AMERICAN UNIVERSITY OF ARMENIA

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TITLE

Indisputable payment obligations as Bankruptcy characteristics in Bankruptcy proceedings

Whether a dispute over the material breach of a contract makes indisputable obligation in Bankruptcy a disputable one. How does it affect creditors' petition of involuntary bankruptcy?

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INTRODUCTION

Bankruptcy is a situation where the debtor is generally unable to pay his/her debts within the time limits envisaged for performing the obligations or where the total amount of obligations of the debtor exceeds the value of his/her assets, i.e. bankruptcy is the inability to pay. All of the debtor's assets are measured and evaluated, and the assets may be used to repay a portion of outstanding debt.”[1]

The institute of Bankruptcy usually evolves with the trends of market economy relations. In developed countries bankruptcy regulations have rich history leading to the instituting of bankruptcy to be one of the necessary phenomena of the legal system. Because of relatively young age of institutions, the field of bankruptcy law is not well developed in the Republic of Armenia and is currently being practiced in courts and thus further developed case by case. The law on bankruptcy itself is being changed and adjusted to the common needs of legal system.

Bankruptcy can also be characterized as a special state of a debtor declared by the court. The framework of the very definition also includes parties involved in the procedure of initiating bankruptcy, who are the debtor and the creditor and their interrelations.

BACKGROUND INFORMATION ON THE PROBLEM

The implementation of legal acts on bankruptcy in the third Armenian Republic (RA) created an entirely new structure. At any stage of settling down bankruptcy relations in modern Armenian reality and legal thought, the system was removing the subjects of law from material output. Maybe this is the reason for unfamiliarity or unreachability among general public and entities in that field: be that a court, another public administration body, or a manager or business-creditor[2].

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[1] http://www.investopedia.com/terms/b/bankruptcy.asp, *last accessed on April 28, 2017*

[2] Gor Movsisyan, 'Bankruptcy Issues of Business Law Entities in the Republic of Armenia',[2012], <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2142371>, 13 Feb. 2017

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Ever since the adoption of first law in Armenia on bankruptcy (RA “Law on Enterprises and Individual Entrepreneurs”), bankruptcy relations are differ from US or Western countries. Those differences are not so much controlled by a simple contrast of legal norms, but by their actual role in economic activities[3]. It can be argued that in the Republic of Armenia the institute of bankruptcy is used as a means of forcing the debtor out of economic activities.

In Armenia there are two structures for settling a bankruptcy case that are stated in Article 3 of the law and Article 2 of the RA “Law on Bankruptcy of Banks, Credit Organizations, Investment Companies, Managers of Investment Funds and Insurance Companies”. In the framework of the system indicated by Article 3 of the law, there are two reasons for declaring natural (including individual entrepreneurs) and legal entities bankrupt: 1. the inability to make payments for 60 days or more – illiquidity and 2. The debt of the debtor exceeds assets – insolvency[4].

These two grounds must be go along with the condition that there is indisputable payment requirements that exceeds thousand times of the minimum wage, i.e. 1,000,000+ AMD (approximately 2 000 USD). Therefore, to announce a subject of business law bankrupt in Armenia, the next conditions must be in place. Firstly, the inability of the entity to make payments for 60 days or more than thousand times of the minimum wage(applicable upon the claim of the creditor). Secondly, the obligations of the creditor must exceed the value of its assets by 1 million dram or more (applicable upon the claim of debtor)[5].

This reasoning was applied when the RA “Law on making amendments in RA Law on Bankruptcy” was adopted on December 22, 2010 by the initiative of the RA Government* (Adopted on 22.12.2010, entered into force on 05.02.2011, RAPT 2011.01.26/4(807) Article 43.). The law seeked to remove internal contradictions. Drafting of the amendment offered: according to Point 1 of anti-justification, the law does not clearly demand the grounds for declaring bankruptcy, because in the case of voluntary bankruptcy, no aspect is visualized. Point 2 of the same anti-justification requires “To declare bankrupt according to paragraph 2 of Article 3 of the law, the inability to make payments for 30 days or more is stipulated”, but the RA Government contemplated that 30 days are too short for proclaiming bankrupt and

[3]Ibid.

[4]Ibid.

[5]Ibid.

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suggested a period of 60 days; simultaneously, instead of 500 000 drams as the minimum threshold, it suggested 1 000 000 drams"[6].

Though, it is a fact that under the conditions of the previous regulation there was no internal conflict such as in the case of compulsory bankruptcy the feature of the debtor of overseeing is creditor's financial difficulties, whereas in the case of voluntary bankruptcy no such feature is necessary. From this perspective, any kind of bankruptcy 'feature' should be excluded.

There has been a rise in the number of bankruptcy cases in Armenia. However, there is a need of further statistical data of several years to conclude sustainable growth in the number of cases, it is indisputable that each bankruptcy case fills the economic reality with specific situations and issues[7].

Chapter 1 discusses the issues of bankruptcy and related matter under Armenian law and practice. Number of cases from the Court of Cassation are used for understanding the reasoning of Armenian courts. Consequently, **Chapter 2** discusses the US legal practice and the institute of "good faith" and how it serves as a deterrence mechanism and its positive effect on bankruptcy and economy at large. This research will specifically address the issue of interpreting the indisputability feature of payment obligations deemed as a precondition for declaring the debtor bankrupt, given that such interpretation is strictly necessary for the consistency of application of the respective provision in the Law.

