If the creditor fails to join the individual partners in an action against the partnership, the court reasoned, the creditor may not use any resulting judgment against the partnership to reach the assets of the partners. This appears to be incorrect. See United States v. Sohn, 971 F.Supp. 488, 490 (D.Or. 1997) (An action against a partnership only does not prevent a plaintiff, when it finds the partnership without assets and its judgment debt unsatisfied, from instituting suit against the individual partners to hold them liable for the debt.). Nonetheless, Resource Recovery chose not to appeal the decision of the Chapter 11 court.

[2]Such plan would not have been feasible had Wood been found to be liable for the state court judgment.

dismiss the case. The bankruptcy court denied the motion to dismiss and entered an order of relief.[3] Resource Recovery moved for a Rule 2004 examination. Resource Recovery argued that the Partnership had no assets other than a claim for contribution from the partners to pay its debts, which, it claimed, the trustee could enforce through 11 U.S.C. § 723. The bankruptcy court found that section 723 does not give the trustee any greater rights than the creditor holds. Therefore, the court dismissed the involuntary bankruptcy because the Partnership had no assets to administer, only one creditor, and the trustee did not have a substantive remedy available to him that was not available to the creditor under state law.

DISCUSSION

One creditor may bring an involuntary case against a debtor when the debtor has less than twelve creditors. 11 U.S.C. § 303. In this case, the Partnership has only one creditor--Resource Recovery. A sole creditor is entitled to prevail in an involuntary case if it can establish either "(1) that the debtor has failed to meet repeated demands of the sole creditor and the creditor cannot obtain adequate relief in a nonbankruptcy forum; or (2) there are special circumstances such as fraud, trick, artifice, or scam being

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[3]The bankruptcy court entered the order for relief out of an abundance of caution recognizing that the trustee has certain avoidance powers that are not available under state law. The court allowed the case to go forward to allow the trustee to investigate and see what was there.

perpetrated by the debtor which evidences the creditor's need for the relief available under the Bankruptcy Code." In re R.V. Seating, Inc., 8 B.R. 663, 665 (S.D.Fla. 1981). An additional factor that may favor dismissal of an involuntary petition is a lack of assets held by the debtor which could be administered for the creditor's benefit.

The above standard derives from 11 U.S.C. § 305. Under section 305, a bankruptcy court may dismiss a case at any time if the interests of the creditors and debtor would be better served by a dismissal. Among the factors to consider in determining whether the interests of creditors and the debtor would be better served by dismissal is the economy of bankruptcy administration. In re R.V. Seating, 8 B.R. at 665. For instance, to allow recovery of a debtor's assets to be eaten up by the expenses of bankruptcy administration would serve the interest of nether creditors or the debtor. Furthermore, available remedies under state law may better serve creditors. Id. Bankruptcy courts have dismissed involuntary petitions where the debtor has one creditor and the debtor has no assets other than a pending legal dispute. In re Axl Indus., Inc., 127 B.R. 482, 484-86 (S.D.Fla. 1991). The bankruptcy forum does not provide an efficient and economical means to try an isolated dispute. Id. at 484.

In this case, the bankruptcy court concluded that the Partnership has no assets, that Resource Recovery is the only creditor, and that there is no bankruptcy remedy that is not

available under nonbankruptcy law. The only potential asset found was the trustee's alleged claim under section 723 for contribution from the partners to the partnership to pay its liabilities. The bankruptcy court found that section 723 does not give the trustee rights any greater than those held by the creditor. The court noted that section 723 reads in part that if there is a deficiency of property of the estate to pay in full all claims which are allowed, the trustee shall have a claim against the general partner to the extent that under applicable nonbankruptcy law such partner is personally liable for such deficiency. The court went on to note that the legislative history of section 723 indicates that its primary purpose is to allow a trustee to bring an action on behalf of creditors, plural, so as to avoid the race to the courthouse type of problem, i.e., to ensure an equitable distribution from the estate to the creditors. The court concluded that either the general partners of the Partnership have some liability under applicable nonbankruptcy law or they don't. If they don't, then the trustee has no claim. If they do, then this being a single creditor case, the court noted, it is appropriate to dismiss the case and allow Resource Recovery to pursue whatever rights under applicable nonbankruptcy law it has against one or more of the partners.

