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Rachel Green

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NOTES

Treating Section 303(b) of the Bankruptcy Code as Subject-Matter Jurisdictional

SOUND APPROACH OR INVOLUNTARY REFLEX?

INTRODUCTION

Bankruptcy is typically thought of as a “last resort,”¹ a process by which debtors can obtain relief from unmanageable debt² and escape the incessant and distressing collection attempts of creditors.³ Given this characterization of bankruptcy as “relief,”⁴ it is not surprising that the vast majority of bankruptcy cases are initiated by debtors, who voluntarily accept the downsides of bankruptcy in exchange for

¹ “Almost all who file for bankruptcy do so as a last resort” 151 CONG. REC. E753, E754 (daily ed. Apr. 25, 2005) (statement of Rep. McCollum). *But see* 151 CONG. REC. S2405, S2474 (daily ed. Mar. 10, 2005) (statement of Sen. Frist) (“For many people, bankruptcy has become a first step rather than a last resort.”); DAVID A. SKEEL JR., *DEBT’S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA* 1 (2001) (“[I]ndividuals and businesses in the United States do not seem to view bankruptcy as the absolute last resort”).

² *See* *Burlingham v. Crouse*, 228 U.S. 459, 473 (1913) (One purpose of bankruptcy is “to give the bankrupt a fresh start.”); *In re Chalasani*, 92 F.3d 1300, 1304 (2d Cir. 1996) (“[O]ne of the principal purposes of the Bankruptcy Code [is] allowing the debtor to begin a new life free from debt”).

³ *See In re Meyers*, 344 B.R. 61, 66-67 (Bankr. E.D. Pa. 2006) (“One significant remedial purpose of a bankruptcy discharge order is to prevent the emotionally harmful conduct associated with debt collection tactics.”); *In re Gervin*, 337 B.R. 854, 863 (Bankr. W.D. Tex. 2005) (“A significant component of [bankruptcy] is being free of the kinds of harassment, threats, and anxiety that debtors were suffering before they filed.”).

⁴ *See, e.g.,* Charles G. Hallinan, *The ‘Fresh Start’ Policy in Consumer Bankruptcy: A Historical Inventory and an Interpretive Theory*, 21 U. RICH. L. REV. 49, 51 (1986) (“The central importance of debtor relief in consumer bankruptcies is a commonplace of legal discussion.”).

freedom from crushing financial obligations.⁵ In fact, in most consumer bankruptcies, creditors have little incentive to see their debtors file for bankruptcy, since there are usually no assets left to distribute after state and federal exemptions are applied to the debtor's estate.⁶ The United States Bankruptcy Code (the "Bankruptcy Code") does, however, provide a means for creditors to force unwilling debtors into bankruptcy,⁷ a potentially appealing option for a creditor who fears that the debtor's existing nonexempt assets will have been squandered by the time the debtor finally files a voluntary bankruptcy petition.⁸

As might be expected, however, a creditor cannot push an unwilling debtor into bankruptcy with the relative ease with which a debtor can do so to itself. Instead, Section 303(b) of the Bankruptcy Code provides a number of requirements⁹ that

⁵ 2 COLLIER ON BANKRUPTCY ¶ 303.01 (Alan N. Resnick & Henry J. Sommer eds., 15th ed. 2002); see also H.R. REP. NO. 108-110, at 2 & n.9 (2003) ("[F]ewer than 1 percent of all bankruptcy case filings are commenced involuntarily."); Richard M. Hynes, *Broke but Not Bankrupt: Consumer Debt Collection in State Courts*, 60 FLA. L. REV. 1, 9 n.43 (2008) ("Involuntary cases are very rare.").

⁶ Ed Flynn, Gordon Bermant, & Suzanne Hazard, *Bankruptcy by the Numbers: Chapter 7 Asset Cases*, AM. BANKR. INST. J., Dec. 2002-Jan. 2003, at 22 ("About 96 percent of chapter 7 cases are closed without any funds collected and distributed to creditors . . ."); SKEEL, *supra* note 1, at 8 ("Although creditors can push a debtor into bankruptcy by filing an involuntary bankruptcy petition, they have little incentive to do so.").

⁷ 11 U.S.C. § 303 (2006).

⁸ See, e.g., Evan D. Flaschen & Carrie A. Brodzinski, *Involuntary Petitions Under the Bankruptcy Code*, 547 PLI/COMM 93, 97-98 (1990) (detailing several situations that might prompt a creditor to file an involuntary bankruptcy petition); H.R. REP. NO. 108-110, at 2 ("[A]n involuntary bankruptcy petition can serve as a useful creditor collection tool. For example, it can preserve assets from further dissipation and provide for their orderly liquidation by a bankruptcy trustee, a fiduciary charged by statute to protect such assets and maximize their value for the benefit of creditors."); COLLIER, *supra* note 5, ¶ 303.01 ("[T]here are certain key situations in which the filing of an involuntary case remains a beneficial, and sometimes optimal, choice for creditors . . ."); *In re All Media Props., Inc.*, 5 B.R. 126, 134 (Bankr. S.D. Tex. 1980) ("[I]t is important that involuntary petitions be tried and resolved promptly because if the debtor is not paying its debts as they become due, then its creditors are entitled to the protection of their rights afforded by the Code and to prevent the debtor from wasting its assets.").

⁹ 11 U.S.C. § 303(b). This provision provides in relevant part:

An involuntary case against a person is commenced by the filing with the bankruptcy court of a petition under chapter 7 or 11 of this title—

(1) by three or more entities, each of which is . . . a holder of a claim against such person that is not contingent as to liability or the subject of a bona fide dispute as to liability or amount . . . if such noncontingent, undisputed claims aggregate at least [\$13,475] more than the value of any lien on property of the debtor securing such claims held by the holders of such claims; [or]

must be met in order for relief to be entered in an involuntary bankruptcy proceeding.¹⁰ The majority of courts and commentators have interpreted these requirements as prima facie elements of an involuntary bankruptcy case, which must be either disputed or waived by the debtor.¹¹ However, in *In re BDC 56*,¹² the Second Circuit Court of Appeals joined the minority of jurisdictions and interpreted certain of these requirements as being subject-matter jurisdictional in nature,¹³ meaning that they pertain to “the courts’ statutory or constitutional *power* to adjudicate the case.”¹⁴ The Second Circuit based its position on the argument that creditors should be forced to prove the sufficiency of the involuntary petition “at the earliest practicable point.”¹⁵ This Note argues that the Second Circuit’s treatment of the Section 303(b) requirements as subject-matter jurisdictional is contradictory to the provision’s implied goals of fairness and judicial efficiency, and is inconsistent with the jurisdictional structure of the United States bankruptcy system.

Part I of this Note surveys the history of the Bankruptcy Code, focusing on the origins and development of federal jurisdiction over bankruptcy cases. It details the jurisdictional structure of the bankruptcy system, laying a

(2) if there are fewer than 12 such holders . . . by one or more of such holders that hold in the aggregate at least \$10,000 of such claims . . .

Id.

¹⁰ Note that in the context of an involuntary bankruptcy, a debtor who opposes the petition is seeking dismissal rather than relief. See *In re Alta Title Co.*, 55 B.R. 133, 135-36 (Bankr. D. Utah 1985) (“An involuntary petition must end either in the entry of an order for relief against the debtor or dismissal of the creditors’ petition.”).

¹¹ See, e.g., *In re Trusted Net Media Holdings, LLC*, 525 F.3d 1095, 1101 (11th Cir. 2008) (collecting cases and authority supporting this proposition), *overruled by* 550 F.3d 1035 (11th Cir. 2008) (en banc).

¹² *In re BDC 56 LLC*, 330 F.3d 111 (2d Cir. 2003).

¹³ *Id.* at 118. In fact, although the Second Circuit shares its position with a small number of bankruptcy courts in other circuits, it is the only circuit court to have explicitly adopted this holding. See, e.g., *In re Paczesny*, 283 B.R. 715, 718 (Bankr. N.D. Ill. 2002) (“The absence of a bona fide dispute [as required by § 303(b)] is a jurisdictional prerequisite.”); *In re New Mexico Props., Inc.*, 18 B.R. 936, 939-40 (Bankr. D.N.M. 1982) (describing § 303(b) as a “[jurisdictional] hurdle for petitioning creditors to overcome”). The Ninth and Eleventh Circuits are the only other circuits to have explicitly ruled on this issue, both concluding that § 303(b) is not subject-matter jurisdictional in nature. *In re Trusted Net Media*, 550 F.3d at 1046; *In re Rubin*, 769 F.2d 611, 615 (9th Cir. 1985).

¹⁴ *Steel Co. v. Citizens for a Better Env’t*, 523 U.S. 83, 89 (1998); see *infra* Part III.A.1 (describing the basic principles of subject matter jurisdiction).

¹⁵ *In re BDC 56 LLC*, 330 F.3d at 118.

foundation for the argument that the Section 303(b) requirements do not pertain to the bankruptcy courts' jurisdiction. Part II investigates the Section 303(b) circuit split, examining three cases in which courts have justified their treatment of the Section 303(b) requirements either as subject-matter jurisdictional or as "substantive matters which must be proved or waived for petitioning creditors to prevail in involuntary proceedings."¹⁶ Part III assesses the various rationales for, and implications of, both sides of the circuit split and contends that the Second Circuit's approach to the Section 303(b) requirements is inconsistent with the jurisdictional structure of the Bankruptcy Code, wastes judicial resources, and therefore should be abandoned. This section highlights two recent cases, one from the United States Supreme Court¹⁷ and another from the Bankruptcy Court of the Southern District of New York,¹⁸ both of which cast doubt on the Second Circuit's treatment of Section 303(b) as subject-matter jurisdictional and indicate that *BDC* should no longer be upheld as good law. This Note concludes that the Second Circuit should resolve the circuit split in favor of treating Section 303(b) as substantive, and not subject-matter jurisdictional, in nature.

I. DEVELOPMENT OF THE MODERN BANKRUPTCY CODE

In order to appreciate the merits and weaknesses of the arguments on either side of the Section 303(b) circuit split, it is first necessary to understand the overall structure of the Bankruptcy Code, including the role of involuntary bankruptcy proceedings and the rationale behind the modern jurisdictional structure of the U.S. bankruptcy system. Involuntary bankruptcy cases, though far less common today than they were at the inception of our nation's bankruptcy laws,¹⁹ were always within the jurisdiction of the bankruptcy courts.²⁰ While

¹⁶ *In re Rubin*, 769 F.2d at 614 n.3.

¹⁷ *Arbaugh v. Y & H Corp.*, 546 U.S. 500 (2006).

¹⁸ *In re MarketXT Holdings Corp.*, 347 B.R. 156 (Bankr. S.D.N.Y. 2006).

¹⁹ SKEEL, *supra* note 1, at 8 ("Under current law, the vast majority of debtors file for bankruptcy voluntarily In the nineteenth century, by contrast, involuntary bankruptcy figured quite prominently."); *supra* note 5 (discussing infrequency of involuntary bankruptcy petitions today).

²⁰ SKEEL, *supra* note 1, at 27 ("By 1867, it was evident that Congress could enact both voluntary and involuntary laws . . . [which] were administered through the federal district courts."); David S. Kennedy & R. Spencer Clift, III, *An Historical Analysis of Insolvency Laws and Their Impact on the Role, Power, and Jurisdiction of Today's United States Bankruptcy Court and its Judicial Officers*, 9 J. BANKR. L. &

the jurisdictional structure of bankruptcy courts is quite different today, its evolution has been shaped by the desire to make the bankruptcy process as fair, efficient, and cost-effective as possible.²¹ In order to further these objectives, Section 303(b) must be interpreted as substantive rather than jurisdictional because this approach better comports with the statutory structure of the bankruptcy system, creates greater predictability, and leads to more efficient resolution of bankruptcy cases.

A. *Involuntary Bankruptcy and the Roots of Modern U.S. Bankruptcy Law*

The English bankruptcy laws, from which our modern bankruptcy system evolved, were in fact remarkably different from the scheme that the United States has in place today.²² Most notably, the first English bankruptcy statutes, enacted under Henry VIII in 1582, treated the debtor as a criminal, did not release the debtor from debts remaining after liquidation and distribution, and could only be invoked on the initiative of the creditors.²³ Although later versions of English bankruptcy law decriminalized the proceedings and provided for discharge of unsatisfied obligations,²⁴ the process remained one that was commenced by creditors against potentially unwilling debtors.²⁵ In other words, the only bankruptcy proceeding available was involuntary.²⁶

With little debate or fanfare, the Founding Fathers granted to Congress the constitutional power to pass bankruptcy laws.²⁷ When Congress passed the first federal

PRAC. 165, 170-71 (2000) (the first Bankruptcy Act of the United States provided for only involuntary bankruptcy cases, and gave district courts jurisdiction to appoint “non-judicial, bankruptcy ‘commissioners’ to assist in administering proceedings under this Act”).

²¹ The goal of the Bankruptcy Code is to “secure the just, speedy, and inexpensive determination of every case and proceeding.” FED. R. BANKR. P. 1001.

²² Marcia S. Krieger, “*The Bankruptcy Court is a Court of Equity*”: *What Does That Mean?*, 50 S.C. L. REV. 275, 281-82 (explaining that “American social, economic, and philosophical influences modified English tradition to create American bankruptcy law”).

²³ Kennedy & Clift, *supra* note 20, at 169.

²⁴ *Id.* at 169-70.

²⁵ *See id.* at 169-70.

²⁶ *Id.* at 169.

²⁷ U.S. CONST. art. I, § 8, cl. 4 (granting Congress the power to pass “uniform Laws on the subject of Bankruptcies”); Jonathan C. Lipson, *Debt and Democracy: Towards a Constitutional Theory of Bankruptcy*, 83 NOTRE DAME L. REV. 605, 608

bankruptcy statute in 1800, it adopted the creditor-friendly involuntary approach used in England.²⁸ However, the Bankruptcy Act of 1800 was soon repealed and it was not until two more failed attempts by Congress that a workable bankruptcy system emerged in 1898.²⁹ The intervening years witnessed a continuous struggle between debtors and creditors to shape the law in their respective favor.³⁰ But by 1898, it became evident that debtors had definitively won the battle for voluntary bankruptcy proceedings, which first appeared in the Bankruptcy Act of 1841 and have remained a fixture of United States bankruptcy law ever since.³¹ Nevertheless, the 1898 Bankruptcy Act still included provisions for involuntary bankruptcy petitions,³² which remain substantially unchanged to this day.³³

(2008) (this constitutional provision was drafted “with surprisingly little debate”); SKEEL, *supra* note 1, at 23 (the provision was included “almost as an afterthought . . . and it was approved with little debate”).