[6]Ibid.

[7]GorMovsisyan, "The Boundaries to Approve the Indisputability of the Claims in Bankruptcy Proceedings," SSRN Scholarly Paper (Rochester, NY: Social Science Research Network, September 13, 2013), https://papers.ssrn.com/abstract=2325680.

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CHAPTER 1

Armenian legal practice of Involuntary Bankruptcy

The indisputability feature of payment obligations as a precondition for declaring the debtor bankrupt

For as long as there have been people there have been debtors and creditors. Moreover, as long as there have been debtors and creditors there have been debtors who were not able to pay their debts. All over history, however, there has been very slight in the practice of organized bankruptcy proceedings go and overcome the turmoil left when debts go unpaid and the lender wants his money back or at least anything in return for the lost acquired. Therefore we have debtors vs. creditors or lenders.

Problems generated by bad debts and bad debtors can influence and create problems for economies. The difficulty is, what happens if the company or business needs funds and the lenders reject to lend since they have lost money on too many bad loans in the past? What happens when the borrower is just no longer able to pay?[8]

In contrast, there is the lender's interest. The government and the courts are devoted to maintaining the lenders as satisfied as possible and therefore ready to build the environment where lending is encouraged. Oppositely, there are the debtors. One issue for debtors is that they need some sort of legal system that defends them from creditors who are trying to enforce severe terms on loans or who use undesirable collection practices[9].

Having the above situation, it is obvious that any economy requires some sort of governmental scheme for managing the lending, payment, and collection of funds. There are two ways of initiating bankruptcy proceedings - voluntary and involuntary. A voluntary bankruptcy is initiated by a debtor who wishes to seek relief. Involuntary bankruptcies are initiated by a debtor's creditors who want to receive payment for what they are owed.

So far we know that as a matter of fact creditors are allowed to file an involuntary petition to protect their interest in the debtor's property. Some legal systems make it tougher for a creditor to file, while others permit them a greater amount of liberty. But the basic question to

[8] "Introduction to the Bankruptcy Laws," *National Paralegal College / National Juris University*, accessed May 4, 2017.

[9] Ibid.

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be answered is what would the creditors do in the case that their legal system provides them with the freedom to file whenever they have an unpaid due obligation and what are the effects on the economy at large?

This is what happens in Armenian reality, our legal system not only gives them freedom, in certain situations it forces them to file a bankruptcy petition, for example the Article 6 of ALB (hence Armenian Law on Bankruptcy) forces the state government or local self-governing bodies to file a bankruptcy during 6 months when there are certain obligations by debtors such as taxes other fees etc.

The issues of bankruptcy and related matter under Armenian law and practice

In this research we will specifically discuss involuntary bankruptcy cases. Most involuntary bankruptcies are filed against businesses. One or more creditors can file a petition against an individual and ask the court to declare the debtor bankrupt. Involuntary bankruptcy can be filed under Article 3 of the Law on Bankruptcy of RA. If there is an indisputable payment obligation and it is considered indisputable and the debtor does not object to the bankruptcy petition, the bankruptcy will proceed. Under Armenian legislation there are no general limitations when the creditor can file a claim and when the courts hear it. Conversely the US law envisions holding hearings if the creditor's petition was filed in **good faith.**

According to the article 3 of the Law on Bankruptcy of the RA "The debtor may be declared bankrupt by the judgment of the court,

1) based on involuntary bankruptcy claim , if 60 days delinquency of 1 million dram or more indisputable payment debts by debtor is the case and the delinquency continues by the time the judgment on bankruptcy is issued. The payment debt is considered indisputable, if the debtor doesn't object against the claim or in case of objections; the part of the claim not being challenged exceeds thousand times the minimum wage, i.e. 1,000,000+ AMD.[10]

With regard to consistency application of this provision the Court of Cassation of the Republic of Armenia in ESHD/0009/04/12 (05 April 2013) case states that, in case of involuntary bankruptcy, the indisputable payment debts by debtor, 60 days delinquency of

[10] The Decision of the Court of Cassation of the Republic of Armenia (ԵՇԴ/0009/04/12) 05 April 2013

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payment obligation and the continuation of delinquency by the time of the judgment on bankruptcy are the main three conditions each of which is separately necessary and altogether sufficient for having someone been recognized as bankrupt.

The payment obligation is considered indisputable, if the debtor does not object to the claim. Despites the provisions of the law consider also the case when the debtor objects to the claim. Here the debtor need to bring a well reasoned justification to claim the disputability of the payment obligation.

The Court of Cassation provides excessive interpretation on indisputability of bankruptcy claims. The court in VD/1809/05/13 case reasons on the importance of indisputability of bankruptcy claim, whereas creditors are sufficiently protected under the Civil Code provisions, therefore debtor must provide sufficient enough grounds for disputing the justification of the claim. The court concluded that the debtor did not provide sufficient enough reasons for disputing the creditor's claim. Also, research suggests that in any case where there is a dispute on payment obligations, the debtor should have the opportunity to subject the dispute to full judicial examination, only after which a question regarding the performance of his/her indisputable payment obligation may arise.

