COLLATERAL DAMAGE: NON-DEBTOR RECOVERY FOR BAD FAITH INVOLUNTARY BANKRUPTCY PETITIONS

ABSTRACT

Involuntary bankruptcy is a powerful tool that creditors can use as a last resort in attempting to collect a debt. Because this option is inherently dangerous to undeserving debtors, the Bankruptcy Code provides for extensive damages if creditors pursue involuntary bankruptcy in bad faith. Unsurprisingly, this danger extends to non-debtor third parties tied to the economic wellbeing of the debtors, but a recent circuit split creates a question as to whether protection extends to these non-debtors as well.

While no court found that the collaterally harmed third parties had standing under the damages provision of the Bankruptcy Code, in August 2016 the Third Circuit split from Ninth Circuit precedent by finding that non-debtor third parties could pursue recovery in state court. The Ninth Circuit had previously relied on complete preemption to foreclose these opportunities.

This Comment argues the Third Circuit's approach is moving in the right direction and ultimately proposes a hybrid approach that attempts to solve the flaws in both circuit decisions.

INTRODUCTION

An August 2016 decision by the Third Circuit created a circuit split on an issue of importance for creditors contemplating filing and parties harmed by an involuntary bankruptcy petition.[1] The split concerns whether, under § 303 of the Bankruptcy Code (the "Code"), a non-debtor third party is preempted by the Code from pursuing a claim under state law resulting from an involuntary bankruptcy petition filed in bad faith.[2] The Third Circuit ultimately ruled in favor of the injured non-debtor third parties, ruling against preemption.[3] This decision set the Third Circuit in conflict with the Ninth Circuit, which previously interpreted the Code to completely preempt state law claims and prevent non-debtor third parties from having standing to pursue damages for an involuntary bankruptcy petition filed in bad faith.[4] This circuit split involves interpretive

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[1] Rosenberg v. DVI Receivables XVII, LLC, 835 F.3d 414, 419 (3d Cir. 2016).

[2] *Compare* Rosenberg, 835 F.3d at 419, *with* Miles v. Okun (*In re* Miles), 430 F.3d 1083, 1094 (9th Cir. 2005).

[3] Rosenberg, 835 F.3d at 419.

[4] *In re* Miles, 430 F.3d 1083.

differences of statutory construction, competing jurisdictional doctrines, congressional intent, and the ultimate purpose of the Code within the realm of involuntary bankruptcy law in the United States.[5]

This Comment argues that the Third Circuit's interpretation is more consistent with the Supreme Court's presumption against preemption and reduces tension within the Code created by the Ninth Circuit's prior ruling. Additionally, this Comment suggests a third, hybrid approach to how the courts could interpret the Code in order to achieve the goals set forth by both Circuits.

First, this Comment explores the history, purpose, and current trends of involuntary bankruptcy within the U.S. Bankruptcy system. There are three central building blocks inherent in any of these situations, and thus this Comment next provides important background information of each in turn: (1) the relevant Code provisions; (2) the complex and often overlapping preemption and removal doctrines; and (3) the situations in which a non-debtor third party might be damaged in an involuntary bankruptcy filing.

This Comment then proceeds in three parts by (1) detailing the recent Third and Ninth Circuit cases and the resulting split between them; (2) arguing that the Third Circuit result is preferable; and (3) examining the potential impact of this ruling on the current involuntary bankruptcy trends. Finally, this Comment suggests a potential third option for courts to interpret the Code in these situations and concludes with a call to Congress to clarify its intent.

I. BACKGROUND

A. *History and Purpose of Involuntary Bankruptcy*

Involuntary bankruptcy, as its name suggests, is a tool that creditors can use to force unwilling debtors into a chapter 7 or chapter 11 bankruptcy.[6] The concept has existed since bankruptcy laws were first enacted in 16th century England.[7] In fact, involuntary bankruptcy was the only type of bankruptcy available in the United States until the United States Bankruptcy Act of 1841.[8] The dominant purpose of the original bankruptcy system was to help creditors collect debts, not to aid debtors in finding relief from creditors, and as such only

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[5] *See* Rosenberg, 835 F.3d at 419; *In re* Miles, 430 F.3d at 1094.

[6] 11 U.S.C. § 303 (2016).

[7] Charles Jordan Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5, 7–8 (1995).

[8] *Id.* at 11, 14 & 17.

creditors could commence the bankruptcy proceeding.[9] Bankruptcy was thus premised only on "debtor misconduct" and involuntary bankruptcy continued its reliance on this concept all the way until the Bankruptcy Reform Act of 1978,[10] at which point bankruptcy policy began to shift from debtor misconduct to debtor relief. As this Comment discusses below, the broad theme of bankruptcy law in the United States has shifted almost completely to the other side of the pendulum, but the tension between the competing objectives still exists today and permeates through the Code and case law.[11]

Thus, the purpose of involuntary bankruptcy in the current Code system is still to provide creditors with a tool to "compel a reorganization or liquidation of the debtor's estate."[12] This tool is especially useful if the creditor suspects the debtor is wasting or concealing assets, or to prevent other creditors from seizing the debtor's property.[13] However, Congress has recognized this tool inherently opens the door for creditor abuse and thus included significant debtor protection provisions in the Code as well.

1. *Trends in Involuntary Bankruptcy*

In order to examine when a creditor might be liable for a dismissed involuntary bankruptcy petition, it is important to first briefly inspect when, why, and how often creditors pursue this path. This section highlights the trends in involuntary bankruptcy law in the U.S. as well as reasons why creditors might not be choosing this option for collecting on a debt.

Despite the prevalence of involuntary bankruptcy proceedings in the early stages of bankruptcy law and Congress' continued support of their use, in modern history, the number of involuntary bankruptcy proceedings filed each year is surprisingly low, both in total and in comparison to the number of voluntary bankruptcy cases filed each year, as seen in Figure 1 below.

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[9] Tabb, *supra* note 7, at 8.

[10] *Id.*

[11] *See* Benjamin Weintraub & Alan N. Resnick, *Involuntary Petitions under the New Bankruptcy Code*, 97 BANKING L.J. 292, 328 (1980).

[12] *Id.*

[13] Joseph G. Rosania, *Involuntary Petitions under the Bankruptcy Reform Act of 1978*, 13 COLO. LAW. 1367, 1368 (1984).

Year	Total Bankruptcies	Total Involuntary	% Involuntary
1970	194,399	1,099	0.57%
1975	254,484	1,286	0.51%
1980	210,364	936	0.44%
1985	364,536	1,597	0.44%
1990	749,981	1,637	0.22%
1995	883,457	1,142	0.13%
2000	1,262,102	730	0.06%
2005	1,782,643	563	0.03%
2010	1,596,355	1,054	0.07%
2015	860,182	351	0.04%

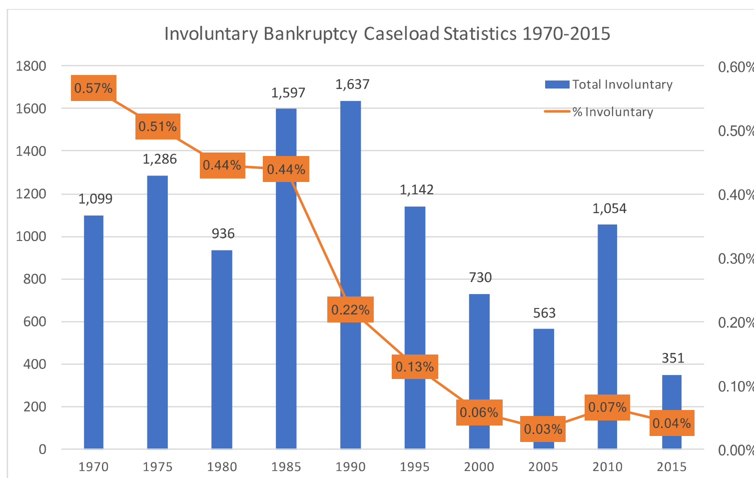

Figure 1: Involuntary Bankruptcy Cases Filed by Year[14]

Congress enacted the Bankruptcy Reform Act of 1978 in part to encourage involuntary bankruptcies by relaxing the standard that creditors must prove to successfully place a debtor into involuntary bankruptcy.[15] Notwithstanding these efforts, involuntary bankruptcies have remained few and continued to decline.[16] The significant risks a creditor faces when filing an involuntary bankruptcy,

[14] U.S. Bankruptcy Courts—Voluntary and Involuntary Cases Filed, by Chapter of the Bankruptcy Code. http://www.uscourts.gov/sites/default/files/data_tables/Table7.02.pdf.

[15] Susan Block-Lieb, *Why Creditors File So Few Involuntary Petitions and Why the Number Is Not Too Small*, 57 BROOK. L. REV. 803, 804 (1991).

[16] *Id.*

combined with the variety of alternative options for collecting on a debt, have left involuntary bankruptcies as a last resort, a view supported by the bankruptcy courts.[17]

It is important to note, however, that "these statistics do not present a clear picture of the extent to which debtors are coerced into bankruptcy. The line between voluntary and involuntary filings is an ambiguous one because debtors often file voluntary petitions in reaction to creditors' collection efforts."[18] Elizabeth Warren accentuates this by stating "[a] very real issue-and one often ignored-is whether the barriers to involuntary filings discourage too many creditors who should force a defaulting creditor into the bankruptcy process."[19] If Congress were to takes steps to combat these overly coerced voluntary bankruptcies, involuntary bankruptcy could see increased usage and significance.

Overall, involuntary bankruptcies are likely here to stay, even as an infrequently used last resort.[20] Despite the seemingly inconsequential number of involuntary bankruptcies relative to the entire bankruptcy scheme, this process remains an important aspect of both the Code and creditor collection options and thus warrants continued analysis.

2. *Requirements For Filing an Involuntary Bankruptcy Petition Under § 303*

Involuntary bankruptcy cases are governed by § 303 of the Code, which sets forth the requirements for a creditor to be able to file an involuntary bankruptcy petition.[21] As previously mentioned, creditors may initiate involuntary bankruptcy proceedings under either chapter 7 or chapter 11.[22] However, there

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[17] *See* Higgins v. Vortex Fishing Sys., Inc., 379 F.3d 701, 707 (9th Cir. 2004); *In re* Capital Fin., Inc., No. BAP CC-07-1122-BAKPA, 2007 Bankr. LEXIS 4913, at *1 (B.A.P. 9th Cir. Nov. 14, 2007); *In re* Meltzer, 516 B.R. 504, 515 (Bankr. N.D. Ill. 2014).

[18] Block-Lieb, *supra* note 15.

[19] Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775, 798 (1987).

[20] Block-Lieb, *supra* note 15.

[21] 11 U.S.C. § 303 (2016).