In this appeal, Resource Recovery goes to great lengths to educate the court regarding the applicable partnership law and the liability of general partners. It outlines the powers of the

trustee in pursuing the partners where a debtor partnership's assets cannot satisfy its debts and concludes that the bankruptcy code provides unique remedies unavailable in state court.[4] Nonetheless, the trustee only has a claim under section 723 to the extent one exists under applicable nonbankruptcy law.[5] The code does not provide a claim to the trustee that does not exist for the creditor under applicable nonbankruptcy law. Resource Recovery may pursue the general partners in state court to the extent that the Partnership cannot satisfy the judgment. As the Sohn court noted:

> [A plaintiff may], when it finds the partnership without assets and its judgment debt unsatisfied, [institute a] suit against the individual partners to hold them liable for that debt. . . .
>
> [U]nder ORS 68.270, a partner may be held personally liable for the unsatisfied debts of the partnership in a subsequent court action, regardless of whether the partner was named as an individual defendant in the

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[4]Perhaps the trustee's avoidance powers provide a unique weapon that a creditor would not have outside bankruptcy. The bankruptcy court invited briefing on whether there was, for example, a section 547 claim available to the trustee that may be a basis for continuing the case. Apparently the only claim noted by Resource Recovery was the section 723 claim.

[5]Milton Wood's briefing examines the plain language and legislative history of section 723. See Response Brief of Milton R. Wood (#79) at pp. 38-42. The language of section 723 is clear that a trustee only shall have a claim against a general partner to the extent that under applicable nonbankruptcy law such general partner is personally liable. The court is persuaded that the legislative history and case law also support the conclusion that section 723 does not provide a special bankruptcy remedy. See, e.g., In re Judiciary Towers Assoc., 175 B.R. 796, 801 (D.D.C. 1994) (the trustee stands in the shoes of the creditors and his cause of action is identical to the cause of action belonging to the creditors; the liability asserted by the trustee is no more and no less than the liability that could be asserted by the creditors).

original complaint.

971 F.Supp. at 490.

While Resource Recovery may prefer to have the trustee exercise his powers to, for example, enjoin other creditors from collecting property of the partners based upon valid debts, such does not demonstrate that the interests of the creditor and debtor are not better served by the dismissal of the bankruptcy case. Resource Recovery does not demonstrate the need for a trustee to preserve any claim it may have against the partners. The involuntary Chapter 7 was initiated simply to litigate a two-party dispute which can be adequately resolved in a nonbankruptcy forum.

Further, Resource Recovery does not show that special circumstances such as fraud preclude a section 305 dismissal.[6] Resource Recovery did not raise any allegations of fraud before the Chapter 7 court and thus there is no factual record for this court to review for clear error or abuse of discretion.

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[6]Resource Recovery argues that Milton Wood's sons, also general partners in the Partnership, refuse to trigger the partnership's rights against their father although he allegedly used partnership property for his own benefit. As noted above, Resource Recovery may go after any individual partner in state court. The Uniform Partnership Act provides a mechanism for contribution from other partners should one partner pay more than his fair share. Thus, contrary to creditor's assertion, the partners do have an incentive to investigate the treatment of partnership property. See UPA § 40(d) (partners shall contribute their share of liabilities in the relative proportions in which they share profits). Therefore, such allegations do not evidence a need for relief under the bankruptcy code. At any rate, as noted above, because Resource Recovery did not raise such factual matters before the Chapter 7 court, the court did not commit clear error or abuse its discretion in not finding special circumstances evidencing a need for bankruptcy relief.

Because the involuntary Chapter 7 proceedings initiated by Resource Recovery involved a debtor with no assets and only one creditor who has available to it adequate nonbankruptcy avenues to seek relief, the bankruptcy court did not abuse its discretion in dismissing the case. Under such circumstances, use of the bankruptcy process is disfavored and Resource Recovery fails to present special circumstances evidencing a need for relief under the bankruptcy code.[7] As such, the bankruptcy court's dismissal of the involuntary Chapter 7 petition against the Partnership is affirmed.

CONCLUSION

For the reasons stated above, the bankruptcy court's decision to dismiss the involuntary Chapter 7 bankruptcy against M. Wood Enterprises is affirmed.

DATED this 21st day of July, 1999.

Michael R. Hogan
United States District Judge

[7] It should also be noted that Resource Recovery argues that the Chapter 7 court should have allowed it to conduct additional discovery before dismissing the case. Resource Recovery has conducted discovery into the Partnership's and Wood's financial affairs in three different courts already. Before dismissal, the trustee investigated whether the partnership had any assets and found none. Resource Recovery essentially admitted that the Partnership had no assets other than a right of contribution from the partners. There is no showing that additional discovery would lead to a different outcome in this case. One other issue raised by Resource Recovery involves the argument that the bankruptcy court misapplied res judicata. However, res judicata was not a basis for the court's decision.

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF OREGON

RESOURCE RECOVERY GROUP INC

Appellant,

v.

Civil No. 99-6053-HO
97-62839-aer7

M WOOD ENTERPRISE, et al

Appellees.

JUDGMENT

The bankruptcy court's decision to dismiss the involuntary Chapter 7 bankruptcy against M Wood Enterprises is affirmed.

Dated: July 22, 1999.

Donald M. Cinnamond, Clerk

by Lea Force
Lea Force, Deputy

JUDGMENT **DOCUMENT NO:** _____

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