Primary and secondary research indicate practice-related problems regarding the application of the Article 3(2) of Bankruptcy Law on payment obligations. The Court of Cassation of the Republic of Armenia has opined in precedent-bound decisions, such EKD/0074/04/09, EKD/0137/04/09, EKD/0090/04/15, SHD/0009/04/12, KD2/0078/04/14/, that disputing the claim was used a legal tactic for rejecting an application for bankruptcy. In particular, debtors base their objections to the filed bankruptcy on the argument that the payment obligation between the parties is disputable, justifying it with the substantive dispute having arisen between the parties, i.e. the party may dispute through judicial procedure the ground for debt relationship between them, such as material breach of a contract, which then courts consider being sufficient for rejecting the application for bankruptcy. However, there is a tension the recognition of the debtor as bankrupt by the court is a legal fact, implying the exclusion of any circumstance where it can be questioned.

So coming to the research problem of the paper I would like to repeat, Whether a dispute over the material breach of a contract makes indisputable obligation in Bankruptcy a disputable one. The answer is **Yes**. But, what is the reason of doing so?

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The absence of Good Faith institute in RA can be the explanatory factor for disproportionately large number of disputable obligations in voluntary bankruptcy (80% to 20%). In US bankruptcy case law, the Good faith or Bona Fide institute serve as deterrent for preventing arbitrary involuntary bankruptcy claims against debtors, especially when there is an intention to bad faith. It can result in dismissal.

In US Bankruptcy legal practice when a company is in financial distress, the question arises whether creditors can "force" the company into bankruptcy. Even though the answer is more complex than it may seem, therefore it is essential to figure out what being "forced into bankruptcy" actually means (there are two distinct ways this can occur) and why it is important to companies and creditors[11].

Voluntary bankruptcy filing immediately places the company in bankruptcy, making it bound to the Bankruptcy Code's provisions and the bankruptcy court's supervision. On the other hand, another kind of bankruptcy — an involuntary bankruptcy filing — does not. A question emerges: if the company does not consent, can creditors actually urge a company into bankruptcy anyway? The answer is yes, in some circumstances, and dependent on implementing the requirements for filing an involuntary bankruptcy petition.

How is an involuntary different? After an involuntary petition is filed, the automatic delay of bankruptcy contributes immediately to avert creditor actions, but that's where the parallels with voluntary bankruptcy end[12]. And what if the involuntary fails? Filing an involuntary bankruptcy petition against a company is for sure, serious business, and the outcomes of failing are similarly serious.

- When filed, an involuntary petition cannot be released without a warning and anchance for a hearing, even if the petitioning creditors and the company comply.
- If the involuntary petition is released, the petitioning creditors can be accountable for costs and attorney's fees of the company.

[11]Bob Eisenbach, "Forced Into Bankruptcy: The Involuntary Bankruptcy Process," *In The (Red)®*, May 24, 2012.
[12]Ibid.

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- If the bankruptcy court decides that the involuntary petition was filed in bad faith, the petitioning creditors can be accountable as well for losses caused by the involuntary filing and indeed for punitive damages[13].

The possibility of creditor accountability for costs, attorney's fees, damages, and possibly punitive damages makes involuntary petitions one of the less applicable creditor instruments. Involuntary bankruptcy is frequently used when unsecured creditors doubt scam on the part of a company, such as when a Ponzi scheme is revealed, or for some other odd reasons[14]. In another way, creditors will usually seek collection of their own claims openly, as well as through litigation in state or federal court. That could end up "imposing" the company into bankruptcy, but theoretically it would be a voluntary kind bankruptcy.

In Armenian legal practice such regulation often results in abuses in the field of law, for example, where the debtor starts to dispute the grounds for legal relationship for formal purposes, burdening the courts with claims which in essence are groundless, and depriving the debtor of the opportunity to satisfy the claim within a reasonable period. The Court of Cassation of the Republic of Armenia in EMD/0049/04/15 case reasons that the **underlying purpose for declaring bankruptcy is to secure the stability of civil financial system at large,** recovering insolvent participants or pushing them away from the system – so that it does not have adverse effects on others and protecting the rights of solvent participants. Here lies the discretion of court on ruling bankruptcy decisions (admissibility or indisputability on grounds) – having the aim of securing financial stability in mind.

Besides, there is a "delicate" procedural line between the endorsement of indisputability fact of bankruptcy claim and the settlement of the disagreement itself. Additionally, while approving the indisputability of the bankruptcy claim (that is to relate with the factual substantiation of the claim reinforced by Law) the court may cross a "red line" by resolving disagreement between the debtor and the potential creditor[15]. The courts may come across to the mentioned situation when;

a) determining the admissibility of bankruptcy relief,

b) announcing the debtor's bankruptcy,

[13]Ibid.
[14]Ibid.
[15]Ibid.

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c) confirming the claims of creditors.