[22] In chapter 11 bankruptcy, debts are not liquidated but restructured such that debt repayment is possible. The debtor maintains possession of its assets in chapter 11. In chapter 7 bankruptcy assets are sold and liquidated to repay as much of the debt as possible. Much of the remaining debt is discharged (forgiven). Chapter 11 bankruptcy is more common in situations involving corporations and other businesses, and chapter 7 bankruptcy is more commonly used by individuals; "Involuntary chapter 13 cases are not permitted…To do so would constitute bad policy, because chapter 13 only works when there is a willing debtor that wants to repay his creditors. Short of involuntary servitude, it is difficult to keep a debtor working for his creditors when he does not want to pay them back." S. REP. 95-989, at 32 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5787, 5818; 2 NORTON BANKR. L. & PRAC. 3d § 22:1 (3rd ed. 2018); 11 U.S.C. § 303(a).

are more than five times as many chapter 7 involuntary bankruptcy petitions as chapter 11.[23] This reflects the fact that involuntary bankruptcy proceedings do not usually occur until it is too late for an optimistic outlook towards restructuring and reorganization of the debtor—the goals of chapter 11—and the creditor is hoping to recover whatever it can through the liquidation that results from a chapter 11 case.[24] This highlights the recurring theme in involuntary bankruptcy that creditors must balance the risks of forcing debtors into bankruptcy and the potential serious penalties, if incorrect, against their goal of recovering at least some of the debt.

Under either chapter there are several requirements that must be met for a debtor to be eligible for an involuntary bankruptcy proceeding.[25] First, the aggregate amount of eligible unsecured claims held by the debtors must be at least $15,775.[26] If the debtor has twelve or more creditors, then at least three of the creditors must participate in the filing.[27] If there are fewer than twelve creditors, only one creditor must file for the petition to qualify.[28] Finally, a claim is only considered eligible for involuntary bankruptcy if there is no legitimate reason that the debtor has not paid the debt, and thus the court disqualifies claims that are (1) contingent as to a liability, or (2) subject to a dispute.[29]

Once the creditor(s) petition the bankruptcy court, the debtor can only defend against being forced into bankruptcy by filing an answer to the petition.[30] Once the creditor petition meets the various administrative requirements, including on time filing and satisfying the above thresholds for the dollar amount of claims and number of creditors, the court will review the case.[31] The court will rule against the debtor and thus put them into involuntary bankruptcy only if (1) the debtor is "generally not paying such debtors' debts as such debts become due;"[32] or (2) a custodian has been appointed or taken possession of all

[23] U.S. Bankruptcy Courts—Voluntary and Involuntary Cases Filed, by Chapter of the Bankruptcy Code. http://www.uscourts.gov/sites/default/files/data_tables/Table7.02.pdf.

[24] Block-Lieb, *supra* note 15, at 850.

[25] 11 U.S.C. § 303.

[26] 11 U.S.C. § 303(b).

[27] 11 U.S.C. § 303(b)(2).

[28] 11 U.S.C. § 303(b)(1).

[29] *Id.*

[30] 11 U.S.C. § 303(d).

[31] *Id.*

[32] *See* 2 NORTON BANKR. L. & PRAC, *supra* note 22 ("To establish that a debtor is not paying its debts as they become due, a petitioning creditor must do more than establish that the debtor has unpaid creditors or creditors whose obligations carry no fixed dates; petitioners must, in fact, outline the regular payment terms for the debts and then show that the debts are overdue according to those terms.4 Furthermore, it must be shown that the debtor's delinquency is germane. Courts have used four factors in making this determination: (1) the

or substantially all of the debtor's assets within 120 days before the filing date of creditor petition.[33]

3. Damages Awarded for Dismissed Involuntary Bankruptcy Petition Under § 303(i)

Courts carefully scrutinize involuntary bankruptcy decisions because "the filing of an involuntary petition is an extreme remedy with serious consequences to the alleged debtor, such as loss of credit standing, inability to transfer assets and carry on business affairs, and public embarrassment," regardless of whether the petitions ends up heard or dismissed.[34] The courts are also wary of becoming overburdened if seen as a common tool for collecting any debts:

> An allegation of bankruptcy is a charge that ought not to be made lightly. It usually chills the alleged debtor's credit and his sources of supply. It can scare away his customers. It leaves a permanent scar, even if promptly dismissed. It is also obvious that the use of the bankruptcy court as a routine collection device would quickly paralyze this court.[35]

Because the courts view involuntary petitions as a last resort remedy for creditors that has severe ramifications for the debtor, the Code sets forth serious consequences for creditors who file an involuntary bankruptcy petition that ends up being dismissed.[36] Section 303(i) establishes that:

> **(i)** If the court dismisses a petition under this section other than on consent of all petitioners and the debtor, and if the debtor does not waive the right to judgment under this subsection, the court may grant judgment—
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> **(1)** against the petitioners and in favor of the debtor for—
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> (A) costs; or
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> (B) a reasonable attorney's fee; or
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> **(2)** against any petitioner that filed the petition in bad faith, for—
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> **(A)** any damages proximately caused by such filing; or
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> **(B)** punitive damages.[37]

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number of unpaid claims; (2) the amount of such claims; (3) the materiality of the nonpayment; and (4) the debtor's overall conduct of its financial affairs.").

33 11 U.S.C. § 303(d).

34 *In re* Reid, 773 F.2d 945, 946 (7th Cir. 1985).

35 *In re* SBA Factors of Miami, Inc., 13 B.R. 99, 101 (Bankr. S.D. Fla. 1981).

36 11 U.S.C. § 303(i).

37 11 U.S.C. § 303(i).

By holding creditors accountable for costs, attorney's fees, and even compensatory and punitive damages if the involuntary bankruptcy proceeding is dismissed in bad faith, Congress has firmly expressed its view that involuntary bankruptcies should not be taken lightly when a creditor evaluates its options for collecting a debt.[38] This is a primary reason why involuntary bankruptcies are becoming increasingly rare,[39] and it is a reflection of how far the U.S. bankruptcy system has shifted from helping creditors collect to protecting debtors from collection.

As discussed in more detail below, § 303(i)(1) of the Code expressly reserves awards for costs and reasonable attorney's fees for only the debtor.[40] The circuit split and this Comment focus on the rights of non-debtors whose potential claim would only arise under § 303(i)(2). Section 303(i)(2) provides for compensatory and punitive damages if the involuntary bankruptcy petition is filed in bad faith.[41] Thus, it is important to examine how a court determines what constitutes "bad faith" with respect to involuntary bankruptcy petitions.

First, "there is a presumption of good faith in favor of the petitioning creditor, and thus the alleged debtor has the burden of proving bad faith."[42] Additionally, "this burden is a significant one" as the debtor "must prove bad faith by at least a preponderance of the evidence."[43] This high burden makes sense considering the harsh penalties the creditor faces if this burden is met. Because "the determination of bad faith is a fact intensive determination" and the standard for defining bad faith is not defined in the Code, "courts have applied a dizzying array of standards."[44]

Recently, the Third Circuit illustrated this dizzying array of standards, calling it a "totality of the circumstances" standard of review.[45] It stated that

> courts may consider a number of factors, including, but not limited to, whether: (1) the creditors satisfied the statutory criteria for filing the petition; (2) the involuntary petition was meritorious; (3) the creditors made a reasonable inquiry into the relevant facts and pertinent law before filing; (4) there was evidence of preferential payments to certain

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[38] *In re* Reid, 773 F.2d at 946.

[39] Lynn M. LoPucki, *A General Theory of the Dynamics of the State Remedies/Bankruptcy System*, 1982 WIS. L. REV. 311, 353 (1982).

[40] 11 U.S.C. § 303(i)(1).

[41] 11 U.S.C. § 303(i)(2).

[42] U.S. Fid. & Guar. Co. v. DJF Realty & Suppliers, Inc., 58 B.R. 1008, 1011 (N.D.N.Y. 1986).

[43] *In re* CLE Corp., 59 B.R. 579, 583 (Bankr. N.D. Ga. 1986).

[44] *In re* Forever Green Athletic Fields, Inc., 804 F.3d 328, 335 (3d Cir. 2015).

[45] *Id.*

> creditors or of dissipation of the debtor's assets; (5) the filing was motivated by ill will or a desire to harass; (6) the petitioning creditors used the filing to obtain a disproportionate advantage for themselves rather than to protect against other creditors doing the same; (7) the filing was used as a tactical advantage in pending actions; (8) the filing was used as a substitute for customary debt-collection procedures; and (9) the filing had suspicious timing.[46]

Therefore, unsurprisingly, the court will employ a case-by-case analysis to determine whether a petitioning creditor acted in bad faith,[47] and if it finds that such creditors acted in bad faith, the compensatory and punitive damages awarded are often severe.[48] For example, in *In re Forever Green Athletic Fields, Inc.*, the Third Circuit used a combination of the third, seventh, eighth, and ninth factors to determine that the creditor filed the petition in bad faith.[49] In *Forever Green*, the creditor had a pending judgment against the debtor which it could have used to satisfy payments owed to the creditor. However, the creditor in *Forever Green* filed an involuntary bankruptcy petition that was "light on meritorious arguments," had suspicious timing, and was clearly being used as a tactical advantage in pending actions to get an advantage over other creditors and "to gain a personal advantage in other pending actions or as a debt-collection service."[50] The court concluded that this did in fact constitute a bad faith involuntary bankruptcy petition.[51]

B. Preemption and Removal Jurisdiction Doctrine

In addition to the specific Code sections governing involuntary bankruptcies, preemption and removal play an important role within bankruptcy law in general and in the involuntary bankruptcy context. While the Code is federal law, bankruptcy almost always involves issues of contract law, over which state law

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[46] *In re* Forever Green Athletic Fields, Inc., 804 F.3d at 336.

[47] *See* Block-Lieb, *supra* note 15, at 842 ("There is no single definition of bad faith for purposes of section 303(i). Some courts emphasize petitioners' desires to harass, embarrass or harm the debtor as indicative of bad faith." Others have found bad faith in the petitioning creditors' [attempts] to use bankruptcy as a substitute for their state collection remedies. Collusive behavior has also often been held to constitute bad faith. That one or more creditors solicited others to join in the involuntary petition is not alone indicative of collusion or bad faith. Although one court was persuaded that a petitioning creditor did not act in bad faith when it relied on erroneous legal advice, several others have found that the petitioners' reliance on legal advice is not dispositive of their good faith.").

[48] *In re* John Richards Homes Bldg. Co., L.L.C., 439 F.3d 248 (6th Cir. 2006) (finding that the bankruptcy court did not err in awarding costs, attorney's fees, compensatory damages, and punitive damages totaling $6.4 million pursuant to § 303(i) based on bad-faith filing of involuntary petition.).

[49] *In re* Forever Green Athletic Fields, Inc., 804 F.3d at 336.

[50] *Id.*

[51] *Id.* at 338.

typically governs.[52] Thus, it is unsurprising that these often overlap, compete, and sometimes clash and consequently invoke the very essence of preemption. In addition to the substantive issues involved in the case, the forum in which these issues are litigated and decided also often intersect.[53] This leads to additional issues related to removal of bankruptcy related proceedings from state to federal courts.

These federalism issues—preemption and removal—are central to the theme of this Comment and the fulcrum of the circuit split, and as such the Comment next provides an overview of federal preemption and removal jurisdiction.

