THE ONE, TWO, THREES OF INVOLUNTARY BANKRUPTCY: CREDITOR NUMEROSITY IN THE FIFTH CIRCUIT

Comment

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I. INTRODUCTION: ILLUSTRATING A LOOPHOLE IN THE BANKRUPTCY CODE

Imagine the following scenarios:

Scenario One: A debtor owes you twenty thousand dollars. They have assets, but are not paying their bills;

Scenario Two: The debtor owes you twenty thousand dollars, but also owes twenty other creditors one thousand dollars each; and

Scenario Three: The debtor owes twenty creditors one thousand dollars each, but now owes you one million dollars.[1]

The United States Bankruptcy Code (the Code)[2] provides a remedy for creditors holding significant, unsecured claims against a debtor who is generally not paying their debts: involuntary bankruptcy.[3] In Scenario One, a single creditor could bring an involuntary petition to reclaim the twenty thousand dollars.[4] But in Scenario Two, that same creditor would need to recruit two additional creditors to join in the involuntary petition for its petition to succeed.[5] This change does not occur because the other creditors hold a high percentage of the total outstanding debt.[6] Rather, it is because, according to the Code, whenever the number of creditors holding a claim against the debtor exceeds eleven, a minimum of three creditors must join in the petition to commence an involuntary bankruptcy.[7]

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1. *See generally In re* CorrLine Int'l, LLC, 516 B.R. 106 (Bankr. S.D. Tex. 2014) (dealing with a factual scenario in which the alleged creditors' claims were objectively significant, but were dwarfed by the petitioning creditor's claim).

2. Hereinafter, any reference to "the Code" is a reference to the United States Bankruptcy Code, otherwise known as Title 11.

3. *See* 11 U.S.C. § 303 (2012).

4. *See id.*

5. *See id.*

6. *See id.*

7. *See id.*

Scenario Three presents the same barrier to invoking an involuntary bankruptcy for a single petitioning creditor as in Scenario Two.[8] Despite the fact that the single petitioning creditor in this circumstance holds the vast majority of the outstanding debt, it must still recruit two additional creditors to join in the petition for the bankruptcy to proceed.[9] The only way to avoid this result is to exclude the insignificant claims from the number of qualified creditors.[10] But even in the Fifth Circuit, which boasts highly progressive case law on this issue, the significance of the other creditors' claims for purposes of "numerosity" is not determined in relation to that of the petitioning creditor.[11] Even though the other creditors' claims are insignificant in comparison to the one million dollar claim, the other claimholders possess the same rights and power to stop the petition in Scenario Three as they do in Scenario Two because the significance of each claim is measured objectively—when it is measured at all.[12]

Unlike the Second, Ninth, and Tenth Circuits, the Fifth Circuit does consider the significance of those smaller claims.[13] Since the 1970s, the Fifth Circuit has disregarded claims that are small and insignificant when determining whether to count those claimholders among the creditors for purposes of § 303(b)(2) numerosity.[14] While this progressive stance is noble, bankruptcy courts need an update to this doctrine with more explicit guidelines.[15] The Fifth Circuit case law is in a position of such confusion that trial courts are too timid to apply the confusing, judicially created doctrine effectively and too hamstrung to disregard it.[16] The Fifth Circuit must either march forward with a bold—and honest—standard that disregards insignificant claims as measured against the claim of the petitioning creditor, or retreat to the firm footing of a plain language interpretation of Bankruptcy Code § 303.[17] This Comment recommends the former but predicts the latter.[18]

Congress initially enacted United States bankruptcy laws to soften the sharp effects of economic busts.[19] But the current bankruptcy law in the Fifth

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8. *See id.*
9. *See id.*
10. *See infra* Part IV.
11. *See infra* Part IV.
12. *See infra* Part IV.
13. *See* Hornblower & Weeks-Hemphill, Noyes v. Okamoto *(In re* Okamoto), 491 F.2d 496, 498 (9th Cir. 1974); Denham v. Shellman Grain Elevator, Inc. (*In re* Denham), 444 F.2d 1376, 1379 (5th Cir. 1971); *In re* Elsa Designs, Ltd., 155 B.R. 859, 865 (Bankr. S.D.N.Y. 1993); *In re* Hoover, 32 B.R. 842, 847 (Bankr. W.D. Okla. 1983); *infra* Part IV.
14. *In re Denham*, 444 F.2d at 1379.
15. *See infra* Parts VI–VII.
16. *See infra* Part VII.
17. *See infra* Part VII.
18. *See infra* Part VII.
19. SHEILA M. WILLIAMS ET AL., BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2005: LAW & EXPLANATION ¶ 51, at 53 (2005) ("Historically, federal bankruptcy laws were temporary responses to periodic economic collapses.").

Circuit is unclear and ill-equipped to handle the involuntary bankruptcies that result from dramatic economic shifts.[20] For example, abrupt drops in the price of oil "put acute pressure on energy companies with weak balance sheets . . . [and] hurt sales for related services companies that sell everything from sand to drilling rigs to temporary housing."[21] Because these sector-wide retractions place many creditors in Scenario Three, lawmakers need to provide clear, sound rules to govern involuntary bankruptcies.[22]

Part II of this Comment provides context for the problem that arises when fewer than three large creditors seek to place a debtor in involuntary bankruptcy.[23] Because little scholarship exists to aid practitioners regarding involuntary bankruptcy generally, Part III discusses the current statutory requirements for sustaining an involuntary bankruptcy.[24] Part IV focuses on one of the statutory concerns, the debtor's total number of creditors, and highlights the problem with including all statutorily qualified creditors.[25] Part V discusses the confusion in Fifth Circuit case law stemming from its 1971 decision, *Denham v. Shellman Grain Elevator* (*In re Denham*), to exclude some claims from the numerosity calculation.[26] Part VI examines whether *Denham* was correctly decided, whether it remains good law, and also whether, without *Denham*, the Code produces an absurd result.[27] Part VII recommends ways that Congress and the Fifth Circuit could close the loophole in the Code, and provides suggestions for debtors and creditors in the meantime.[28] Part VIII concludes with a brief discussion of how adopting

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20. *See infra* Parts V–VI.

21. Greg Roumeliotis, *Exclusive: Blackstone Sets Up New Credit Fund to Seek Undervalued Oil and Gas Assets*, REUTERS, Jan. 27, 2015, http://www.reuters.com/article/2015/01/27/us-blackstone-energy fund-idUSKBN0L00D420150127. As of this writing, the price of crude oil is under $50 per barrel and domestic oil inventories just reached their highest level in eighty years. Nicole Friedman, *Oil Prices Slump as Inventories Rise Near 80-Year Highs*, WALL ST. J. (Feb. 4, 2015, 4:56 PM), http://www.wsj.com/articles/oil-holds-on-to-bulk-of-recent-gains-1423031216. Major oil producers are laying off their workforces at an alarming rate. Erin Ailworth, *Three More Energy Companies in Texas Warn of Layoffs*, WALL ST. J. (Feb. 2, 2015, 4:38 PM), http://www.wsj.com/articles/three-more-energy-companies-in-texas-warn-of-layoffs-1422913133. While total domestic production is likely to remain stable through the end of 2015, some have projected that the number of drilling rigs in operation will fall by 30%. Clifford Krauss, *Oil Falls to 5-Year Low, and Energy Companies Start to Retrench*, N.Y. TIMES (Dec. 8, 2014), http://www.nytimes.com/2014/12/09/business/energy-environment/oil-falls-to-5-year-low-and-companies-start-to-retrench-.html?_r=1. Many believe that in addition to normal price fluctuation, OPEC intends to depress prices by eliminating upstart competition and "leav[ing] the weakest behind." Bradley Olson & Rebecca Penty, *OPEC Refusal to Pressure Oil's Weakest from Iran to Shale*, BLOOMBERG (Nov. 28, 2014, 1:21 PM), http://www.bloomberg.com/news/articles/2014-11-28/opec-refusal-to-pressure-oil-s-weakest-from-iran-to-shale. One oil exploration capital management executive said simply, "[i]t's going to be ugly." *Id.*

22. *See infra* Part VII.

23. *See infra* Part II.

24. *See infra* Part III.

25. *See infra* Part IV.

26. *See infra* Part V.

27. *See infra* Part VI.

28. *See infra* Part VII.

those recommendations would alleviate the problem illustrated by the three scenarios above.[29]

II. THE ONE-PETITIONER PROBLEM

An involuntary bankruptcy begins when a creditor files a petition for involuntary bankruptcy seeking to have the debtor's assets placed under court control, just as if the debtor had filed bankruptcy itself.[30] The total number of entities that hold a claim against the debtor determines whether a creditor can move forward without other creditors joining the petition.[31] If the total number of qualified entities holding a claim against the debtor is twelve or greater, a single petitioning creditor cannot bring the involuntary bankruptcy; it takes three creditors joining together.[32] It is important to note that the holders of small claims need not declare any aversion to the bankruptcy to prevent it from proceeding, nor must they file any pleadings with the court to halt the proceeding.[33] Their inaction is all that is required to prevent the petitioning creditor from succeeding.[34] These circumstances pose a real problem when a large debt is held by one creditor: the other claimholders are often too small to bother with the expense of litigation, but they are also too numerous to allow a single large creditor to petition the court alone.[35]

This problem is particularly onerous when the single petitioning creditor is very large.[36] If the underlying business is large enough to have incurred substantial debt, even from one creditor, it is likely that the business also incurred many *de minimis* debts.[37] As businesses increase in size, the services they consume typically increase in number.[38] As this Comment demonstrates, many day-to-day services and expenses meet the Code's definition of *creditor*.[39] Therefore, utility bills, maintenance agreements, magazine subscriptions, storage building rentals, and the like can block the use of involuntary bankruptcy by a large creditor even when those routine expenses comprise an extremely small portion of the overall debt.[40]

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29. *See infra* Part VIII.
30. *See* 11 U.S.C. § 303(b) (2012).
31. *Id.* § 303(b)(1)–(3).
32. *See id.*
33. *See* Jefferson Tr. & Sav. Bank of Peoria v. Rassi (*In re* Rassi), 701 F.2d 627, 632 (7th Cir. 1983).
34. *See id.*
35. *See id.*
36. *See generally In re* CorrLine Int'l, LLC, 516 B.R. 106, 123–27 (Bankr. S.D. Tex. 2014) (showing that a joint venture with around one million dollars in special purpose debt initially claimed to have over fifty creditors, almost all of which were business vendors).
37. *See id.*
38. *See id.*
39. *See* 11 U.S.C. § 101(10) (2012); *infra* Part III.
40. *See In re Rassi*, 701 F.2d at 632.

III. CODE TREATMENT OF PETITIONING CREDITORS

The Code places certain requirements on who may file an involuntary petition.[41] The petitioning creditor, and any creditors joining in the petition, must be a "holder of a claim . . . that is not contingent as to liability or the subject of a bona fide dispute as to liability or amount, . . . [aggregating] at least [$15,325] more than the value of any lien on property of the debtor securing such claims."[42]

A. The Holder of a Claim

In describing who may file an involuntary petition, § 303(b) of the Code begins with a very broad description: "[the] holder of a claim."[43] Section 101(5) of the Code defines a claim as a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured."[44] In conferring the power to seek repayment through involuntary bankruptcy, the Code begins with the broadest possible grant—the holder of a claim—and adds limitations from there.[45]

In 1978, when the modern-day Code became effective, it only prohibited claims that were "contingent."[46] In 1984, Congress added the limitation requiring that the claims of petitioning creditors not be "the subject of a bona fide dispute."[47] In 2005, Congress clarified that a bona fide dispute would preclude a creditor from petitioning regardless of whether the dispute was "as to liability or amount."[48] Though the statutory qualifications of petitioning creditors have grown more exclusive over time, the Code still begins with the position that any claim holder may file or join an involuntary petition.[49] The Code then carves out exceptions to that privilege rather than singling out specific types of claims and granting the power of petition to them.[50] This is an inclusive statutory construct.[51]

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41. *See* 11 U.S.C. § 303.