In the case of determining the admissibility of bankruptcy relief, the court may stand on the edge of confirming the indisputability of bankruptcy claims and adjustments of differences while deciding the admissibility of the involuntary bankruptcy claim based on the article 3 and similarly to the procedure reinforced by articles 13thand 14th of the ALB. The article 3 of ALB requires the following; “The debtor may be announced bankrupt by the judgment of the court,

1) according to involuntary bankruptcy clause, if there is indisputable after payment of 1 million drams or more and delinquency, the delinquency continues even after the court ruling on bankruptcy. The payment debt is considered indisputable, if the debtor doesn’t object against the claim or in case of objections;

a) the payment debt is accepted by the judgment of the court in force with no chance for compensation,

b) the claim arises from a written contract and the debtor has no evidence on satisfactory grounds to question the claim (including the reimbursement),

c) the claim arises from the debtor’s duty to pay taxes, fees or other compulsory payments and the debtor has no evidence on satisfactory grounds to question the claim,

d) the part of the claim not being questioned goes above thousand times the minimum wage, i.e. 1,000,000+ AMD[16].

According to the article 14 of the ALB the court announces unacceptable the claims brought against an entity which can not acquire the debt. The latter requirement refers to an entity whose debts are estimated disputable in respect of the rules of article 3.

Announcing the debtor’s bankruptcy is the second bordering situation may take place just after the positive conclusion of admissibility under the emergence of bankruptcy relief. Equally, at this point the disclosure of new evidences may spread a light on the debtor’s constitutional or other type of obligations, and therefore turn the latter once from indisputable to disputable once. Simply, the article 3 of the Armenian Law on Bankruptcy allows the discretion to determine the indisputability to the court case by case. In both discussed cases the disputability of debtor’s bankruptcy corresponds with the disputability of debts

[16]Ibid.

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considering an indisputable truth that the declaration of bankruptcy relies entirely on the payment debts.

The third probable stage of bankruptcy process during which the court may encounter the problem of deciding the indisputability of the claims is the period devoted to the registration of the creditor's claims under the article 46 of the Law. The wording of the article 46 of the ALB is below:

"1. The creditors could submit their claims within a month after the announcement
of the debtor's bankruptcy.

"2. The creditors claim should at least include;

a) for the usual entity the name and the address of the permanent residence,
and for the legal entity a place of business and the trademark.

b) the causes of the debt and the scheduled date of its conduct,

c) the amount of the claim comprised of separate statements on the main debt, the damages and the punishments with appropriate accountings,

d) the conditions substantiating the claims[17].

The proofs justifying the presence of the claim should be attached.

The claim and the attached documents should be introduced in three examples…..

Regarding the bankruptcy administrator, debtor and the creditors present written arguments against the preference or the claim itself represented in the initial list of claims within seven days succeeding the publication in the press entitled to issue data on the official recording of legal entities, the judge holds a hearing within 7 days succeeding the receipt of the objection and the bankruptcy administrator, debtor and creditors ought to be informed about the date and place of the hearing by the help of the above-mentioned means of mass media[18].

As a consequence of the hearing the court determines lawfulness, amount, preference, security of the claims and accepts the final list of the creditor's claims. The court's decision on endorsement of the list can be disputed before the court of higher instance."

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[17]GorMovsisyan, "The Boundaries to Approve the Indisputability of the Claims in Bankruptcy Proceedings," SSRN Scholarly Paper (Rochester, NY: Social Science Research Network, September 13, 2013), https://papers.ssrn.com/abstract=2325680.

[18]Ibid.

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The aforementioned decrees indicate that the court has more discretion given to the evidence that decision of the court on the lawfulness of the claim, an issue with multi-layer characteristics, could in fact resolve the property dispute between the debtor and creditor[19].

Also, it can be concluded that in each case the court passes the identified red line of disputability and indisputability as if it doesn't apply the law in a manner it is obliged to, and moreover it breaks the logic of the relations. Nevertheless, this conclusion is fully appropriate only for the two previous phases (initiating the procedure and bankruptcy relief) and is insignificant for the third stage (registration of claims)[20].

[19]Ibid.
[20]Ibid.

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CHAPTER 2

The US legal practice of Involuntary Bankruptcy and the "Bona Fide Dispute" or "Good Faith Dispute"

This chapter investigates the US law concerning the institute of bankruptcy, specifically the principles of "Bona Fide Dispute" or "Good Faith Dispute".

The main part of the substantive law controlling creditors' entitlement to involuntary bankruptcy relief was combined into section 303 of the Bankruptcy Code, under the Bankruptcy Reform Act of 1978. Two provisions of that act should be discussed. The first is section 303(b) that manages the issue of eligibility to file an involuntary petition, and the other provision of interest is section 303(h)(1)[21]. It comprises of the first, and also the more leading, of the two alternative grounds' upon which involuntary relief could be approved after the jurisdiction of the bankruptcy court has been properly appealed under section 303(b). According to the Reform Act version of section 303(h)(1), if the debtor refuted the petition, relief could not be ordered against the debtor unless the petitioners could demonstrate that, such as of the date of filing, the debtor was usually not paying its debts as they became due[22].

In 1984, as part of the improvements to the Code realized by Title III of the Bankruptcy Amendments and Federal Judgeship Act of 1984. Congress amended the Reform Act's requests for involuntary bankruptcy by entering alike language in sections 303(b) and 303(h)(1) which eliminates for both resolutions claims and debts bound by a "bona fide (good faith) dispute[23]." Upon the enactment of the 1984 Act, these corresponding amendments became immediately operational, and applied to all cases unresolved or registered after that date. By creating this amendment, legislators expected that these changes would dispel the uncertainty which had ascended in the case law under the Reform Act concerning the appropriate management of disputed debts in involuntary bankruptcies[24].