1. Federal Preemption

Established by the Supremacy Clause of the Constitution,[54] the Supreme Court has "long recognized that state laws that conflict with federal law are without effect."[55] Preemption embodies the Founders' separation of powers concerns in drafting the Constitution as a doctrine that is a "necessary but precarious component of our system of federalism under which the states and the federal government possess concurrent sovereignty."[56] The Supreme Court requires that any preemption analysis "must be guided by two cornerstones of our preemption jurisprudence."[57] These two cornerstones are (1) "the purpose of Congress is the ultimate touchstone in every preemption case;" and (2) "in all preemption cases, and particularly in those in which Congress has legislated … we start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress." [58] In other words, in every preemption case the courts are required to (1) look first and foremost to Congress' intent to supersede the state law; and (2) unless such congressional intent is "clear and manifest," examine the case with a "presumption against preemption."[59] With this framework in mind, the court has demonstrated that there are two overarching types of federal preemption: complete and ordinary.[60] While both deal with situations in which federal law supersedes state law, there are multiple differences between them.

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[52] *See* Butner v. United States, 440 U.S. 48, 49 (1979).
[53] *See* Gonzales v. Parks, 830 F.2d 1033, 1036 (9th Cir. 1987).
[54] U.S. Const., art. VI, cl. 2.
[55] Altria Grp., Inc. v. Good, 555 U.S. 70, 76 (2008).
[56] Sikkelee v. Precision Airmotive Corp., 822 F.3d 680, 687 (3d Cir. 2016).
[57] Wyeth v. Levine, 555 U.S. 555, 565 (2009).
[58] Medtronic, Inc. v. Lohr, 518 U.S. 470, 485 (1996).
[59] Wyeth, 555 U.S. at 565.
[60] Sullivan v. Am. Airlines, Inc., 424 F.3d 267, 272 (2d Cir. 2005).

2. *Ordinary Preemption*

Much more common than complete preemption, ordinary preemption is known as "defensive preemption" because it is a tool that defendants can use to prove in a state law action that "because federal law preempts state law, the defendant cannot be held liable under state law."[61] Ordinary preemption doctrine provides that after a plaintiff files suit in state court under a state law cause of action, one of the defendant's defenses may be that the state law at issue in the case is preempted by federal law, and thus the plaintiff's complaint cannot be successful.[62] As will become evident in the next section, it is important to note that this defensive preemption serves only as a defense in the state court trial, not as justification for federal subject matter jurisdiction and thus a removal of the case to federal courts.[63]

The Supreme Court has found that "ordinary defensive preemption comes in three familiar forms: express preemption, conflict preemption, and field preemption."[64]

> (1) Congress' intent may be *explicitly* stated in the statute's language or implicitly contained in its structure and purpose. In the absence of an express congressional command, (2) state law is pre-empted if that law actually *conflicts* with federal law, or (3) if federal law so thoroughly occupies a legislative *field* as to make reasonable the inference that Congress left no room for the States to supplement it.[65]

Field preemption is at the heart of the circuit split discussed below. Field preemption occurs when "an Act of Congress touches a field in which the federal interest is so dominant that the federal system will be assumed to preclude enforcement of state laws on the same subject."[66] As discussed above, field preemption, as with all the other preemption doctrines, requires that "congressional intent to supersede state laws must be clear and manifest."[67]

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[61] Sullivan, 424 F.3d at 272–73.

[62] *See* Caterpillar, Inc. v. Williams, 482 U.S. 386, 392 (1987); Blab T.V. of Mobile, Inc. v. Comcast Cable Commc'ns, Inc., 182 F.3d 851, 855 (11th Cir. 1999); Geddes v. Am. Airlines, Inc., 321 F.3d 1349, 1352 (11th Cir. 2003).

[63] *See* Caterpillar, Inc., 482 U.S. at 393.

[64] Sullivan, 424 F.3d at 273.

[65] Cipollone v. Liggett Grp., Inc., 505 U.S. 504, 516 (1992) (emphasis added) (internal quotation marks and citations omitted); Franchise Tax Bd. of State of Cal. v. Constr. Laborers Vacation Tr. for S. Cal., 463 U.S. 1, 14 (1983) ("[I]t is now settled law that a case may not be removed to federal court on the basis of a federal defense, including the defense of pre-emption, even if the defense is anticipated in the plaintiff's complaint, and even if both parties concede that the federal defense is the only question truly at issue.").

[66] English v. Gen. Elec. Co., 496 U.S. 72, 79 (1990).

[67] *Id.*

3. *Complete Preemption*

The other type of preemption is complete preemption. Despite its name, complete preemption is "less a principle of substantive preemption than it is a rule of federal jurisdiction,"[68] and at its core is an exception to the well pleaded complaint rule for removal to federal court.[69] The well pleaded complaint rule is a procedural rule stating that federal jurisdiction does not apply to a case unless the plaintiff's complaint asserts on its face an issue of federal law. Consequentially, the only way a federal question is litigated in federal court is if the *plaintiff* brings up the federal issue. Thus, within the preemption context, unless the plaintiff's claim mentions federal law, a defendant cannot remove the case based on a defense of ordinary federal preemption. This has been made particularly clear by the Supreme Court, stating that "a case may not be removed to federal court on the basis of a federal defense, including the defense of preemption, even if the defense is anticipated in the plaintiff's complaint, and even if both parties concede that the federal defense is the only question truly at issue."[70]

Complete preemption exists as an exception to this rule. While it remains a rare, "troublesome and confusing" doctrine,[71] "[u]nder the complete-preemption doctrine, certain federal statutes are construed to have such 'extraordinary' preemptive force that state-law claims coming within the scope of the federal statute are transformed, for jurisdictional purposes, into federal claims."[72] Because "preemption and jurisdiction are . . . inexorably intertwined,"[73] this doctrine allows for cases to be removed to federal courts even if the plaintiff did not assert the federal issue in their complaint and the claims are decided under federal law. Complete preemption alone grants both removal and preemption all at once. The Supreme Court has only extended complete preemption to three statutes: (1) § 301 of the Labor and Management Relations Act ("LMRA"), 29 U.S.C. § 185;[74] (2) § 502 of the Employee Retirement Income Security Act of

[68] Blab T.V. of Mobile, Inc, 182 F.3d at 855.

[69] *Id.*; *In re* Miles, 430 F.3d at 1094.

[70] Caterpillar Inc., 482 U.S. at 393.

[71] Beneficial Nat. Bank v. Anderson, 539 U.S. 1, 21 (2003) (Scalia, J., dissenting); *In re* Miles, 430 F.3d at 1094.

[72] Sullivan, 424 F.3d at 272.

[73] MSR Expl., Ltd. v. Meridian Oil, Inc., 74 F.3d 910, 912 (9th Cir. 1996).

[74] *See* Avco Corp. v. Aero Lodge No. 735, 390 U.S. 557 (1968).

1974 (“ERISA”), 29 U.S.C. § 1132;[75] and (3) § 85 and § 86 of the National Bank Act, 12 U.S.C. §§ 85, 86.[76]

4. *Comparing and Distinguishing Field And Complete Preemption*

The line between field and complete preemption is both narrow and complicated and continues to evolve. While they do “serve distinct purposes”[77] and “must be distinguished,”[78] they are also so similar their analyses have even led to “some courts’ confusion of field preemption with the complete preemption doctrine,[79] “occasionally . . . equat[ing] complete preemption to field preemption,”[80] or describing complete preemption as a “subspecies of field preemption.”[81] The confusion permeates throughout multiple circuit courts.[82]

As previously mentioned, their primary difference is that complete preemption is at its core a jurisdictional doctrine used to *remove* a case to federal court while field preemption is used to *decide* a case, usually by state court justices applying the preemptive federal law. Complete preemption “applies only where Congress creates an exclusive federal cause of action,”[83] while the field preemption tests whether “Congress intended to foreclose any state regulation.”[84] This means that in complete preemption, Congress enacts legislation that not only completely supersedes, or preempts, any state law on the subject, but also can only be litigated in federal courts. Field preemption only accomplishes the former objective of preempting any state law on the issue.

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[75] *See* Metro Life Ins. Co. v. Taylor, 481 U.S. 58, 63 (1987).

[76] *See* Beneficial Nat’l Bank, 539 U.S. 1. For a detailed explanation of these three cases and how the relate to bankruptcy; *see also* Oleksandra Johnson, *The Bankruptcy Code as Complete Preemption: The Ultimate Trump?*, 81 AM. BANKR. L.J. 31, 64 (2007).

[77] Retail Prop. Tr. v. United Bhd. of Carpenters & Joiners of Am., 768 F.3d 938, 948 (9th Cir. 2014).

[78] Sullivan, 424 F.3d at 272.

[79] S. Candice Hoke, *Preemption Pathologies and Civic Republican Values*, 71 B.U. L. REV. 685, 747 (1991).

[80] Retail Prop. Tr., 768 F.3d at 948.

[81] Cook v. Rockwell Int’l Corp., 790 F.3d 1088, 1097 (10th Cir. 2015).

[82] *See e.g.*, Sullivan, 424 F.3d at 272; Balcorta v. Twentieth Century-Fox Film Corp., 208 F.3d 1102, 1107 n. 7 (9th Cir. 2000); SPGGC, LLC v. Ayotte, 488 F.3d 525, 530 n. 4 (1st Cir. 2007); *In re* NOS Commc’ns, 495 F.3d 1052, 1058 (9th Cir. 2007); Ting v. AT&T, 319 F.3d 1126, 1135 (9th Cir. 2003); ARCO Envtl. Remediation, 213 F.3d at 1114; Johnson v. MFA Petroleum Co., 701 F.3d 243, 254 (8th Cir. 2012) (Beam, J., dissenting); Boomer v. AT&T Corp., 309 F.3d 404, 417 (7th Cir. 2002); Lehmann v. Brown, 230 F.3d 916, 919 (7th Cir. 2000).

[83] Carter v. Cent. Reg’l W. Va. Airport Auth., Triad Eng’g, Inc., Civil Action No. 2:15-cv-13155, 2016 U.S. Dist. LEXIS 96523, at *38 (S.D. W. Va. July 25, 2016).

[84] *Id.* at *44.

Likely unsurprising at this point, however, both doctrines "bear a number of similarities" and "rest on the breadth . . . of a federal statute's preemptive force."[85] As such, and most important for the analysis in this Comment, the line between them is sufficiently narrow that the analysis of one would very likely lead to the same result as the analysis of the other.[86] If the relevant evidence does not demonstrate clear and manifest congressional intent to "regulate the entire field,"[87] neither field nor complete preemption is likely to apply. Figure 2 provides a diagram demonstrating how field and complete preemption fit into the larger preemption doctrine.