²⁸ SKEEL, *supra* note 1, at 25; Kennedy & Clift, *supra* note 20, at 170-71.

²⁹ Kennedy & Clift, *supra* note 20, at 171-75 (“[The 1898] Act formed the basis of our modern bankruptcy laws.”).

³⁰ DAVID A. MOSS, WHEN ALL ELSE FAILS: GOVERNMENT AS THE ULTIMATE RISK MANAGER 136-37 (2004); Krieger, *supra* note 22, at 293 (“Until the middle of the nineteenth century, bankruptcy law was decidedly pro-creditor. Since then it has oscillated between provisions favoring debtors and those favoring creditors, depending on economic and political pressures at a given time.”).

³¹ Kennedy & Clift, *supra* note 20, at 171-75; MOSS, *supra* note 30, at 136-38.

³² Bankruptcy Act of 1898, ch. 541, § 59, 30 Stat. 544, 561-62 (1898) (repealed 1978). The provision governing involuntary cases under this Act stated:

[t]hree or more creditors who have provable claims against any person which amount in the aggregate, in excess of the value of securities held by them, if any, to five hundred dollars or over; or if all of the creditors of such persons are less than twelve in number, then one of such creditors whose claim equals such amount may file a petition to have him adjudged a bankrupt. . . . If it be averred in the petition that the creditors of the bankrupt are less than twelve in number, and less than three creditors have joined as petitioners therein, and the answer avers the existence of a larger number of creditors, there shall be filed with the answer a list under oath of all the creditors, with their addresses, and thereupon the court shall cause all such creditors to be notified of the pendency of such petition and shall delay the hearing upon such petition for a reasonable time, to the end that parties in interest shall have an opportunity to be heard

Bankruptcy Act of 1898 § 59(b), (d).

³³ Compare Bankruptcy Act of 1898 § 59(b) (requirements for creditors to file an involuntary bankruptcy petition), with 11 U.S.C. § 303(b), (c) (2006), and FED. R. BANKR. P. 1003(b) (same).

B. Development of the Present-Day Jurisdictional Structure of the Bankruptcy Code

The 1898 Bankruptcy Act remained in place until the passage of the 1978 Bankruptcy Code, which was enacted after lengthy studies by both the Brookings Institution³⁴ and the congressionally established Commission on the Bankruptcy Laws of the United States.³⁵ By 1970, it had become apparent that in addition to being outdated in a variety of respects, the 1898 Act caused confusion and inefficiency in bankruptcy suits because of serious jurisdictional deficiencies.³⁶ In particular, bankruptcy court jurisdiction under the 1898 Act was limited to the bankruptcy proceeding itself plus a narrow class of controversies that arose during the course of the bankruptcy proceeding.³⁷ All other disputes that arose during the case had to be litigated separately in either state or federal district court.³⁸ The resulting “bifurcated jurisdiction” led to great expense and delay due to both the “threshold jurisdictional litigation” as well as the practical inconvenience of litigating in multiple forums.³⁹ The 1978 Bankruptcy Code sought to remedy

³⁴ Kennedy & Clift, *supra* note 20, at 177. “The Brookings Institution is a nonprofit public policy organization based in Washington, D.C. . . [whose] mission is to conduct high-quality, independent research and, based on that research, to provide innovative, practical recommendations [to] [s]trengthen American democracy; [f]oster the economic and social welfare, security and opportunity of all Americans and [s]ecure a more open, safe, prosperous and cooperative international system.” Brookings Institution, <http://www.brookings.edu/about.aspx> (last visited Jan. 12, 2010).

³⁵ Judith A. McKenna & Elizabeth C. Wiggins, *Alternative Structures for Bankruptcy Appeals*, 76 AM. BANKR. L.J. 625, 638 (2002) (“Congress established [the Commission] in 1970 . . . to ‘study, analyze, evaluate, and recommend changes’ in the Bankruptcy Act. The ensuing report and hearings ultimately led to the passage of the Bankruptcy Reform Act of 1978.”) (footnote omitted) (quoting COMM’N ON THE BANKRUPTCY LAWS OF THE U.S., REPORT ON THE BANKRUPTCY LAWS OF THE U.S., H.R. DOC. NO. 137 93d Cong., 1st Sess., part I, at 1-2 (1973)); Kennedy & Clift, *supra* note 20, at 177.

³⁶ Kennedy & Clift, *supra* note 20, at 177, 188. The term “jurisdiction” in this discussion, and in this Note generally, relates to subject matter jurisdiction rather than personal jurisdiction. Personal jurisdiction is relatively easy to obtain in bankruptcy proceedings, at least where the defendant is located in the United States, because the bankruptcy courts can effect nationwide service of process. FED. R. BANKR. P. 7004; Leonard Gerson, *Class Proofs of Claim and Class Actions in Bankruptcy: Clarifying the Law, Improving the Process, and Expanding the Use of Class Actions*, 17 J. BANKR. L. & PRAC. 6 Art. 2, at n.208 (“[C]ourts . . . have determined that the minimum contacts required for a bankruptcy court to have personal jurisdiction over an entity is satisfied by the entity’s presence in the U.S. as a whole rather than in any particular state.”).

³⁷ Kennedy & Clift, *supra* note 20, at 187.

³⁸ *Id.* at 187-88.

³⁹ *Id.* at 188; Ralph Brubaker, *On the Nature of Federal Bankruptcy Jurisdiction: A General Statutory and Constitutional Theory*, 41 WM. & MARY L. REV. 743, 792 (2000) (“The primary vice of the 1898 Act’s jurisdictional regime was that it

this shortcoming by granting expansive subject matter jurisdiction to the bankruptcy courts.⁴⁰ Thus, the Code created independent bankruptcy courts that were instructed to exercise “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.”⁴¹

Within four years, however, this broad jurisdictional grant to bankruptcy courts failed a constitutional challenge in the United States Supreme Court.⁴² In 1982, the Supreme Court in *Northern Pipeline Construction v. Marathon Pipeline Company* held that the jurisdictional grant of the 1978 Bankruptcy Code was unconstitutional because it allowed non-Article III judges⁴³ to adjudicate matters governed by state law that were merely “related to” a bankruptcy case.⁴⁴ Justice Brennan’s plurality opinion explained that Article III of the United States Constitution was designed to ensure the separation of powers and to protect the independence of the judiciary.⁴⁵ While Congress has the authority to assign certain judicial functions to non-Article III “adjunct tribunals,”⁴⁶ the

engendered an excessive amount of preliminary litigation over jurisdictional issues surrounding the bifurcation of bankruptcy jurisdiction.”)

⁴⁰ Brubaker, *supra* note 39, at 791; Kennedy & Clift, *supra* note 20, at 188; see also *In re Hospitality Ventures/LaVista*, 358 B.R. 462, 478 (Bankr. N.D. Ga. 2007) (“One of [the] primary objectives [of the Bankruptcy Reform Act of 1978] was to expand bankruptcy jurisdiction and eliminate disputes over what bankruptcy judges could hear in order to avoid costly and time-consuming arguments over jurisdiction.”).

⁴¹ 28 U.S.C. §§ 151, 1471 (Supp. III 1980).

⁴² See *Northern Pipeline Constr. Co. v. Marathon Pipeline Co.*, 458 U.S. 50, 50 (1982).

⁴³ *Id.* at 61 (“[T]here is no doubt that the bankruptcy judges created by the [1978] Act are not Art. III judges.”).

⁴⁴ *Id.* at 88; 1 HON. WILLIAM L. NORTON, JR. & WILLIAM L. NORTON, III, NORTON BANKRUPTCY LAW AND PRACTICE § 4:24 (3d ed. 2009); THOMAS J. SALERNO & JORDAN A. KROOP, BANKRUPTCY LITIGATION AND PRACTICE § 3.05 (2006) (“The Supreme Court’s principal concern was that bankruptcy judges, who were appointed for fixed terms and had salaries subject to reduction by Congress, had jurisdiction under the law to hear and decide all matters, even those based solely on state law and having only a tangential nexus to the bankruptcy estate.”).

⁴⁵ *Northern Pipeline*, 458 U.S. at 57-60. The bulk of this protection comes from the fact that Art. III judges are given life-tenure and guaranteed a non-diminishing salary, thus ensuring that concerns about their compensation do not color their judgment. *Id.* at 59; U.S. CONST. art. III, § 1. Under the 1978 Act, bankruptcy judges served only 14-year terms, they were subject to removal for “incompetency, misconduct, neglect of duty, or physical or mental disability,” 28 U.S.C. § 1471 (1978), and were not provided a guaranteed salary. *Northern Pipeline*, 458 U.S. at 53.

⁴⁶ *Northern Pipeline*, 458 U.S. at 77, 80-82. “The [1978] Act designate[d] the bankruptcy court in each district as an ‘adjunct’ to the district court.” *Id.* at 63 n.13 (quoting 28 U.S.C. § 151(a) (1976)).

1978 Act vested bankruptcy judges with all the “essential attributes’ of the judicial power of the United States.”⁴⁷ Finding that this broad jurisdictional grant exceeded “Congress’ power to create adjuncts to Art. III courts,” a plurality of the Court held that the jurisdictional provision of the 1978 Act was unconstitutional.⁴⁸

In order to keep the bankruptcy system afloat, the federal courts adopted the “Emergency Rule,” which was effectively a return to bifurcated jurisdiction.⁴⁹ When Congress finally passed the Bankruptcy Amendments and Federal Judgeship Act of 1984, it essentially maintained this bifurcated approach.⁵⁰ Under the act, Congress granted jurisdiction over bankruptcy proceedings to the federal district courts via 28 U.S.C. § 1334.⁵¹ It also designated bankruptcy courts as “unit[s] of the district court[s]”⁵² and authorized district courts to refer Title 11 cases to the bankruptcy court in their judicial districts via 28 U.S.C. § 157(a).⁵³ As a result of the 1984 Code’s demarcation between “core” and “non-core” (or “related to”) proceedings,⁵⁴ an approach that was adopted in order to implement the lessons learned in *Marathon Pipeline*, bifurcated jurisdiction became entrenched.⁵⁵ Core proceedings are those matters having a sufficiently close nexus to the pending bankruptcy so as to make final determination by the bankruptcy court proper.⁵⁶ Non-core matters, on the other hand, cannot be finally determined by the bankruptcy court without the consent of the affected parties.⁵⁷ Without such consent, the bankruptcy court can only make a recommendation, which

⁴⁷ *Id.* at 84-85.

⁴⁸ *Id.* at 87.

⁴⁹ Kennedy & Clift, *supra* note 20, at 189-90.

⁵⁰ *Id.* at 190-91 (“Broadly and briefly stated, another bifurcated jurisdictional approach was adopted by Congress in the 1984 amendments.”).

⁵¹ The statute provides in relevant part that “the district courts shall have original and exclusive jurisdiction of all cases under title 11.” 28 U.S.C. § 1334(a) (1982).

⁵² *Id.* § 151.

⁵³ This provision states that “[e]ach district court may provide that any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 shall be referred to the bankruptcy judges for the district.” *Id.* § 157(a).

⁵⁴ *Id.* § 157; Kennedy & Clift, *supra* note 20, at 191-92; 1 NORTON & NORTON, *supra* note 44, at §§ 4:10 & 4:28.

⁵⁵ Kennedy & Clift, *supra* note 20, at 180, 191.

⁵⁶ 1 NORTON & NORTON, *supra* note 44, at § 4:28 (“A nonexhaustive listing of ‘core’ proceedings is set forth in 28 [U.S.C.] § 157(b)(2).”).

⁵⁷ *Id.*

must go up to the district court for entry of a final order.⁵⁸ Moreover, Congress mandated that, upon timely motion of a party, federal courts must abstain from hearing a state law claim that could not have otherwise been commenced in the federal court had it not been introduced in a bankruptcy proceeding.⁵⁹ This jurisdictional structure has been preserved through subsequent amendments to the Bankruptcy Code and is still in effect today.⁶⁰

While numerous disputes as to the proper scope of bankruptcy jurisdiction remain,⁶¹ two observations emerge that are relevant to the analysis of Section 303(b). First, the Bankruptcy Code is divided, both conceptually and organizationally, into separate substantive and jurisdictional sections, with the substantive sections establishing the various types of bankruptcy cases available⁶² and the jurisdictional provisions granting district courts and bankruptcy courts the authority to hear those cases.⁶³ It has never been doubted that involuntary bankruptcy cases, like any other bankruptcy proceeding, are “cases under title 11” for the purposes of Congress’ grant of subject matter jurisdiction to the bankruptcy courts.⁶⁴ Thus, to the extent that the provisions of Title 11 are

⁵⁸ *Id.*

⁵⁹ 28 U.S.C. §§ 1334(c)(2), 157 (2006); SALERNO & KROOP, *supra* note 44, at § 3.10[B].

⁶⁰ 1 NORTON & NORTON, *supra* note 44, at § 4:10.

⁶¹ *See, e.g.*, Jackie Gardina, *The Bankruptcy of Due Process: Nationwide Service of Process, Personal Jurisdiction and the Bankruptcy Code*, 16 AM. BANKR. INST. L. REV. 37, 54 & n.85 (2008) (pointing out disagreement between circuit courts as to whether a bankruptcy court may retain “their ‘related to’ jurisdiction . . . after the bankruptcy has been dismissed”); Radha A. Pathak, *Breaking the “Unbreakable Rule”: Federal Court, Article I, and the Problem of “Related To” Bankruptcy Jurisdiction*, 85 OR. L. REV. 59, 61 (2006) (“The United States Supreme Court appears to have accepted the constitutionality of ‘related to’ bankruptcy jurisdiction, but it has never explicitly articulated the constitutional basis for such jurisdiction.”); 1 NORTON & NORTON, *supra* note 44, at § 4:63 (identifying “split of authority on whether a particular type of proceeding is ‘core’ or ‘related to’ the bankruptcy case”).

⁶² The substantive provisions reside in Title 11. *See, e.g.*, 11 U.S.C. Ch. 7 (concerning liquidation cases); 11 U.S.C. Ch. 11 (concerning reorganization cases); 11 U.S.C. Ch. 13 (concerning adjustment cases).

⁶³ The jurisdictional provisions reside in Title 28. *See, e.g.*, 28 U.S.C. §§ 157 & 1334.