42. *Id.* The $15,325 amount is an adjusted number in accordance with 11 U.S.C. § 104. *See infra* Part III.C.

43. *See In re* Tampa Chain Co., 35 B.R. 568, 574 n.5 (Bankr. S.D.N.Y. 1983).

44. 11 U.S.C. § 101(5)(A).

45. 11 U.S.C. § 303(b).

46. *See In re Tampa Chain*, 35 B.R. at 574–75.

47. Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub L. No. 98-353, § 426(b)(1), 98 Stat. 333, 369 (1984) (current version at 11 U.S.C. § 303(b)(1)).

48. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 1234(a)(1), 119 Stat. 23, 204 (2005) (current version at 11 U.S.C. § 303(b)(1)).

49. 11 U.S.C. § 303.

50. *See id.*

51. *See id.*

B. Not Contingent or the Subject of a Bona Fide Dispute

One argument against the expansive use of involuntary petitions, particularly when prosecuted by a single petitioning creditor, is that the extreme nature of the remedy and significant consequences on the debtor's creditworthiness make involuntary petitions inappropriate for most two-party disputes.[52] The requirement that the claim held by the petitioning creditor "not [be] contingent as to liability or the subject of a bona fide dispute as to liability or amount" ensures that many of these disputes do not wind up in bankruptcy court, but instead are resolved in the more appropriate forum: state court.[53]

A claim is contingent as to liability if (1) the debtor will only become liable to pay "upon the occurrence or happening of an extrinsic event" and (2) the "triggering event or occurrence was one reasonably contemplated by the debtor and creditor."[54] Thus, debtors need not worry about involuntary bankruptcy if their unsecured liabilities are based on future exigencies that may never materialize.[55]

Determining whether a claim is subject to a bona fide dispute has given courts more trouble than determining whether a claim is contingent.[56] Generally speaking, bankruptcy courts regard pending litigation between the petitioning creditor and the putative debtor as a strong indication that a bona fide dispute exists over the claim.[57] But other courts have held that the bankruptcy court, in assessing the involuntary petition, must independently inquire into the validity of the underlying lawsuit.[58] In these jurisdictions, a bankruptcy court can grant an involuntary petition even when the claim is being litigated because, while the presence of litigation on the matter establishes that a dispute exists, it does not establish that the dispute is bona

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52. *See In re* McMeekin, 18 B.R. 177, 177 (Bankr. D. Mass. 1982) ("[A]n involuntary petition is an extreme remedy with serious consequences to the alleged debtor. . . . [T]he credit world is put on notice . . . [and the debtor] may be unwillingly saddled with the harsh effects it may cause . . . .").

53. *See, e.g.*, *In re* Demirco Holdings, Inc., No. 06-70122, 2006 WL 1663237, at *2 (Bankr. C.D. Ill. June 9, 2006) (quoting 11 U.S.C. § 303(b)(1) (2006)). "Courts have . . . scrutinized one-creditor filings closely to make sure that an involuntary petition is not filed unfairly or abusively by a creditor to put an operating company into bankruptcy in order to gain leverage in resolving legitimate disputes." *Id.* at *4.

54. *In re* All Media Props., Inc., 5 B.R. 126, 133 (Bankr. S.D. Tex. 1980), *aff'd*, 646 F.2d 193 (5th Cir. 1981).

55. *See id.*

56. *Compare In re* CorrLine Int'l, LLC, 516 B.R. 106, 146–51 (Bankr. S.D. Tex. 2014) (analyzing the many factors that bankruptcy courts must consider to determine whether pending state-court litigation is proof of a bona fide dispute), *with In re All Media Props*., 5 B.R. at 133 (holding that a debt is contingent simply if it becomes payable on the occurrence of an extrinsic event).

57. *See* Credit Union Liquidity Servs., L.L.C. v. Green Hills Dev. Co. (*In re* Green Hills Dev. Co.), 741 F.3d 651, 660 (5th Cir. 2014).

58. *See* Liberty Tool, & Mfg. v. Vortex Fishing Sys., Inc. (*In re* Vortex Fishing Sys., Inc.), 277 F.3d 1057, 1066 (9th Cir. 2002).

fide.[59] This leaves a fine line for the bankruptcy court to walk.[60] On one hand, finding that a dispute is not bona fide could provide the petitioning creditor with an unnecessary and unfair shortcut around conventional debt collection suits in state court.[61] On the other hand, allowing a delinquent debtor to improperly shield itself from obvious liability in bankruptcy merely by commencing litigation against its creditor in another court equally abuses the system.[62] But, at a minimum, the presence of underlying litigation suggests that the parties' dispute over the claim is bona fide.[63] Therefore, the requirement that the claim be free of a bona fide dispute serves as another valuable check on creditors who would seek to use involuntary bankruptcy as an alternative to more appropriate conventional methods of settling a two-party dispute.[64]

C. At Least $15,325 Undersecured

Claimholders may only bring an involuntary petition if the debt they are owed is unsecured or undersecured by at least $15,325.[65] Undersecured, for purposes of this analysis, means that the aggregate value of the claims is "at least [$15,325] more than the value of the property of the debtor securing the claims."[66] This provides a check against the abuse of involuntary bankruptcy in a two-party setting because creditors may only maintain an involuntary petition when normal state court remedies are insufficient.[67]

Over time, this minimum amount continues to rise.[68] Every three years, Congress adjusts the minimum in § 303(b)—along with many other monetary amounts in the Code—to reflect inflation and maintain consistent thresholds in real terms.[69] Since the original enactment of the Code in 1978, this value has increased from just $5,000 to its current amount of $15,325.[70] Therefore, while the Code sets the minimum size of a claim with a fixed dollar amount

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59. *In re* Onyx Telecomms., Ltd., 60 B.R. 492, 495 (Bankr. S.D.N.Y. 1985).

60. *Compare In re Green Hills Dev. Co*., 741 F.3d at 660 (holding that "a creditor whose claim is the object of unresolved, multiyear litigation should not be permitted to short-circuit that process by forcing the debtor into bankruptcy"), *with In re CorrLine Int'l*, 516 B.R. at 150 (refusing to find the dispute was bona fide when the court considered each of debtor's claims in the underlying lawsuit and found they were not legitimate claims).

61. *In re Green Hills Dev. Co*., 741 F.3d at 660.

62. *In re CorrLine Int'l*, 516 B.R. at 150.

63. *In re Onyx Telecomms*., 60 B.R. at 495.

64. *See, e.g.*, *In re* Demirco Holdings, Inc., No. 06-70122, 2006 WL 1663237, at *4 (Bankr. C.D. Ill. June 9, 2006).

65. *See* 11 U.S.C. § 303(b) (2012 & Supp. II 2014).

66. *Id.*; *In re* Tsunis, 39 B.R. 977, 978 (Bankr. E.D.N.Y. 1983).

67. *See In re Tsunis*, 39 B.R. at 997.

68. *See* 11 U.S.C. § 104 (2012).

69. *Id.*; *see* Revision of Certain Dollar Amounts in the Bankruptcy Code Prescribed Under Section 104(a) of the Code, 78 Fed. Reg. 12089 (Feb. 21, 2013).

70. *See* 11 U.S.C. § 303(b) (2012 & Supp. II 2014); *In re* Blaine Richards & Co., 10 B.R. 424, 426 (Bankr. E.D.N.Y. 1981).

rather than referring to the size of the debtor or any other creditors, Congress still recognizes the need to maintain constant-dollar consistency.[71]

IV. THE NUMEROSITY REQUIREMENT

In addition to the aforementioned requirements imposed on the individual creditors joining in an involuntary petition, the Code imposes a condition on them collectively as well.[72] Specifically, § 303(b)(1)–(2) requires that three qualified creditors join in the involuntary petition unless there are less than twelve total creditors.[73] Put another way, if the putative debtor has twelve or more qualified creditors, no single petitioning creditor can prosecute an involuntary petition without recruiting at least two other creditors to join.[74] In a contested petition, the bankruptcy court must make two calculations: first, determine how many qualified creditors are joining the petition, and second, determine how many qualified creditors exist.[75] Calculating the number of creditors joining in the petition is relatively straightforward.[76] A creditor qualifies to join in the petition if it meets the three requirements of § 303(b) discussed above: the holder of a claim, that is not contingent, and is sufficiently undersecured.[77] Any such creditor may join the involuntary petition at any time before dismissal "'with the same effect as if such joining creditor were a petitioning creditor' in the original petition."[78] Therefore, the determination of the number of qualified creditors joining in the petition can be determined by looking at the pleadings on the date of inquiry and conducting a limited factual analysis of whether the creditors who have joined in the petition have eligible claims under § 303(b).[79] On the other hand, calculating the number of creditors to determine if a single creditor can maintain a petition can present significant difficulty.[80]

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71. *See* 11 U.S.C. § 104 (2012). The term *constant dollars* is used to describe the variable buying power that a fixed amount of money has in different years due to inflation. *Constant dollars*, BLACK'S LAW DICTIONARY (9th ed. 2009).

72. 11 U.S.C. § 303(b)(1)–(2).

73. *Id.*

74. *See id.*

75. *See id.* § 303.

76. *Compare infra* text accompanying notes 78–79 (describing qualified creditor intervention), *with infra* Part V (describing the precedential difficulties of *Denham)*.

77. *See* 11 U.S.C. § 303(b).

78. Liberty Tool, & Mfg. v. Vortex Fishing Sys., Inc. (*In re* Vortex Fishing Sys., Inc.), 277 F.3d 1057, 1061 (9th Cir. 2002) (quoting 11 U.S.C. § 303(c) (2000)). In accordance with the Federal Rules of Civil Procedure, which have, for the most part, been incorporated into the bankruptcy rules, the bankruptcy court must allow any qualified creditor to intervene as "a matter of right." *In re* Kidwell, 158 B.R. 203, 210–13 (Bankr. E.D. Cal. 1993) (citing FED. R. CIV. P. 24(a)(1)).

79. *See In re Vortex Fishing Sys., Inc.*, 277 F.3d at 1061.

80. *See, e.g.*, *In re* CorrLine Int'l, 516 B.R. 106, 106 (Bankr. S.D. Tex. 2014).

Two basic methodologies exist for calculating the number of eligible creditors for purposes of numerosity.[81] The first is a strict application of the Code's language.[82] This method calculates the number of creditors for numerosity purposes by applying the "holder of a claim" criteria from § 303(b) to each creditor on the debtor's list of creditors.[83] Under the literal language of the statute, this is the end of the inquiry.[84] The second approach to calculating whether the debtor has twelve or more qualified creditors goes beyond the plain language of the statute to dismiss those claims that, for some reason, are insignificant.[85] Because this method is not specifically contained within the language of the Code, this Comment refers to it as the "judicial qualification approach."[86]

A. The Strict Approach to Numerosity

Courts using the strict approach go no further than the requirements of § 303(b) in determining whether a creditor is included for purposes of numerosity.[87] The reason courts applying the strict approach do not disqualify small or insignificant claims is not because that approach lacks a common sense rationale or sound policy justification.[88] Rather, they refuse to read into the statute any additional criteria that the plain text does not include.[89] At least one court has described this not as an issue of policy, but of authority.[90] In *In re Okamoto*, the Ninth Circuit held that "[s]ince Congress made no distinction between large and small claims, we cannot arrogate unto ourselves the power to do so and thereby engraft an additional exception to the [Bankruptcy Code]."[91] Other courts have stated that nothing in the statutory language provides evidence of congressional intent to exclude creditors beyond those whose claims the statute expressly rejects.[92] To courts applying the strict approach, it is not a matter of rightness, fairness, or sound

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81. *See* Jefferson Tr. & Sav. Bank of Peoria v. Rassi (*In re* Rassi), 701 F.2d 627, 630, 632 (7th Cir. 1983).

