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Feature

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Involuntary Cases Meet Abstention in ABC Cases

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Editor's Note: *The author's book on this topic is available in the ABI Store (store.abi.org). Members must log in first to obtain reduced pricing.*

I have written over the years about various aspects of administering assignment for the benefit of creditors (ABC) estates, including how the dot.com era raised the visibility of ABCs as they were often used to deal with failing entities. This article looks at the application of the abstention doctrine in involuntary cases and in *In re Korean Radio Broadcasting Inc. (KRBI)*.[1]

Creditors have few tools to use to "object" to a company executing an ABC, as its process leaves little room for creditor approval. This by itself is nothing new nor a recent development. The most common "tool" used is filing an involuntary petition against the assignor so as to wrest oversight of ABCs to the bankruptcy courts. The most recent case where this was tried comes out of New York, where ABCs are supervised by the New York Supreme (trial) Courts.

Before getting to the facts of the *KRBI* case, a review of the abstention doctrine in ABC cases is appropriate. Recall that individual states are prohibited from creating laws that pre-empt federal laws, and similarly the federal government has the power to establish uniform laws on the subject of bankruptcy.[2] Congress addressed a conflict that can arise when a distressed business elects to use state law versus federal law to deal with the liquidation of its assets and payment of creditors' claims by requiring, under § 543 of the Bankruptcy Code, that custodians turn over the property to the trustee.[3] But as pertains to an ABC, § 543(d)(2) provides that where the debtor has executed an ABC more than 120 days before the commencement of the case, the assignee is exempt from the turnover provisions of § 543.[4] Therefore, what is at issue is what happens when a case is commenced after the execution of the ABC but before expiration of the 120-day provision in § 543(d)(2).

Abstention is provided for in § 305 of the Bankruptcy Code[5] and gives the bankruptcy court the authority to decide whether to retain jurisdiction over an involuntary case. "There are circumstances ... [where] it would be appropriate for the [bankruptcy] court to decline jurisdiction.... The less expensive out-of-court workout [might] better serve the interests of creditors."[6] General assignments are generally considered to be state law reorganization plans and therefore "favored" over federal cases.[7]

The facts of the *KRBI* case are straightforward. KRBI executed an ABC under Article 2 of the New York Debtor and Creditor Law, which assignment was pending in the New York Supreme Court.[8] An affiliated entity, New York Metro Radio Korea Inc., also executed an ABC at the same time. Multicultural Radio Broadcasting Inc. filed an involuntary petition in October 2019. District court litigation between the parties began in 2015, and a series of cases followed between the parties.[9]

The question before the bankruptcy court was whether to retain jurisdiction of the bankruptcy case or dismiss or abstain from hearing the involuntary case. The bankruptcy court held a hearing on the

1 *In re Korean Radio Broad. Inc.*, No. 19-46322-ESS, 2020 WL 2047990, at *2 (Bankr. E.D.N.Y. March 31, 2020).
2 Art. I, U.S. Const. § 8(4).
3 11 U.S.C. § 543.
4 11 U.S.C. § 543(d)(2).
5 11 U.S.C. § 305.
6 Senate Report to Bankruptcy Reform Act of 1978, Report No. 95-989, at p. 36.
7 *See* legislative comments to Code § 305; *see also General Assignments for the Benefit of Creditors: The ABCs of ABCs (4th ed.)* (ABI 2019).
8 Development Specialists, Inc. Executive Chairman **William A. Brandt, Jr.** is the assignee.
9 Memorandum Decision at pp. 4-5.

motion to dismiss or abstain in December 2019 and a continued hearing in January 2020. The memorandum decision not only addressed abstention, but spent a good deal of time addressing dismissal pursuant to § 707(a).[10]

Bankruptcy courts have the ability to exercise discretion from hearing an involuntary case pursuant to § 305(a)(1) of the Bankruptcy Code.[11] Quoting the court's decision, "abstention pursuant to section 305(a) is an extraordinary remedy and is appropriate only in the situation where the court finds that both creditors and the debtor would be better served by a dismissal."[12] Further, the moving party (typically the assignor joined by the assignee) must show that dismissal is warranted for cause, or that the case does not serve a bankruptcy purpose and should not proceed further in the bankruptcy court.

The *KRBI* memorandum decision reviews seven factors in making its decision as to dismissal under § 707(a). These factors are enumerated in the Judiciary Code and include the following: (1) economy and efficiency of administration; (2) whether another forum is available to protect the interests of both parties or there is a pending proceeding in state court; (3) whether federal proceedings are necessary to reach a just and equitable solution; (4) whether there is an alternative means of achieving the equitable distribution of assets; (5) whether the debtor and creditors are able to work out a less expensive out-of-court arrangement that better serves all interests in the case; (6) whether a non-federal insolvency has proceeded so far in those proceedings that it would be costly to start afresh with the federal bankruptcy process; and (7) the purpose for which bankruptcy jurisdiction has been sought.[13] Specifically, the *KRBI* decision looked at the following factors:

- whether the economy and efficiency of administration favors abstention;
- whether there is another forum available to protect the interests of the parties;
- whether there is already a pending proceeding in a state court;
- whether federal proceedings are necessary to reach a just and equitable solution;
- a possible alternative means of achieving the equitable distribution of assets and whether the assignor and the creditors work out a less expensive out-of-court arrangement that better serves all interests in the case;
- whether the non-federal insolvency proceeding has proceeded to a point that it would be costly and time-consuming to start a new proceeding in the bankruptcy court; and
- whether the purpose for which bankruptcy jurisdiction has been sought favors abstention.[14]