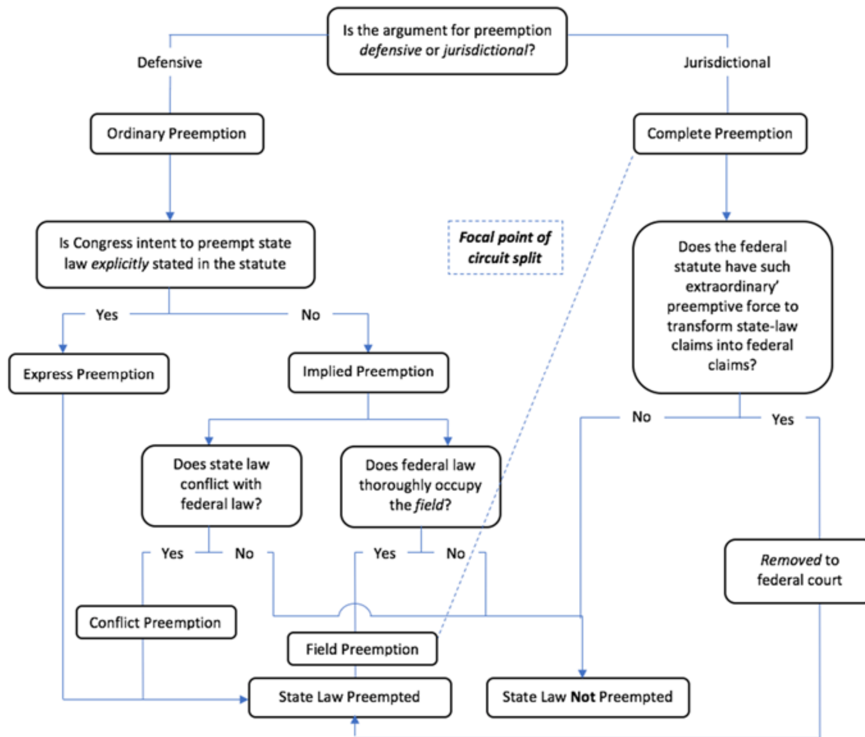

Figure 2: Federal Preemption Doctrine

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[85] Retail Prop. Tr., 768 F.3d at 948.

[86] *See generally* Rosenberg, 835 F.3d 414.

[87] ARCO Envtl. Remediation, L.L.C., 213 F.3d 1108.

5. *Removal Jurisdiction*

Because complete preemption is at its core a jurisdictional doctrine used as a basis for removal, it is also important to provide a brief background of removal jurisdiction in the bankruptcy context. Bankruptcy courts have existed in their present form, a separate federal court in each federal district, since the Bankruptcy Reform Act of 1978.[88] The scope of their jurisdictional power has undergone both expansion and narrowing through the actions of both Congress and Supreme Court.[89] Section 1334 of title 28 governs federal courts' jurisdiction of bankruptcy cases:

> [C]urrently district courts 'have original and exclusive jurisdiction of all cases under title 11,' and 'original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.'[90]

The federal district court may then refer the case to bankruptcy courts. The complex analysis to determine what makes a case "under" versus "arising under" or "arising in related to cases under" title 11 is beyond the scope of this Comment, as is the type of proceedings bankruptcy courts can receive from federal courts.[91] However, once a case is in state court, removal of claims related to bankruptcy cases is governed by both § 1441 (the "general federal removal statute") and § 1452 (the "bankruptcy removal statute") of title 28 of the United States Code.[92] Section 1452 provides:

> § 1452. Removal of claims related to bankruptcy cases
>
> (a) A party may remove any claim or cause of action in a civil action other than a proceeding before the United States Tax Court or a civil action by a governmental unit to enforce such governmental unit's police or regulatory power, to the district court for the district where such civil action is pending, if such district court has jurisdiction of such claim or cause of action under section 1334 of this title.[93]

Thus, a claim within the "original and exclusive jurisdiction … under title 11" as set forth in section 1334 may be removed by any party pursuant

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[88] Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, amended by Pub. L. No. 109-08, 119 Stat. 23 (effective as to cases filed on or after Oct. 17, 2005, with certain specified exceptions) (codified at 11 U.S.C. §§ 101, 1532)(2016).

[89] For a summary of this evolution, *see* Johnson, *supra* note 76.

[90] Johnson, *supra* note 76, at 46.

[91] Johnson, *supra* note 76.

[92] Things Remembered, Inc. v. Petrarca, 516 U.S. 124, 126 (1995).

[93] 28 U.S.C. § 1452 (2016).

to section 1452.[94] This works similarly to the jurisdiction aspect of complete preemption: even if the plaintiff only brings a state law claim, if the court finds the case to meet the statutory bankruptcy jurisdictional requirements the defendant can remove the case based on federal question jurisdiction.[95]

To summarize, preemption doctrine determines whether federal or state law applies to an issue in a case and removal doctrine dictates whether the issue is litigated in federal or state court. Complete preemption at once answers both questions—law and forum—with the federal system.

C. Non-Debtor Third Party in Involuntary Bankruptcy

Finally, in addition to the relevant Code provisions, preemption and jurisdictional doctrines, the issue in these cases and this Comment rests on the rights of non-debtor third parties. While nothing in the Code or its legislative history discusses non-debtors or their potential remedies within the involuntary bankruptcy arena, it is quite intuitive that non-debtors could be proximately or derivatively damaged from a bad faith involuntary bankruptcy petition. For the debtor, involuntary bankruptcy "chills the alleged debtor's credit and his sources of supply. It can scare away his customers. It leaves a permanent scar, even if promptly dismissed."[96] Despite potentially abandoning the debtor, these hypothetical creditors, suppliers, and customers of the debtor are not immune from collateral damage caused by the involuntary bankruptcy petition. Courts have recognized that "it is important here to note that the harm from an improper involuntary bankruptcy petition can result not only to the debtor but also to the debtor's owners, employees, suppliers, customers and other creditors."[97] This is especially true with the vast majority of involuntary bankruptcies initiated under chapter 7, where third parties would be forced to prepare for the complete liquidation of the debtor.[98]

For example, consider how an involuntary bankruptcy petition, filed against a manufacturer, could affect one of the manufacturer's suppliers. The supplier's revenue, cash flow, and credit might be tied to the expectation of sales to the manufacturer. It is no stretch to imagine that the supplier's finances, whether through its stock price or creditworthiness, will likely deteriorate under fear of the lost revenue. This logic applies to large corporations within a global,

[94] Johnson, *supra* note 76, at 46.
[95] Johnson, *supra* note 76.
[96] *In re* SBA Factors of Miami, Inc., 13 B.R. at 101.
[97] *In re* John Richards Homes Bldg. Co., L.L.C., 298 B.R. at 605.
[98] U.S. Bankruptcy Courts—Voluntary and Involuntary Cases Filed, by Chapter of the Bankruptcy Code. http://www.uscourts.gov/sites/default/files/data_tables/Table7.02.pdf.

complex supply chain to small business owners to individual consumers. In an increasingly technological and connected society, news of such a petition will travel faster than ever before with potentially far reaching ramifications.

These proximate or derivative damages also might apply to other creditors of the debtor.[99] Interest on credit can be a significant portion of creditor revenue, and much like the example above, the threat of potential liquidation might also impact other creditors' well-being. Overall, it is easy to imagine involuntary bankruptcy proceedings as having an increasingly negative impact on non-debtors in the current environment.

II. EXAMINING THE CIRCUIT SPLIT

With the Code, preemption and removal doctrines, and non-debtors' roles in mind, this section will proceed in three parts. First, this section examines the cases and their subsequent circuit split between the Ninth and Third Circuits. This section next argues that the Third Circuit's analysis is preferable. Finally, this section examines the potential impact of the *Rosenberg* decision and the resulting split.

A. *Analytical Structure*

Each of the case analyses follows the same structure used by the courts: (1) preemption and (2) standing. The courts employ this construction because in these situations there are two distinct ways in which the non-debtors could recover damages for the dismissed involuntary bankruptcy proceeding: (1) under state law causes of action; or (2) under § 303 of the Code. First, and why preemption doctrine is essential to this issue, in order to recover under state law the court must find that the federal Code does not preempt such state action. If state law is preempted by the Code, the only remaining avenue for recovery requires the court to determine that § 303(i)(2) gives standing to non-debtors.

1. In re Miles

In the Ninth Circuit case *In re Miles*, the defendants filed ten involuntary bankruptcy petitions against Rodney Miles, Ann Miles, and the businesses the Miles affiliated with or owned, all resulting from a neighborly feud.[100] After the bankruptcy court dismissed all of the petitions, nine of them on grounds including bad faith, Ann Miles and the couple's daughters "filed three

[99] *In re* John Richards Homes Bldg. Co., L.L.C., 298 B.R. at 605.

[100] *In re* Miles, 294 B.R. at 758, *aff'd*, 430 F.3d 1083 (9th Cir. 2005).

substantially identical tort actions in a California state court seeking damages for the filing and prosecution of the involuntary petitions."[101] The complaints stated theories of defamation, false light, abuse of process, emotional distress, negligent misrepresentation, and simple negligence.[102] The bankruptcy court, Ninth Circuit Bankruptcy Appellate Panel, and Ninth Circuit all ruled that (1) the state law tort claims were completely preempted by § 303(i) of the Code; and (2) the Miles' did not have standing to pursue damages for bad faith involuntary bankruptcy petitions under § 303(i)(2).[103] This Comment next explores both of these holdings in turn.

a. Preemption

By finding for complete preemption, the court in *In re Miles* achieved the two goals inherent in the complete preemption doctrine: (1) jurisdictionally, the case was properly removed from state court to federal bankruptcy court; and (2) the Code preempts any state law action related to non-debtor third party damages in the bad faith involuntary bankruptcy petition context.[104] As discussed above, the complete preemption doctrine serves as a powerful exception to the well-pleaded-complaint rule and allows for both appropriate removal and "transform[s] the plaintiff's state-law claims into federal claims."[105]

The Ninth Circuit acknowledged that complete preemption remains rare and that the U.S. Supreme Court has only applied complete preemption to specific provisions of three federal statutes, none of which include the Code.[106] Nevertheless, after concluding that the Code and its legislative history are silent on the matter, the court looks to the "structure and purpose" of the Code to determine if Congress intended § 303(i) "to provide the exclusive cause of action for damages resulting from the filing of an involuntary bankruptcy petition."[107] The court employed a four step analysis set forth in a prior Ninth Circuit case to conclude that complete preemption applies in this case: (1) "Congress' placement of bankruptcy jurisdiction exclusively in the federal district court"; (2) the complex and comprehensive nature of the Code; (3) the Constitutional "power to Congress 'to establish…uniform Laws on the subject of Bankruptcies

101 *In re* Miles, 294 B.R. at 758.
102 *Id.* at 759.
103 *In re* Miles, 430 F.3d 1083 (9th Cir. 2005).
104 *Id.*
105 Rivet v. Regions Bank of La., 522 U.S. 470 (1998).
106 *In re* Miles, 430 F.3d at 1085.
107 *Id.*

throughout the United States'"; and (4) extensive remedies for improper conduct already provided for by the Code.[108]

The court applies this logic and thus rules that by "[p]ermitting state courts to decide whether the filing of an involuntary bankruptcy petition was appropriate would . . . undermine uniformity in bankruptcy law by allowing state courts to create their own standards as to when a creditor may properly file an involuntary petition."[109] Finally, while the court states that it does "not hold that all state actions related to bankruptcy proceedings are subject to the complete preemption doctrine," it reaches its decision on the premise that the Code is "far from silent" with respect to remedies and sanctions for behavior in the bankruptcy court.[110] Accordingly, the Ninth Circuit held that "§ 303(i) provides the exclusive cause of action for damages predicated upon the filing of an involuntary bankruptcy petition" and complete preemption must apply.[111]

b. Standing

Once the court ruled that the Miles' state law claims were completely preempted by § 303(i) of the Code, the complaints were "recharacterized as alleging damages claims under § 303(i)" because "[c]omplete preemption recharacterizes a complaint with state law claims into one arising under federal law."[112] Thus, the court had to then examine whether the Miles' had standing to pursue damages under § 303(i)(2).[113]