82. *See id.* at 630–31.

83. *Id.*

84. Sipple v. Atwood (*In re* Atwood), 124 B.R. 402, 406 (S.D. Ga. 1991).

85. *See* Denham v. Shellman Grain Elevator, Inc. (*In re* Denham), 444 F.2d 1376, 1379 (5th Cir. 1971).

86. *See infra* Part IV.B.

87. *See, e.g.*, *In re Rassi*, 701 F.2d at 632.

88. *See id.* at 631–32.

89. *See id.*

90. *See* Hornblower & Weeks-Hemphill, Noyes v. Okamoto (*In re* Okamoto), 491 F.2d 496, 498 (9th Cir. 1974).

91. *Id.*

92. *See, e.g.*, *In re Rassi*, 701 F.2d at 632 (holding that "in the absence of any indication that Congress intended this exclusion, we have no authority to engraft it onto those that Congress expressly provided"); *see also* Grigsby-Grunow Co. v. Hieb Radio Supply Co., 71 F.2d 113, 114 (8th Cir. 1934) ("However persuasive [the argument for excluding small, insignificant debts] may be, it is one which might more properly be addressed to the Congress than to the court.").

policy; it is a matter of being bound by the literal words used by Congress to define the scope of the remedy.[93]

One stark example of the problem with the strict approach comes from *In re Rassi*, decided in 1983 by the Seventh Circuit.[94] In *Rassi*, Jefferson Trust and Savings Bank of Peoria filed a petition for involuntary bankruptcy against Timothy and Virginia Rassi.[95] The bank alleged that the Rassis owed over $450,000.00.[96] The Rassis opposed the petition not by attacking the legitimacy of the claim held by the petitioning creditor, but by filing a list of more than twelve creditors, several of whom held insignificant debts.[97] The court acknowledged that "[i]t would make little sense for this petitioner to be blocked from relief because the Rassis owe $10.00 to a doctor and $9.93 for magazines."[98] Despite its clear appreciation for the inequity of allowing a small creditor to block relief for a large one, the Seventh Circuit adopted the strict approach, and held that the holders of small, recurring claims should count under § 303(b)(2).[99]

B. The Judicial Qualification Approach to Numerosity

The alternative method of calculating the number of creditors under § 303(b)(2) goes beyond the limitations enumerated in the statute and excludes the holders of claims that the court finds to be deficient in some other regard.[100] This method attempts to avoid the inequity of allowing insignificant claims to stand in the way of a large creditor.[101]

The Fifth Circuit adopted this judicial qualification approach in the 1971 case of *In re Denham*.[102] In *Denham*, a creditor holding a claim of $37,343.20 filed an involuntary petition against the debtor.[103] The debtor alleged in his answer that he had eighteen creditors.[104] This, he argued, entitled him to a dismissal of the involuntary petition because there were fewer than three petitioning creditors.[105] The creditor responded that most, if not all, of the other creditors should be excluded because they held only small, insignificant claims.[106] The bankruptcy court, district court, and Fifth Circuit agreed with

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93. *See, e.g.*, *In re Rassi*, 701 F.2d at 632.
94. *Id.*
95. *Id.* at 628.
96. *Id.* at 632.
97. *Id.* at 629.
98. *Id.* at 632.
99. *Id.*
100. *See* Denham v. Shellman Grain Elevator, Inc. (*In re* Denham), 444 F.2d 1376, 1378 (5th Cir. 1971).
101. *In re Rassi*, 701 F.3d at 632.
102. *In re Denham*, 444 F.2d at 1379.
103. *Id.*
104. *Id.* at 1378.
105. *Id.*
106. *Id.*

the petitioning creditor, noting that "[of] the eighteen (18) creditors listed in the answer of the alleged bankrupt, all but one were creditors holding small insignificant debts which consisted of consumer accounts that were customarily paid monthly by the alleged bankrupt."[107] The court also noted that only one of the eighteen creditors was owed more than $100.00.[108] The Fifth Circuit concluded that the presence of these small, insignificant debts should not allow a debtor to defeat an involuntary bankruptcy petition.[109]

Denham highlighted another justification for the judicial qualification doctrine: preventing those in financial trouble from taking on small debts to avoid involuntary bankruptcy.[110] In several of the district-level cases that preceded *Denham*, the courts held that the holders of small claims should not be included for numerosity purposes because the debtor had not taken on those obligations in good faith.[111] Rather, the trial courts concluded that the debtors in those cases took on the debt *for the purpose* of establishing a shield against involuntary bankruptcy.[112] The bankruptcy judge at the trial level in *Denham* found that Denham was engaged in a similar scheme.[113] Though it was not essential to the Fifth Circuit's holding, the presence of such a scheme clearly weighed against the debtor's position.[114]

In a jurisdiction that does not use the judicial qualification approach, bringing on additional small creditors that can easily be repaid effectively insulates the debtor from involuntary bankruptcy filed by a single creditor because those small creditors likely will not join in any bankruptcy proceedings, particularly not an involuntary petition.[115] The court in *In re Colorado Lime Co.* described the scheme:

> A debtor conveys all his property . . . and then he avoids involuntary bankruptcy by creating eleven or more creditors by purchasing small items and having them charged on a monthly account. By paying these monthly accounts promptly each month, . . . the debtor would always have a number of creditors ready to be used to defeat an involuntary bankruptcy petition. It is very unlikely that creditors of this kind . . . would wish to incur the risk of losing a good customer in order to join a bona fide creditor in instituting proceedings in bankruptcy.[116]

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107. *Id.*
108. *Id.*
109. *Id.* at 1379.
110. *Id.*
111. *See id.*
112. *Id.* at 1378–79.
113. *Id.* at 1378.
114. *Id.*
115. *See* Sec. Bank & Tr. Co. v. Tarlton, 294 F. 698, 702 (W.D. Tenn. 1923); *In re* Branche, 275 F. 555, 557 (N.D.N.Y. 1921); *In re* Blount, 142 F. 263, 266 (E.D. Ark. 1906).
116. Pete Lien & Sons, Inc. v. Colo. Lime Co. (*In re* Colo. Lime Co.), 298 F. Supp. 1053, 1055–56 (D. Colo. 1969).

Due to the strong potential for abuse of this phenomenon, on top of the court's refusal to accept that insignificant creditors should be able to frustrate a large creditor, the *Denham* court intervened with a fairly heavy hand.[117]

Application of the principles laid out in *Denham* raises several difficulties.[118] First, the court did not set a specific limitation on what dollar amount represents an insignificant claim.[119] Second, the opinion is ambiguous about how the terms *small*, *recurring*, and *insignificant* work together.[120] For example, *Denham*'s description of the excluded debts as being monthly payments supports the idea that the term *recurring* meant monthly.[121] But the literal definition of *recurring* is much more broad, and some courts have held that debts need not be monthly, or even within a fixed period, to be considered recurring.[122] Third, part of *Denham*'s rationale was the court's conviction that Congress did not intend to allow insignificant debts, "such as utility bills and the like," to frustrate the prosecution of an involuntary bankruptcy by a very large, unsecured creditor.[123] The lack of an express statement about what constitutes an insignificant claim and the relatively bare assertion of congressional intent indicates that *Denham*'s true purpose was to remove small creditors, not because they were small, but because the petitioning creditor was so large.[124] This analysis finds little foundation in the language of the Code but stands the test of reason.[125]

V. *DENHAM*'S TROUBLED LEGACY

Denham has three primary ambiguities that have manifested in subsequent case application.[126] Though the Fifth Circuit has addressed *Denham* at the circuit level in *In re Runyan*, the district courts and bankruptcy courts are the primary guides of the case law in this area.[127] The first point of confusion and disagreement is determining how small is small enough for

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117. *See In re Denham*, 444 F.2d at 1379.

118. *See infra* text accompanying notes 119–25.

119. *See In re Denham*, 444 F.2d at 1379.

120. *Id.* at 1378–79.

121. *See id.* at 1378.

122. *See In re* CorrLine Int'l, LLC, 516 B.R. 106, 154 (Bankr. S.D. Tex. 2014) ("Merriam–Webster's Dictionary defines 'recurring' as 'occurring or appearing at intervals.' This understanding of the term 'recurring' does not require monthly billings; . . . it only requires that the bills be periodic in nature.").

123. *In re Denham*, 444 F.2d at 1379.

124. *See id.* The assertion of congressional intent is bare because the *Denham* court did not point to any language in § 59(b) of the Bankruptcy Act—the predecessor to the Code—that indicated that small claims should be excluded. *Id.* Rather the court pointed to a portion of the Bankruptcy Act stating that the holders of small claims "shall not be counted in computing the number of creditors voting or present at creditors' meetings." *Id.* (quoting 11 U.S.C. § 56(c) (1971)). The *Denham* court did not adopt the terms of that provision as the standard, but rather found that the provision established congressional intent regarding small claims "by analogy." *Id.*

125. *See* 11 U.S.C. § 303 (2012).

126. *See infra* Part V.A–C.

127. *See* Blackmon v. Runyan (*In re* Runyan), 832 F.2d 58, 60 (5th Cir. 1987).

a court to label a claim insignificant.[128] The second significant disagreement is whether *Denham* intended to exclude all small claims or only those claims that were *both* small and recurring.[129] Lastly, even among courts that exclude only claims that are small and recurring, the definition of *recurring* provides another ambiguity.[130]

A. The Lack of a Firm Threshold Leaves Trial Courts Guessing

In re CorrLine International, LLC best illustrates the *Denham* court's failure to establish a firm threshold for what constitutes an insignificant claim.[131] In *CorrLine*, the debtor filed a list of creditors alleging that more than fifty creditors held claims against it.[132] Most of the alleged creditors provided normal business supplies and although evidence existed that the debtor had manipulated the creditor count in its favor, twenty-two out of fifty-two of the alleged creditors' claims, though relatively small, were valid.[133] The determining factor was not the propriety of the claims, but whether the size of the claims was sufficient under *Denham*.[134] The creditor in *CorrLine* proposed that the limit of a small, insignificant claim should be $500.00.[135]

This argument highlights the first shortfall of *Denham*: time has rendered the numerical figures in the case virtually meaningless.[136] The closest that the court came in *Denham* to establishing a hard number requirement was the statement that of the eighteen creditors, only one "exceeds $100.00 [and o]f the eighteen (18) creditors . . . all but one were creditors holding small insignificant debts."[137] Even if modern courts accept that *Denham* established $100.00 as the limit for small, insignificant debts, they are still tasked with updating that doctrine for today's economy.[138] Congress *must* update the Code every three years to reflect changes due to inflation.[139] As of this writing, *Denham* was decided over forty-four years ago.[140]

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128. *See infra* Part V.A.
129. *See infra* Part V.B.
130. *See infra* Part V.C.
131. *See In re* CorrLine Int'l, LLC, 516 B.R. 106, 152–53 (Bankr. S.D. Tex. 2014).
132. *Id.* at 119–20.
133. *See id.* at 152.
134. *Id.* at 152–53.
135. *Id.* at 153.
136. *See infra* text accompanying notes 137–40.
137. Denham v. Shellman Grain Elevator, Inc. (*In re* Denham), 444 F.2d 1376, 1378 (5th Cir. 1971).
138. *See, e.g.*, *In re* Moss, 249 B.R. 411, 419 (Bankr. N.D. Tex. 2000) (excluding only claims of up to $25.00 under *Denham* and rejecting *Smith*'s $275.00 figure); *In re* Smith, 123 B.R. 423, 425 (Bankr. M.D. Fla. 1990) (excluding claims of up to $275.00).
139. 11 U.S.C. § 104(a)(1) (2012) ("[A]t each 3-year interval[,] . . . each dollar amount in effect under [various sections] . . . *shall* be adjusted—(1) to reflect the change in the Consumer Price Index . . . ." (emphasis added)).
140. *In re Denham*, 444 F.2d at 1376.