This decision follows other abstention cases. For example, in *NNN Realty Advisors Inc.*,[15] a bankruptcy court abstained from taking jurisdiction and dismissed a pending involuntary case, stating, "The court, after notice and a hearing, may dismiss a case under this title, or may suspend all proceedings in a case under this title if ... the interests of creditors and the debtor would be better served by such dismissal or suspension."[16] Just as the *KRBI* court recognized, "abstention is an extraordinary remedy"[17] and "[n]evertheless, dismissal is appropriate when it will best serve the interests of the debtor and creditors."[18] Like the *KRBI* decision, the court reviewed the aforementioned factors and found that the abstention was appropriate under the facts of the case:

> [T]he Court concludes that federal bankruptcy jurisdiction is not necessary to reach a just and equitable solution in this case when the [*NNN Realty Advisors Inc.*] ABC Case presents an administratively efficient alternative that is already underway. The Court has no doubts that the reputable professionals handling [*NNN Realty Advisors Inc.*]'s ABC Case can do so in an effective and orderly fashion that protects the best interests of creditors.[19]

However, consider the situation where an involuntary petition is filed against a debtor in an ABC where the debtor's principals have conducted the debtor's affairs in such a way as to warrant the bankruptcy court to retain jurisdiction. One such case was *Mamtek US Inc*. On Dec. 15, 2011, several creditors filed an involuntary petition for chapter 7 relief against Mamtek US Inc. Mamtek had executed an ABC earlier in December 2011. Knowing the extent of the claims of fraud being asserted against Mamtek and its principals, the assignee chose not to request that the court abstain from taking jurisdiction of the involuntary case.

The bankruptcy court issued an order appointing an interim trustee on Dec. 30, 2011, and on Jan. 9, 2012, the court entered its order for relief. The trustee brought fraudulent-transfer actions against the principals. The assignee's decision not to fight the involuntary was vindicated when the court found that there was no genuine dispute as to any material fact with respect to the trustee's right to recover against the company's principals for their receipt of fraudulent transfers, as the evidence indisputably demonstrated that (1) the transfers were made with actual intent to hinder, delay or defraud Mamtek's creditors; and (2) Mamtek was insolvent at the time the transfers were made and received less than reasonably equivalent value in exchange for the transfers. Needless to say, the decision not to fight the involuntary case was the correct decision.[20]

What can be drawn from the *Mamtek*, *KRBI* and *NNN Realty Advisors* cases? Merely trying to move an ABC into the bankruptcy courts is not a guarantee that the involuntary case will stick. However, ABC cases are routinely recognized as viable and appropriate alternatives to bankruptcy cases. Also recognize that getting three creditors to file an involuntary to overturn an ABC also carries risks, includ-

10 This article will not review the discussion about dismissal under § 707, nor the risk of petitioning creditors being found to have filed the involuntary in bad faith. This article deals solely with the abstention argument.

11 11 U.S.C. § 305(a)(1).

12 Quoting *In re Selectron Mgmt. Corp.*, 2010 WL 381 1863, at *5 (Bankr. E.D.N.Y. Sept. 27, 2010) (quoting *In re Global Communicacoes e Participacoes SA*, 317 B.R. 235, 255 (S.D.N.Y. 2004)).

13 Citing *In re Paper I Partners LP*, 283 B.R. 661, 679 (Bankr. S.D.N.Y. 2002) (citing *In re RCM Global Long Term Capital Appreciation Fund Ltd.*, 200 B.R. 514, 525 (Bankr. S.D.N.Y. 1996).

14 *See In re Paper I Partners LP*, 283 B.R. 661 (Bankr. S.D.N.Y. 2002); *see, e.g., In re TPG Troy LLC*, 492 B.R. 150, 160 (Bankr. S.D.N.Y. 2013), *subsequently aff'd*, 793 F.3d 228 (2d Cir. 2015) (citing *In re Monitor Single Lift I Ltd.*, 381 B.R. 455, 464–65 (Bankr. S.D.N.Y. 2008).

15 Case No. 15-30508-RBR, (S.D. Fla. April 18, 2016).

16 11 U.S.C. § 305(a)(1).

17 Citing *In re Fortran Printing Inc.*, 297 B.R. 89, 94 (Bankr. N.D. Ohio 2002).

18 Citing *Int'l Zinc Coatings*, 355 B.R. at 82 (citing *Fortran*, 297 B.R. at 94).

19 *Id.* at p. 6.

20 For more information about the claims against the principals, *see* Rudi Keller, "Mamtek Case Takes New Twist with Objections to Settlement," *Moberly Monitor-Index* (May 12, 2019), *available at* moberlymonitor.com/news/20190512/mamtek-case-takes-new-twist-with-objections-to-settlement (last visited July 20, 2020).

ing the court finding that the involuntary was filed in bad faith (and subjecting petitioning creditors to possible sanctions).[21] Where an ABC with a reputable assignee is already in place and the assignee is already administering assets of the assignor for the creditors' benefit, there is less of a likelihood of staying in bankruptcy versus leaving the "insolvency proceeding" to proceed under state law.

Like any other litigation matter, your *facts* will help you and your clients, be they creditors, the assignor or the assignee, to make more-informed decisions as to whether abstention will lie and the likelihood that a bankruptcy court will grant an abstention motion. Discussing the issues that face the assignee and ABC process before the ABC is executed and accepted is a good start that will help defend against involuntary cases seeking to wrest the liquidation from state law processes to the bankruptcy court. abi

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21 This risk is outside the scope of this article, but it is a consideration that counsel should take into account any time counsel is recommending an involuntary bankruptcy, not just in ABC cases.