⁶⁴ 28 U.S.C. §§ 157 & 1334; *see also In re Trusted Net Media Holdings, LLC*, 550 F.3d 1035, 1044 (11th Cir. 2008) (“As a class of cases, involuntary bankruptcy cases unquestionably arise under Title 11 (the Bankruptcy Code), and thus fall within the congressional grant of subject matter jurisdiction to the bankruptcy courts.”); *In re Bowshier*, 313 B.R. 232, 238 (Bankr. S.D. Ohio 2004) (“There is no dispute that bankruptcy courts have jurisdiction over involuntary bankruptcy proceedings.”).

construed as substantive in nature, Section 303 should be similarly interpreted.⁶⁵

Second, while bankruptcy jurisdiction is notoriously complex,⁶⁶ this complexity stems more from the constitutional uncertainty surrounding the broad congressional grant of jurisdiction to non-Article III judges⁶⁷ than from any significant disagreement as to the finer contours of bankruptcy court jurisdiction. The area of greatest uncertainty in the context of this jurisdiction relates to the bankruptcy courts' ability to entertain cases and proceedings other than the bankruptcy case itself.⁶⁸ While this issue is just as likely to arise in the context of an involuntary bankruptcy as in a debtor-initiated bankruptcy, the issue of whether Section 303(b) relates to subject matter jurisdiction is largely unrelated to this particular area of uncertainty. Rather, it has more to do with general notions of subject matter jurisdiction and statutory construction. Consequently, despite falling within the broader and more complex realm of bankruptcy court jurisdiction, the question of how to best interpret Section 303(b) can be addressed using the same rules of statutory analysis as are used in other contexts.

II. THREE CASES ADDRESSING THE SECTION 303(b) REQUIREMENTS

Section 303(b) of the Bankruptcy Code requires that an involuntary petition be brought by creditors holding claims that “aggregate at least [\$13,475]”⁶⁹ and that are “not contingent as to liability or the subject of a bona fide dispute as

⁶⁵ An involuntary bankruptcy does not, in fact, arise under its own distinct chapter of the Bankruptcy Code, but rather is a bankruptcy case of the type established by 11 U.S.C. Ch. 7 or 11 U.S.C. Ch. 11. 11 U.S.C. § 303(a) (“An involuntary case may be commenced only under chapter 7 or 11 of this title . . .”). Thus, § 303 is best viewed as supplementing those substantive provisions that establish liquidation and reorganization cases, so as to allow for their commencement by a creditor as opposed to the debtor.

⁶⁶ See, e.g., Brubaker, *supra* note 39, at 746 (“[T]he jurisdiction in bankruptcy remains one of the most enduring puzzles of our federal court system.”); Lipson, *supra* note 27, at 645 (“At least as a conceptual matter, bankruptcy jurisdiction is exceedingly—perhaps needlessly—complex . . .”).

⁶⁷ See, e.g., Lipson, *supra* note 27, at 645-46.

⁶⁸ See *supra* note 61.

⁶⁹ 11 U.S.C. § 303(b) (2006). This amount was increased from \$5,000 to \$10,000 in 1994, and the Bankruptcy Code requires that as of 1998, automatic adjustments take place every three years. Bankruptcy Reform Act of 1994, Pub. L. 103-394, § 108(b)(1) (Oct. 22, 1994); 11 U.S.C. § 104; 2 NORTON & NORTON, *supra* note 44, at § 22:7.

to liability or amount.”⁷⁰ Moreover, if the debtor has more than twelve creditors, the petition cannot be brought by fewer than three of those creditors.⁷¹ Few courts have bothered to perform a rigorous analysis of how to best characterize the Section 303(b) requirements, either because the procedural postures of the involuntary cases before them have not required it,⁷² or because they simply chose to apply a precedent that mandated a particular conclusion.⁷³ Nevertheless, those courts that have addressed this issue have reached conflicting results, with the overwhelming majority of them finding that the Section 303(b) requirements are not subject-matter jurisdictional but rather substantive, as recently held by the Eleventh Circuit in *In re*

⁷⁰ 11 U.S.C. § 303(b). The noncontingency requirement prevents claim-holders from being counted toward the requisite number of petitioning creditors if their claims are dependent on the occurrence of a future uncertain event, such as “the liability of a guarantor when the principal has not defaulted.” 2 NORTON & NORTON, *supra* note 44, at § 22:3. The undisputed claim requirement is meant to keep creditors from forcing a debtor into bankruptcy when there is a “legitimate disagreement over whether money is owed, or, in certain cases, how much.” *In re Vortex Fishing Sys., Inc.*, 277 F.3d 1057, 1064 (9th Cir. 2004). It “prevent[s] creditors from using the bankruptcy courts as a club in collecting claims that [are] disputed, although not contingent.” 2 NORTON & NORTON, *supra* note 44, at § 22:3. Although the phrase “bona fide dispute” is not defined in the Bankruptcy Code, the circuit courts have defined it as “an objective basis for either a factual or a legal dispute as to the validity of the debt.” *In re Byrd*, 357 F.3d 433, 437 (4th Cir. 2004) (quoting *Matter of Busick*, 831 F.2d 745, 750 (7th Cir. 1987)). “The bankruptcy court need not resolve the merits of the bona fide dispute, but simply determine whether one exists.” *Id.* (citation omitted).

⁷¹ 11 U.S.C. § 303(b).

⁷² An involuntary bankruptcy petition is often “timely controverted” by the debtor, 11 U.S.C. § 303(h), in which case the characterization of § 303(b) as substantive or jurisdictional loses its significance because there is no longer any question of the debtor’s possible waiver of the § 303(b) requirements as a defense. *See, e.g., In re Reg’l Anesthesia Assocs. PC*, 360 B.R. 466, 470 (Bankr. W.D. Pa. 2007) (dismissing involuntary petition due to “bona fide dispute” after debtor timely controverted the petition); *In re Euro-American Lodging Corp.*, 357 B.R. 700, 730 (Bankr. S.D.N.Y. 2007) (ordering relief against involuntary debtor who filed a timely answer because petitioning creditor adequately demonstrated that the petition satisfied the § 303(b) requirements).

⁷³ *See, e.g., In re Trusted Net Media Holdings, LLC*, 525 F.3d 1095, 1101 n.5 (11th Cir. 2008) (collecting cases in which courts concluded that § 303(b) is subject-matter jurisdictional without providing an explanation of why they did so), *overruled by* 550 F.3d 1035 (11th Cir. 2008) (en banc); *In re Quality Laser Works*, 211 B.R. 936, 941 (B.A.P. 9th Cir. 1997) (stating simply that “[i]t is well settled that the filing of an involuntary petition invokes the subject matter jurisdiction of the bankruptcy court if the petition is sufficient on its face and contains the essential allegations”); *In re Taylor & Assocs., L.P.*, 191 B.R. 374, 377 (Bankr. E.D. Tenn. 1996) (citing precedent from other bankruptcy courts and secondary authorities to conclude that “Courts have long recognized that the elements of Bankruptcy Code 303(b) are not prerequisites to establishing a bankruptcy court’s subject matter jurisdiction over proceedings arising from an involuntary petition”).

Trusted Net Media Holdings, LLC.⁷⁴ This part summarizes three cases in which courts have provided rationales for their differing conclusions. First, it looks at *In re Rubin*,⁷⁵ in which the Ninth Circuit concluded that Section 303(b) is not jurisdictional. Next, it presents *In re BDC 56 LLC*,⁷⁶ in which the Second Circuit held that Section 303(b) is subject-matter jurisdictional. Finally, it examines *In re Trusted Net Media Holdings*,⁷⁷ in which the Eleventh Circuit recognized the circuit split, performed a thoughtful analysis of both sides, and overruled an earlier case to hold that Section 303(b) does not pertain to subject matter jurisdiction.

A. *The Ninth Circuit's Analysis in In re Rubin*

*In re Rubin*⁷⁸ came before the Ninth Circuit Court of Appeals shortly after Congress passed the 1984 amendments to the Bankruptcy Code,⁷⁹ which added to Section 303 the new requirement that petitioning creditors' claims in an involuntary bankruptcy case not be "the subject of a bona fide dispute."⁸⁰ The debtor in the case, Rubin, submitted to the bankruptcy court a timely answer to an involuntary petition filed by ten creditors, in which he asserted that the claims alleged by the petitioning creditors were contingent and that the petition was filed in bad faith.⁸¹ A protracted and extensive discovery process ensued, during which the debtor repeatedly postponed depositions, produced thirty-three boxes of allegedly "disorganized and nonsensical" documents, and provided schedules of disputed claims that the bankruptcy court

⁷⁴ *In re Trusted Net Media Holdings, LLC*, 550 F.3d 1035, 1041 (11th Cir. 2008) (en banc) (stating that "[m]ost other courts to consider the issue likewise have concluded that § 303(b)'s filing requirements are not subject matter jurisdictional," and listing relevant cases).

⁷⁵ 769 F.2d 611 (9th Cir. 1985).

⁷⁶ 330 F.3d 111 (2d Cir. 2003).

⁷⁷ 550 F.3d 1035 (11th Cir. 2008) (en banc), *overruling* 525 F.3d 1095 (11th Cir. 2008).

⁷⁸ 769 F.2d 611 (9th Cir. 1985).

⁷⁹ *See supra* Part I.B (chronicling the development of the Bankruptcy Code).

⁸⁰ *Rubin*, 769 F.2d at 614 & n.2; Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 426(b), 98 Stat. 333, 369 (1984).

⁸¹ *In re Rubin*, 37 B.R. 232, 233 (B.A.P. 9th Cir. 1984). At the time that Rubin filed his answer with the bankruptcy court in 1982, the new bona fide dispute provision was not yet in effect. *Id.* at 232 (decided on February 29, 1984); Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333, 369, 392 (codified as amended at 11 U.S.C. § 303(b) (2006)) ("The amendments made [to § 303(b)] shall become effective upon the date of enactment of this Act[, July 10, 1984].").

repeatedly found “insufficient.”⁸² As a result, the bankruptcy court imposed sanctions on Rubin, “striking Rubin’s answer and entering an order for relief.”⁸³ The Bankruptcy Appellate Panel affirmed this order, and Rubin further appealed to the Ninth Circuit.⁸⁴

In his appearance before the Ninth Circuit, Rubin argued for the first time that the new “bona fide dispute” provision of the Bankruptcy Code was a jurisdictional requirement of an involuntary proceeding, and that his case should therefore be remanded to the bankruptcy court for a determination as to whether it had subject matter jurisdiction.⁸⁵ Although the Ninth Circuit ultimately did reverse and remand for a trial on the sufficiency of the involuntary petition, it did so based on a finding that the bankruptcy court’s discovery sanctions were an abuse of discretion—not on the jurisdictional basis that Rubin asserted.⁸⁶ Nevertheless, the court did engage in a jurisdictional analysis in order to establish its authority to reach the abuse of discretion issue.⁸⁷ The Ninth Circuit held that the undisputed-claims requirement of Section 303(b) was not jurisdictional in nature, but rather went “to the merits—an element that must be established to sustain an involuntary proceeding.”⁸⁸ In so doing, the court analogized this requirement to others in Section 303, which had been labeled as “jurisdictional” in prior cases, but were in fact treated as “substantive matters which must be proved or waived.”⁸⁹ The

⁸² *Rubin*, 769 F.2d at 613.

⁸³ *Id.*

⁸⁴ *Id.* at 613-14.

⁸⁵ *Id.* at 614. The bona fide dispute provisions became effective after the proceedings in the bankruptcy court but before those in the Ninth Circuit. *See supra* note 81.

⁸⁶ *Rubin*, 769 F.2d at 619.

⁸⁷ *Id.* at 614-15. The circuit court held that the bankruptcy court had jurisdiction independent of § 303(b), and that “[t]he bankruptcy court’s order striking Rubin’s answer and entering an order for relief was a final decision,” and thus that the circuit court had appellate jurisdiction to hear this case. *Id.* at 615.

⁸⁸ *Id.* at 614-15.

⁸⁹ *Id.* at 614 n.3. In *In re Mason*, the Ninth Circuit did not explicitly state that the § 303(b) requirements were not jurisdictional in nature, but it did hold that the petition’s failure to meet one of those requirements “did not deprive the bankruptcy court of jurisdiction to enter a valid order for relief,” when the debtor “waived his right to present this defense by failing to raise it in an answer to the petition.” 709 F.2d 1313, 1318-19 (9th Cir. 1983). In *In re Visioneering Construction*, a case similar to *Rubin* involving a debtor that allegedly obstructed discovery proceedings, the court held that the bankruptcy court did not abuse its discretion in imposing sanctions on the debtor by striking the debtor’s answer and ordering relief against the debtor. 661 F.2d 119, 123-24 (9th Cir. 1981). Discovery in that case was intended to help the

court also suggested that the nature of subject matter jurisdiction is such that a failure to satisfy the Section 303(b) requirements could not deprive the bankruptcy court of its already-existing power to hear the case.⁹⁰

B. The Second Circuit's Analysis in In re BDC 56 LLC

In *In re BDC 56 LLC*,⁹¹ the debtor, owner of the Chambers Hotel in Manhattan, successfully moved for dismissal of an involuntary petition filed by three construction companies that claimed to be owed money for work performed on the hotel.⁹² The bankruptcy court dismissed the petition based on BDC's assertion that two of the creditors' claims were subject to bona fide disputes⁹³ and that the third lacked

bankruptcy court determine whether it had subject matter jurisdiction over the case. *Visioneering*, 661 F.2d at 121. As a result of striking the debtor's answer, the bankruptcy court treated the allegations in the petition as admitted by the debtor, and found that those allegations "were sufficient to confer subject matter jurisdiction." *Id.* at 122. The *Rubin* court, in its analysis of *Visioneering*, observed that the notion of "conferring subject matter jurisdiction" by admission of the parties is entirely inconsistent with the Supreme Court's holding that "parties cannot confer subject matter jurisdiction on a federal court by their consent." *Rubin*, 769 F.2d at 614 n.3 (quoting *Insurance Corp. of Ireland v. Compagnie des Bauxite de Guinee*, 456 U.S. 694, 702 (1982)). Thus, despite the use of the term "subject matter jurisdiction" in *Mason* and *Visioneering*, the *Rubin* court held that those cases did not in fact establish that the § 303(b) requirements were anything other than "substantive matters which must be proved or waived." *Rubin*, 769 F.2d at 614 n.3.

⁹⁰ *Rubin*, 769 F.2d at 614 ("Subject matter jurisdiction deals with a court's competence to hear and determine cases of the general class to which the proceedings in question belong and the power to deal with the general subject involved in the action."). The court cited *In re Earl's Tire Service, Inc.*, in which a nonpetitioning creditor sought to have an involuntary petition against its debtor dismissed in order to prevent the trustee from voiding the creditor's collection activities. *Id.* (citing *In re Earl's Tire Serv., Inc.*, 6 B.R. 1019, 1020 (D. Del. 1980)). In order to get around its lack of standing to object to the petition, the creditor in *Earl* characterized its objection that there were an insufficient number of petitioning creditors as an attack on the court's subject matter jurisdiction. *Earl*, 6 B.R. at 1021. The *Earl* court observed that, since "Earl's Tire was qualified to be a debtor under the Bankruptcy Code, it is difficult to perceive how an arguable defect in the procedural mechanism for commencing a bankruptcy action would deprive the court of its subject matter jurisdiction." *Id.* at 1022. It went on to warn that courts' sometimes inaccurate use of the word "jurisdictional" does not provide a basis for "'jurisdictional' challenges raised by disgruntled creditors." *Id.* at 1023.