Comparing *In re Smith*, a 1990 bankruptcy case from the Middle District of Florida, and *In re Moss*, a 2000 case from the Northern District of Texas, also highlights the uncertainty that has resulted for litigants.[141] Although Florida courts are no longer part of the Fifth Circuit, they are bound to apply *Denham* because it became law before the creation of the 11th Circuit.[142] While the decisions of the Florida courts may or may not have an impact on current Fifth Circuit bankruptcy courts, the fact that they are operating from the same precedent makes their interpretation relevant to *Denham*'s workability as a doctrine.[143]

The Florida court applied *Denham* broadly and excluded from the creditor count claims of up to $275.00.[144] The court held, "It is a well-established proposition that insignificant debts which are customarily paid on a regular basis should not be counted to defeat an involuntary petition."[145] The opinion lacks a precise recitation of the excluded items.[146] Rather, the court merely noted that fourteen of the alleged creditors held

> claims that represent regular recurring monthly expenses connected with the operation of the Debtor's business, such as bills for maintenance, utilities, and the like. These bills range in amount from $20–$275 and are expenses for goods and services which were received by the Debtor on a regular basis prior to and after the filing of the involuntary Petition.[147]

The court labeled each of these creditors' claims *de minimis* under *Denham* and excluded them.[148] This approach necessarily assumes that claims up to $275.00 are *de minimis* so long as they result from the sort of recurring bills that are necessary for operating a business and are customarily paid on demand.[149]

The *Smith* court never addressed why it felt free to extend *Denham*'s exclusion principle to claims of up to $275.00, whereas *Denham* had only excluded claims up to $100.00.[150] Presumably, the court considered *Denham*'s characterization of the nature of the excluded debts as more important than simply the amount.[151] Perhaps, as the creditor argued in

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141. *Compare In re Smith*, 123 B.R. at 425 (excluding claims of up to $275 as insignificant), *with In re Moss*, 249 B.R. at 419 (rejecting *Smith* and applying *Denham* narrowly).

142. *In re Smith*, 123 B.R. at 425 (citing Bonner v. City of Prichard, 661 F.2d 1206 (11th Cir. 1981)).

143. *See id.*

144. *See id.*

145. *Id.*

146. *See id.*

147. *Id.*

148. *Id.*

149. *Id.*

150. *See id.* at 423.

151. *Id.* at 425 (noting that in *Denham* the court excluded small, insignificant debts, but failing to mention *Denham*'s discussion of the precise dollar figures).

CorrLine, the court felt that it could exclude an increased claim size because of the intervening time and corresponding inflation.[152]

In any case, some courts have disagreed sharply with the *Smith* court's exclusion of claims larger than $100.00.[153] In 2000, some ten years after *Smith*, the Northern District of Texas decided *In re Moss*.[154] In *Moss*, the court reluctantly agreed that *Denham* is the controlling law in the Fifth Circuit, but adamantly rejected the *Smith* court's extension of *Denham* to exclude claims of up to $275.00.[155] The largest claim excluded in *Moss* was only $58.00.[156]

The only other guidance from the Fifth Circuit for bankruptcy courts regarding how far the insignificance exclusion can go is *In re Runyan*.[157] In that case, the Fifth Circuit determined that *Denham* could not operate to exclude claims between $600.00 and $800.00.[158] The Fifth Circuit held that those claims were much too large to be excluded under *Denham* and noted that creditors who had claims excluded from consideration would hold claims of less than $25.00.[159] But *Runyan* was decided in 1987, several years before the *Smith* court excluded claims up to $275.00, and nearly fifteen years before the *Moss* court refused to exclude claims over $58.00.[160] Therefore, *Runyan* provides little help today, not only because of the varying applications by bankruptcy courts, but also because *Runyan* itself was decided nearly thirty years ago—so the question remains open as to how the same court would have treated $600.00 to $800.00 claims in today's dollars.[161]

In any event, the normal pattern of increasing dollar amount thresholds according to inflation is not occurring in any predictable way.[162] This could be due to general hostility on the part of some bankruptcy courts to use the *Denham* rationale, or it could be due to genuine disagreement about the proper interpretation of *Denham*.[163] Either way, practitioners—and bankruptcy judges for that matter—stand on unstable ground when asserting that a particular debt should be excluded under *Denham*.[164]

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152. *See In re* CorrLine Int'l, LLC, 516 B.R. 106, 153 (Bankr. S.D. Tex. 2014).

153. *See, e.g.*, *In re* Moss, 249 B.R. 411, 419 (Bankr. N.D. Tex. 2000).

154. *Id.* at 411.

155. *Id.* at 419.

156. *See id*.

157. *See generally* Blackmon v. Runyan (*In re* Runyan), 832 F.2d 58, 59–60 (5th Cir. 1987) (holding that *Denham* does not exclude creditors with larger claims).

158. *Id.* at 60.

159. *Id.*

160. *Compare id.* at 58 (decided in 1987), *with In re* Smith, 123 B.R. 423, 423 (Bankr. M.D. Fla. 1990) (decided in 1990), *and In re Moss*, 249 B.R. at 411 (decided in 2000).

161. *In re Runyan*, 832 F.2d at 58.

162. *See supra* Part III.C.

163. *Compare In re Moss*, 249 B.R. at 419 ("Until overruled, this Court is bound to follow *Denham* . . . ."), *with In re* CorrLine Int'l, LLC, 516 B.R. 106, 153 (Bankr. S.D. Tex. 2014) ("This Court finds that [the petitioning creditor's] 'inflation' argument has merit; however, this Court believes that $500.00 is too high.").

164. *See supra* Part I.

B. Another Ambiguity: Are Small, Non-recurring Claims Excludable Under Denham?

Another area of division among courts is whether, in addition to being *de minimis*, claims must also be recurring to be excluded under *Denham*.[165] In *In re Atwood*, the court unequivocally held that *Denham* would not serve to exclude a claim merely because it is small because "even small claims may be counted unless they are also recurring."[166] The *CorrLine* court held the exact opposite.[167] According to *CorrLine*, a *de minimis* claim—such as a small, one-time fee—should be excluded under *Denham* without imposing the additional requirement that the claim be recurring in nature.[168]

The *CorrLine* court analyzed the list of alleged claimholders under both approaches "to ensure a different result in this case would not occur if th[e] Court's original understanding of *Denham* as barring only *de minimis* claims is incorrect."[169] This approach may have prevented an appeal, but the outright acknowledgment that there are multiple, plausible interpretations of *Denham* did not synthesize previous cases or advance the law toward a more concrete position.[170] Rather, *CorrLine*'s approach is an express acknowledgment of the ambiguous state of the law in this regard.[171]

C. Conditional Ambiguity: If Denham *Only Excludes Claims That Are Small and Recurring, What Is the Definition of Recurring?*

Another less-than-clear aspect of *Denham* is what constitutes a recurring debt.[172] If a court accepts that *Denham* only serves to exclude debts that are small and recurring, as opposed to just *de minimis*, the court must then define the term *recurring*.[173] This definition is less than clear.[174] The *Denham* court cited previous case law that "reject[ed] the contention that small current debts, contracted to be paid *monthly* and on demand, such as claims for rent, groceries, drugs, etc.," should be allowed to contribute to the creditor count

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165. *Compare* Sipple v. Atwood (*In re* Atwood), 124 B.R. 402, 406 (S.D. Ga. 1991) (reading *Denham* as excluding only amounts both small and recurring), *with In re CorrLine Int'l*, 516 B.R. at 154 (reading *Denham* as excluding *de minimis* claims).

166. *In re Atwood*, 124 B.R. at 406.

167. *In re CorrLine Int'l*, 516 B.R. at 154–55.

168. *Id.*

169. *Id.* at 154.

170. *See id.*

171. *See id.*

172. *See* Denham v. Shellman Grain Elevator, Inc. (*In re* Denham), 444 F.2d 1376, 1379 (5th Cir. 1971).

173. *See In re CorrLine Int'l*, 516 B.R. at 154–55. Although the Bankruptcy Court for the Southern District of Texas believed that *Denham* excludes all *de minimis* claims, it acknowledged the divergence of interpretation and also analyzed the alleged claimholders under a small *and* recurring test. *Id.*

174. *Id.*

and defeat an involuntary petition.[175] The court went on to say that "it was not the intent of Congress to allow recurring bills . . . to create a situation . . . [that] can defeat [an involuntary petition] by a large creditor . . . ."[176] Some subsequent opinions highlight the monthly nature of the bills as an important aspect of the *Denham* exclusion.[177]

The *CorrLine* court analyzed this aspect of *Denham* and addressed the interpretations of prior bankruptcy decisions.[178] In *CorrLine*, the alleged debtor claimed to have several creditors whom it paid regularly, but not necessarily on a monthly basis.[179] Citing Merriam–Webster's Dictionary, the court pointed out that *recurring* does not necessarily mean monthly; in fact, it does not even require a consistent pattern.[180] Rather, *recurring* is defined as "periodic" and "occurring or appearing at intervals."[181] Acknowledging that previous courts may have understood *Denham* to exclude only monthly bills, the Bankruptcy Court for the Southern District of Texas held that even if a claim must be recurring to be considered insignificant, it need not be billed monthly so long as the claim is "recurring over time."[182]

The *CorrLine* understanding is probably more consistent with *Denham* than those opinions that require a claim be billed monthly to be excluded.[183] While the *Denham* court mentioned that the excluded debts were billed on a monthly basis, it also explained the rationale behind excluding these periodic payments.[184] Creditors who provide periodic goods or services have a simple remedy for non-payment; they can cancel the service.[185] Because this remedy is effective for small claimholders, they have no need to pursue bankruptcy proceedings and are unlikely to undertake the time and expense to participate in bankruptcy proceedings.[186] Allowing claimholders who are unlikely to join in an involuntary petition to block the prosecution of that petition through their absence is the result that *Denham* sought to avoid.[187] The *CorrLine* analysis is consistent with that purpose because it focuses on the ability of the claimholder to seek an alternate remedy.[188] Bimonthly,

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175. *In re Denham*, 444 F.2d at 1378–79 (emphasis added).
176. *Id.* at 1379.
177. *See, e.g.*, *In re CorrLine Int'l*, 516 B.R. at 106.
178. *Id.* at 154–55.
179. *See id.*
180. *Id.*
181. *Id.* at 154.
182. *Id.* Examples of the non-monthly claims excluded in *CorrLine* were those held by Iberia Parish and the State of Louisiana. *Id.* The alleged debtor owed sales tax to these entities whenever it conducted business in the territory. *Id.* Due to the nature of the alleged debtor's business, those sales occurred at irregular intervals. *Id.* But the claims held by these debtors would "recur[] over time" so long as the alleged debtor operated the business. *Id.* at 153–54.
183. *See id.*
184. Denham v. Shellman Grain Elevator, Inc. (*In re* Denham), 444 F.2d 1376, 1379 (5th Cir. 1971).
185. *See id.*
186. *See id.*
187. *Id.*
188. *See In re CorrLine Int'l*, 516 B.R. at 153–55.