B. The 1898 Act

[21] "U.S. Code: Title 11 - BANKRUPTCY," *LII / Legal Information Institute*, accessed April 28, 2017, https://www.law.cornell.edu/uscode/text/11.
[22] Lawrence Ponoroff, "Involuntary Bankruptcy and the Bona Fides of a Bona Fide Dispute," *Ind. LJ* 65 (1989): 315.
[23] "U.S. Code."
[24] Ponoroff, "Involuntary Bankruptcy and the Bona Fides of a Bona Fide Dispute."

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Bankruptcy law for most of this century was administrated by the National Bankruptcy Act of 1898, which lasted until canceled by the Reform Act. The Bankruptcy Act settled firm and comprehensive conditions which creditors were obliged to comply with in order to enforce an involuntary bankruptcy administration. Concerning the threshold issue of standing to appropriately launch a case, the Bankruptcy Act ordered that the petitioning creditors be the holders of "provable claims" against the debtor. The concept of a "provable claim" had a meaning different from what one might suppose[25]. Instead of requiring the formation of the merits of a contested claim by appropriate evidence, the idea of provability changed entirely on the nature and subject matter of the claim. The Act listed nine separate classes or categories of claims that would be deliberated "provable" for purposes of a bankruptcy case[26].

THE PRE-1984 ACT CASE LAW

A. Disputed Debts under Section 303(b)

The prevailing attitude taken by the courts in considering disputed debts under the new Bankruptcy Code's eligibility criteria for pursuing involuntary relief was stated and sharply illustrated in *In re All Media Properties, Inc*. In that situation, which essentially implicated distinct petitions against two united companies, the debtors had required to disqualify the holders of certain immature and disputed claims on the grounds that such claims were unsuccessful for satisfying the statutory demand that a petitioner's claim be "not contingent as to liability[27]." The court used the circumstance to replicate on the importance of the omission from section 303(b) of an exclusion for the holders of immature, disputed or unliquidated claims[28].

By these purposes, the All Media court detained that a claim is not liable simply because it is ambiguous as to amount, so long as liability is absolutely fixed. By the same clue, the court warned that a legal obligation is not construed contingent because a dispute as to liability appears after it is incurred. The terms "contingent" and "disputed" are not synonymous[29]. Instead of, the court determined that the merits or demerits of the debtor's

[25] Ibid.
[26] "U.S. Code."
[27] Ponoroff, "Involuntary Bankruptcy and the Bona Fides of a Bona Fide Dispute."
[28] "U.S. Code."
[29] Ponoroff, "Involuntary Bankruptcy and the Bona Fides of a Bona Fide Dispute."

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suspected defenses to a creditor's claim are largely related to the issue of the court's subject matter jurisdiction over an involuntary petition. Consequently, deliberation of the validity of disputed but non-contingent claims would be delayed till successively raised, although at all, by appropriate proceedings in the subsequent bankruptcy administration[30].

Therefore, the *All Media* court left open the likelihood that, under the right conditions, a commendable defense could be used to invalidate a petitioning creditor's claim in case that such defense could be built clearly and without the need to apply to extensive proof[31].

The greatest opposition to All Media was the bankruptcy court's view in In re Kreidler Import Corp. According to it, the debtor opposed to the standing of a creditor that had tied in the involuntary petition on the ground of a suspected counterclaim against such creditor which, if proven, would have absolutely compensated the amount of the creditor's claim[32]." Referring to its examination of the record, the court decided that the debtor's counterclaim had at least a bona fide factual grounds and, as a result, abolished the creditor's claim as founding the basis for joinder in the involuntary petition. Particularly, the court in Kreidler similarly invalidated the claim of another petitioning creditor whom the court determined had accepted and then failed to give up before the petition was filed. This is considered as preventable preference under section 547(b) of the Code[33].

After confirming that the presence of a good faith dispute did not defeat the court's jurisdiction under section 303(b), in All Media, the court considered the influence of prolonging its reasoning to the issue of the petitioners' entitlement to relief. Noticing that debtors do not have a desire for paying disputed debts merely to prevent being forced into bankruptcy, the court spent little time in concluding that "where a debtor falls to pay a debt which is subject to a bona fide dispute that debt should not be considered a debt which has not been paid as it became due[34]." Thus, in the judgment of the All Media court, an appealing creditor's debt could be calculated for one aim under section 303 (standing), but not for

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[30] Ibid.
[31] Ibid.
[32] "IN RE KREIDLER IMPORT CORP., (Bankr.D.Md. 1980), 4 B.R. 256 (Bankr. D. Md. 1980) | Casetext," accessed April 28, 2017, https://casetext.com/case/in-re-kreidler-import-corp.
[33] Ibid.
[34] "In Re All Media Properties, Inc., 5 B.R. 126 – CourtListener.com," *CourtListener*, accessed April 28, 2017, https://www.courtlistener.com/opinion/1534915/in-re-all-media-properties-inc/.