The Ninth Circuit first examined the text of the Code.[114] The Code permits the court to grant judgment "against the petitioners and in *favor of the debtor*" under § 303(i)(1)[115] and "*against any petitioner* that filed the petition in bad faith"[116] under § 303(i)(2).[117] The court found that there are two possible readings for "mentioning only the debtor and the petitioning creditors in § 303(i)(1)" but omitting the words "and in favor of the debtor" in § 303(i)(2): (1) Congress intended to limit the debtor's standing; or (2) Congress intended to allow standing for non-debtors if the involuntary petition was filed in bad

[108] *In re* Miles, 430 F.3d at 1085.
[109] *Id.*
[110] *Id.* at 1088.
[111] *In re* Miles, 430 F.3d 1083, 1093 (9th Cir. 2005).
[112] *In re* Miles, 430 F.3d 1083, 1093 n.6 (9th Cir. 2005) (quoting Stewart v. U.S. Bancorp, 297 F.3d 953, 958 (9th Cir. 2002)) (internal quotes omitted).
[113] *In re* Miles, 430 F.3d 1083, 1093 (9th Cir. 2005).
[114] *In re* Miles, 430 F.3d 1083, 1093 (9th Cir. 2005).
[115] 11 U.S.C. § 303(i)(1) (2016) (emphasis added).
[116] 11 U.S.C. § 303(i)(2) (2016) (emphasis added).
[117] 11 U.S.C. § 303(i) (2016) (emphasis added).

faith.[118] In finding multiple potential interpretations, the court stated that the language is ambiguous and thus the court must consider "legislative history, relevant case law, and public policy to resolve the question."[119]

Thus, the court extracted the relevant 1977 House and Senate Reports, adding emphasis to "debtor" to interpret congressional intent limiting damages from bad faith involuntary bankruptcy filings:

> [I]f a petitioning creditor filed the petition in bad faith, the court may award the *debtor* any damages proximately caused by the filing of the petition. These damages may include such items as loss of business during and after the pendency of the case, and so on.[120]

The court finished its ruling by returning to a textual analysis in examining the introductory clause to § 303(i) that grants "the debtor" the ability to "waive the right to judgment under this subsection:"[121]

> **(i)** If the court dismisses a petition under this section other than on consent of all petitioners and the debtor, and *if the debtor does not waive the right to judgment under this subsection*, the court may grant judgment—
> **(2)** against any petitioner that filed the petition in bad faith, for—
> **(A)** any damages proximately caused by such filing; or
> **(B)** punitive damages.[122]

The court read this provision such that "allowing third parties to seek damages could invite abuse of the system" because debtors could extort petitioning creditors or non-debtors seeking damages into paying for waiver or non-waiver by the debtor.[123] Therefore, because Congress "took great care" in drafting the Code such that it would prevent abuse of the bankruptcy process, Congress could not have intended this provision to apply to non-debtor third parties.[124]

c. *Judge Berzon's Concurrence*

In his concurrence, Judge Berzon relied on other Ninth Circuit precedent to argue for a simpler approach: any action that collaterally attacks a bankruptcy petition are within the exclusive original jurisdiction of the federal courts, and

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[118] *In re* Miles, 430 F.3d at 1094.

[119] *Id.*

[120] H.R.Rep. No. 95–595, at 324 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6280 (emphasis added); S.Rep. No. 95–989, at 34 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5820 (identical text).

[121] 11 U.S.C. § 303(i) (2016).

[122] *Id.* (emphasis added).

[123] *In re* Miles, 430 F.3d 1083, 1094 (9th Cir. 2005).

[124] *Id.*

thus the state court in such a situation has no power to hear the case.[125] Judge Berzon agreed that "state law claims in the present case are preempted because state law cannot add to the remedial scheme Congress created under the Bankruptcy Code" but also found that the majority holding "would to a degree swallow the well-pleaded complaint rule, by permitting removal to federal court in any circumstance in which federal law provides someone a cause of action and also precludes state law causes of action."[126] He summarized his argument:

> In short, there is removal jurisdiction under the exclusive jurisdiction rationale . . . I see no reason to expand the troublesome and confusing doctrine of complete preemption . . . as there is another, simpler ground for reaching the same result. I therefore would not reach the question of whether there is complete preemption in this case.[127]

Judge Berzon essentially disagreed with the *jurisdictional* reasoning "in the choice-of-law sense" for removal to the federal courts.[128] Judge Berzon's argument reached the same result with a different line of reasoning: (1) the filing of involuntary bankruptcy petitions is clearly a "case under title 11" and subject to exclusive original jurisdiction of the federal court and sufficient to deem the removal proper;[129] (2) the state law action is preempted by ordinary field preemption, not complete;[130] and finally, (3) agreeing that the non-debtors do not have standing under the preemptive Bankruptcy Code.[131] It is important here to note that the *Miles* court could have reached their exact same conclusion without invoking the troublesome and confusing complete preemption doctrine.[132]

2. Rosenberg v. DVI Receivables XVII, LLC

In *Rosenberg v. DVI Receivables XVII, LLC*, the Third Circuit split from the Ninth Circuit's complete preemption ruling in *Miles* with respect to non-debtor

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125 *In re* Miles, 430 F.3d at 1095–96 (Berzon, J., concurring) ("Gonzales v. Parks held that all actions, such as the present one, that collaterally attack bankruptcy petitions are within the exclusive jurisdiction of the federal courts under 28 U.S.C. § 1334(a). *See* 830 F.2d at 1035 n.6 (stating that '[f]ilings of bankruptcy petitions are a matter of exclusive federal jurisdiction and that '[s]tate courts are not authorized to determine whether a person's claim for relief under a federal law, in a federal court, and within that court's exclusive jurisdiction, is an appropriate one' because '[s]uch an exercise of authority would be inconsistent with and subvert the exclusive jurisdiction of the federal courts'")).

126 *In re* Miles, 430 F.3d 1095–96 (Berzon, J., concurring).

127 *Id.*

128 *Id.*

129 *Id.*

130 *Id.*

131 *Id.*

132 *Id.*

third parties pursuing state law damages for bad faith filings.[133] A "fragment of more than a decade of ongoing litigation", the appeal in *Rosenberg* involved a similar fact pattern to *Miles*.[134] To finance the purchase of medical imaging equipment, Maury Rosenberg (the plaintiff's husband) entered into leases with DVI. During litigation in state court over money Rosenberg owed under the leases, DVI Receivables filed involuntary bankruptcy petitions against Rosenberg.[135] After multiple suits and appeals, Rosenberg eventually won an action under § 303(i) against DVI Receivables in which he was awarded $1.1 million in compensatory damages and $5 million in punitive damages under § 303(i)(2) for the bad faith filing by DVI receivables.[136] Non-debtor third parties aside, these high amounts awarded to the debtor demonstrate just how seriously the bankruptcy system punishes bad faith involuntary bankruptcy petitioners.

Subsequently, Rosenberg's wife Sara, along with several Rosenberg businesses entities, "brought suit to recover damages stemming from the involuntary bankruptcy petitions filed against Maury Rosenberg" under a "single claim of tortious interference with contracts and relationships."[137] The complaint alleged that DVI Receivables filed the involuntary bankruptcy petitions to force Rosenberg's real estate company to default on underlying mortgages, which ultimately happened.[138] The district court ruled to dismiss, finding that the "state law tortious interference claim was preempted by the involuntary bankruptcy provisions of the Bankruptcy Code."[139] On appeal, and similar to the Ninth Circuit in *Miles*, the Third Circuit considered both standing and preemption. The Third Circuit "agree[d] with the Miles Court that non-debtors lack standing under § 303(i) to recover damages."[140] The court did not provide any additional analysis on this point. However, the Third Circuit rejected *Miles* by holding that "Bankruptcy Code § 303(i) does not preempt state law claims by non-debtors for damages based on the filing of an involuntary bankruptcy petition."[141]

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133 Rosenberg, 835 F.3d at 419.
134 *Id.* at 416.
135 *Id.*
136 *Id.* at 417.
137 *Id.*
138 *Id.*
139 *Id.* at 418.
140 *Id.* at 421.
141 *Id.* at 416.

a. Preemption

The *Rosenberg* court performed its preemption analysis through the lens of field preemption instead of complete preemption. However, it points out that while "complete preemption is not the same as field preemption . . . finding complete preemption in the context § 303(i) would also support finding field preemption in our case."[142] Because field preemption and complete preemption are so similar with respect to substantive preemption issues, and, if anything, complete preemption requires more on the preemption spectrum; the court ultimately found that if field preemption did not apply, the lack of such preemptive force meant that neither would a finding of complete preemption.[143] Thus, the preemption analyses between the cases are comparable and thus a significant split exists.

The Third Circuit in *Rosenberg* began its preemption analysis very differently from the Ninth in *Miles*. The Third Circuit first explained and emphasized the overarching Supreme Court doctrine of the presumption against preemption both generally and in bankruptcy cases:

> In deciding whether Congress has occupied a field for exclusive federal regulation, we begin, based on concerns of federalism, with a sturdy 'presumption against preemption.' 'This strong presumption against inferring Congressional preemption also applies in the bankruptcy context.' It is overcome when 'a Congressional purpose to preempt … is clear and manifest.'[144]

With this foundation, the Third Circuit analyzed each of the text, structure, and purpose of the Code.[145] Similar to the analysis in *Miles*, the *Rosenberg* court acknowledged that the Code is "silent as to potential remedies for non-debtors harmed by an involuntary bankruptcy petition."[146] How the court interpreted this silence is what differed from *Miles*:

> This suggests that when Congress passed the provision it either did not intend to disturb the existing framework of state law remedies for non-debtors or (more likely) was not thinking about non-debtor remedies at all. In either case, field preemption does not apply.[147]

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[142] Rosenberg, 835 F.3d at 421 n.4.
[143] *Id.* at 419.
[144] *Id.* (internal citations omitted).
[145] *Id.*
[146] *Id.*
[147] *Id.*

Here, the Third Circuit again quoted the Supreme Court, rationally refusing to interpret congressional silence as a clear and manifest intention to "remove all means of judicial recourse for those injured by illegal conduct."[148]

The court also found no field preemption with respect to structure and purpose.[149] The court looked to the "remedial purpose" of § 303(i), which it believed to be essentially a balance of the inherent risks involved by "giving creditors the ability to bring a debtor into bankruptcy."[150] The Third Circuit found preempting state law remedies for non-debtors cuts directly against this remedial purpose, especially in light of the almost guarantee of proximate or derivative damage to third parties in these situations.[151]

The opinion pivoted its analysis to disposing of various counterarguments. It specifically identified the public policy based uniformity concerns from *Miles* in which the Ninth Circuit believed state laws would interfere with the federal scheme.[152] The *Rosenberg* court acknowledged that there likely will be conflicts between federal regulation and state law, but they were willing to "'rely on the traditional comity between the two systems . . . .' and trust that state courts faithfully will account for federal bankruptcy law to the extent it may be relevant to a state law claim against a creditor."[153] The *Miles* court acknowledged that state courts can account for federal bankruptcy law in other areas, but does not extend this trust to involuntary bankruptcy remedies like the *Rosenberg* court does here.