semiannual, and periodic claimholders who provide necessary business services to an alleged debtor may avail themselves of a break in service just as effectively as a monthly claimholder.[189]

Whether the *CorrLine* court was correct in applying *Denham*'s substance over its form, the decision has left both alleged debtors and bankruptcy practitioners confused about which alleged claimholders will be excluded under *Denham*.[190] Significant authority exists for the proposition that a claim may only be excluded under *Denham* if it contracted to be paid monthly, a proposition that was soundly rejected in *CorrLine*.[191] How should a potential involuntary debtor view its position with regard to creditors paid regularly but not monthly?[192] How confident can debtors be that they are safe from involuntary bankruptcy brought by one creditor?[193] To whatever extent its list of creditors contains small bills payable on something other than a monthly basis, any putative debtor today cannot accurately predict its fortune if an involuntary bankruptcy petition is filed against it.[194]

VI. ANALYSIS: WHERE DOES *DENHAM* STAND TODAY?

A. Is Denham *Even Good Law?*

One question looming over virtually every application of *Denham* is whether the case is still good law.[195] Because *Denham* was decided under a previous bankruptcy statute, the Bankruptcy Act of 1898, it is unclear whether it is a valid doctrine under the modern Code.[196] The Fifth Circuit acknowledged this issue in *Runyan*, but did not resolve it.[197] *Runyan* presented the question of whether claims between $600 and $800 could be excluded under *Denham*.[198] Because the specific dollar figures involved were much larger than the claims excluded in *Denham*, the Fifth Circuit did not need to reach the question of whether *Denham* was still good law.[199] Rather, the court "[a]ssum[ed] without deciding that *Denham* remain[ed] viable after the enactment of the Bankruptcy Code," and concluded that the claims in question could not be excluded.[200] While *Runyan* gives some

189. *See In re Denham*, 444 F.2d at 1379.

190. *See In re CorrLine Int'l*, 516 B.R. at 152–55.

191. *See, e.g.*, Sipple v. Atwood (*In re* Atwood), 124 B.R. 402, 406 (S.D. Ga. 1991) (excluding "small, recurring debts, such as a monthly utility bill or rental payment").

192. *See generally supra* Part I (illustrating the lack of clarity in involuntary bankruptcy proceedings).

193. *See generally supra* Part I (highlighting the difficulty a potential involuntary debtor has in predicting the outcome of an involuntary bankruptcy proceeding).

194. *See supra* Part V.A–B.

195. *See infra* text accompanying notes 196–201.

196. Blackmon v. Runyan (*In re* Runyan), 832 F.2d 58, 60 (5th Cir. 1987).

197. *See id.*

198. *Id.*

199. *Id.*

200. *Id.*

limited insight into *Denham*'s analysis, it does not establish *Denham*'s validity in a post-Act world.[201]

1. Wrong from the Outset?

Moving forward, the Fifth Circuit must confront the possibility that *Denham* was wrongly decided from the outset.[202] This critique stems from the fact that, under one interpretation, even the portions of the Bankruptcy Act which were retained after the enactment of the Code did not support *Denham*'s conclusion.[203] In *In re Rassi,* the court stated that *Denham*'s observation that small creditors are unlikely to join in an involuntary petition was correct, and even agreed that some debtors could use this reluctance as part of a plan to insulate themselves from involuntary petitions.[204] However, the court explained that the policy support for *Denham*, compelling though it may be, does not justify the departure from Congress's express provision:

> [R]egardless of how wise and salutary exclusion of small, recurring claims might be, Congress has not specifically authorized exclusion, and in the absence of any indication that Congress intended this exclusion, we have no authority to engraft it onto those that Congress expressly provided.[205]

An even more plain critique comes from the Ninth Circuit, which said, "We are not persuaded by *Denham*, for it appears to us that the *Denham* court ignored unambiguous Congressional direction."[206]

The Fifth Circuit regularly applies a plain meaning approach to interpreting the Code.[207] It has stated that "[t]he most certain expression of legislative intent in nearly every instance is the words of the subject statute [and w]e may not look beyond them when, taken as a whole, they are rational and unambiguous."[208] If given the opportunity to reconsider *Denham*, it seems likely that the Fifth Circuit, known as a court that strictly adheres to the plain meaning doctrine, would be sensitive to the critique that *Denham* represents judicial invention, unjustified by the plain language of the statute.[209]

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201. *See id.*

202. *See, e.g.*, Jefferson Tr. & Sav. Bank of Peoria v. Rassi (*In re* Rassi), 701 F.2d 627, 632 (7th Cir. 1983); Hornblower & Weeks-Hemphill, Noyes v. Okamoto (*In re* Okamoto), 491 F.2d 496, 497–98 (9th Cir. 1974) (criticizing *Denham* harshly for ignoring the plain language of the Bankruptcy Act and inventing congressional intent when there was none).

203. *See In re Rassi*, 701 F.2d at 632.

204. *Id.*

205. *Id.*

206. *In re Okamoto*, 491 F.2d at 498.

207. *See* Hammers v. IRS (*In re* Hammers), 988 F.2d 32, 34 (5th Cir. 1993).

208. *Id.*

209. *See id.*

2. Overruled by the Bankruptcy Code?

A second, less harsh critique of *Denham* is that while it may have been correctly decided when issued, the Code has effectively overruled it.[210] Prior to the enactment of the Code, holders of claims under fifty dollars were not allowed to participate in creditors' meetings.[211] Multiple courts have assumed that the *Denham* court inferred a congressional intent to exclude small claims from consideration in the involuntary bankruptcy context on the basis that those claimholders would not be able to participate in the creditors' meetings.[212] Neither the Code nor the modern Federal Rules of Bankruptcy Procedure have a similar restriction on which creditors may participate in the creditors' meetings.[213] Therefore, to whatever extent *Denham* found its authority to exclude small creditors from the pre-Code mechanics of the creditors' meetings, the Code and the Bankruptcy Rules have overruled *Denham* by rendering that concern moot.[214]

Another argument exists that the Code overruled *Denham*, not by changing the language governing insignificant claims and creditors' meetings, but by simply not including a provision to *Denham*'s effect in the modern Bankruptcy Code or in any of its revisions.[215] Irrespective of *Denham*'s validity under the Bankruptcy Act, is a lack of codification in the modern Code enough to warrant a presumption against *Denham*?[216]

Because Congress presumably acts intentionally when drafting and revising statutory language, courts must also presume that Congress acts with an awareness of "well-established" judicial interpretations.[217] While courts vary in their enthusiasm for this canon of construction, some have taken the position that "[w]here Congress knows how to say something but chooses not to, its silence is controlling."[218] Congress drafted the Code less than ten years

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210. *See In re* Elsa Designs, Ltd., 155 B.R. 859, 864–65 (Bankr. S.D.N.Y. 1993).

211. *See id.* (noting that "§ 56c of the [Bankruptcy] Act . . . provided that '[c]laims of $50 or less shall not be counted in computing the number of creditors voting or present at creditors' meetings, but shall be counted in computing amount'" (quoting 11 U.S.C. § 92 (repealed))).

212. *See id.*; *see also In re* Hoover, 32 B.R. 842, 847 (Bankr. W.D. Okla. 1983).

213. *In re Elsa Designs, Ltd.*, 155 B.R. at 865 ("Section 56c, however, has no counterpart under the Code and Rule 2007 of the Federal Rules of Bankruptcy Procedure has deleted the provision in its forerunner, Bankruptcy Rule 207, which prohibited a holder of a claim less than $100 from voting at a creditors' meeting.").

214. *See id.*

215. *See infra* text accompanying notes 217–21.

216. *See infra* text accompanying notes 217–21.

217. *See, e.g.*, Lorillard, Div. of Loew's Theatres, Inc. v. Pons, 434 U.S. 575, 580 (1978) ("Congress is presumed to be aware of an administrative or judicial interpretation of a statute and to adopt that interpretation when it re-enacts a statute without change."), *abrogated by* Griffith v. United States (*In re* Griffith), 206 F.3d 1398 (11th Cir. 2000).

218. Haas v. IRS (*In re* Haas), 48 F.3d 1153, 1156 (11th Cir. 1995) ("'[I]t is generally presumed that Congress acts intentionally and purposely when it includes particular language in one section of a statute but omits it in another,' and that presumption is even stronger when the omission entails the replacement of standard legal terminology with a neologism." (quoting BFP v. Resolution Tr. Corp., 511 U.S. 531 (1994))), *abrogated by In re Griffith*, 206 F.3d 1389. *But see* Griffith v. United States (*In re* Griffith), 174

after *Denham*.[219] Irrespective of whether *Denham*'s basis was the now-nonexistent restriction on participation in creditors' meetings or a public policy stance found in the substance of the rule, Congress had the opportunity to embrace *Denham*'s policy as part of the Code but did not.[220] If one is to presume that Congress was aware of circuit-level decisions when drafting the Code, the absence of any provisions mandating or even allowing *Denham*'s exclusion of insignificant claims raises a strong presumption that the Code did, in fact, overrule *Denham*.[221]

B. Without Denham*, Does Bankruptcy Code § 303 Produce an Absurd Result?*

Concluding that *Denham*'s practice of excluding insignificant claims is nowhere to be found in the text of the Code does not completely close the door on *Denham*'s validity.[222] One of the oldest precepts of American jurisprudence is that "judges may deviate from even the clearest statutory text" when a literal application would produce "absurd" results.[223] A statute that proclaims "a prisoner who breaks prison shall be guilty of felony" can hardly be considered ambiguous.[224] But the judiciary will not extend the consequence to a prisoner who breaks free from a burning jailhouse to avoid being burned alive.[225] This is not to say that courts should freely substitute their judgment for the plain instruction of the statutory language whenever the legislatively mandated outcome is a poor one.[226] The Supreme Court has often expressed its clear preference for giving effect to the plain words of a statute whenever possible.[227] Doing otherwise would run counter to our constitutional structure, which places the Judiciary in a subordinate lawmaking capacity to the Legislature.[228] But the apparent intent of the

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F.3d 1222, 1227 (11th Cir. 1999) ("We suggest that this presumption [that Congress was aware of existing interpretations] is relatively weak, however, when the background law is the entire [Internal Revenue Code] . . . ."), *vacated*, *In re Griffith*, 206 F.3d 1389.

219. *Compare* Denham v. Shellman Grain Elevator, Inc. (*In re* Denham), 444 F.2d 1376 (5th Cir. 1971) (decided in 1971), *with* 11 U.S.C. § 101 (2012) (becoming effective in 1978).

220. 11 U.S.C. § 101.

221. *See In re Haas*, 48 F.3d at 1156 (citing *BFP*, 511 U.S. 531).

222. *See infra* text accompanying notes 223–37.

223. John F. Manning, *The Absurdity Doctrine*, 116 HARV. L. REV. 2387, 2388 (2003).

224. *Id.* (citing United States v. Kirby, 74 U.S. 482, 487 (1868)).

225. *Id.*

226. *See* United States v. Hartwell, 73 U.S. 385, 396 (1867) ("If the language be clear it is conclusive. There can be no construction where there is nothing to construe.").