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another (entitlement to relief); a possibly profound, but barely revolutionary, conception that diverse standards may be applied to explain a phrase when the outcomes of the outcome differ [35].

Definitely, it could not each time be the same debts which are examined under the two analyses. A debtor may dispute entitlement to relief under section 303(h)(1) by questioning the validity of the claims of non-petitioning and also petitioning creditors. On the other hand, under section 303(b) only the claims of petitioning creditors are primary[36].

B. Disputed Debts Under Section 303(h)

As noted earlier, if the debtor controverts an involuntary petition, the Code requires the petitioners to establish the existence of proper grounds for entry of an order of relief.7 Under section 303(h)(1), relief is warranted if the petitioning creditors can show that, at the time of filing,7 6 the debtor was insolvent in the "equity sense" of not satisfying current obligations as they became due.

In re Covey, the Seventh Circuit, while following *All Media* although the section 303(b) analysis was concerned," carry a quite different attitude to the disputed debts issue under section 303(h)(1)[37]. In large extent, the court saw its attitude as ruled by the policies behind the Reform Act. The court highlighted that a significant objective of the new Bankruptcy Code was the protection of creditors' interest through a quick determination of the involuntary petition. This inevitably comprised an interest in quick resolution of the question of concerning the debtor who was generally not paying its existing debts. Therefore, while empathizing with the *All Media* court's affair over unjustified coercion of the debtor, the Covey court understood that total elimination of disputed debts destabilized an important objective of the new Bankruptcy Code-maintaining creditors' rights to the debtor's property. In contrast, the power of the competing policy interests deterred the court from approving a per se rule of inclusion of disputed debts in the "generally not paying" analysis[38].

[35] Ponoroff, "Involuntary Bankruptcy and the Bona Fides of a Bona Fide Dispute."
[36] "In Re All Media Properties, Inc., 5 B.R. 126 – CourtListener.com."
[37] Ponoroff, "Involuntary Bankruptcy and the Bona Fides of a Bona Fide Dispute."
[38] Ibid.

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For resolving the dilemma, the court in Covey defined a set of comprehensive guidelines for the bankruptcy courts to apply on a case-by-case basis. If the dispute involved only the amount of the responsibility, the bankruptcy court would be ordered, without further investigation, to take the debt into account when assessing whether the debtor was generally paying its current obligations[39]. Nevertheless, if the debtor's dispute went to the presence or the validity of the claim, the court would need to go to the next phase and consider the complication of the litigation necessary to resolve the dispute. Should considerable litigation be needed to measure the merits of the dispute, the debt would merely be counted under section 303(h)(1)[40]. In contrast, if the meaning of the dispute could be arbitrated without comprehensive or compound litigation, the bankruptcy court would be required to weigh the creditors' interest in a quick purpose of the involuntary petition against the debtor's interest in evading bankruptcy, and then only achieve the merits of the dispute when the debtor's interest prevailed. In that case, inclusion or exclusion for determinations of section 303(h)(1) would be founded on the court's real evaluation of the validity of the debtor's defenses[41]. Nevertheless, should the balance point in the creditor's favor, the debt would, again, inevitably be considered unpaid for purposes of the "generally not paying" analysis, with the understanding that the court would accept determining the merits of the specific dispute until after access of an order for relief[42].

The 1984 Act anticipated a judicial resolution of the objection between Covey and All Media referring the influence of legitimately disputed debts under section 303(h)(1). However, in most of the cases determined up to that time courts accepted the understanding of dealing with the disputed debts issue inconsistently depending on whether it ascended in the context of the court's jurisdiction to consider a petition for involuntary relief or in connection with the petitioner's claim on the merits to such relief. Accordingly, by the time Congress was viewing the 1984 amendments to the Code, the courts had not only already taken understanding of the problem of disputed claims and debts under section 303, but also really developed numerous methods of analysis to consider such debts. Even though definitely no consensus had established as to which methodology was best, in almost all cases the courts had created

[39] Ibid.
[40] "U.S. Code."
[41] Ponoroff, "Involuntary Bankruptcy and the Bona Fides of a Bona Fide Dispute."
[42] Ibid.

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attitudes with a recognition for the fact that it made a difference why the question was being asked[43].

EXISTENCE OF A BONA FIDE DISPUTE: AN ALTERNATIVE FRAMEWORK FOR ANALYSIS

Before the 1984 Act, courts commonly acknowledged the presence of jurisdiction over petitions filed by creditors carrying disputed claims, but then took the presence of such disputes into account in ruling on the merits of the petition. This system, had "proved to be both workable and fair in practice[44]." Thus, it is rational to interpret the amendments as modifying the current practice to the minimum extent possible compatible with their goal, thus avoiding the mistake of repairing something which wasn't broken.