The court concluded its analysis by specifically confronting the *Miles* decision but does "not find *Miles* persuasive on the preemption issue" because:

> Near the beginning of its analysis, the Miles Court admitted that the 'Bankruptcy Code and its legislative history are silent on whether Congress intended 11 U.S.C. § 303(i) to provide the exclusive basis for awarding damages predicated upon the filing of an involuntary bankruptcy petition.' If we apply faithfully the presumption against preemption, silence on the part of Congress should be the end of the analysis. But the Court went on to 'infer from Congress's clear intent to provide damage awards only to the debtor ... that Congress did not intend [non-debtors] to be able to circumvent this rule by pursuing those very claims in state court.' Absent evidence that Congress

148 Rosenberg, 835 F.3d at 419.
149 *Id.*
150 *Id.*
151 *Id.*
152 *Id.* at 420.
153 *Id.*

> actually meant for § 303(i) to be an exclusive remedy, we do not make the same inference.[154]

Finally, the Third Circuit further distanced itself from the *Miles* decision by reiterating that the Supreme Court "has never recognized complete preemption in the Bankruptcy Code, and it seems the Ninth Circuit stands alone in this regard."[155] Thus, the Third Circuit expressly held "that Bankruptcy Code § 303(i) does not preempt state law claims by non-debtors for damages based on the filing of an involuntary bankruptcy petition."[156]

B. The Recent Third Circuit Decision is Preferable to the Ninth Circuit Precedent

The Third Circuit's decision in *Rosenberg* takes a significant step towards correcting the problem of non-debtor third parties lacking an avenue toward recovery in these cases. The *Rosenberg* decision acknowledges that Congress would likely not intend to foreclose any opportunity for non-debtors to pursue damages for bad faith involuntary bankruptcy petitions.[157] By ignoring the presumption against preemption and relying almost entirely on uniformity policy principles, the Ninth Circuit in *Miles* failed to consider the practical consequences of involuntary bankruptcy petitions considered in *Rosenberg*.

This section argues that the Third Circuit decision is preferable to the Ninth Circuit precedent for four reasons: (1) it is more consistent with the purpose of § 303(i); (2) it is more consistent with the modern trends in bankruptcy law; (3) it correctly applies the presumption against preemption doctrine; and (4) it encourages Congress to clearly manifest its intent.

1. More Consistent with Purpose of § 303(i)

As shown, an involuntary bankruptcy petition provides creditors with a path to inflict potentially serious damage to debtors, and the damages provision in § 303(i) reflects how seriously Congress considered this tool and these risks. It is counterintuitive to hold that Congress would recognize and plan for such inherent risks in involuntary bankruptcy and provide comprehensive debtor protection while simultaneously foreclosing any and all remedies for non-debtors. Additionally, the potential damages that non-debtor third parties could

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[154] Rosenberg, 835 F.3d at 421–22.
[155] *Id.* at 421.
[156] *Id.* at 422.
[157] *Id.* at 418.

suffer from a bad faith involuntary bankruptcy proceeding are likely to be significantly higher now than in 1977 when Congress last spoke on the matter, which the *Miles* court relied on in support of preemption.[158] The level of interconnectivity and rapid information sharing in 2018 is exponentially greater than in 1977,[159] and as such third parties to both individuals and business are more exposed than ever to the type of bad faith petition involved in these situations.

If both the Third and Ninth Circuits are correct that non-debtors do not have standing under § 303(i), it would be inequitable to foreclose all opportunities to recover by these non-debtors and against what Congress would likely intend. Thus, even though it is allowing non-debtors to seek remedies under state law and not the Code, the *Rosenberg* court is still furthering the purpose of § 303(i) by protecting those potentially suffering serious harm by the very tool that Congress created.

A likely counterargument is the potential "floodgate of litigation" leading to an overburdened court system.[160] If non-debtors are suddenly permitted to sue for bad faith involuntary bankruptcy petitions, the number of potential claimants might increase dramatically. Additionally, if in fact the increased interconnectivity of modern society has caused non-debtor damage to be both more likely and widespread than it was in 1977, this number of potential claimants and "flood" of litigation would be even worse. The court in *Rosenberg* acknowledged these "fears of a flood of state court litigation challenging the actions of creditors that would chill the use of involuntary bankruptcy proceedings and permit state courts to rewrite bankruptcy law."[161]

However, involuntary bankruptcies by definition are initiated by the creditor, and there are a variety of reasons why the number of involuntary bankruptcy filings remain so low.[162] Increasing the potential damages a creditor might face is only going to make it *less* likely that creditors use this tool, thus counteracting any additional lawsuits brought by non-debtor third parties.

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[158] H.R.Rep. No. 95–595, at 324 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6280 (emphasis added); S.Rep. No. 95–989, at 34 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5820 (identical text).

[159] Stanley Fawcett, *Information Sharing and Supply Chain Performance: The Role of Connectivity and Willingness*, 12 SUPPLY CHAIN MGMT.: AN INT'L J. 358, 368 (2007).

[160] *See* Eastman Kodak Co. v. Image Tech. Servs. Inc., 504 U.S. 451, 489 (1992) (Scalia, J., dissenting); *In re* Lawrence, 293 F.3d 615, 621 (2d Cir. 2002); Whitbeck v. Cook, 15 Johns. 482, 490 (N.Y. Sup. Ct. 1818).

[161] Rosenberg, 835 F.3d at 420.

[162] Block-Lieb, *supra* note 15, at 844-46 (including reasons such as preference for extrajudicial alternatives, informational disadvantages, and the damages provisions in § 303(i)).

Finally, under the *Rosenberg* decision, these lawsuits will be heard in state courts throughout the U.S., not burdening the federal bankruptcy courts.

2. More Consistent with Modern Trends in Bankruptcy Law

As discussed, throughout the Bankruptcy Code there is tension between the competing goals for creditors and debtors. As the focus has continued to shift from creditor recovery of debts to debtor relief from the harassment of relentless creditors,[163] the involuntary bankruptcy provisions should be interpreted this way as well. By holding that the Code both preempts state law actions while simultaneously not providing standing to third parties, the *Miles* decision creates inconsistency by moving in the other direction.

The exposure that non-debtor third parties have to the damage caused by bad faith involuntary petitions is likely to continue to increase. The *Rosenberg* decision recognized that non-debtors can suffer close to if not just as much harm as the debtor.[164] The Code provides extensive protection for debtors,[165] and the *Rosenberg* court identified that even if the Code does not yet extend to non-debtors, the courts should recognize this increasing opportunity for harm and not foreclose on the opportunity for non-debtors under state law.[166] Creditors have numerous alternative methods for debt collection both in state courts and by encouraging debtors to enter into voluntary bankruptcy.[167] If they are going to pursue the last resort that is involuntary bankruptcy then they should have to consider the risk to non-debtors as well as debtors.

3. Presumption Against Preemption

As the *Rosenberg* court made clear, the presumption against preemption is one of two foundational principles required by the Supreme Court in any preemption analysis. The only way to overcome this presumption is if Congress' intention is explicitly clear, and ambiguity should be interpreted in favor of presumption.

The courts in both *Miles* and *Rosenberg* interpreted the language in § 303(i) as ambiguous:

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[163] Block-Lieb, *supra* note 15, at 807.

[164] Rosenberg, 835 F.3d at 420.

[165] *See, e.g.*, 11 U.S.C. § 362.

[166] Rosenberg, 835 F.3d at 420.

[167] Block-Lieb, *supra* note 15, at 844-46 (including reasons such as preference for extrajudicial alternatives, informational disadvantages, and the damages provisions in § 303(i)).

Miles: "The statute is ambiguous as to whether damages under § 303(i) can be awarded only in favor of the debtor or in favor of other parties."[168]

Rosenberg: "Starting with text, § 303(i) provides a remedy to the debtor, but is silent as to potential remedies for non-debtors harmed by an involuntary bankruptcy petition."[169]

The *Rosenberg* court, however, correctly interpreted ambiguity to mean that congressional intent is *not* clear and manifest.[170] Neither the majority nor concurrence in *Miles* followed or even acknowledged the very well established presumption against preemption. By finding that non-debtors lack standing under § 303(i), entirely excluding the presumption against preemption from their analysis, and then finding that the most extreme level of preemption applies, the *Miles* court too quickly and inappropriately concluded that complete preemption applied in this case.

4. *Getting Congress' Attention & Separation of Powers*

By interpreting congressional silence to mean that states have the responsibility to assess certain damages related to a bankruptcy proceeding, the Third Circuit's ruling in *Rosenberg* encourages Congress to clarify its intent. This is one of the primary reasons the presumption against preemption exists.[171] If Congress' intent is to foreclose state law opportunities for non-debtors, the Third Circuit's interpretation in *Rosenberg* forces Congress to clearly say so. This is the appropriate role of the judiciary within the separation of powers context as well.[172]

C. *The Impact of* Rosenberg

The obvious impact of the *Rosenberg* decision is the amplified risks to creditors. As this Comment has shown, the chain reaction of damages resulting from dismissed petitions could cast a wide net of potential claimants that is likely to continue increasing in the future.[173] This increased economic exposure is thus likely to result in continued reduction of involuntary bankruptcy petitions. Creditors, already exposed to substantial damages in favor of just the debtor, will have to be even more careful when electing to use involuntary bankruptcy.

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168 *In re* Miles, 430 F.3d at 1093.
169 Rosenberg, 835 F.3d at 419.
170 *Id.*
171 Silkwood v. Kerr–McGee Corp., 464 U.S. 238, 251 (1984).
172 Perez v. Mortg. Bankers Ass'n, 135 S. Ct. 1199, 1216 (2015).
173 Fawcett, *supra* note 159.

III. A Proposed Interpretation

In summary, both circuit courts agree that § 303(i) does not provide standing to non-debtors to pursue damages for bad faith involuntary bankruptcy petitions. The courts split on whether the Code preempts state law action arising from these same petitions, with the Ninth Circuit finding for complete preemption and the Third finding no preemption. This section introduces a proposed, comparatively hybrid interpretation that would read § 303(i) as providing standing to non-debtors for bad faith involuntary bankruptcy proceedings combined with the application of removal jurisdiction and ordinary preemption. This proposal not only follows well-established statutory interpretation doctrines, but also allows the courts to achieve the policy goals underlying both the *Miles* and *Rosenberg* decisions. Similar to the prior analysis, this section proceeds in three parts by analyzing this proposal with respect to (1) standing, (2) preemption and removal, and (3) effects.