227. *See, e.g.*, Hubbard v. United States, 514 U.S. 695, 703 (1995) ("[A]bsent any 'indication that doing so would frustrate Congress's clear intention or yield patent absurdity, our obligation is to apply the statute as Congress wrote it.'" (quoting BFP v. Resolution Tr. Corp., 511 U.S. 531, 570 (1994) (Souter, J., dissenting))).

228. Manning, *supra* note 223, at 2394 n.19 ("In our system of government the framers of statutes . . . are the superiors of the judges. The framers communicate orders to the judges through legislative texts . . . . If the orders are clear, the judges must obey them." (quoting Richard A. Posner, *Legal Formalism, Legal*

Legislature also plays some role in statutory interpretation.[229] An exhaustive discussion of the absurdity doctrine is well beyond the scope of this Comment, but suffice it to say that, in narrow circumstances, even the most textualist courts will not apply the strict language of a statute, however clear on its face, if the result is too outrageous.[230] In other words, if a particular result is too strange or runs too counter to the overall purpose of the statute and common notions of justice, it is better to infer that the Legislature did not intend the absurd result.[231]

Some form of the absurdity doctrine, though not expressed in such terms by the *Denham* court, may very well underpin *Denham*'s exclusion of insignificant claims.[232] *Denham*'s key passage states that allowing "recurring bills such as utility bills and the like to . . . defeat the use of the Bankruptcy Act by a large creditor . . . . would be grossly inequitable, and for this reason this Court refuses to [interpret the Bankruptcy Act as such]."[233] This logic closely tracks the classic absurdity case *United States v. Brown*, in which the Supreme Court said that "[n]o rule of construction necessitates our acceptance of an interpretation resulting in patently absurd consequences."[234] If *Denham*'s exclusion of insignificant claims has no basis in the text of the Code, as many critics have suggested, the lesson may be that the Code simply contains a fundamental flaw and Congress, not the Fifth Circuit, should amend the statute.[235] Recall, for example, *In re Rassi*, in which the Seventh Circuit held that *Denham* was not a proper application of the Code.[236] The Seventh Circuit instructed the bankruptcy court to include a magazine subscription in the creditor list that would potentially prevent the involuntary bankruptcy when hundreds of thousands of dollars were at stake.[237] Frankly, that result sounds absurd.

For proponents of *Denham*, the absurdity doctrine is ultimately a half measure—even if it justifies *Denham*'s result in the abstract.[238] Because the Fifth Circuit has traditionally taken a very narrow view of what constitutes

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Realism, and the Interpretation of Statutes and the Constitution, 37 CASE W. RES. L. REV. 179, 189 (1986))).

229. *See id.* at 2389. Though the absurdity doctrine may be said to work against the Legislature's lawmaking function, it can also signify considerable respect on the part of the judiciary: "When used in a proper manner, this narrow exception to our normal rule of statutory construction does not intrude upon the lawmaking powers of Congress, but rather demonstrates a respect for the coequal Legislative Branch, which we assume would not act in an absurd way." Pub. Citizen v. U.S. Dep't of Justice, 491 U.S. 440, 470 (1989) (Kennedy, J., concurring).

230. *See* Manning, *supra* note 223, at 2389.

231. *See id.* at 2389–90.

232. *See* Denham v. Shellman Grain Elevator, Inc. (*In re* Denham), 444 F.2d 1376, 1379 (5th Cir. 1971).

233. *Id.*

234. United States v. Brown, 333 U.S. 18, 27 (1948).

235. *See* Jefferson Tr. & Sav. Bank of Peoria v. Rassi (*In re* Rassi), 701 F.2d 627, 632 (7th Cir. 1983).

236. *See id.*

237. *Id.*

238. *See infra* text accompanying notes 241–55.

an absurd result, *Denham* exists on suspicious support as long as absurdity is the justification.[239] Also, while the absurdity doctrine may support *Denham*'s logic, its standard is no more certain.[240]

The Fifth Circuit is not eager to employ the absurdity doctrine when confronted with strange results seemingly mandated by the plain meaning of a statute.[241] The language this court employs when using the doctrine is frequently begrudging or serves merely as an alternative justification for an otherwise valid interpretation.[242] Given the strong preference for strict statutory interpretation in the Fifth Circuit and for particularly strict construction of the Code by the Supreme Court, no proponents of *Denham* should feel confident that the doctrine will be long maintained on the basis of absurdity.[243] This reality highlights the need for a congressional response to the one-petitioner problem.[244] Because, in this Author's opinion, the result mandated by a plain reading of § 303 of the Code rises to the level of absurdity, this Comment recommends maintaining *Denham* on absurdity grounds if necessary.[245] But this is not to say that creditors relying on *Denham* should feel comfortable with the absurdity doctrine as a permanent basis for extending *Denham*.[246]

Proponents of *Denham* should also hesitate to embrace the absurdity doctrine as a basis for retaining *Denham* lest they persuade the Fifth Circuit and win a pyrrhic victory.[247] After all, many of the problems with *Denham*'s current status, as discussed previously, are rooted in uncertainty.[248] Creditors cannot currently say with confidence whether other claims will block their petition even if the number and amount of those other creditors and claims are known.[249] If the absurdity doctrine is used as the rationale for *Denham*'s exclusions going forward, the court may simply compound the ambiguity of

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239. *See* Waggoner v. Gonzales, 488 F.3d 632, 638 (5th Cir. 2007).

240. *See infra* text accompanying notes 241–55.

241. *See generally Waggoner*, 488 F.3d at 638 (recognizing that strict adherence to the plain meaning of statutes, at times, results in unfair and improper rulings). Because absurdity is, by its nature, a case-by-case approach, precise lines around the Fifth Circuit's definition of absurdity cannot be drawn. *Id.* That said, *Rassi*, for example, reflects an aversion to the use of the absurdity doctrine as a basis for setting aside a plain language interpretation. But the relative paucity of cases in which the Fifth Circuit's holding turned on the absurdity doctrine could merely reflect an unwillingness by parties to advance the theory. A thorough empirical study of the frequency with which the Fifth Circuit embraces an assertion of the absurdity doctrine is beyond the scope of this Comment because it is unnecessary to reach the general conclusion that the Fifth Circuit is unlikely to maintain *Denham* long-term on the basis of the absurdity doctrine.

242. *See, e.g.*, Atchison v. Collins, 288 F.3d 177, 181 (5th Cir. 2002) ("Moreover, this interpretation is consistent with the common mandate of statutory construction to avoid absurd results.").

243. *See* Peter H. Carroll, III, *Literalism: The United States Supreme Court's Methodology for Statutory Construction in Bankruptcy Cases*, 25 ST. MARY'S L.J. 143, 144 (1993).

244. *See infra* Part VII.A.

245. *See infra* Part VII.B.

246. *See* Carroll, III, *supra* note 243.

247. *See infra* text accompanying notes 248–55.

248. *See supra* Part V.

249. *See, e.g.*, *In re* CorrLine Int'l, LLC, 516 B.R. 106, 151–55 (Bankr. S.D. Tex. 2014).

muddled precedent by adding an additional case-by-case absurdity analysis.[250]

Imagine that the Fifth Circuit issued an opinion that validated *Denham* exclusions on the basis of the absurdity doctrine.[251] Practitioners and creditors would continue to wonder what exactly *Denham*'s exclusionary principle stands for, but would also be burdened with the case-by-case uncertainty of whether the inclusion of insignificant claims produced an absurd result *in that instance*.[252] Also, a ruling that excludes insignificant claims when their inclusion would produce an absurd result continues to beg the question: How should *insignificant* be defined?[253] For sure, a circuit court's affirmation of *Denham* on *any* grounds could eliminate the anxiety that the circuit will overrule *Denham* at the next opportunity.[254] But the larger, more central, more insidious problems with the current state of the law would remain, and an additional layer of unpredictability would complicate matters further.[255]

VII. RECOMMENDATIONS: WHAT TO DO WITH *DENHAM*

The current state of affairs is far from certain.[256] Debtors, creditors, lawmakers, and judges must all confront the existing uncertainty in their own way.[257] The most important solution to the one-petitioner problem must come from Congress through a revision of the Code that unifies the circuits, ends the uncertainty, and addresses the substance of the inequity that a plain language application of today's Code mandates.[258] But until then, the Fifth Circuit must navigate a fork in the road the next time a *Denham*-based decision reaches its court.[259] Similarly, debtors and creditors must address matters as they arise, and do not have the luxury of waiting for a clearer legal landscape.[260] Fortunately, for as many questions that remain surrounding the treatment of insignificant claims, there are some reliable lessons to be learned from the existing case law and some working assumptions that, though subject to change, warrant action by debtors and creditors.[261]

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250. *See supra* Part V.
251. *See infra* Part VII.B.
252. *See infra* Part VII.B.
253. *See infra* Part VII.B.
254. *See supra* Part VI.A.
255. *See supra* Part V.
256. *See supra* Parts V–VI.
257. *See infra* Part VII.A–C.
258. *See infra* Part VII.A.
259. *See infra* Part VII.B.
260. *See infra* Part VII.C.
261. *See infra* Part VII.C.

A. Congress Should Act on Denham*'s Strong Public Policy*

Regardless of whether the Fifth Circuit continues to apply some version of *Denham* to prevent insignificant claims from blocking an involuntary petition filed by one large creditor, Congress should revise the Code and resolve the uncertainty.[262] As it stands, creditors receive different treatment depending on where the petition is filed.[263] While some variation between jurisdictions is inevitable, a split like this one frustrates the purpose of a unified federal bankruptcy law and invites unsavory forum shopping, rather than analysis of the merits, to enter into the litigation calculus.[264] Further, Congress should not abstain on this matter and leave it to the courts because the problems *Denham* was engineered to solve are better resolved by statute.[265] Lastly, in addressing the substance of the single creditor problem, Congress should embrace the heart of *Denham*'s policy and prevent debtors from shielding themselves from involuntary bankruptcy through their other insignificant debts.[266]

1. Congressional Action Would Unite the Circuits

While many courts have criticized *Denham* and refused to adopt it, those critiques routinely focus on *Denham*'s interpretation of the Code, not on the underlying public policy.[267] In fact, several of the outright rejections of *Denham* expressed a preference for the policy behind *Denham*.[268] Therefore, it stands to reason that if Congress were to bring the Code into accord with this public policy, bankruptcy courts would not hesitate to embrace the new position.[269]

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262. *See infra* Part VII.A.1–3.

263. *See* Hornblower & Weeks-Hemphill, Noyes v. Okamoto (*In re* Okamoto), 491 F.2d 496, 497–98 (9th Cir. 1974); Denham v. Shellman Grain Elevator, Inc. (*In re* Denham), 444 F.2d 1376, 1378–79 (5th Cir. 1971); Theis v. Luther, 151 F.2d 397, 398 (8th Cir. 1945); Grigsby-Grunow Co. v. Hieb Radio Supply Co., 71 F.2d 113, 114–15 (8th Cir. 1934); Pete Lien & Sons, Inc. v. Colo. Lime Co. (*In re* Colo. Lime Co.), 298 F. Supp. 1053, 1055–56 (D. Colo. 1969); *In re* Kirk, 198 F. Supp. 771, 771 (W.D. Pa. 1961); *In re* Murray, 14 F. Supp. 146, 147 (W.D.N.Y. 1936); *In re* Hall, 27 F.2d 999, 1000 (W.D. Pa. 1928); *In re* Alden, 2 F.2d 61, 62 (D. Mass. 1924); *In re* Brown, 111 F. 979, 980 (C.C.E.D. Mo. 1901).