⁹¹ 330 F.3d 111 (2d Cir. 2003).

⁹² *Id.* at 114.

⁹³ *Id.* at 115 (debtor had "a longstanding dispute with [the first creditor] concerning its performance under the contract," and "contended that [the second creditor's] right to payment had not yet arisen under its contract"); see also 11 U.S.C. § 303(b); *supra* note 70.

standing.⁹⁴ After the creditors moved unsuccessfully for reconsideration and lost an appeal in the district court, they appealed to the Second Circuit.⁹⁵ At the circuit court, the parties argued for different standards of review—with BDC seeking review for “clear error” and the creditor-appellants urging “de novo review.”⁹⁶ Instead, the Second Circuit construed the Section 303(b) requirements as subject-matter jurisdictional and therefore applied plenary review.⁹⁷ In support of its holding that the Section 303(b) requirements were jurisdictional, the court stated that “[w]hether an alleged debtor is properly before the bankruptcy court in an involuntary case is a threshold determination that should be made at the earliest possible stage of the proceedings.”⁹⁸ The court cautioned that a result of failing to treat Section 303(b) as subject-matter jurisdictional would be that “creditors could, on the basis of relatively untested claims, haul a solvent debtor with whom they have legitimate disputes into bankruptcy court and force it to defend an involuntary proceeding while the bankruptcy court leaves for later merits determination whether the debtor is even properly before it.”⁹⁹ In addition to its own analysis, the court also relied on two previous holdings within the Second Circuit in which the courts repeatedly referred to Section 303(b) challenges as “jurisdictional.”¹⁰⁰

⁹⁴ *BDC 56*, 330 F.3d at 115 (the third creditor was a subcontractor of another party with whom debtor had contracted directly and to whom debtor had tendered complete payment).

⁹⁵ *Id.* at 116.

⁹⁶ *Id.* at 118.

⁹⁷ “When reviewing a district court’s determination of its subject matter jurisdiction, we review factual findings for clear error and legal conclusions *de novo*.” *Id.* at 119 (quoting *In re Vogel Van & Storage, Inc.*, 59 F.3d 9, 11 (2d Cir. 1995)); see also *Zappia Middle East Constr. Co. v. Emirate of Abu Dhabi*, 215 F.3d 247, 249 (2d Cir. 2000) (per curiam).

⁹⁸ *BDC 56*, 330 F.3d at 118.

⁹⁹ *Id.* at 118-19.

¹⁰⁰ *In re Elsa Designs, Ltd.*, 155 B.R. 859, 863 (Bankr. S.D.N.Y. 1993) (stating that the undisputed-claim requirement of § 303(b) “is both an element of the condition upon which a controverted order for relief may be entered and a necessary prerequisite for the bankruptcy court’s jurisdiction”); *In re Onyx Telecomm., Ltd.*, 60 B.R. 492, 495 (Bankr. S.D.N.Y. 1985) (stating that in a 12(b)(1) facial attack on an involuntary bankruptcy petition, “Section 303(b)(1) of the Bankruptcy Code is the applicable jurisdictional provision”). These cases do not explain the reasoning behind their conclusions that § 303(b) is jurisdictional. However, it is clear from both cases’ detailed discussions of the § 303(b) challenges that the court was indeed analyzing these challenges as subject-matter jurisdictional, and not merely making a careless “drive-by jurisdictional ruling[.]” *Arbaugh v. Y & H Corp.*, 546 U.S. 500, 511 (2006) (quoting *Steel Co. v. Citizens for a Better Env’t*, 523 U.S. 83, 91 (1998)); *Elsa*, 155 B.R. at 863, 864 n.2; *Onyx*, 60 B.R. at 493-97 (discussing at great length the difference between a

C. *The Eleventh Circuit Addresses the Split in In re Trusted Net Media Holdings, LLC*

In 2008, in *In re Trusted Net Media Holdings, LLC*,¹⁰¹ the Eleventh Circuit convened en banc to rehear an appeal from the lower court's denial of a motion to dismiss an involuntary bankruptcy petition.¹⁰² An involuntary Chapter 7 petition was filed in 2002 by a single creditor of Trusted Net.¹⁰³ After the debtor failed to respond, the bankruptcy court entered an order for relief.¹⁰⁴ Two years later, David W. Huffman, an officer of Trusted Net, moved to dismiss the petition on the basis that the single-creditor petition failed to meet the Section 303(b) requirements for subject matter jurisdiction because the claim was subject to a bona fide dispute and the debtor had twelve or more creditors.¹⁰⁵ Although the bankruptcy court denied this motion, no appeal was taken.¹⁰⁶ Two more years passed, at which point a number of Trusted Net's creditors reached a settlement with the trustee.¹⁰⁷ Huffman, whose deferred salary also made him a creditor of Trusted Net,¹⁰⁸ was not included in the settlement agreement and his objections to the settlement were overruled by the bankruptcy court.¹⁰⁹ Huffman then filed another motion to dismiss the case, in which he raised the same argument that he raised in 2004—namely, the lack of subject matter jurisdiction due to the use of a disputed claim and an insufficient number of petitioning creditors.¹¹⁰ In denying the motion, the bankruptcy court ruled that the requirements of Section 303(b) were not subject-matter jurisdictional and that the objection to the petition, raised more than four years after the commencement of the proceeding, had been waived by the

facial attack and a factual attack under 12(b)(1) before applying legal principles to the facts of that case).

¹⁰¹ 550 F.3d 1035 (11th Cir. 2008) (en banc).

¹⁰² *Id.* at 1037-38.

¹⁰³ *Id.* at 1037.

¹⁰⁴ *Id.*

¹⁰⁵ *Id.* at 1037-38.

¹⁰⁶ *Id.* at 1038.

¹⁰⁷ *Id.*

¹⁰⁸ *In re Trusted Net Media Holdings, LLC*, 525 F.3d 1095, 1097 (11th Cir. 2008), *rev'd*, 550 F.3d 1035 (11th Cir. 2008) (en banc).

¹⁰⁹ *In re Trusted Net Media Holdings, LLC*, 550 F.3d 1035, 1038 (11th Cir. 2008) (en banc).

¹¹⁰ *Id.*

debtor.¹¹¹ When the district court affirmed, Trusted Net appealed to the Eleventh Circuit solely on the basis that the “requirements in Section 303(b) are jurisdictional, and thus cannot be waived.”¹¹² Despite concluding that Section 303(b) is properly construed as substantive rather than jurisdictional in nature, the Eleventh Circuit, found itself to be bound by contrary precedent.¹¹³ Consequently, with more than a bit of hesitation, the court reversed the lower court’s denial of Trusted Net’s motion to dismiss;¹¹⁴ however, the court subsequently vacated its decision¹¹⁵ and convened en banc to rehear the appeal.¹¹⁶

On rehearing, the Eleventh Circuit undertook a systematic analysis of the issue, looking not only at the “statutory framework for bankruptcy court jurisdiction and the commencement of involuntary bankruptcy cases,” but also the split between the Ninth and the Second Circuits.¹¹⁷ In its decision, the court concluded that Section 303(b) should not be treated as subject-matter jurisdictional for four main reasons: (1) there is no indication in the language of the provision that Congress intended to condition the court’s jurisdiction on satisfaction of the Section 303(b) requirements;¹¹⁸ (2) other

¹¹¹ *Id.*

¹¹² *Trusted Net*, 525 F.3d at 1097.

¹¹³ *Id.* at 1107 (finding itself bound by the precedent of *In re All Media Prop., Inc.*, 646 F.2d 193 (5th Cir. 1981), *aff’d* 5 B.R. 126 (Bankr. S.D. Tex. 1980)). In *All Media*, the former Fifth Circuit analyzed § 303 in one of the first cases to apply the then-new Bankruptcy Code in an involuntary proceeding. *All Media*, 5 B.R. at 131. Rather than explicitly stating that § 303(b) was jurisdictional, the *All Media* court made repeated reference to it as such. *Id.* at 133, 134, 138, 140, 142 (referring to various subsections of § 303 as jurisdictional). The *Trusted Net* court found that this treatment nevertheless qualified as a holding, because “a determination that § 303(b) is subject matter jurisdictional was a necessary predicate for the court’s consideration of [the debtor’s] argument—which was raised neither in the pleadings nor at trial—that the creditor . . . did not satisfy the statutory requirement of having an unsecured or undersecured claim.” *Trusted Net*, 525 F.3d at 1106-07.

¹¹⁴ *Trusted Net*, 525 F.3d at 1107.

¹¹⁵ *In re Trusted Net Media Holdings, LLC*, 530 F.3d 1363 (11th Cir. 2008).

¹¹⁶ *In re Trusted Net Media Holdings, LLC*, 550 F.3d 1035, 1042 (11th Cir. 2008) (en banc) (“Because this Court sitting *en banc* is not bound by prior decisions of a panel of this Court or its predecessor, we need not revisit *All Media*. Instead, we reach our own conclusions as to the proper interpretation of § 303(b).” (internal citation omitted)).

¹¹⁷ *Id.* at 1038.

¹¹⁸ The court stated that “the language of § 303(b) does not evince a congressional intent to implicate the bankruptcy courts’ subject matter jurisdiction.” *Id.* at 1043. This conclusion was based, in part, on the Supreme Court’s opinion in *Arbaugh v. Y & H Corp.* See *infra* Part III.A.3. The *Trusted Net* court also noted that not only is there “no indication from the text of § 303 that Congress intended bankruptcy courts to consider *sua sponte* at any point in the proceedings whether the

similar provisions of the Bankruptcy Code have been interpreted as substantive rather than as jurisdictional;¹¹⁹ (3) this conclusion is consistent with “the bankruptcy-related jurisdictional grant in Title 28, as well as the basic nature of subject matter jurisdiction[;]”¹²⁰ and (4) this conclusion is consistent with the other provisions of Section 303.¹²¹ After the Eleventh Circuit’s en banc holding in *Trusted Net*, the Second Circuit stands alone in treating Section 303(b) as subject-matter jurisdictional in nature.¹²²

III. THE SECOND CIRCUIT ERRED IN FINDING SECTION 303(b) JURISDICTIONAL

The Section 303(b) requirements are best viewed as substantive rather than subject-matter jurisdictional. First, treating the Section 303(b) requirements as substantive better comports with the “basic nature of subject matter jurisdiction,”¹²³ the specific jurisdictional structure of the Bankruptcy Code, and the language and purpose of Section 303 itself. Additionally, the 2006 United States Supreme Court case, *Arbaugh v. Y & H Corp.*, definitively resolves this issue by establishing a test for determining whether a statute is jurisdictional or substantive in nature.¹²⁴ Second, a comparison between Section 303 and analogous provisions of the Bankruptcy Code that have been treated as either substantive or jurisdictional demonstrates that Section 303(b) should also be construed as nonjurisdictional for the sake of consistency. Third, the Second Circuit’s treatment of Section 303(b) as jurisdictional actually undercuts the court’s implied goals of fairness and judicial efficiency. In fact, a subsequent case

involuntary petition filing requirements have been met,” but that “the statutory language strongly suggests the opposite.” *Trusted Net*, 550 F.3d at 1044.

¹¹⁹ “[T]his Court has interpreted similar ‘commencement of the case’ language, found elsewhere in the Bankruptcy Code, to be non-jurisdictional.” *Trusted Net*, 550 F.3d at 1043.

¹²⁰ *Id.* at 1044.

¹²¹ *Id.* at 1044-45 (referring to § 303(c), (h)).

¹²² *See supra* note 13.

¹²³ *Id.* at 1044.

¹²⁴ *Arbaugh v. Y & H Corp.*, 546 U.S. 500, 515-16 (2006) (holding that a statutory requirement should be treated as subject-matter jurisdictional only when Congress evinces a clear intent to make it so, and relying also in part on questions of fairness and judicial efficiency).

within the Second Circuit¹²⁵ demonstrates that the circuit's jurisdictional treatment of Section 303(b) is unworkable.

A. *Subject Matter Jurisdiction in the Bankruptcy Code:
Does Section 303 Belong?*

Treating Section 303(b) as jurisdictional conflicts with general notions of subject matter jurisdiction as well as the specific jurisdictional structure of the Bankruptcy Code, and prevents the other provisions of Section 303 from operating as Congress intended. Furthermore, this interpretation is a direct violation of the Supreme Court's holding in *Arbaugh v. Y & H Corporation*.¹²⁶

1. The Nature of Subject Matter Jurisdiction and Its
Place in the Bankruptcy Code

Subject matter jurisdiction refers to “the courts’ statutory or constitutional *power* to adjudicate the case.”¹²⁷ Because it goes to the fundamental ability of a court to entertain and adjudicate a proceeding, it is never too late to raise an objection based on lack of subject matter jurisdiction, even if the issue has not been introduced until appeal.¹²⁸ Nothing that the parties do in the course of litigation can serve to create jurisdiction that would otherwise be lacking.¹²⁹ A lack

¹²⁵ *In re MarketXT Holdings Corp.*, 347 B.R. 156 (Bankr. S.D.N.Y. 2006).

¹²⁶ *Arbaugh v. Y & H Corp.*, 546 U.S. 500 (2006).

¹²⁷ *Steel Co. v. Citizens for a Better Env't*, 523 U.S. 83, 89 (1998) (internal citation omitted) (emphasis in original); *In re Rubin*, 769 F.2d 611, 614 (9th Cir. 1985) (“Subject matter jurisdiction deals with a court’s competence to hear and determine cases of the general class to which the proceedings in question belong and the power to deal with the general subject involved in the action.” (internal citation omitted)); Howard M. Wasserman, *Jurisdiction, Merits, and Procedure: Thoughts on a Trichotomy*, 102 NW. U. L. REV. 1547, 1547-48 (2008) (“[Subject matter jurisdiction] can broadly be defined as the court’s raw, baseline power and legitimate authority to hear and resolve the legal and factual issues in a class of cases.”).