A. *Standing*

The argument that § 303(i) of the Code gives standing to non-debtors rests on practical and policy arguments as well as three established textual canons of statutory interpretation: (1) the presumption of intention when a statute includes a word in one section but not another; (2) the plain meaning canon of construction; and (3) the rule against surplusage.

As previously discussed, the Code permits the courts to grant judgment "against the petitioners *and in favor of the debtor*" under § 303(i)(1)[174] and only "against any petitioner that filed the petition in bad faith"[175] under § 303(i)(2). The language expressly states that § 303(i)(1), awarding attorney's fees and costs, applies to the debtor only, but § 303(i)(2) does not include the express language when awarding compensatory and punitive damages when the petition is filed in bad faith.[176] Unlike the holding in *Miles* and *Rosenberg*, policy implications and Supreme Court statutory interpretation doctrines demonstrate that this discrepancy should be interpreted to be intentional and providing standing to non-debtors. This section next examines both the textual and non-textual arguments in favor of this interpretation.

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[174] 11 U.S.C. § 303(i) (2016) (emphasis added).

[175] *Id.*

[176] *Id.*

B. *Textual Canons of Statutory Interpretation*

The Supreme Court has clearly ruled on situations where statutes include language in one section but not in others: "where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion."[177] Because Congress included the debtor in § 303(i)(1) but not § 303(i)(2), the courts should presume that Congress did so on purpose and that by not expressly limiting damages for bad faith involuntary petitions to the debtor, non-debtors should be able to recover under this section. Neither the *Miles* nor *Rosenberg* courts acknowledge this Supreme Court canon.

Courts often use this presumption of intent with the plain meaning construction,[178] and this combination of the canons can also be seen within the context of the Code. First, even within the same section, § 303(i)(2) includes the words "bad faith" while § 303(i)(1) does not.[179] However, § 303(i)(2) is clearly understood to mean that punitive damages are only available if the court finds the petition to be filed in bad faith.[180] The court should interpret the single inclusion of "debtor" in the same manner.

Another example of the combination of this presumption of intent and plain meaning canon can be found in the interpretation of § 362(c) of the Code.[181] Section 362 governs one of the most important aspects of bankruptcy and the Code: the automatic stay.[182] The automatic stay prevents creditors from beginning or continuing any pursuit against the debtor once the bankruptcy petition has begun. Section 362(c) provides for situations in which the automatic stay is terminated.[183] Section 362(c)(3) governs when a debtor files for bankruptcy within one year of a dismissed bankruptcy petition.[184] Subsection (A) of § 362(c)(A) provides that the automatic stay for actions "taken with respect to a debt or property securing such debt or with respect to any lease shall

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[177] Russello v. United States, 464 U.S. 16, 23 (1983) (citing United States v. Wong Kim Bo, 472 F.2d 720, 722 (5th Cir. 1972)).

[178] *See* Caminetti v. United States, 242 U.S. 470, 485 (1917).

[179] 11 U.S.C. § 303(i) (2016).

[180] Gonzales, 830 F.2d at 1036.

[181] 11 U.S.C. § 362 (2016).

[182] *Id.*

[183] *Id.*

[184] *Id.*

terminate *with respect to the debtor* on the 30th day after the filing of the later case."[185] However:

> [t]he majority view is that the automatic stay terminates under § 362(c)(3)(A) only with regard to the debtor and property of the debtor, not property of the estate.[186] Many of these courts have relied on the 'plain language' of § 362(c)(3)(A) in determining that the automatic stay is not terminated in regard to property of the estate after the 30–day period expires.[187]

Here, the courts have reasoned that by including "property of the estate" in other Code provisions, but not in § 362(c)(3)(A), the plain language and presumption of Congress' intent in these situations dictate that the omission was intentional.[188] A bankruptcy judge has explained this "plain language" approach:

> Section 362(c)(3)(A) as a whole is not free from ambiguity, but the words, 'with respect to the debtor' in that section are entirely plain; a plain reading of those words makes sense and is entirely consistent with other provisions of § 362 and other sections of the Bankruptcy Code. Section 362(c)(3)(A) provides that the stay terminates 'with respect to the debtor.' How could that be any clearer?[189]

Thus, bankruptcy courts are not only familiar with using these canons when interpreting the Bankruptcy Code but have held that they are the appropriate manner in which to interpret the Code. A similar method should be used with respect to § 303(i) and damages for bad faith involuntary filings. Even if § 303(i) "as a whole is not free from ambiguity . . . a plain reading of those words makes sense."190

Outside of the bankruptcy context, the Supreme Court has been very clear about the plain meaning canon of construction, stating that "the meaning of a statute must, in the first instance, be sought in the language in which the act is framed, and if that is plain…the sole function of the courts is to enforce it according to its terms."[191] When the language is plain, "the duty of interpretation

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[185] 11 U.S.C. § 362 (2016); *In re* Stanford, 373 B.R. 890, 894–95 (Bankr. E.D. Ark. 2007).

[186] *See, e.g., In re* Jumpp, 356 B.R. 789 (1st Cir. BAP 2006); *In re* Tubman, 364 B.R. 574 (Bankr. D. Md. 2007); *In re* McFeeley, 362 B.R. 121 (Bankr. D. Vt. 2007); *In re* Hollingsworth, 359 B.R. 813 (Bankr. D. Utah 2006); *In re* Pope, 351 B.R. 14 (Bankr. D.R.I. 2006); *In re* Murray, 350 B.R. 408 (Bankr. S.D. Ohio 2006).

[187] *In re* Stanford, 373 B.R. at 895.

[188] *Id.*

[189] *In re* Jones, 339 B.R. 360, 363 (Bankr. E.D.N.C. 2006).

[190] *Id.*

[191] Caminetti, 242 U.S. at 485.

does not arise and the rules which are to aid doubtful meanings need no discussion."[192]

By simply finding the omission to mean ambiguity, neither of the split courts gave proper deference to this Supreme Court doctrine. The meaning of § 303(i) can be interpreted plainly and clearly from the statute itself, and thus the courts had no "duty of interpretation." The courts' inquisitions into the purpose and dated legislative history of § 303(i) were unwarranted, and because Congress limited § 303(i)(1) to the debtor but did not do so for § 303(i)(2), the courts should interpret this to allow non-debtors to have standing.

The third applicable canon of construction is the rule against surplusage, a "basic interpretive canon that a statute should be construed to give effect to all its provisions, so that no part will be inoperative or superfluous, void or insignificant."[193] While marginally overlapping with the prior two canons, by reading § 303(i)(2) as excluding all but the debtor, the Court made Congress' use of "in favor of the debtor" in § 303(i)(1) superfluous.[194] This clearly violates this basic interpretative canon and the provision should be interpreted as giving standing to non-debtor third parties.

Overall, the few decisions ruling on these situations do not give proper deference to Supreme Court textual canons of statutory interpretation. If remedied, the courts should find that § 303(i)(2) does give standing to non-debtors to pursue damages for bad faith involuntary bankruptcy petitions.

C. Preemption & Removal Jurisdiction

Once a court finds that the omission of "debtor" in 303(i)(2) means that the plain language of the statute can be interpreted to give non-debtors standing, those non-debtor plaintiffs will be able to sue under the Code. However, if a non-debtor plaintiff instead brings state law claims in state court, the court and thus this Comment still must consider both preemption and removal jurisdiction. While the *Miles* court goes too far in applying complete preemption, there are legitimate reasons why both removal jurisdiction and ordinary preemption should apply in these cases even when considering the strong presumption against preemption, especially once non-debtor standing exists under § 303(i)(2).

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[192] Caminetti, 242 U.S. at 485.

[193] Corley v. United States, 556 U.S. 303, 314 (2009) (quoting Hibbs v. Winn, 542 U.S. 88, 101 (2004)) (internal quotations omitted).

[194] 11 U.S.C. § 303(i)(1) (2016).

Consequently, with respect to preemption and removal jurisdiction, this proposed interpretation supports Judge Berzon's concurrence in *Miles*.[195] While Judge Berzon agreed that § 303 did not grant standing to non-debtors, his reasoning for removal and preemption is by far the most in line with precedent and practical in its future application.

For removal jurisdiction purposes, the Ninth Circuit itself previously ruled that:

> Proceedings to recover damages under § 303(i) constitute cases under title 11 for the purposes of § 1334, both because they depend on bankruptcy law for their existence, and because they do not arise unless an involuntary bankruptcy petition is dismissed by the bankruptcy court.[196]

If § 303 does fall within the courts' original and exclusive jurisdiction, which this Comment argues that it does, "[s]tate courts are not authorized to determine whether a person's claim for relief under a federal law, in a federal court, and within that court's exclusive jurisdiction, is an appropriate one."[197] Even if the claim is a state law cause of action, the relief sought still pertains solely to a *federal* involuntary bankruptcy petition. Thus, "it is for Congress and the federal courts, not the state courts, to decide what incentives and penalties are appropriate for use in connection with the bankruptcy process."[198] The effect of this reasoning is similar to that of complete preemption, but its application is significantly less complicated and well understood across both federal and state courts.[199] It is interesting that the Ninth Circuit is one of two courts to explicitly rule that § 303(i) proceedings satisfy the requirements for original and exclusive jurisdiction and removal to federal court,[200] yet still chose to apply complete preemption when its own precedent would have achieved essentially the same result. No court has declared § 303(i) to fall outside of the § 1334 original and exclusive jurisdiction of the bankruptcy court.

Rosenberg relied on the presumption against preemption because it found that the Code is "silent as to potential remedies for non-debtors harmed by an involuntary bankruptcy petition."[201] This argument still has merit. However, § 303(i)(2) should be interpreted not as silent, but instead as granting standing

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[195] *In re* Miles, 430 F.3d at 1095–96 (Berzon, J., concurring).
[196] Johnson, *supra* note 76.
[197] Gonzales v. Parks, 830 F.2d at 1036.
[198] *Id.*
[199] Johnson, *supra* note 76.
[200] Gonzales, 830 F.2d at 1035; Glannon v. Carpenter, 245 B.R. 882, 887 (Bankr. D. Kan. 2000).
[201] Rosenberg, 835 F.3d at 419.

to non-debtors. Once non-debtors have standing under the Code, the Code provides the exclusive remedy and the presumption against preemption no longer applies just as it would not apply to the debtor for the same claim.[202]

D. Practical and Policy Implications

Giving non-debtors standing to pursue damages for bad faith involuntary bankruptcy petitions can further several underlying practical and policy goals in both *Miles* and *Rosenberg*. There are at least four such rationales: (1) constitutional uniformity principles; (2) the purpose of § 303(i); (3) avoiding complete preemption doctrine; and (4) encouraging Congress to clarify its intent.