264. *See infra* Part VII.A.1.

265. *See infra* Part VII.A.2.

266. *See infra* Part VII.A.2.

267. *See, e.g.*, Jefferson Tr. & Sav. Bank of Peoria v. Rassi (*In re* Rassi), 701 F.2d 627, 631–32 (7th Cir. 1983).

268. *Id.*

269. *Id.* ("[R]egardless of how wise and *salutary* exclusion of small, recurring claims might be, Congress has not specifically authorized exclusion . . . ." (emphasis added)).

2. A Statutory Response Would Better Address Denham*'s Problems*

Because interpreting *Denham* has proven difficult, Congress should incorporate *Denham*'s policy into the Code rather than rely on a judicial fix.[270] The *Denham* court outlined a precedent partly by describing the specific claims it saw fit to exclude in that circumstance.[271] This is part of the inherent limitation on judge-made law; it always acts on a particular controversy and does not lay out positions in a vacuum.[272] But an addition to the Code language could craft a universal definition without the need to address specific claims.[273] A change to the Code could be accomplished through congressional hearings, testimony, negotiation, and public comment by interested parties.[274] This process separates the wheat from the chaff, so to speak, and allows Congress to determine which of the problems discussed *supra* are top priorities and which are simply fringe annoyances. A congressional change could improve the state of the law very quickly, whereas continual tinkering through court opinions could take many more years to find a reasonable resolution.

3. Proposed Changes to the Code

Congress could update Bankruptcy Code § 303 to reflect *Denham*'s original approach by establishing a minimum threshold below which the bankruptcy court should disregard the claim.[275] This is a small step in the right direction.[276] Two other approaches exist, however, that might produce better results.[277]

The first option is simply to codify a notion similar to the absurdity doctrine.[278] Congress could supplement § 303 of the Code by expressly granting bankruptcy judges the power to exclude from the creditor count claims that they deem to be insignificant.[279] This would encapsulate the public policy behind *Denham*, albeit in a case-by-case way.[280] In this

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270. *See supra* Part V.

271. *See* Denham v. Shellman Grain Elevator, Inc. (*In re* Denham), 444 F.2d 1376, 1378–79 (5th Cir. 1971).

272. *See* ERWIN CHEMERINSKY, CONSTITUTIONAL LAW: PRINCIPLES AND POLICIES § 2.4, at 52 (4th ed. 2011) ("[T]he prohibition against advisory opinions helps ensure that cases will be presented to the Court in terms of specific disputes, not as hypothetical legal questions.").

273. *See infra* Part VII.A.3.

274. *See About Congressional Hearings*, GPO http://www.gpo.gov/help/index.html#about_fdsys2.htm (last visited Oct. 20, 2015).

275. *See supra* Part VI.B.

276. *See supra* Part VI.B.

277. *See infra* text accompanying notes 278–91.

278. *See infra* text accompanying notes 279–84.

279. *See infra* text accompanying note 281.

280. *See* Denham v. Shellman Grain Elevator, Inc. (*In re* Denham), 444 F.2d 1376, 1379 (5th Cir. 1971).

Author's opinion, if Congress chooses this strategy, § 303(b)(2) should read as follows:

> if there are fewer than 12 such holders, excluding any employee or insider of such person and any transferee of a transfer that is voidable under [this title] *and any claims which are de minimis or were not incurred in good faith by the debtor,* by one or more of such holders that hold in the aggregate at least $15,325[281]

Admittedly, this method would invite litigation on the subject of what claims were *de minimis*, but it would allow the bankruptcy courts to make specific determinations in context.[282] This approach properly acknowledges that what is *de minimis* in one circumstance is significant in another.[283] This change would bring the law into alignment with the true purpose of *Denham*: preventing insignificant claims from blocking an involuntary bankruptcy.[284]

An even better approach exists, however.[285] To embrace relative significance, while still providing predictable guidelines, Congress should group together all the non-participating claimholders and compare the sum of their claims, on a percentage basis, with the debt held by the one or two petitioning creditors.[286] Congress could hear testimony on how these problems typically arise and find a percentage threshold that would effectively achieve the underlying public policy.[287] Without the benefit of such investigation, 5% of the total outstanding debt stands out as a rough approximation of what constitutes significance.[288] Under this proposed system, any creditor who holds 95% of the aggregate debt could prosecute an involuntary petition as long as the other requirements of § 303 were met.[289] In this Author's opinion, the percentage threshold approach is the most ideal solution, and Congress should amend the Code § 303(b)(2) to read as follows:

> if there are fewer than 12 such holders, excluding any employee or insider of such person and any transferee of a transfer that is voidable under [this

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281. *See* 11 U.S.C. § 303(b)(2) (2012 & Supp. II 2014) (italicized language reflects Author's proposed changes).

282. *See In re Denham*, 444 F.2d at 1379.

283. *See In re* Elsa Designs, Ltd., 155 B.R. 859, 856 (Bankr. S.D.N.Y. 1993).

284. *See supra* Part V.

285. *See infra* text accompanying notes 286–90.

286. *See infra* text accompanying note 290.

287. *See About Congressional Hearings*, *supra* note 274 ("A hearing is a meeting or session of . . . Congress . . . to obtain information and opinions on proposed legislation . . . .").

288. *See generally In re* CorrLine Int'l, LLC, 516 B.R. 106, 160 (Bankr. S.D. Tex. 2014) (emphasizing that if the court disregarded the petitioning creditor's more contented claims, it would still hold over 72% of the outstanding debt).

289. *See infra* text accompanying note 290.

> title], by one or more of such holders that hold in the aggregate at least $15,325 *or greater than 95% of the total* of such claims.[290]

Certainly it is wise and just to say that if a debtor is not paying its obligations to a creditor who holds an enormous portion of the outstanding debt, the inaction of creditors holding a tiny fraction of the debt should not frustrate the prosecution of the bankruptcy regardless of their numerosity.[291]

B. The Fifth Circuit Should Abandon Denham *or Embrace Relative Significance*

Unless and until Congress resolves the uncertainty in the Code and unifies the treatment of insignificant claims, the Fifth Circuit should lay out a clear stance.[292] Three basic paths forward exist.[293] First, the Fifth Circuit could continue to do as the bankruptcy courts and district courts are now.[294] This means applying *Denham* and its progeny to cases that are clear while ironing out some of the remaining questions—such as what dollar figure should be used as the threshold for insignificance and whether all small claims should be excluded or only those that are small and recurring.[295] But this approach does nothing to unify case law among the circuits and, perhaps more importantly, it continues to ignore the elephant in the room: Significance is relative.[296] Unless courts require some nexus between the size of the claim or claims held by the petitioning creditor and the size of the claims held by those opposing, or simply ignoring, the bankruptcy petition, the application of the Code will remain ripe for inequity.[297] The Fifth Circuit should either join the mainstream interpretation of the Code or allow the bench to disregard insignificant claims in the truest sense of the word—claims that, in the scheme of things, simply do not matter much.[298]

1. The Value of Uniformity and Certainty

The federal courts generally disfavor forum shopping, but as long as we have an adversary system, parties will seek to have their matters heard in

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290. *See* 11 U.S.C. § 303(b)(2) (2012 & Supp. II 2014) (italicized language reflects Author's proposed changes).

291. *See* Jefferson Tr. & Sav. Bank of Peoria v. Rassi (*In re* Rassi), 701 F.2d 627, 632 (7th Cir. 1983) (exposing the need for a congressional authorization to exclude insignificant claims in the interest of justice).

292. *See supra* Parts V–VI.

293. *See infra* text accompanying notes 294–98.

294. *See generally In re* CorrLine Int'l, LLC, 516 B.R. 106, 152 (Bankr. S.D. Tex. 2014) (discussing why *Denham* has been and should be applied unless and until the Fifth Circuit overrules it).

295. *See supra* Part V.

296. *See infra* Part VII.B.2.

297. *See infra* Part VII.B.2.

298. *See infra* Part VII.B.2.

front of judges and juries that they perceive to be preferable.[299] The rules governing forum selection in bankruptcy cases are particularly permissive.[300] One thorough empirical study in 1991, and another in 2013, "found that a 'substantial number' of [bankruptcy] cases had forum shopped."[301] The more recent study, which focused on large bankruptcies produced by the Great Recession found that "[f]rom 2007 to 2012, 69% of Megacases had forum shopped."[302]

Forum shopping at this level can damage the perception of the bankruptcy system as a fair and impartial process.[303] Stakeholders speculate that forum selection stems from the level of flexibility or partiality given to the filing parties.[304] But the parties to a case are not at fault for the practice of forum shopping.[305] After all, parties *should* seek every tactical advantage legally available.[306] Rather, the parties react to the perceived differences between venues.[307] Additional inequity arises when, as here, there is more than a perceived preference for one venue over another; there is a substantial difference in the legal treatment of creditors from one circuit to another.[308]

On this issue, the Fifth Circuit's current position separates it from other prominent forums.[309] It draws criticism from other circuits and receives only begrudging acceptance from bankruptcy courts in its jurisdiction.[310] If the circuit is unwilling to define *significance* in relative terms, it should join its counterparts in a more plain meaning application of the Code.[311] This is likely the best approach to the plain meaning of the Code and means including all claimholders, however insignificant, in determining creditor

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299. *See* Debra Lyn Bassett, *The Forum Game*, 84 N.C. L. REV. 333, 334 (2006).

300. *See* Samir D. Parikh, *Modern Forum Shopping in Bankruptcy*, 46 CONN. L. REV. 159, 159 (2013).

301. *Id.* at 173.

302. *Id.* at 177.

303. *Id.* at 197.

304. *See id.*

305. *See* Cheeseman v. Carey, 485 F. Supp. 203, 215 (S.D.N.Y. 1980) ("Forum shopping is no more an evil than any other tactical determination a party makes in its behalf.").

306. *See* Bassett, *supra* note 299, at 338–39 ("Forum 'shopping' suggests unfairness in choosing to litigate in a particular forum . . . . [but] the Constitution itself and our federal system permit, encourage, and expect states to create their own laws."); Friedrich K. Juenger, *Forum Shopping, Domestic and International*, 63 TUL. L. REV. 553, 572 (1989) ("[A]ttorneys owe a duty to vindicate their clients' rights wherever they can expect the best results."); *see also* MODEL RULES OF PROF'L CONDUCT 1.3 cmt. 1 (AM. BAR ASS'N 2004) (stating that attorneys must be reasonably diligent on behalf of their clients).

307. *See* Parikh, *supra* note 300, at 197.

308. *See id*.

309. *Compare* Denham v. Shellman Grain Elevator, Inc. (*In re* Denham), 444 F.2d 1376, 1378–79 (5th Cir. 1971) (establishing the exclusion of insignificant claims), *with In re* Elsa Designs, Ltd., 155 B.R. 859, 865 (Bankr. S.D.N.Y. 1993) (refusing to exclude small claims).

310. *In re* Moss, 249 B.R. 411, 419 (Bankr. N.D. Tex. 2000) ("Until overruled, this Court is bound to follow *Denham* and exclude small, recurring claims from the creditor count."); *In re Elsa Designs*,155 B.R. at 856.