¹²⁸ FED. R. CIV. P. 12(b)(1) & 12(h); *Arbaugh*, 546 U.S. at 506 (“The objection that a federal court lacks subject-matter jurisdiction . . . may be raised by a party, or by a court on its own initiative, at any stage in the litigation, even after trial and the entry of judgment.”) (citing FED. R. CIV. P. 12(b)(1)); *Kontrick v. Ryan*, 540 U.S. 443, 455 (2004) (“A litigant generally may raise a court’s lack of subject-matter jurisdiction at any time in the same civil action, even initially at the highest appellate instance.” (internal citations omitted)). *But see Kontrick*, 540 U.S. at 455 n.9 (“Even subject-matter jurisdiction, however, cannot be attacked collaterally”); RESTATEMENT (SECOND) OF JUDGMENTS § 12 (1982) (listing the few circumstances in which subject matter jurisdiction may be attacked post-judgment).

¹²⁹ *Kontrick*, 540 U.S. at 456 (“Characteristically, a court’s subject-matter jurisdiction cannot be expanded to account for the parties’ litigation conduct”); *Ins.*

of subject matter jurisdiction can be raised by any party or the court sua sponte.¹³⁰ Once a federal court is found to lack subject matter jurisdiction, it is not within the court's discretion to retain the case.¹³¹

Like all federal courts, bankruptcy courts have limited subject matter jurisdiction,¹³² the scope and extent of which is defined by Congress.¹³³ It is well-established that Congress defined the subject matter jurisdiction of bankruptcy courts in sections 1334 and 157 of Title 28.¹³⁴ These sections provide that

Corp. of Ireland v. Compagnie des Bauxites de Guinee, 456 U.S. 694, 702 (1982) (“[N]o action of the parties can confer subject-matter jurisdiction upon a federal court.”).

¹³⁰ FED. R. CIV. P. 12(b)(1) & 12(h)(3) (“When it appears by suggestion of the parties or otherwise that the court lacks jurisdiction of the subject matter, the court shall dismiss the action.”); *Arbaugh*, 546 U.S. at 506 (“The objection that a federal court lacks subject-matter jurisdiction . . . may be raised by a party, or by a court on its own initiative, at any stage in the litigation, even after trial and the entry of judgment.”) (citing FED. R. CIV. P. 12(b)(1)); *Peretz v. United States*, 501 U.S. 923, 953 (1991) (Scalia, J., dissenting) (“One of the hoariest precepts in our federal judicial system is that a claim going to the court’s subject-matter jurisdiction may be raised at any point in the litigation by any party.”) (emphasis added).

¹³¹ *Compagnie des Bauxite*, 456 U.S. at 702 (“[T]he rule, springing from the nature and limits of the judicial power of the United States is inflexible and without exception, which requires this court, of its own motion, to deny its jurisdiction, and, in the exercise of its appellate power, that of all other courts of the United States, in all cases where such jurisdiction does not affirmatively appear in the record.”) (quoting *Mansfield, C. & L.M. Ry. Co. v. Swan*, 111 U.S. 379, 382 (1884)); *Morrison v. Allstate Indem. Co.*, 228 F.3d 1255, 1261 (11th Cir. 2000) (“[L]ower federal courts are empowered to hear only cases for which there has been a congressional grant of jurisdiction, and once a court determines that there has been no grant that covers a particular case, the court’s sole remaining act is to dismiss the case for lack of jurisdiction.” (internal citation omitted)). Moreover, the question of whether subject matter jurisdiction is available is one for the court, and not a jury. 13 CHARLES A. WRIGHT, ARTHUR R. MILLER, EDWARD H. COOPER, & RICHARD D. FREER, FEDERAL PRACTICE AND PROCEDURE § 3522 (2008); Wasserman, *supra* note 127, at 1547-48 (“[T]he court resolves any factual issues on which jurisdiction turns.”).

¹³² *Morrison*, 228 F.3d at 1260-61.

¹³³ *Kline v. Burke Const. Co.*, 260 U.S. 226, 234 (1922) (“Only the jurisdiction of the Supreme Court is derived directly from the Constitution. Every other court created by the general government derives its jurisdiction wholly from the authority of Congress.”); *see also* 28 U.S.C. §§ 157 & 1334 (2006).

¹³⁴ *Kontrick*, 540 U.S. at 452-53 (“Only Congress may determine a lower federal court’s subject-matter jurisdiction Congress did so with respect to bankruptcy courts in Title 28”) (citation omitted); *In re Banks*, 235 Fed. Appx. 943, 944 (3d Cir. 2007) (“Two statutes, 28 U.S.C. §§ 1334 and 157, provide the source of a bankruptcy court’s jurisdiction.” (citation omitted)); *Valley Historic Ltd. P’ship v. Bank of New York*, 486 F.3d 831, 839 n.3 (4th Cir. 2007) (“Whether a bankruptcy court may exercise subject matter jurisdiction over a proceeding is determined by reference to 28 U.S.C. § 1334.”); *In re U.S. Brass Corp.*, 301 F.3d 296, 303 (5th Cir. 2002) (“The source of the bankruptcy court’s jurisdiction is 28 U.S.C. §§ 1334 and 157”) (quoting *United States Tr. v. Gryphon at the Stone Mansion, Inc.*, 216 B.R. 764, 769 (W.D. Pa. 1997), *aff’d*, 166 F.3d 552 (3d Cir. 1999)); 1 NORTON & NORTON, *supra* note 44, at § 4:4 (“The present Bankruptcy Code does not confer subject-matter jurisdiction, which is established solely by provisions of Title 28.”); *see also supra* Part I.B.

bankruptcy courts may exercise jurisdiction over “any or all cases under title 11,” pursuant to referral from the district court.¹³⁵ In contrast to the jurisdictional provisions of Title 28, Title 11 “contains the body of substantive law governing the federal bankruptcy regime.”¹³⁶ The practical effect of this statutory structure is that a bankruptcy court unquestionably has the jurisdiction to entertain an involuntary bankruptcy case, which by definition falls under Title 11.¹³⁷ In the course of exercising that jurisdiction, the bankruptcy court’s task is to determine whether the substantive requirements for bankruptcy relief are satisfied. The question of whether the substantive requirements of Title 11 are satisfied does not, in any case, affect the threshold determination that the court has the jurisdiction to hear and resolve the case.¹³⁸ The mere reference to Title 11 in the statutory provision that establishes bankruptcy jurisdiction¹³⁹ is not a ground for translating all of Title 11’s substantive requirements into jurisdictional requirements.¹⁴⁰

Given this jurisdictional and statutory framework, it is more sensible to conclude that Section 303(b) is unrelated to

¹³⁵ 28 U.S.C. § 157(a).

¹³⁶ Pathak, *supra* note 61, at 66 & n.21. *Cf. In re Trusted Net Media Holdings, LLC*, 525 F.3d 1095, 1098 (11th Cir. 2008) (describing Chapter 7, which defines liquidation, as the substantive provisions, and Chapter 3, which contains § 303, as “the procedural statute at issue”); *see also supra* Part I.B.

¹³⁷ 28 U.S.C. §§ 157 & 1334; 11 U.S.C. § 303; *In re Trusted Net Media Holdings, LLC*, No. 07-13429, 2008 WL 5069824, at *8 (11th Cir. Dec. 2, 2008) (“As a class of cases, involuntary bankruptcy cases unquestionably arise under Title 11 . . .”).

¹³⁸ *Steel Co. v. Citizens for a Better Env’t*, 523 U.S. 83, 89 (1998); *Bell v. Hood*, 327 U.S. 678, 682 (1946). In *Bell*, the Supreme Court stated:

Jurisdiction, therefore, is not defeated . . . by the possibility that the averments might fail to state a cause of action on which petitioners could actually recover. For it is well settled that the failure to state a proper cause of action calls for a judgment on the merits and not for a dismissal for want of jurisdiction. Whether the complaint states a cause of action in which relief could be granted is a question of law and just as issues of fact it must be decided after and not before the court has assumed jurisdiction over the controversy. If the court does later exercise its jurisdiction to determine that the allegations in the complaint do not state a ground for relief, then dismissal of the case would be on the merits, not for want of jurisdiction.

Bell, 327 U.S. at 682.

¹³⁹ *See, e.g.*, 28 U.S.C. § 1334(a) (“[T]he district courts shall have original and exclusive jurisdiction of all cases under title 11.”); 28 U.S.C. § 157(a) (“Each district court may provide that any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 shall be referred to the bankruptcy judges for the district.”).

¹⁴⁰ *See, e.g., In re Bowshier*, 313 B.R. 232, 238 (Bankr. S.D. Ohio 2004) (“[I]t is important to note that not every statutory requirement is a matter of jurisdiction.”).

subject matter jurisdiction. First, Section 303(b) is codified within Title 11, which contains the substantive body of bankruptcy law, rather than in Title 28, which is the jurisdictional grant to federal courts.¹⁴¹ Second, Section 303 makes no reference to jurisdictional requirements.¹⁴² Third, treating Section 303(b) as jurisdictional could lead to the illogical result of incentivizing an involuntary debtor's default.¹⁴³ Consider, for example, a hypothetical case in which a single creditor files an involuntary bankruptcy petition against a debtor with more than twelve qualified creditors. If the debtor files an answer asserting that the petition fails to satisfy Section 303(b), he will then be required to supply the petitioning creditor with a list of his creditors' names and addresses and a description of their claims, in order for notice to be sent.¹⁴⁴ This allows the petitioning creditor to alert the other claimholders to the involuntary petition and gives those creditors an opportunity to join the petition with the same effect as if they were original petitioning creditors.¹⁴⁵ More likely than not, the requisite number of creditors will join the petition to ensure that they receive some part of the distribution of assets, and the debtor will lose his Section 303(b) jurisdictional defense.

Now consider a situation in which the same debtor fails to file a timely answer to the petition. Akin to a default judgment in a civil case,¹⁴⁶ if the debtor does not answer, the court must allow the bankruptcy case to proceed pursuant to

¹⁴¹ 11 U.S.C. § 303(b); *see supra* notes 62-63.

¹⁴² 11 U.S.C. § 303; *In re* Trusted Net Media Holding, 525 F.3d 1095, 1102 (11th Cir. 2008) ("Section 303(b) does not contain any explicit reference to its requirements being jurisdictional in nature."); *cf.* *Arbaugh v. Y & H Corp.*, 546 U.S. 500, 502, 516 (2006) (holding that the employee-numerosity requirement of 42 U.S.C. § 2000e(b) is not jurisdictional, in part because "the 15-employee threshold appears in a . . . provision that 'does not speak in jurisdictional terms or refer in any way to the jurisdiction of the district courts.'") (quoting *Zipes v. Trans World Airlines, Inc.*, 455 U.S. 385, 394 (1982)).

¹⁴³ Admittedly, treating § 303(b) as substantive could lead to the undesirable result of allowing a creditor to force a debtor into bankruptcy on the basis of a single claim that would be better resolved through state collection procedures, or on the basis of a disputed claim. *See infra* Part III.C.2. However, this result is consistent with the judicial policy that a litigant's default may work to its detriment, and is more sensible than the alternative. *Id.*

¹⁴⁴ FED. R. BANKR. P. 1003(b).

¹⁴⁵ 11 U.S.C. § 303(c); FED. R. BANKR. P. 1003(b) and advisory committee note (d). This arrangement is sensible given that the debtor is the party with the most knowledge about his or her own financial affairs. *See In re Coppertone Commc'ns, Inc.*, 96 B.R. 233, 236 (Bankr. W.D. Mo. 1989).

¹⁴⁶ *See* FED. R. CIV. P. 55.

Section 303(h).¹⁴⁷ However, if Section 303(b) is treated as subject-matter jurisdictional, a default would actually be in the debtor's best interest since he could then move to dismiss the petition *after* the court has entered relief against him—still early enough to raise lack of subject matter jurisdiction as a defense but too late for additional creditors to join the petition.¹⁴⁸ In order to incentivize full disclosure by the debtor, it makes far more sense to treat the requirement of three or more petitioning creditors as a waivable affirmative defense, i.e., substantive rather than jurisdictional.¹⁴⁹ Under this approach, a debtor that fails to disclose the existence of claimholders gives up his Section 303(b) defense¹⁵⁰ and may be left with undischargeable debts if his creditors are not notified of the bankruptcy.¹⁵¹

2. A Non-Jurisdictional Interpretation Ensures that Section 303 Operates Effectively

When examined in conjunction with the other subsections of Section 303, it is plain that Section 303(b) must be treated as nonjurisdictional in order for the statute to operate sensibly.¹⁵² First, not only does a jurisdictional reading

¹⁴⁷ 11 U.S.C. § 303(h) (“If the petition is not timely controverted, the court shall order relief against the debtor in an involuntary case under the chapter under which the petition was filed.”); 2 NORTON & NORTON, *supra* note 44, at § 22:12.

¹⁴⁸ See 11 U.S.C. § 303(c) (“After the filing of a petition under this section *but before the case is dismissed or relief is ordered*, a creditor . . . may join in the petition with the same effect as if such joining creditor were a petitioning creditor”) (emphasis added). Moreover, while bankruptcy courts have broad powers to remedy bad faith conduct by litigants, see 11 U.S.C. § 105(a); 2 NORTON & NORTON, *supra* note 44, at § 13:4, they cannot use their equitable powers to expand the scope of their jurisdiction. 1 NORTON & NORTON, *supra* note 44, at § 4:5 (“The grant of equitable power to a bankruptcy court does not create, confer, or supply subject-matter jurisdiction if it is otherwise lacking.”). Thus, if § 303(b) was jurisdictional, the bankruptcy court would be unable to rely on its equitable powers to allow joinder of creditors after the entry of relief, as this would amount to a unilateral expansion of its jurisdiction. *Cf.* Kontrick v. Ryan, 540 U.S. 443, 454 (2004) (explaining that bankruptcy courts cannot use the Federal Rules of Bankruptcy Procedure to expand the scope of their jurisdiction); *In re Granger Garage, Inc.*, 921 F.2d 74, 77 (6th Cir. 1990) (“[Section] 105(a) [is not a] jurisdictional provision[] The subject matter jurisdiction of the bankruptcy court is limited to that which congress specifically grants.”).

¹⁴⁹ *In re Coppertone Commc'ns, Inc.* 96 B.R. 233, 236 (Bankr. W.D. Mo. 1989).

¹⁵⁰ *Id.*

¹⁵¹ See, e.g., 3 NORTON & NORTON, *supra* note 44, at § 57:20 (“Under Code § 523(a)(3), creditors who are neither listed by the debtor in the schedule of creditors filed with the court, nor who have otherwise learned of the bankruptcy case within a limited period of time, may have their claims excepted from discharge.”).

