Neither a Borrower Nor a Lender be …[1]

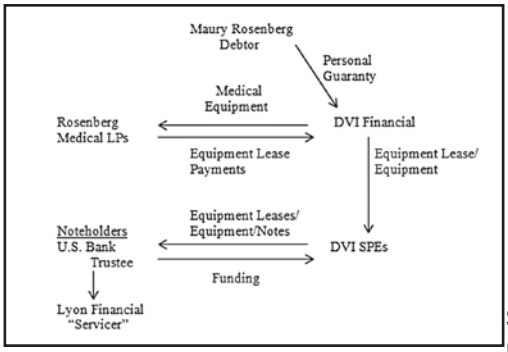
By David H. Conaway, Shumaker, Loop & Kendrick, LLP

1 … for loan oft loses both itself and friend. Polonius to his son Laertes in Shakespeare's Hamlet.

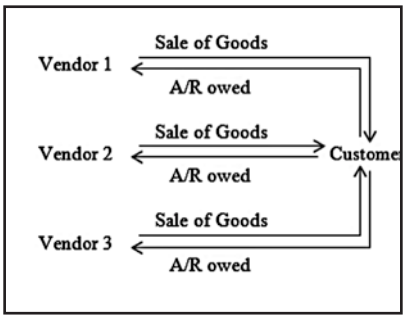
Many lawyers have written articles about a February 27, 2015 U.S. Court of Appeals (11th Circuit) ruling (In re *Maury Rosenberg*) against petitioning creditors of an involuntary Chapter 7 proceeding.

Introduction

Creditors owed over $5 million filed an involuntary bankruptcy petition against Maury Rosenberg, a Philadelphia businessman who ran a group of radiology screening centers. As reported by Law360 (an online publication), not only did Rosenberg get the petition dismissed, he obtained a judgment of over $1 million against the petitioning creditors for costs and attorneys' fees as well as compensatory and punitive damages of $360,000, based on a complaint he filed against U.S. Bank and others for $50 million over the "bad faith" involuntary filing.



Not surprisingly, the articles written cite the *Rosenberg* case as a cautionary tale for creditors contemplating the filing of an involuntary petition under Section 303 of the U.S. Bankruptcy Code. Yet, a deeper dive into the facts of the case indicates it was a flawed filing from the get-go.



Background

The Rosenberg case was based on asset-backed securitization transactions in 2000 gone wrong. Maury Rosenberg's affiliated limited partnerships (the "Rosenberg LPs") entered into equipment leases with DVI Financial Services, Inc. (itself a Chapter 11 debtor), for a $27 million financing of the acquisition of medical equipment. DVI Financial bought the equipment, leased it to the Rosenberg LPs, which made lease payments to DVI. As a security, Rosenberg signed a personal guaranty to DVI.

As part of various asset securitization transactions, DVI Financial transferred the leases and equipment to various DVI SPE's (special purpose entities), who obtained loans from and issued notes to various lenders, for whom the agent was U.S. Bank. Lyon Financial Services, Inc. became the "loan servicer" for U.S. Bank and the noteholders.

In 2003, the Rosenberg LPs defaulted on the equipment leases, Lyon filed suit in state court, and in 2005 the parties restructured the debts. Lyon signed the settlement agreement, not any of the DVI entities. As part of the settlement, Maury Rosenberg issued a superseding $7.7 million guaranty to "the Agent", defined as "Lyon Financial Services, Inc. d/b/a U.S. Bank Portfolio Services as successor servicer for the DVI Entities …."

In 2008, the Rosenberg LPs defaulted on the restructured obligations, and Lyon obtained a judgment against the Rosenberg LPs and on the Guaranty in the amount of $4.7 million.

Later in 2008, Lyon's Director of Operations, **on behalf of the DVI Entities**, signed and filed an involuntary Chapter 7 petition against Maury Rosenberg in Pennsylvania. The petitioning creditors were listed as the DVI entities, whose claims totaled about $5.4 million. The involuntary Chapter 7 petition was transferred to the Southern District of Florida, where Rosenberg was a resident.