1. Constitutional Uniformity Principles

In *Miles*, the court seemed to reach its conclusion based primarily on uniformity concerns:

> [T]he need for uniformity in the administration of the bankruptcy laws persuaded the Framers to expressly grant Congress the power 'to establish . . . uniform Laws on the subject of Bankruptcies throughout the United States.' Art. I, § 8, cl. 4. Permitting state courts to decide whether the filing of an involuntary bankruptcy petition was appropriate would subvert the exclusive jurisdiction of the federal courts and undermine uniformity in bankruptcy law by allowing state courts to create their own standards as to when a creditor may properly file an involuntary petition.[203]

This is a legitimate line of reasoning. The *Rosenberg* court casually brushed this argument aside by relying on the "traditional comity" between the state and federal systems.[204] However, it is important to remember that this situation only involves bad faith petitions, and as discussed above, the standards for determining bad faith with respect to involuntary petitions are themselves anything but uniform.[205] This interpretation prevents the already "dizzying array of standards" from being multiplied across fifty unique state jurisdictions.[206] Furthermore, this potential extrapolation of bad faith standards still does not

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[202] Gonzales v. Parks, 830 F.2d 1033, 1036 (9th Cir. 1987) ("Congress' authorization of certain sanctions for the filing of frivolous bankruptcy petitions should be read as an implicit rejection of other penalties, including the kind of substantial damage awards that might be available in state court tort suits.").

[203] *In re* Miles, 430 F.3d at 1090.

[204] Rosenberg, 835 F.3d at 421.

[205] *In re* Forever Green Athletic Fields, Inc., 804 F.3d at 335.

[206] *Id.*

even include the wide variety of additional state law actions to be litigated and adjudicated once bad faith is determined.

For example, in *Miles* the plaintiff asserted claims of defamation, false light, abuse of process, emotional distress, negligent misrepresentation, and simple negligence,[207] each of which have their own standards across the fifty states. In *Rosenberg* the plaintiff only filed a "single claim of tortious interference."[208] It is unlikely that this difference from *Miles* was determinative to the final holding, but it is a significant difference between the plaintiffs' assertions in state court. This disparity could have influenced the *Rosenberg* court to give more weight to uniformity principles than in *Miles*.

Moreover, while it is difficult to have any sympathy for a creditor filing an involuntary bankruptcy petition in bad faith, this potentially vast number of bad faith standards and unknown types of state law claims makes it extremely difficult for creditors to know if their petition will be considered bad faith. Congress has committed to keeping involuntary bankruptcy in the Code despite its infrequent utilization,[209] and such a potentially broad, and increased, economic exposure to creditors might curb its use altogether or lead to significant forum shopping and other conflict of law issues. Overall, interpreting § 303(i) as allowing non-debtors a path to recovery is likely to accomplish the primary goal of the Ninth Circuit's ruling in *Miles* of encouraging "uniform Laws on the subject of Bankruptcies throughout the United States."[210]

2. *The Purpose of § 303(i)*

If uniformity is the primary goal of the *Miles* court, the purpose of § 303(i) is likewise the principal policy objective underlying the Third Circuit's ruling in *Rosenberg*. Similarly, as this hybrid interpretation achieved the uniformity goals, it also preserved the remedial purpose of § 303(i). As discussed, § 303(i) serves dual purposes. First, debtors and non-debtors are at risk for serious harm from unwarranted involuntary bankruptcy filings,[211] especially in light of increasing interconnectivity and rapid information sharing. Second, allowing the court to apply such strict, even punitive, damages serves as a deterrence to creditors contemplating the use of a bad faith involuntary bankruptcy petition as a collection tool:

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[207] *In re* Miles, 430 F.3d at 1086.
[208] Rosenberg, 835 F.3d at 417.
[209] Block-Lieb, *supra* note 15.
[210] U.S. CONST. art. I, § 8, cl. 4.
[211] *In re* SBA Factors of Miami, Inc., 13 B.R. at 101.

> The purpose of punitive damages is to deter similar acts in the future, both by the petitioning creditors and to serve as an example for others in similar circumstances [a] second purpose for punitive damages is to punish the petitioning creditors for wrongdoing in filing the petition in bad faith.[212]

This proposed interpretation furthers both of these objectives. As the court argued in *Rosenberg*, it is unlikely that Congress would affirmatively and intentionally foreclose all opportunities for non-debtors in these situations.[213] Combined with the fact that non-debtors are increasingly susceptible to harm in modern society, this interpretation serves the remedial purpose of protecting those exposed to malicious creditor activity.

Second, including non-debtors in the scope of creditor liability will only further the deterrence scheme underlying the award of compensatory and punitive damages under § 303(i). When considering their decision to file, creditors must be even more careful to avoid doing so in a manner constituting bad faith. An additional advantage is that it will also further protection for debtors themselves under § 303(i)(2) if creditors are less likely to file a petition in bad faith as a collection tactic. Debtor protection remains one of the most important goals of the modern Code and bankruptcy system,[214] and it is intuitive that the Code would also protect third parties suffering from intentionally harmful creditor collection methods.[215]

While a more structural or textual analysis, it is important to emphasize the way in which Congress' purpose is evident if non-debtors are given standing under § 303(i)(2). Under this interpretation, non-debtors can still only pursue damages for *bad faith* involuntary petitions. While debtors can collect attorney's fees and costs for any dismissed involuntary bankruptcy petition, petitions filed by creditors who demonstrate more malevolence than simply being incorrect that a debtor is failing to pay its debts. In these situations, it is intuitive that a creditor should be liable for all damage proximately caused by the petition.

3. *Avoiding Complete Preemption*

The complete preemption doctrine has only been applied by the Supreme Court within the context of three statutes, none of which include the Bankruptcy

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212 *In re* Johnston Hawks, Ltd., 72 B.R. 361, 367 (Bankr. D. Haw. 1987).
213 Rosenberg, 835 F.3d at 417.
214 *In re* John Richards Homes Bldg. Co., L.L.C., 298 B.R. at 605.
215 *Id.*

Code.[216] The Ninth Circuit in *Miles* is the first and only circuit to apply the doctrine within the bankruptcy context.[217] Even if the *Miles* court correctly interpreted § 303(i)(2) to preempt any state law action for non-debtors against creditors who file a bad faith involuntary bankruptcy petition, it unnecessarily extended the complete preemption doctrine to this case.

The confusing complete preemption doctrine can be entirely avoided if the courts interpret § 303(i)(2) as granting standing to non-debtors, removal jurisdiction is appropriate, and ordinary preemption applies. Because complete preemption is so unclear and controversial it has invited academic analyses highlighting its inconsistency and the difficulty in expanding to areas beyond the specific situations where the Supreme Court has already done so.[218] Unsurprisingly, a variety of concerns have been identified in expanding complete preemption without further explanation from the Supreme Court. These include chiefly that the doctrine still lacks a clear rule or guideline for application outside of the LMRA, ERISA, and NBA contexts.[219] The Supreme Court's decisions applying complete preemption lack a "coherent framework of principles and rules"[220] and the tests are "unworkable" and "capable of producing opposite results."[221] Finally, this confusion has led to "only a handful" of lower court cases extending the complete preemption doctrine, further stymieing its development.[222]

When combining the inconsistent doctrine with the uniformity concerns, expanding the complete preemption doctrine in the bankruptcy context would undermine the uniformity of the bankruptcy system, and removal jurisdiction of the statute is more appropriate and less inconsistent:

> Uniformity of the law should and can be instead accomplished by removing cases within the original jurisdiction under the general removal statute. Such removal does not deprive the states of their power to act since only cases already within the federal jurisdiction can be removed. Removal of claims within the original jurisdiction of

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[216] Avco Corp. v. Aero Lodge No. 735, 390 U.S. 557 (1968); Metro Life Ins. Co. v. Taylor, 481 U.S. 58 (1987); Beneficial Nat'l Bank v. Anderson, 539 U.S. 1 (2003).

[217] Rosenberg, 835 F.3d at 422.

[218] Johnson, *supra* note 76.

[219] *Id.*

[220] Tristin K. Green, Comment, *Complete Preemption - Removing the Mystery from Removal*, 86 CAL. L. REV. 363, 371 (1998).

[221] Johnson, *supra* note 76, at 58.

[222] *Id.* at 59.

> the bankruptcy courts also results in the desired uniformity of the bankruptcy law.[223]

Finally, in relation to the purpose of § 303(i) and more generally the Code, federalism principles require that there be limitations on federal law and deference be given to states.[224] Because bankruptcy and state law overlap to such an extent, when the Code does not expressly provide a solution to a situation the courts must defer to state law.[225] While this Comment argues that, in this case, there is such express statutory support for non-debtor standing, removal to bankruptcy court, and preemption of state law claims, it is a risky and potentially slippery slope proposition to achieve the result by applying complete preemption to the Code. Once a court finds that the Code completely preempts state law in the context of § 303, complete preemption might then be easily extended to additional Code sections and thus upset the delicate balance between federal and state law that exists in the bankruptcy context.

4. *Encourages Congress to Clarify its Intent*

The Supreme Court has stated that the test for the complete preemption doctrine is primarily based on congressional intent.[226] Like in *Rosenberg*, this interpretation also encourages Congress to clarify its intent without inferring it for them but still providing non-debtors a path to a remedy in the meantime. Because § 303 would now provide standing for non-debtors, if Congress did in fact want to bar them from an avenue towards recovery, it would be forced to do so expressly. This again prevents courts from legislating as a judiciary.

E. *Impact of Proposed Interpretation*

The impact of this proposed interpretation would be similar to the impact from *Rosenberg*, with an increasing number of non-debtor claims and a corresponding further decrease in involuntary bankruptcy petitions. However, and distinct from the impact of the *Rosenberg* decision, limiting the claims to federal court and § 303 should lead to a more efficient and expedient development of standards and predictable results around which parties can negotiate outside of the court system, a result likely favored by all parties involved.[227] Furthermore, because so few courts have had to address these issues

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[223] Johnson, *supra* note 76, at 63.
[224] *Id.* at 61.
[225] *Id.* at 63-64.
[226] Metro Life Ins. Co., 481 U.S. at 66.
[227] Block-Lieb, *supra* note 15, at 844.

of fact and law,[228] there is little chance of a gate behind which a flood of non-debtors are waiting for § 303 standing before bringing their claim.[229]

CONCLUSION

In conclusion, this nuanced and sparsely litigated area of law warrants further analysis by both Congress and the courts. As long as Congress continues its support of the involuntary bankruptcy process, despite its decline in use, those harmed by its abuse deserve a clear answer to their options for recovery.

This issue is one of continually competing principles and objectives: creditor versus debtor bankruptcy goals; federal versus state federalism interests of both law and forum; textual versus intent statutory interpretative methods; and constitutional uniformity versus the remedial purpose of bankruptcy law. While the Ninth Circuit in *Miles* favored federal law and constitutional uniformity in bankruptcy law, the Third Circuit in *Rosenberg* deferred to state law and the remedial purpose of the Bankruptcy Code. If forced to choose, the author would rather sacrifice uniformity before foreclosing non-debtors "remov[ing] all means of judicial recourse for those injured by illegal conduct."[230] As such, the recent Third Circuit decision creating the circuit split is preferable.

Lastly, a hybrid approach would instead confer Code standing to non-debtor third parties harmed by bad faith involuntary bankruptcy petitions, while reaffirming established preemption removal jurisdiction doctrines. This interpretation offers a path that reconciles bankruptcy uniformity and purpose principles while protecting those taking collateral damage.

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[228] *In re* Miles, 430 F.3d at 1094.

[229] Rosenberg, 835 F.3d at 420.

[230] *Id.* at 419.

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