¹⁵² *In re Trusted Net Media Holdings, LLC*, 525 F.3d 1095, 1102 (11th Cir. 2008) (“Interpreting § 303(b) as non-jurisdictional . . . results in a harmonious

of Section 303(b) incentivize a debtor's default when combined with Section 303(c),¹⁵³ but it also causes Section 303(c) to operate in contradiction of the general principles of subject matter jurisdiction.¹⁵⁴ If the bankruptcy court were to allow a nonpetitioning creditor to "join in the petition with the same effect as if such joining creditor were a petitioning creditor under [Section 303(b)],"¹⁵⁵ it would essentially be acting so as to confer jurisdiction upon itself, thus violating a rule that the Supreme Court has described as "inflexible."¹⁵⁶ By contrast, if a Section 303(b) defect is merely a substantive failure, then permitting a creditor to join the petition would effectuate Section 303(c) while adhering to the rules of subject matter jurisdiction.

Next, a jurisdictional reading of Section 303(b) would also cause Section 303(d) to violate general principles of subject matter jurisdiction. Section 303(d)'s limitation on who may file an answer to an involuntary petition¹⁵⁷ has been interpreted as an exhaustive list.¹⁵⁸ This list indicates that creditors, including

operation of the statutory subsections."), *overruled by* 550 F.3d 1035 (11th Cir. 2008) (en banc).

¹⁵³ See *supra* Part III.A.1.

¹⁵⁴ See *id.* (discussing general principles of subject matter jurisdiction); *In re* Trusted Net Media Holdings, LLC, 550 F.3d 1035, 1044-45 (11th Cir. 2008) (en banc) ("[I]t seems anomalous at best to conclude that a bankruptcy court, which lacks jurisdiction over an involuntary case because the petition was defectively filed, subsequently may create jurisdiction for itself by permitting additional creditors to join the petition [under § 303(c)].").

¹⁵⁵ 11 U.S.C. § 303(c).

¹⁵⁶ *Ins. Corp. of Ireland v. Compagnie des Bauxite de Guinee*, 456 U.S. 694, 702 (1982) ("[T]he rule, springing from the nature and limits of the judicial power of the United States is inflexible and without exception, which requires this court, of its own motion, to deny its jurisdiction, and, in the exercise of its appellate power, that of all other courts of the United States, in all cases where such jurisdiction does not affirmatively appear in the record.") (quoting *Mansfield, C. & L.M. Ry. Co. v. Swan*, 111 U.S. 379, 382 (1884)); *Morrison v. Allstate Indem. Co.*, 228 F.3d 1255, 1261 (11th Cir. 2000) ("[L]ower federal courts are empowered to hear only cases for which there has been a congressional grant of jurisdiction, and once a court determines that there has been no grant that covers a particular case, the court's sole remaining act is to dismiss the case for lack of jurisdiction.").

¹⁵⁷ 11 U.S.C. § 303(d) ("The debtor, or a general partner in a partnership debtor that did not join in the petition, may file an answer to a petition under this section.").

¹⁵⁸ See, e.g., FED. R. BANKR. P. 1011(a), (e) ("The debtor named in an involuntary petition . . . may contest the petition. . . . No other pleadings shall be permitted . . ."); *In re* MarketXT Holdings Corp., 347 B.R. 156, 160 (Bankr. S.D.N.Y. 2006) (interpreting § 303(d) to mean that "only [t]he debtor, or a general partner in a partnership debtor that did not join in the petition, may file an answer") (emphasis added); *In re* Taylor & Assocs., L.P., 191 B.R. 374, 378-79, 381 (Bankr. E.D. Tenn. 1996) (this rule "prohibit[s] creditors from contesting an involuntary petition in order to prevent creditors from protecting a preference or retaining some other unfair

petitioning creditors who are undoubtedly parties to the litigation, are not authorized to raise objections to an involuntary petition based on a Section 303(b) deficiency.¹⁵⁹ It is fundamental, however, that any party may raise an objection based on lack of subject matter jurisdiction.¹⁶⁰ Thus, if Section 303(b) is jurisdictional in nature, one of the most basic and longstanding features of subject matter jurisdiction would not apply. Rather than creating an unprecedented exception to the well-accepted principles of subject matter jurisdiction, the more logical approach is to interpret Section 303(b) in a manner that is consistent with both the principles of subject matter jurisdiction and the statutory structure to which Section 303(b) belongs.¹⁶¹ This approach leads to the conclusion that Section 303(b) is nonjurisdictional.

3. Distinguishing Jurisdictional and Substantive Statutory Provisions Under *Arbaugh*: Is the Split Over Section 303(b) Moot?

Part of the difficulty in characterizing any statutory provision as jurisdictional or substantive stems from the frequent and longstanding misuse of the word “jurisdiction” by courts.¹⁶² In 2006, the Supreme Court addressed this issue in *Arbaugh v. Y & H Corp.*,¹⁶³ when the Court faced the question of whether an employee-numerosity requirement in Title VII was

advantage”); *In re Westerleigh Development Corp.*, 141 B.R. 38, 40 (S.D.N.Y. 1992); *In re New Era Co.*, 115 B.R. 41, 44-45 (Bankr. S.D.N.Y. 1990) (listing cases in support of this proposition).

¹⁵⁹ FED. R. BANKR. P. 1011. The rationale for this rule is that “a creditor may have an incentive to protect a preference or to gain some unfair advantage at the expense of other creditors, contrary to the policy of requiring an equitable distribution of the debtor’s assets among all creditors.” *New Era*, 115 B.R. at 45.

¹⁶⁰ See *supra* note 130.

¹⁶¹ *In re Trusted Net Media Holdings, LLC*, 525 F.3d 1095, 1102 (11th Cir. 2008) (“Interpreting § 303(b) as non-jurisdictional, on the other hand, results in a harmonious operation of the statutory subsections.”).

¹⁶² *Kontrick v. Ryan*, 540 U.S. 443, 454 (2004) (“Courts, including this Court, it is true, have been less than meticulous in this regard; they have more than occasionally used the term ‘jurisdictional’ to describe emphatic time prescriptions in rules of court.”); *Steel Co. v. Citizens for a Better Env’t*, 523 U.S. 83, 90 (1998) (“‘Jurisdiction,’ it has been observed, ‘is a word of many, too many, meanings’”); *Da Silva v. Kinsho Intern. Corp.*, 229 F.3d 358, 361 (2d Cir. 2000) (“Court decisions often obscure the issue by stating that the court is dismissing for ‘lack of jurisdiction’ when some threshold fact has not been established, without explicitly considering whether the dismissal should be for lack of subject matter jurisdiction or for failure to state a claim.”); *United States v. Wey*, 895 F.2d 429, 431 (7th Cir. 1990) (“As for ‘jurisdiction’: the word is a many-hued term”).

¹⁶³ 546 U.S. 500 (2006).

subject-matter jurisdictional or substantive.¹⁶⁴ In *Arbaugh*, the plaintiff brought a Title VII suit against her employer alleging sexual harassment.¹⁶⁵ Two weeks after the trial court entered judgment for the plaintiff, the defendant moved to dismiss for lack of subject matter jurisdiction on the basis that the word “employer,” as defined under Title VII, included only those people who have “fifteen or more employees.”¹⁶⁶ The defendant asserted that he employed fewer than fifteen people and, therefore, the court lacked jurisdiction over the case.¹⁶⁷ In its decision, the Supreme Court held that courts should construe statutory requirements as nonjurisdictional unless Congress makes it clear that the requirement is intended to function as a jurisdictional limitation.¹⁶⁸ The Court also addressed the tendency of lower courts to carelessly label dismissals as “jurisdictional” when they were in fact based on a party’s failure to establish a substantive element of its claim,¹⁶⁹ and characterized “such unrefined dispositions as ‘drive-by jurisdictional rulings’ that should be accorded ‘no precedential effect’ on the question whether the federal court had authority to adjudicate the claim in suit.”¹⁷⁰ In addition to the main legislative intent test, the *Arbaugh* Court also mentioned the “‘unfair[ness]’ and ‘waste of judicial resources’” that would result from construing the employee numerosity requirement as jurisdictional, as factors in its decision.¹⁷¹

When the Eleventh Circuit first addressed the question of how to characterize Section 303(b) in *Trusted Net*, it held that it was not governed by *Arbaugh*.¹⁷² The original *Trusted Net* court found that because *All Media* explicitly treated

¹⁶⁴ *Id.* at 503.

¹⁶⁵ *Id.* at 503-04.

¹⁶⁶ 42 U.S.C. § 2000e(b); *Arbaugh*, 546 U.S. at 503-04.

¹⁶⁷ *Id.* at 504.

¹⁶⁸ *Id.* at 509, 515-16. The *Arbaugh* Court stated:

If the Legislature clearly states that a threshold limitation on a statute’s scope shall count as jurisdictional, the courts and litigants will be duly instructed and will not be left to wrestle with the issue. . . . But when Congress does not rank a statutory limitation on coverage as jurisdictional, courts should treat the restriction as nonjurisdictional in character.

Id. at 515-16. The Court also provided a nonexhaustive list of statutes in which Congress clearly stated its intent that a requirement be jurisdictional. *Id.* at 516 n.11.

¹⁶⁹ *Id.* at 511.

¹⁷⁰ *Id.* (quoting *Steel Co. v. Citizens for a Better Env’t*, 523 U.S. 83, 91 (1998)).

¹⁷¹ *Id.* at 515.

¹⁷² *In re Trusted Net Media Holdings, LLC*, 525 F.3d 1095, 1104 n.11 (11th Cir. 2008), *overruled by* 550 F.3d 1035 (11th Cir. 2008) (en banc).

Section 303(b) as jurisdictional, as opposed to simply labeling it as such, the decision was not a “drive-by jurisdictional ruling”¹⁷³ and therefore must be treated as binding precedent.¹⁷⁴ When the Eleventh Circuit subsequently reheard *Trusted Net* en banc, however, it overruled *All Media* after applying the *Arbaugh* factors and finding that the Section 303(b) requirements are in fact not subject-matter jurisdictional.¹⁷⁵ Consistent with the main test articulated in *Arbaugh*, the en banc panel focused primarily on the failure of Section 303(b) to “speak in jurisdictional terms.”¹⁷⁶ Although the *Trusted Net* court did not address the question of “‘unfair[ness]’ and ‘waste of judicial resources,’”¹⁷⁷ such considerations would have also militated in favor of its conclusion.¹⁷⁸ Indeed, a jurisdictional reading of Section 303(b) would allow the debtor to strategically default so as to prevent the petitioning creditors from curing a defective petition,¹⁷⁹ a blatantly unfair strategy. It would also allow creditors to squirrel away jurisdictional objections to be used in the event that the involuntary bankruptcy case does not appear to be progressing in their favor,¹⁸⁰ thus wasting the court’s time and depleting the debtor’s estate.¹⁸¹ In the face of *Trusted Net*’s well-reasoned application of *Arbaugh* and the fairness and efficiency considerations

¹⁷³ *Id.*; *Steel Co.*, 523 U.S. at 91.

¹⁷⁴ *Trusted Net*, 525 F.3d at 1104 n.11. In fact, this panel could have overruled the *All Media* precedent without having to convene en banc. *Id.* at 1104 n.7 (“We have . . . held that when an earlier panel of this court has adopted a lower court’s order, that order is binding precedent *unless and until overruled by the Supreme Court* or this Court sitting *en banc*.”) (first emphasis added). While the Supreme Court did not expressly hold that § 303(b) was nonjurisdictional, it did issue a clear directive to courts that, “when Congress does not rank a statutory limitation on coverage as jurisdictional, courts should treat the restriction as nonjurisdictional in character.” *Arbaugh v. Y & H Corp.*, 546 U.S. 500, 516 (2006).

¹⁷⁵ *In re Trusted Net Media Holdings, LLC*, 550 F.3d 1035, 1042-43 (11th Cir. 2008) (en banc). “Applying the Supreme Court’s . . . recent *Arbaugh* test, § 303(b)’s requirements are not subject matter jurisdictional,” because “the language of § 303(b) does not evince a congressional intent to implicate the bankruptcy courts’ subject matter jurisdiction.” *Id.* at 1046.

¹⁷⁶ *Trusted Net*, 550 F.3d at 1043 (quoting *Arbaugh*, 546 U.S. at 515).

¹⁷⁷ *Arbaugh*, 546 U.S. at 515.

¹⁷⁸ The emphasis on efficiency, demonstrated in FED. R. BANKR. P. 1001, also applies in the context of involuntary bankruptcy cases. *See supra* note 21; FED. R. BANKR. P. 1013 (“The court shall determine the issues of a contested [involuntary] petition at the earliest practicable time . . .”).

¹⁷⁹ *See supra* Part III.A.1.

¹⁸⁰ *See supra* notes 158-159.

¹⁸¹ 11 U.S.C. § 503 (providing for certain bankruptcy related expenses to be paid out of the debtor’s estate).

suggested by the *Arbaugh* Court, the Second Circuit's position is now even more tenuous.

B. *Analogous Provisions in the Bankruptcy Code*

Like Section 303(b), other provisions of the Bankruptcy Code have been the subject of debate regarding whether they are jurisdictional or substantive in nature. Significantly, most of these provisions have been deemed to be nonjurisdictional. A brief look at the rationales provided for some of these provisions suggests that the debate over Section 303(b) should be similarly resolved.¹⁸²

1. 11 U.S.C. §§ 546(a) and 549(d): Time Limit on Adversary Proceedings

Sections 546(a) and 549(d) of the Bankruptcy Code establish a time limit after which a trustee can no longer bring certain adversary proceedings to recover property of the debtor's estate that has been transferred away.¹⁸³ In *In re Pugh*, the Eleventh Circuit held that these sections were not jurisdictional, but rather waivable statutes of limitations.¹⁸⁴ In *Pugh*, the debtors did not raise the untimeliness of the trustee's adversary proceeding in their response since they asserted that it was jurisdictional and therefore could be raised at any time.¹⁸⁵ In refuting this interpretation, the court relied on the "plain language of the provisions themselves," the overall statutory

¹⁸² Cf. Wasserman, *supra* note 127, at 1547-49 ("[I]f only some jurisdictional grants are bound up with the merits, there is no explanation or justification for why some merits issues should be jurisdictional and others not.")

¹⁸³ 11 U.S.C. §§ 546(a) & 549(d). The trustee's ability to void transfers of a debtor's property is referred to as his "avoiding power." See, e.g., 1 NORTON & NORTON, *supra* note 44, at § 3:11. The trustee uses this power in order to maximize the value of the debtor's estate for distribution to creditors, and to prevent preferential treatment of favored creditors. *Id.* at § 22:12.