311. *See supra* text accompanying notes 253–56.

numerosity.[312] The Bankruptcy Court for the Southern District of New York expressed the position well:

> Section 56c [of the previous bankruptcy statute], however, has no counterpart under the Code and Rule 2007 of the Federal Rules of Bankruptcy Procedure has deleted the provision in its forerunner, Bankruptcy Rule 207, which prohibited a holder of a claim less than $100 from voting at a creditors' meeting. . . . [U]nder the broad definition of claim as provided in 11 U.S.C. § 101(5) "it would stretch judicial interpretation to the breaking point to read into the definition an exception based on the amount of the claim. If a creditor has a claim, and the creditor is not one that would be excluded pursuant to the provisions of § 303(b)(2), then that creditor should be counted in determining the sufficiency of a petition filed under that section."[313]

The Southern District of New York has seen more than its fair share of complex involuntary bankruptcies.[314] Because this position is more in line with the plain language of the Code, and accurately represents the majority position on *Denham*, the Fifth Circuit must also adopt a similar stance if it wants to bring its substantive law in accord with the mainline of legal thinking.[315]

2. *Accomplishing* Denham*'s True Purpose Requires a Relative, Rather Than Objective, Measure of Insignificance*

Unfortunately, the mainline of legal thinking currently allows insignificant creditors, through their inaction, to prevent otherwise valid involuntary bankruptcies.[316] If the Fifth Circuit is unwilling to allow insignificant claims to prevent a large, undersecured creditor from proceeding with prosecution of an involuntary bankruptcy petition, then it must begin measuring the significance of those claims in relation to one another.[317] The judicial interpretations and applications of *Denham* beg for a congressional response or at least a circuit-level clarification, but as long as those solutions attempt to define *significance* in objective terms, they will fall short.[318] One of the few points of reference in applying *Denham* is *In re Runyan*, in which the Fifth Circuit held that, regardless of whether *Denham* remains good law, claims of $600 to $800 are not insignificant.[319] That case,

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312. *See In re Elsa Designs,* 155 B.R. at 865.
313. *Id.* (quoting *In re* Hoover, 32 B.R. 842, 848 (Bankr. W.D. Okla. 1983)).
314. *See* Parikh, *supra* note 300, at 179.
315. *See supra* Part VI.
316. *See* Jefferson Tr. & Sav. Bank of Peoria v. Rassi (*In re* Rassi), 701 F.2d 627, 632 (7th Cir. 1983).
317. *See infra* text accompanying note 322.
318. *See supra* Part V.
319. *See* Blackmon v. Runyan (*In re* Runyan), 832 F.2d 58, 60 (5th Cir. 1987). The Fifth Circuit has only cited *Denham* three times in a published opinion. *See id.*; NCI Bldg. Sys. LP v. Harkness (*In re*

decided in 1987, indicates that if the court were to update the doctrine with modern-dollar thresholds it would opt for modest figures.[320] But bankruptcy cases frequently involve creditors whose claims against the debtor are mind-bogglingly high.[321] The Southern District of New York, in rejecting *Denham*, acknowledged this problem:

> Involuntary petitions in which the alleged debtor has debts in excess of $100,000,000 are a commonplace in this court. In the context of such a case, a claim as large as $5,000 (if not larger) could be considered *de minimis* whereas in another case such a claim would be sizeable. In the absence of an expression from Congress as to what it considered *de minimis*, it would indeed be difficult to pick a number below which a claim would not be counted.[322]

The Southern District of New York was certainly correct that picking a number that indicates insignificance presents considerable difficulty.[323] But it is also important enough to try.[324] Until Congress acts to remedy the one-petitioner problem, the Fifth Circuit should retain *Denham*'s policy of excluding insignificant creditors, clarify the contours of the doctrine to better guide bankruptcy courts, and give greater certainty to petitioning creditors and putative debtors.[325]

C. Counsel for Putative Debtors and Counsel for Petitioning Creditors Should Take Nothing for Granted: How to Prevail at a Numerosity Hearing

Until Congress, the Fifth Circuit, or both revisit the one-petitioner problem, single creditors wishing to prosecute an involuntary bankruptcy petition, and debtors seeking to oppose them, must make do with the case law that is available.[326] For debtors, that means proving up the list of creditors filed in opposition to the involuntary petition by demonstrating that each of

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Harkness), 189 F. App'x 311, 313 (5th Cir. 2006); Fid. Standard Life Ins. Co., v. First Nat'l Bank & Tr. Co., 510 F.2d 272, 273 (5th Cir. 1975). Only *Runyan* dealt with the pertinent holding of *Denham*. *See In re Runyan*, 832 F.2d at 68. Instead, the courts applied *Denham*'s other holding, which addressed whether a claim that has been reduced to judgment remains contingent for purposes of qualification under § 303. *See In re Harkness*, 189 F. App'x at 313; *Fid. Standard Life Ins*., 510 F.2d at 273. Interestingly, this proposition remains good law. *See In re Harkness*, 189 F. App'x at 313 (citing *Denham* for the proposition that claims that have been reduced to judgment are not contingent); *Fid. Standard Life Ins*., 510 F.2d at 273.

320. *See In re Runyan*, 832 F.2d at 60; *see also In re* CorrLine Int'l, LLC, 516 B.R. 106, 152–55 (Bankr. S.D. Tex. 2014) (refusing to accept the creditor's argument that the proper application of *Denham* would exclude claims under $500 because of inflation).

321. *See In re* Elsa Designs, Ltd., 155 B.R. 859, 865 (Bankr. S.D.N.Y. 1993).

322. *Id.*

323. *See id.*

324. *See supra* Part V.

325. *See supra* Parts V, VII.A.

326. *See supra* Part VII.A–B.

the creditors is a qualified holder of a claim under the Code.[327] For creditors, it means the opposite: showing that some, if not all, of the alleged creditors should not be included for purposes of numerosity.[328] While many questions remain unanswered, strategies exist to assist the parties.[329]

1. Insulating a Debtor from Involuntary Bankruptcy: Proving Up an Alleged Creditor List

Debtors should remember that the Code begins with a broad definition of a claim: any "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured."[330] While the qualifications in § 303 of the Code certainly chip away at what claimholders will ultimately count for purposes of numerosity, a debtor may be surprised to learn that many vendors qualify as claimholders.[331] Also, debtors should be aware of nontraditional obligations that meet the Code's definition of a claim.[332] For instance, the *CorrLine* debtor had agreed to participate in a trade show nearly a year in the future.[333] Even though the first portion of the registration payment was not due for several months, the court found that the trade show sponsor had a claim against the debtor as of the petition date.[334] Therefore, the sponsor was included in the list of creditors.[335] A more cursory review of the debtor's accounts might not have revealed this nontraditional claim.[336]

Beyond ensuring that all claimholders are included in the creditor list, the other key for debtors litigating creditor numerosity is attacking the precedential value of *Denham*.[337] With so many opinions criticizing *Denham*, it is possible that the next involuntary bankruptcy will provide the impetus for the Fifth Circuit to abandon or modify the doctrine.[338] While some would regard this as more of a dream and less of a strategy, a debtor–litigant with the resources to pursue an appeal to the circuit level should seriously consider doing so, and in the meantime, should make a trial record with a view to convincing the Fifth Circuit to overturn its holding in *Denham*.[339]

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327. *See* FED. R. BANKR. P. 1003(b).
328. *See id.*
329. *See infra* Part VII.C.1–2.
330. *See* 11 U.S.C. § 101(5)(A) (2012).
331. *See supra* Parts III–IV.
332. *See, e.g.*, *In re* CorrLine Int'l, LLC, 516 B.R. 106, 126 (Bankr. S.D. Tex. 2014).
333. *Id.*
334. *Id.*
335. *Id.*
336. *See id.*
337. *See supra* Part VI.
338. *See supra* Part VI.
339. *See supra* Part VI.

2. Prosecuting an Involuntary Bankruptcy Petition: Defeating the Alleged Creditor List

Creditors in the Fifth Circuit who wish to utilize *Denham* should be mindful of the most likely claim-size thresholds, and, if applicable, should emphasize any bad faith on the part of the debtor.[340] The most difficult job a bankruptcy court has when applying *Denham* today is deciding what threshold to use for disqualifying small claims.[341] Considering that the most recent cases have excluded claims of up to $275, creditors can likely feel confident that this threshold is reasonable.[342] Case law indicates that creditors may face a threshold as low as $25, but only a very aggressive bankruptcy court would exceed the $600–$800 range that was denied in *Runyan*.

Bad faith plays an important role for a petitioning creditor refuting a list of creditors because the debtor in *Denham* seemed to be acting in bad faith when he took on additional creditors to block the bankruptcy.[343] Neither *Denham*, nor subsequent opinions, required a showing of bad faith.[344] But these opinions suggest that any demonstration of bad faith favors the petitioning creditor, considering the Code's treatment of bad faith debtors generally and in *Denham*'s specific context.[345]

VIII. CONCLUSION

Imagine the following scenarios:

Scenario One: A debtor owes you twenty thousand dollars. They have assets, but are not paying their bills;

Scenario Two: The debtor owes you twenty thousand dollars, but also owes twenty other creditors one thousand dollars each; and

Scenario Three: The debtor owes twenty creditors one thousand dollars each, but now owes you one million dollars.

In most jurisdictions, the primary creditor in Scenario Three is out of luck.[346] Under current Fifth Circuit law, the creditor in Scenario Three can make a case for the exclusion of the other creditors from the involuntary

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340. *See supra* Part VI.

341. *See* Blackmon v. Runyan (*In re* Runyan), 832 F.2d 58, 60 (5th Cir. 1987); *In re* Moss, 249 B.R. 411, 419 (Bankr. N.D. Tex. 2000).

342. *In re* CorrLine Int'l, LLC, 516 B.R. 106, 152 (Bankr. S.D. Tex. 2014).

343. Denham v. Shellman Grain Elevator, Inc. (*In re* Denham), 444 F.2d 1376, 1379 (5th Cir. 1971).

344. *Id.*; *see also supra* Part V.

345. *See, e.g.*, *In re CorrLine Int'l*, 516 B.R. at 161. Recently, the Supreme Court has reaffirmed the notion that bankruptcy judges may go to great lengths to rebut debtors who act in bad faith, perhaps even going so far as to ignore the plain meaning of the statute. Marrama v. Citizens Bank of Mass., 549 U.S. 365, 376 (2007) (recognizing the "inherent power of every federal court to sanction abusive litigation practices").

346. *See supra* Part IV.A.

petition, but is unlikely to succeed.[347] This one-petitioner problem calls for pragmatism on the part of lawmakers.[348] While solidarity among the circuits is a noble goal, the Fifth Circuit should maintain its progressive position in this field and refuse to allow the nearly absurd result that the plain meaning of the Code allows.[349] Most importantly, Congress should amend the Code either to empower bankruptcy courts to disregard insignificant claims in their discretion, or to specify a percentage of outstanding debt, beyond which a creditor may prosecute an involuntary bankruptcy without regard to the number of small remaining creditors.[350]

Either of this Comment's proposed changes to the Code would resolve the inequity illustrated by the three scenarios.[351] If Congress granted bankruptcy courts the power to disregard insignificant claims, bankruptcy judges would easily dispatch the twenty small claims.[352] If Congress chose the aggregate percentage approach, the large creditor in Scenario Three would succeed because it holds 98% of the outstanding debt.[353] The Fifth Circuit, by retaining and clarifying *Denham*, could similarly prevent the small claims from blocking the large creditor.[354] Considering the cost, in both legal fees and judicial resources, of litigating the veracity of a creditor list without clear guidelines, and the likely spike in involuntary bankruptcies in the Fifth Circuit, the time for an update is now.

347. *See supra* Part V.
348. *See supra* Part VII.A–B.
349. *See supra* Part VII.B.
350. *See supra* Part VII.A.
351. *See supra* Part VII.A.
352. *See supra* Part VII.A.
353. *See supra* Part VII.A.
354. *See supra* Part VII.B.