A. Determining a Bona Fide Dispute Under Section 303(b)

Having the certain and straight language of amended section 303(b), it is challenging to dispute that by virtue of the 1984 Act Congress influenced the practice created in In re All Media Properties, Inc. of comprising approximately all uncertain claimholders in the category of creditors available to appeal to the bankruptcy court's jurisdiction under section 303(b)[45]. Nevertheless, as identified in cases determined similarly before and after enactment of the amendment to section 303. A debtor's main protection against a non-meritorious petition is and appropriately should be found in the evaluation of whether or not appropriate grounds for relief exist under section 303(h)[46]. Besides, it turns repeating that a considerable deterrent against inappropriately perceived or abusive filings still exists in the form of section 303(i)[47]. Consequently, it is a fault to read the amendment to section 303(b) as approving as unexpected a departure from earlier practice as attained by strict application of the tests attached in either *In re Stroop* or *In re Lough*[48]. There is merely no convincing reason why a creditor should be required to accept the heavy burden of proving the absence of any

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[43] Ibid.
[44] "Problems in the Code By G. David Dean and Saul Ehrenpreis," October 2014, https://www.google.am/?gws_rd=cr,ssl&ei=wLQDWZL1CoTO6AS1vLrQBg#q=Problems+in+the+Code+By+G.+David+Dean+and+Saul+Ehrenpreis.
[45] "In Re All Media Properties, Inc., 5 B.R. 126 – CourtListener.com."
[46] Ibid.
[47] Ponoroff, "Involuntary Bankruptcy and the Bona Fides of a Bona Fide Dispute."
[48] "In Re All Media Properties, Inc., 5 B.R. 126 – CourtListener.com."

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substantial issue of fact or law relating on the debtor's liability simply as a condition for having the merits of an involuntary petition heard.

The principal question of the debtor's eventual liability on any certain creditor's claim, whether disputed or not, is never the subject directly at issue at the trial of an involuntary petition. Hence, it is confusing that the petitioning creditors have been obliged at any point in the process of gaining a command for relief to found the absence of all factual or legal obstacles to the debtor's liability on their claims[49]. The principal becomes even more decreased in the context of section 303(b) where the goal for the investigation of the bona fide dispute issue is much narrower and more restricted than the critical question of whether or not an involuntary case should go forward. The only question that actually turns on resolution of the bona fide dispute issue for section 303(b) purposes is the nearly procedural one of eligibility to appeal the bankruptcy court's jurisdiction[50].

Considered from that perspective, it would be reliable with both conventional civil practice and the unusual legislative history of section 303 to deal with the debtor's contradiction of a petitioning creditor's claim as an approving legal defense to that creditor's claim to preserve suit for involuntary relief. Particularly, the debtor would generally be responsible not only for disputing the validity of the claim, but would also accept the ultimate burden for presenting the presence of a bona fide dispute[51].

A just and unprejudiced apparatus of “involuntary bankruptcy” might derive from freeing the norms for giving a definition of a *bona fide* conflict under sections 303(b) and 303(h)(1) and redeveloping the test for everyone in such a way that it is responsive to every specific enquiry. As stated previously, this might require not as much difference from previous practices as the explanation that, to a great degree, the courts have added until now. Moreover, this attitude might make clearer and somehow polish the judicially-generated interpretation on the earliest 1978 form of the statute, not concurrently demanding a total neglect of five years of fruitful progress of case law. More significantly, applying these norms to determine in which case a debtor’s conflict to a specific debt or demand will be considered a *bona fide* conflict under section 303 might not make necessary to take to pieces a main

[49] Ponoroff, “Involuntary Bankruptcy and the Bona Fides of a Bona Fide Dispute.”
[50] Ibid.
[51] Ibid.

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statutory apparatus that was intentionally and cautiously created to hit a just stability among the concerns of "debtors and creditors".

As the study of "post-1984 Act case law" has demonstrated, there does not exist less ambivalence and lack of certainty concerning the function and influence of conflicted debts in "involuntary bankruptcy" legal actions after amending section 303 than it was before. As a result, there exists space, and possibly necessity, for more improvement and progress in the norms that define a *bona fide* conflict. When tackling this issue and endeavoring to improve the vague condition of the existing "case law", the courts ought to be not as much under an obligation to not validated worries about unfairness in the apparatus, and more responsive to the basic "bankruptcy policy" of guaranteeing the most just and even-handed dispersal of finite property between conflicting applicants. Taking into consideration this approach, the aforementioned suggestions have been put forward and hopefully they would be reviewed and assessed in that framework.

The Good Faith Filing Requirement

By judicially-enforced mandate, bankruptcy filings also have to be initiated in good faith. Failure to do in such a way can end in dismissal. This implicit good faith filing obligation suits equally to involuntary as well as voluntary cases. Many scholars approve the opinion that good faith in this context means reliability with prevalent bankruptcy policy. Nevertheless, if, as many argue, bad faith is not usually the right opposite of good faith, then neither can the opposite suggestion be true in every case. Moreover, even if the term "bad faith" unavoidably is used to indicate to conduct which lacks the indirect good faith filing obligation, it does not always mean that the same term, when used in a different context, should have the similar meaning[52].

Having the parallel existence of an implied good faith filing requirement and mandatory sanctions in Bankruptcy Rule 9011 for filings initiated without valid inquiry into the facts and law, the question can directly be raised, what distinct role is left for section 303(i)(2). One opinion could be that if the involuntary petition is expelled for either need of

[52] Lawrence Ponoroff, "The Limits of Good Faith Analyses: Unraveling and Redefining Bad Faith in Involuntary Bankruptcy Proceedings," *Neb. L. Rev.* 71 (1992): 209.