¹⁸⁴ *In re Pugh*, 158 F.3d 530, 530 (11th Cir. 1998). The court characterized the issue in this case as

whether these code provisions constitute grants of subject matter jurisdiction that leave a court without any authority to hear certain proceedings—i.e., that extinguish the right of action itself by divesting a court of its subject matter jurisdiction over certain proceedings—after the limitations period has elapsed, or whether they are true statutes of limitations that restrict the power of a court to grant certain remedies in a proceeding over which it has subject matter jurisdiction.

Id. at 533-34.

¹⁸⁵ *Id.* at 532.

scheme, decisions of other courts, and the legislative history in concluding that the limitations were not jurisdictional in nature.¹⁸⁶ In its rejection of the alternative view, the *Pugh* court noted that the key precedent in support of that approach was “devoid of analysis”¹⁸⁷ and relied on the faulty assumption that a limitation on a cause of action is automatically a limitation on a court’s subject matter jurisdiction over that cause of action.¹⁸⁸ As the Eleventh Circuit noted in *Trusted Net*, “[t]he reasons in *Pugh* apply equally to Section 303(b).”¹⁸⁹

2. 11 U.S.C. § 109(e): Limits on Amount of Debt to Qualify for Chapter 13 Relief

Under Section 109(e), the Code places a statutory cap on the amount of debt an individual can owe and still be a Chapter 13 debtor.¹⁹⁰ In *Rudd v. Laughlin*,¹⁹¹ the bankruptcy trustee alleged that the debtors had abused the bankruptcy system by filing six Chapter 13 petitions in a six-year period, despite their inability to qualify as Chapter 13 debtors under Section 109(e) due to the amount of their unsecured debt.¹⁹² In response to the trustee’s attempt to convert their case into a

¹⁸⁶ *Id.* at 538. This is the majority view. See, e.g., *In re Outboard Marine Corp.*, 299 B.R. 488, 496 (Bankr. N.D. Ill. 2003) (“The clear weight of recent authority bolsters the conclusion that § 546(a) is [nonjurisdictional].”); *In re Commercial Fin. Servs., Inc.*, 294 B.R. 164, 174 (Bankr. N.D. Okla. 2003) (“The court finds the analysis in *Pugh* to be persuasive.”); *In re Rodriguez*, 283 B.R. 112, 120 (Bankr. E.D.N.Y. 2001) (“Based on the *Pugh* case and the decisions cited in *Pugh*, the Court finds that Section 546(a) is [nonjurisdictional].”); *In re Klayman*, 228 B.R. 805, 806 (Bankr. M.D. Fla. 1999) (“The case of [*Pugh*] . . . follows the majority view.”).

¹⁸⁷ *Pugh*, 158 F.3d at 535-36 (“[T]he few other courts that have adopted this jurisdictional view offer little analysis to support their position.”). The Eleventh Circuit made the same observation with regard to § 303(b) in *Trusted Net*, where it noted that “[a]lthough some bankruptcy courts earlier had reached the same conclusion as the Second Circuit [in *BDC*], that § 303(b) is subject matter jurisdictional, they did so without explanation.” *In re Trusted Net Media Holdings, LLC*, 525 F.3d 1095, 1101 n.5 (11th Cir. 2008), *overruled by* 550 F.3d 1035 (11th Cir. 2008) (en banc). This pattern lends credence to the Supreme Court’s concern over “drive-by jurisdictional rulings.” *Steel Co. v. Citizens for a Better Env’t*, 523 U.S. 83, 91 (1998); *Arbaugh v. Y & H Corp.*, 546 U.S. 500, 511 (2006).

¹⁸⁸ *Pugh*, 158 F.3d at 535-36.

¹⁸⁹ *In re Trusted Net Media Holdings, LLC*, 550 F.3d 1035, 1044 (11th Cir. 2008) (en banc). Significantly, at least one bankruptcy court within the Second Circuit has adopted *Pugh*’s reasoning. *In re Rodriguez*, 283 B.R. 112, 119-20 (Bankr. E.D.N.Y. 2001).

¹⁹⁰ 11 U.S.C. § 109(e). The current amounts are \$336,900 for unsecured debt, and \$1,010,650 for secured debt, and are subject to adjustment every three years. 11 U.S.C. §§ 104, 109(e).

¹⁹¹ 866 F.2d 1040 (8th Cir. 1989).

¹⁹² *Id.* at 1041.

Chapter 7 liquidation, the debtors asserted that the bankruptcy court lacked subject matter jurisdiction over the case due to the Section 109(e) deficiency.¹⁹³ When the Eighth Circuit Court of Appeals affirmed the conversion to Chapter 7, it agreed with the district court that the Section 109(e) deficiency was more akin to a failure to state a claim than a jurisdictional defect.¹⁹⁴ The circuit court noted that the congressional grant of subject matter jurisdiction over bankruptcy cases comes from 28 U.S.C. §§ 1334 and 157 and, unlike the requirements for diversity jurisdiction in 28 U.S.C. § 1332, makes no reference to an amount in controversy.¹⁹⁵ This analysis applies with equal force to Section 303(b). To the extent that the *Rudd* court rejected the notion that “a case filed by an ineligible debtor is a nullity, and the court has no jurisdiction to convert the nonexistent case to another chapter,”¹⁹⁶ it would be illogical to conclude that an involuntary case filed by an insufficient number of creditors is incapable of being cured.¹⁹⁷ Instead, it more closely resembles a failure to state a claim, which does not implicate subject matter jurisdiction.¹⁹⁸

3. 11 U.S.C. § 109(h)(1): Credit Counseling Requirement

Both Section 301 (governing voluntary petitions) and Section 303 (governing involuntary petitions) state that a bankruptcy case can only be commenced by or against one who

¹⁹³ *Id.*

¹⁹⁴ *Id.* at 1041-42.

¹⁹⁵ *Id.* The *Rudd* court relied in part on a Fifth Circuit case in which the court recognized a split in authority over whether § 109 was jurisdictional. *Promenade Nat'l Bank v. Phillips*, 844 F.2d 230, 236 n.2 (5th Cir. 1988). The Fifth Circuit noted that “the courts holding that the issue is not jurisdictional generally have engaged in an analysis of the issue, while the courts holding that it is a matter of jurisdiction have not.” *Promenade*, 844 F.2d at 235 n.2. Once again, the Supreme Court’s concern about “drive-by jurisdictional rulings” appears well-founded. *Steel Co. v. Citizens for a Better Env't*, 523 U.S. 83, 91 (1998); *Arbaugh v. Y & H Corp.*, 546 U.S. 500, 511 (2006); *supra* note 187.

¹⁹⁶ *Rudd*, 866 F.2d at 1041.

¹⁹⁷ At least one bankruptcy court within the Second Circuit agrees with the reasoning in *Pugh*. *In re Toronto*, 165 B.R. 746, 756 (Bankr. D. Conn. 1994) (“Section 109(e) relates to the eligibility of a debtor for chapter 13 relief, not the jurisdiction of the court.”); *cf.* *Cavaliere v. Sapir*, 208 B.R. 784, 786 (D. Conn. 1997) (describing § 109(e) as jurisdictional, though without any meaningful analysis); *In re Rifkin*, 124 B.R. 626, 629 (Bankr. E.D.N.Y. 1991) (same); *In re Jerome*, 112 B.R. 563, 564 (Bankr. S.D.N.Y. 1990) (same).

¹⁹⁸ *Cf. Rudd*, 866 F.2d at 1041.

“may be a debtor.”¹⁹⁹ In 2005, amendments to the Bankruptcy Code added the requirement that an individual must receive credit counseling within the 180 days preceding the bankruptcy petition in order to be a debtor.²⁰⁰ In the context of a voluntary Chapter 13 petition where the debtor did not complete his credit counseling within the allotted time, one bankruptcy court has held that it “simply lacks jurisdiction over a debtor’s case where the debtor fails to comply with [the credit counseling requirement].”²⁰¹ For debtors facing involuntary bankruptcy, this holding must have prompted shouts of joy—if they simply refused credit counseling, they could not qualify as debtors under Title 11 and the court would have to dismiss the involuntary petition for lack of subject matter jurisdiction. Not surprisingly, later courts have rejected this contention both on the basis of its sheer absurdity²⁰² and statutory construction.²⁰³ Nonetheless, it provides a good example of a nonjurisdictional²⁰⁴ provision within Title 11 that cannot be logically distinguished from the statutory requirements imposed by Section 303(b).

¹⁹⁹ 11 U.S.C. §§ 301(a), 303(a) (2006).

²⁰⁰ 11 U.S.C. § 109(h)(1) (“[A]n individual may not be a debtor under this title unless such individual has, during the 180-day period preceding the date of filing of the petition by such individual, received . . . credit counseling . . .”).

²⁰¹ *In re Giles*, 361 B.R. 212, 214 (Bankr. D. Utah 2007).

²⁰² *In re Allen*, 378 B.R. 151, 153 (Bankr. N.D. Tex. 2007) (“While the court recognizes that § 303(a) requires that a person who is the subject of an involuntary case qualify as a debtor, interpreting this provision as requiring that an involuntary debtor comply with section 109(h)(1) would lead to an absurd result.”).

²⁰³ *Id.* at 153 (finding that because “[t]he statutory language of section 109(h)(1) requires that the credit counseling occur before ‘the filing of the petition by such individual,’” the requirement only applied to voluntary cases) (emphasis in original).

²⁰⁴ That the credit counseling requirement is unrelated to subject matter jurisdiction is further evidenced by the fact that there are bases, albeit limited ones, upon which a court may waive the requirement. 11 U.S.C. § 109(h)(3)(A). The ability of the court to waive the credit counseling requirement is fundamentally inconsistent with the conclusion that this requirement is subject-matter jurisdictional. *Morrison v. Allstate Indem. Co.*, 228 F.3d 1255, 1261 (11th Cir. 2000) (once a court determines that it lacks subject matter jurisdiction, “the court’s sole remaining act is to dismiss the case for lack of jurisdiction”).

C. *Breaking Down BDC*

1. The Second Circuit's Argument "fails on its own terms"²⁰⁵

Perhaps one of the biggest weaknesses of the Second Circuit's holding in *BDC* that Section 303(b) is jurisdictional is its surprisingly superficial reasoning. As the *Trusted Net* court pointed out in its first analysis of Section 303(b), the Second Circuit failed to address the interaction of Section 303(b) with the other subsections of Section 303 and "ignore[d] the fact that subject matter jurisdiction turns only upon whether the court has the statutorily-conferred power to hear the case before it, and therefore has nothing to do with the speedy determination of claims or whether an alleged debtor—or any other party—is 'properly before the . . . court.'"²⁰⁶ To the extent that the Second Circuit specifically considered the proper characterization of Section 303(b) and explicitly held that it is jurisdictional in nature,²⁰⁷ its holding can hardly be called a "drive-by jurisdictional ruling[]." ²⁰⁸ At the same time, it also falls short of the detailed treatment given by courts that have found Section 303(b) to be nonjurisdictional.²⁰⁹ The *BDC* court provided only a summary rationale for its conclusion, stating that "[w]hether an alleged debtor is properly before the bankruptcy court in an involuntary case is a threshold determination that should be made at the earliest possible stage of the proceedings," so that creditors cannot "haul a solvent debtor with whom they have legitimate disputes into bankruptcy court and force it to defend an involuntary bankruptcy proceeding while the bankruptcy court leaves for a later merits determination whether the debtor is even properly before it."²¹⁰ While the propriety of the involuntary petition is undoubtedly something that should be

²⁰⁵ *In re Trusted Net Media Holdings, LLC*, 525 F.3d 1095, 1102 (11th Cir. 2008).

²⁰⁶ *Id.* at 1102 (quoting *In re BDC 56 LLC*, 330 F.3d 111, 118 (2d Cir. 2003)).

²⁰⁷ *BDC 56*, 330 F.3d at 118 ("We believe the more sound view is that the [§ 303(b) undisputed claim] requirement is subject matter jurisdictional, and now so hold.").

²⁰⁸ *Arbaugh v. Y & H Corp.*, 546 U.S. 500, 511 (2006) (quoting *Steel Co. v. Citizens for a Better Env't*, 523 U.S. 83, 91 (1998)).

²⁰⁹ See, e.g., *Trusted Net*, 525 F.3d at 1100-04; *In re Saunders*, 379 B.R. 847, 855-57 (Bankr. D. Minn. 2007); *In re Earl's Tire Svc., Inc.*, 6 B.R. 1019, 1021-23 (D. Del. 1980).

²¹⁰ *BDC 56*, 330 F.3d at 118.

resolved as soon as possible,²¹¹ labeling Section 303(b) as jurisdictional allows precisely the opposite to occur since a lack of subject matter jurisdiction can be raised at any time.²¹² The *BDC* court failed to address this issue.

The unworkable nature of the *BDC* holding became evident in *In re MarketXT Holdings*,²¹³ a 2006 decision by a bankruptcy court in the Second Circuit. In *MarketXT*, the court entered involuntary Chapter 11 relief against a debtor who failed to file a motion opposing the petition.²¹⁴ Approximately six months later, a nonpetitioning creditor sought to have the case against the debtor dismissed for lack of subject matter jurisdiction, alleging that the petitioning creditor's claim was subject to a bona fide dispute.²¹⁵ While maintaining that it was adhering to the Second Circuit's ruling that Section 303(b) is jurisdictional,²¹⁶ the bankruptcy court nevertheless denied the creditor's motion to dismiss, relying on Section 303(d)'s provision that only the debtor may file an answer to an involuntary petition.²¹⁷ Although the court acknowledged the circuit's position that Section 303(b) is subject-matter jurisdictional,²¹⁸ it simultaneously stripped the provision of two

²¹¹ *Id.*; FED. R. BANKR. P. 1001.

²¹² *Trusted Net*, 525 F.3d at 1102 (“*BDC*’s rationale also fails on its own terms . . . [because] if § 303(b)’s requirements are subject matter jurisdictional, an involuntary debtor could raise a § 303(b) challenge at any point in the proceedings, whereas if § 303(b) is non-jurisdictional, § 303(h) and Rule 1013 would require that the issue of the petitioning creditors’ compliance with § 303(b) be determined at the outset—as a threshold matter—or be forever waived.”). Admittedly, while the nonjurisdictional approach would put the issue of the petition’s propriety to rest if not raised within a certain period of time, it would do so at the expense of an actual determination of that issue. However, there are other provisions of the Bankruptcy Code that provide the debtor with protection against frivolous involuntary petitions, such that it is not necessary to rely on a jurisdictional reading of § 303(b) to accomplish this goal. See *infra* Part III.C.2.

²¹³ 347 B.R. 156 (Bankr. S.D.N.Y. 2006).

²¹⁴ *Id.* at 158.

²¹⁵ *Id.* at 158-59.