Lyon's Director of Operations signed and filed the involuntary petition in name of the DVI entities, without the DVI Entities' knowledge and without obtaining their authorization for the filing.

In 2009, the Bankruptcy Court granted Maury Rosenberg's motion to dismiss the involuntary petition because, among other reasons:

- The DVI Entities were not creditors of Rosenberg … the guaranty was in favor of Lyon.
- The DVI Entities were not "real parties in interest", rather they were "pass through" entities to facilitate the asset securitization transactions.
- A demand for payment was not made on Rosenberg.

Initially, Rosenberg won trial verdicts of $1.1 million for costs and attorneys' fees, and for compensatory and punitive damages in the amount of $6.1 million. The trial judge later reduced the $6.1 million award to $360,000. As for the $1.1 million of costs and attorneys' fees, the 11th Circuit generally upheld the award of attorneys' fees but remanded the case to District Court (still pending) with the implication being the amount of the reward could be reduced.

Takeaways and remaining questions

- This case is not about the inherent risk of three creditors filing an involuntary petition. Rather, it illustrates how asset based securitization transactions can obscure who owns the claims against a debtor and thus who has the right and authority to file an involuntary petition.

  Consider a "normal" vendor-customer transaction.

  When creditors are suppliers to a customer, there is normally little risk of a dismissal of an involuntary filing on the basis that such creditors do not have authority to file the petition, which was the case in the Rosenberg dismissal. In any Section 303 involuntary petition, creditors must establish that (1) 3 or more creditors have claims against the debtor in the aggregate over $15,325 (in 2015), (2) the claims are not contingent as to liability, (3) the claims are not subject to a bona fide dispute, and (4) the target debtor is not paying its debts generally as they come due.

  Some of the unresolved issues in the case include:

- What will Rosenberg ultimately recover on the attorneys' fee claim? How much has he spent in legal fees since 2003?
- How much has U.S. Bank, et al recovered on the original $27 million financing?
- How much has U.S. Bank spent on legal fees?

Despite the Rosenberg ruling, an involuntary petition remains a viable remedy for creditors in appropriate circumstances. With all legal action, an involuntary petition should be pursued carefully, in compliance with the clear requirements of Section 303, and with a sound strategy for recovery for unsecured creditors.

We hope you found this useful and informative. Please contact us if you have any questions about this, or any other matter.

David H. Conaway's *principal areas of practice are bankruptcy (primarily Chapter 11 proceedings), non-bankruptcy insolvencies or restructurings, workouts, commercial transactions, and international transactions, disputes and insolvencies.*

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Vendor Forum of the Remittance Coalition to Meet at the CRF Forum & EXPO in Seattle in August

The **Remittance Coalition** is a volunteer, industry-driven coalition of more than 350 individuals dedicated to enhancing the process of B2B transactions to make them more automated and efficient. In late 2013, the **Vendor Forum** was created as a workgroup of the Coalition to help members partner with software vendors to encourage the adoption of standards related to remittance and payments processing.

The goal of the Forum is to provide a venue in which AR & AP solution providers can:

- Learn about the benefits of adopting key standards (existing & emerging) that facilitate use of e-payments, e-remittance information exchange & straight-through-processing (STP)
- Strategize on how to mitigate barriers to adoption of these standards
- Identify ways to improve interoperability among existing services & systems offered by these vendors
- Support efforts to reduce the variation in how standards are implemented in order to enable STP

Forum at the Forum - The Vendor Forum, a subgroup of the Remittance Coalition, meeting at the CRF Forum & EXPO in Denver, August 2014. The Vendor Forum will meet again at the CRF Forum & EXPO in Seattle, Aug. 10-12, 2015. *Photo by Tom Diana*

The Vendor Forum meets at least three times per year, including an in-person meeting that takes place in conjunction with CRF's August Forum & EXPO. In addition, a Subcommittee of the Vendor Forum has been formed to focus on issues related to AP & AR in order to discern the drivers and incentives of payment standards adoption.

For more information on the Remittance Coalition or Vendor Forum, please contact Katy Jacob at the Federal Reserve Bank of Minneapolis: remittance.coalition.smb@mpls.frb.org or 612-204-6550.