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good faith or absence of colorable grounds, section 303(i)(2) mixes the petitioning creditors' misery by revealing them to the likelihood of further punishment in the procedure of real and even punitive damages[53].

The main limitation of this view is that it arises in a definition of bad faith which condenses conduct initiated without either an intent to harm or an offensive hidden motive. Such an extensive explanation exceeds even the ambitious intentions of the statute, which are basically to protect debtors from intentionally overreaching creditors and, only after, to maintain the integrity of the bankruptcy courts' jurisdiction. In either case, creditor conduct requiring deliberation of damages under section 303(i)(2) must be restricted to conduct decided to have been undertaken with the cautious and hateful intention of harming the debtor. Besides, this determination happens, if at all, after release of the petition on the merits [54]. Any more extensive application of the bad faith rule in section 303(i)(2) can only help to deter creditors from pursuing relief in bankruptcy. Whereas this couldn't harm the individual debtor qua debtor, it potentially aggravates the general bankruptcy goal of equality of distribution amongst correspondingly positioned creditors. Additionally, as of a business debtor, the in ter-rorem effect of a very broad definition of bad faith could be damaging not only to those creditors who arrive late to the feeding frenzy that portrays state grab law, but equally to all the other parties with an interest in the debtor as a going responsibility. This could comprise of the community at large, employees, retirees, customers, and among others[55]
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[53] Ibid.
[54] Ibid.
[55] Ibid.

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CONCLUSION

Under Armenian legislation there are no general limitations when the creditor can file a claim and when the courts hear it. Conversely the US law envisions holding hearings for determining good faith of creditor's petition.

According to Article 3 of the Law on Bankruptcy of the Republic of Armenia the debtor may be declared bankrupt by the judgment of the court, by the initiation of debtor – voluntary bankruptcy or by the initiation of creditor - involuntary bankruptcy claim, if 60 days delinquency of 1 million dram or more indisputable payment debts by debtor is the case and the delinquency continues by the time the judgment on bankruptcy is issued. The payment debt is considered indisputable, if the debtor doesn't object against the claim or in case of objections; the part of the claim not being challenged exceeds thousand times the minimum wage, i.e. 1,000,000+ AMD.

With regard to consistency application of this provision the Court of Cassation of the Republic of Armenia states that, in case of involuntary bankruptcy, the indisputable payment debts by debtor, 60 days delinquency of payment obligation and the continuation of delinquency by the time of the judgment on bankruptcy are the main three conditions each of which is separately necessary and altogether sufficient for having someone been recognized as bankrupt.

As a practicing attorneys in Bankruptcy field states: the debtors are using a legal tactic for rejecting an application for bankruptcy. In particular, debtors base their objections to the filed bankruptcy on the argument that the payment obligation between the parties is disputable, justifying it with the substantive dispute having arisen between the parties, i.e. the party may dispute through judicial procedure the ground for debt relationship between them, such as material breach of a contract, which then courts consider being sufficient for rejecting the application for bankruptcy. However, the recognition of the debtor as bankrupt by the court is a legal fact, and there should be no question about that fact.

The reason of bringing another dispute by the debtor in order to make the undisputable obligation a disputable one in involuntary bankruptcy, is the absence of the Good Faith institute in our bankruptcy legal practice. Where every single creditor can initiate involuntary bankruptcy against the debtor in presence of certain requirements. There is also risk of Single Creditor in such cases.

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It often results in abuses in the field of law, for example, where the debtor starts to dispute the grounds for legal relationship for formal purposes, burdening the courts with claims which in essence are groundless, and depriving the debtor of the opportunity to satisfy the claim within a reasonable period.

In American legal system by judicially-imposed mandate, bankruptcy filings also must be undertaken in good faith. Failure to do so can result in dismissal. This implied good faith filing requirement applies equally to involuntary as well as voluntary cases. In US Bankruptcy filings must be undertaken in good faith and failure to do so can result in dismissal. If the involuntary petition is dismissed, the petitioning creditors can be liable for costs and attorney's fees of the company. If the bankruptcy court determines that the involuntary petition was filed in bad faith, the petitioning creditors can be liable as well for damages caused by the involuntary filing and even for punitive damages. That is the reason that in US creditors will typically pursue collection of their own claims directly, including through litigation in state or federal court. That might end up "forcing" the company into bankruptcy, but technically it would be a bankruptcy of the voluntary kind.

This paper believes, that the underlying purpose for declaring bankruptcy is to secure the stability of civil financial system at large, recovering insolvent participants or pushing them away from the system – so that it does not have adverse effects on others and protecting the rights of solvent participants. I believe that the view of that good faith and the main purpose of Bankruptcy must be interpreted in the context of current bankruptcy policy as restated in our Court of Cassation decisions.

Recommendations

- The localization of good faith institute in the Republic of Armenia would not only help in bankruptcy cases, but would also have a positive impact on corporate law matters. However, the process is a long-shot, and could take years or decades.
- A more practical solution to the discussed issue, is courts' willingness to take into account the aim of securing financial stability in mind.
- The formal requirements (1,000,000drams) do not effectively stop the large amount of filings, hence a single amendment to the current law (10 million AMD) will suffice.

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