²¹⁶ *Id.* at 160. Interestingly, the *MarketXT* court failed to even acknowledge *United Marine, LLC v. Just for Windows, Inc.*, decided one year before *BDC*, in which the court recognized that “[t]he weight of the authority clearly supports the holding that the § 303(b) requirements are not jurisdictional and that the affirmative defense that a petition does not comply with such requirements may be waived pursuant to § 303(h).” No. 01 Civ. 5066(HB), 2002 WL 72933, at *2 (Bankr. S.D.N.Y. Jan. 17, 2002). In *United Marine*, the court found that the debtor had waived his right to challenge the petition based on an insufficient number of petitioning creditors and failure to allege unsecured claims in the required aggregate amount. *Id.* at *1.

²¹⁷ *MarketXT*, 347 B.R. at 160; see 11 U.S.C. § 303(d) (2006) (“The debtor, or a general partner in a partnership debtor that did not join in the petition, may file an answer to a petition under this section.”); see also *supra* Part III.A.2.

²¹⁸ *MarketXT*, 347 B.R. at 160.

of the most fundamental characteristics of subject matter jurisdiction—namely, that it can be raised by any party, at any time, and that when it is lacking, it cannot be conferred by the actions of the parties or the court.²¹⁹ The court’s justification was that this interpretation was necessary to preserve the function of Section 303(d).²²⁰ Interestingly, the court held that the Second Circuit’s policy of determining “whether an alleged debtor is properly before the bankruptcy court in an involuntary proceeding” as early as possible is carried out by Section 303(h),²²¹ which directs a bankruptcy court to enter relief against a debtor who fails to controvert an involuntary petition.²²² Accordingly, there should be no need to achieve this objective by calling Section 303(b) jurisdictional. In fact, treating it as such would actually undermine the goal of resolving the propriety of the petition as soon as possible.²²³

In the end, the only sensible part of the *MarketXT* opinion is the outcome.²²⁴ It is apparent and well-recognized that a creditor is not able to move for dismissal of an

²¹⁹ *Id.*; see *supra* Part III.A.1 (discussing the fundamental rules of subject matter jurisdiction).

²²⁰ *MarketXT*, 347 B.R. at 160; see 11 U.S.C. § 303(d). The bankruptcy court acknowledged that subject matter jurisdiction can be challenged by any party but stated that this was “no justification for invalidating another part of the same statute [i.e., § 303(d)].” *MarketXT*, 347 B.R. at 160. The court also stated that “[n]othing in *BDC 56 LLC* suggests that the jurisdictional aspect of § 303(b) would trump the command of § 303(h) that an order for relief be entered if the petition is not ‘timely controverted,’” *Id.* at 162, indicating that it might also reject a debtor’s motion for dismissal for a § 303(b) deficiency if it is untimely.

²²¹ *Id.* at 161-62 (internal quotation marks omitted) (quoting *In re BDC 56 LLC*, 330 F.3d 111, 118 (2d Cir. 2003)).

²²² 11 U.S.C. § 303(h) (“If the petition is not timely controverted, the court shall order relief against the debtor in an involuntary case under the chapter under which the petition was filed.”).

²²³ See *supra* note 212 and accompanying text.

²²⁴ What *MarketXT* demonstrates is a lower court bound by an unworkable precedent, that must fashion a coherent argument for its holding from contradictory authority. In its battle to make sense of *BDC*’s holding, the bankruptcy court even misconstrued a passage from a widely recognized authority on bankruptcy when it stated that “subject matter jurisdiction arises ‘in other contexts under section 303, most notably subsections (b) and (h).’” *MarketXT*, 347 B.R. at 161 (quoting 2 COLLIER ON BANKRUPTCY ¶ 303.02[6] (Alan N. Resnick & Henry J. Sommer eds., 15th ed. 2002)). In fact, that source was referring to the issue addressed in *BDC*, and went on to conclude that “[t]he better argument is that the . . . requirements of section 303(b) can be waived.” COLLIER, *supra* note 5, ¶ 303.08[3]. Moreover, the *MarketXT* court also downplayed the significance of the Supreme Court’s holding in *Arbaugh*, stating merely that “in recent decisions the Supreme Court has narrowed the effect of the term [‘jurisdiction’].” *MarketXT*, 347 B.R. at 162. Rather than acknowledge that the Second Circuit improvidently labeled § 303(b) as jurisdictional, the bankruptcy court simply declined to extend *BDC*. *Id.*

involuntary bankruptcy case.²²⁵ However, it remains unclear how the Second Circuit will respond to a case where the debtor waits to raise the Section 303(b) defense until after an order for involuntary bankruptcy relief has been entered. The mere fact that the outcome of this hypothetical is uncertain points to the flaws in the circuit's current approach.²²⁶

2. Making Sense of *BDC*

What makes the Second Circuit's conclusion in *BCD* all the more puzzling is that the determination that Section 303(b) is subject-matter jurisdictional was unnecessary given the procedural posture of the case.²²⁷ Specifically, the debtor filed a timely response and therefore could raise affirmative defenses based on the substantive requirements of Section 303(b),²²⁸ thus making the issue of Section 303(b)'s construction superfluous.²²⁹ The circuit court purported to address the issue to determine the proper standard of appellate review²³⁰ when it adopted a plenary standard of review²³¹ over the more commonly-accepted

²²⁵ See, e.g., *MarketXT*, 347 B.R. at 160 (interpreting § 303(d) to mean that “only [t]he debtor, or a general partner in a partnership debtor that did not join in the petition, may file an answer”) (emphasis added). “A ‘creditor is not authorized to contest an involuntary petition because a creditor may have an incentive to protect a preference or to gain some unfair advantage at the expense of other creditors.’” *Id.* (quoting *In re Westerleigh Dev. Corp.*, 141 B.R. 38, 40 (Bankr. S.D.N.Y. 1992)) (internal alterations omitted); *In re Taylor & Assocs., L.P.*, 191 B.R. 374, 378-79, 381 (Bankr. E.D. Tenn. 1996) (this rule “prohibit[s] creditors from contesting an involuntary petition in order to prevent creditors from protecting a preference or retaining some other unfair advantage”); *In re New Era Co.*, 115 B.R. 41, 44-45 (Bankr. S.D.N.Y. 1990) (listing cases in support of this proposition). This interpretation is also reinforced by FED. R. BANKR. P. 1011(a).

²²⁶ The two apparent options in such a case are: (1) that the court will apply the *BDC* holding that § 303(b) is jurisdictional, and allow the debtor to obtain dismissal even after entry of relief by showing that the debt is subject to a bona fide dispute; or (2) that it will distinguish *BDC* on the grounds that the debtor from *BDC* moved for dismissal before entry of relief, and deny dismissal to the untimely debtor. See, e.g., *United Marine L.L.C. v. Just for Windows, Inc.*, No. 01 Civ. 5066(HB), 2002 WL 72933 (Bankr. S.D.N.Y. Jan. 17, 2002) (where the court essentially took the latter approach). Because *MarketXT* has already demonstrated that *BDC*'s version of subject matter jurisdiction allows for exceptions, there is no principled way of predicting what further exceptions may be made on a case-by-case basis.

²²⁷ The debtor answered the involuntary petition within twenty days, as mandated by FED. R. BANKR. P. 1011(b). *Key Mech. Inc. v. BDC 56 LLC*, No. 01 Civ. 10169(RWS), 2002 WL 449856, at *1 (S.D.N.Y. Mar. 22, 2002); *supra* note 72.

²²⁸ *Key Mech.*, 2002 WL 449856, at *1.

²²⁹ See *supra* note 72.

²³⁰ *In re BDC 56 LLC*, 330 F.3d 111, 118-19 (2d Cir. 2003).

²³¹ *Id.* at 116-17, 119.

review for clear error.²³² However, if the court's objective was simply to apply a more rigorous standard of review than the clearly erroneous standard, it could have accomplished it without construing Section 303(b) as subject-matter jurisdictional.²³³ In sum, the facts and procedural posture of *BDC* simply did not require the court to hold that Section 303(b) is jurisdictional.

The Second Circuit's concern with the potential unfairness of involuntary bankruptcy cases is legitimate—treating Section 303(b) as substantive could lead to the undesirable result of allowing creditors to force debtors into bankruptcy on the basis of disputed claims²³⁴ because a Section 303(b) deficiency would be an affirmative defense that is waived if not timely raised.²³⁵ However, while the waiver of affirmative defenses for failure to raise them in a timely manner arguably leads to unfairness in any circumstance, it nonetheless is uniformly accepted by the federal courts.²³⁶ The

²³² See *id.* at 118 n.3 (collecting cases in which other circuit courts “held that the clearly erroneous standard of review applies on appeal of a bankruptcy court’s determination that a bona fide dispute exists.”).

²³³ The courts that have adopted a per se rule of reviewing a bankruptcy court’s findings regarding a bona fide dispute for clear error have justified it on the basis that such a determination “will often depend . . . upon an assessment of witnesses’ credibilities and other factual considerations.” *In re Rimell*, 946 F.2d 1363, 1365 (8th Cir. 1991). When facts are in dispute, this approach is proper. FED. R. BANKR. P. 8013. However, in cases where the facts concerning the claim are not in dispute, the question of whether there is a “bona fide dispute” under § 303(b) can be treated as a question of law and given de novo review. See, e.g., *In re Dilley*, 339 B.R. 1, 5 (B.A.P. 1st Cir. 2006) (“Although some appellate courts suggest that the existence of a bona fide dispute is a fact question and thus the clearly erroneous standard always applies, we decline to adopt a per se rule.”) (footnote omitted). Although the *Dilley* court cited *BDC* for this proposition, it did so without adopting *BDC*’s holding that § 303(b) is jurisdictional. *Id.*

²³⁴ See *supra* note 70.

²³⁵ See, e.g., *In re Trusted Net Media Holdings, LLC*, 550 F.3d 1035, 1037 (11th Cir. 2008) (en banc) (“[W]e conclude that § 303(b)’s requirements are not subject matter jurisdictional in nature, and therefore can be waived.”); *In re Mason*, 709 F.2d 1313, 1318 (9th Cir. 1983) (finding that the debtor “waived his right to present [a § 303(b)] defense by failing to raise it in an answer to the petition”).

²³⁶ 5 CHARLES ALLEN WRIGHT & ARTHUR R. MILLER, FEDERAL PRACTICE AND PROCEDURE § 1278 (3d ed. 2008) [hereinafter FEDERAL PRACTICE AND PROCEDURE] (“It is a frequently stated proposition of virtually universal acceptance by the federal courts that a failure to plead an affirmative defense as required by Federal Rule 8(c) results in the waiver of that defense and its exclusion from the case”); *id.* at § 1278 n.1 (collecting cases). The purpose of this rule is to provide the plaintiff with “fair notice of the defense that is being advanced.” *Rogers v. McDorman*, 521 F.3d 381, 385 (5th Cir. 2008) (internal quotation marks and citation omitted). “The concern is that a defendant should not be permitted to lie behind a log and ambush a plaintiff with an unexpected defense.” *Id.* (internal quotation marks and citation omitted). “A bankruptcy pleading also is subject to the Rule 8 requirements as to the pleading of . . . affirmative defenses” FEDERAL PRACTICE AND PROCEDURE § 1229.

apparent desire of the Second Circuit to protect debtors from unscrupulous creditors that would use involuntary bankruptcy as a way to force disputed payments is sensible, but distorting well-established legal principles is a poor way to achieve it.

In addition, the Bankruptcy Code also provides other avenues that do not depend upon Section 303(b) being classified as subject-matter jurisdictional for a debtor to object to an involuntary petition that threatens to work an injustice. For example, the debtor can request that the bankruptcy court abstain from hearing the case on the basis that the parties would be better served by non-bankruptcy proceedings.²³⁷ Alternatively, a debtor that has failed to timely object to an involuntary petition can move to vacate the order for relief by showing that it has “a meritorious defense and that arguably one of the four conditions for relief applies—mistake, inadvertence, surprise, or excusable neglect.”²³⁸ In its evaluation

²³⁷ 11 U.S.C. § 305(a) (“The court, after notice and a hearing, may dismiss a case under this title, or may suspend all proceedings in a case under this title, at any time if . . . the interests of creditors and the debtor would be better served by such dismissal or suspension . . .”). The power to abstain under § 305(a) applies to both voluntary and involuntary bankruptcy cases. *See, e.g., In re Mountain Dairies, Inc.*, 372 B.R. 623, 634-35 (Bankr. S.D.N.Y. 2007) (“Even if [the creditor] were an eligible petitioner under 11 U.S.C. § 303, this Court would be compelled to abstain pursuant to 11 U.S.C. § 305 because this is essentially a two-party dispute for which the parties have adequate remedies in state court. The bankruptcy court is not a collection agency.” (internal footnote omitted)); *In re Aerovias Nacionales de Colombia S.A.*, 303 B.R. 1, 9 n.11 (Bankr. S.D.N.Y. 2003) (“The legislative history of § 305(a)(1) indicates that Congress had in mind a debtor undertaking a voluntary out-of-court restructuring and an involuntary case then being ‘commenced by a few recalcitrant creditors to provide a basis for future threats to extract full payment. The less expensive out-of-court workout may better serve the interests of the case.’”) (quoting H.R. REP. No. 95-595, 95th Cong., 1st Sess. 325 (1977)); *In re Spade*, 258 B.R. 221, 225-31, 37 (Bankr. D. Colo. 2001) (discussing the showing necessary for a bankruptcy court to abstain from hearing an involuntary case, collecting cases, and concluding that “a court may consider any factors it considers to be relevant to the determination of whether a dismissal of the case or a suspension of all proceedings would better serve the interests of the creditors and the debtor,” including the debtor’s “legitimate interest in avoiding the stigma that attaches to those forced into bankruptcy”); *In re ABQ-MCP Joint Venture*, 153 B.R. 338, 342 (Bankr. D.N.M. 1993) (“A court may properly abstain from hearing an involuntary bankruptcy case which is essentially a two-party dispute, where the creditor has adequate state law remedies, and the debtor has no significant assets for the bankruptcy court to administer.”); *In re G-N Partners*, 48 B.R. 459, 461 (Bankr. D. Minn. 1985) (“While there may be other situations in which dismissal under § 305(a) is appropriate, the one most clearly applicable is that in which an out of court ‘work-out’ has been accomplished or is soon to be accomplished and a few recalcitrant creditors have filed an involuntary bankruptcy petition.”).

²³⁸ *In re Hutter Assocs., Inc.*, 138 B.R. 512, 516 (W.D. Va. 1992) (emphasis and alterations removed); *see also In re High Voltage Eng’g Corp.*, 360 B.R. 369, 381-82 (Bankr. D. Mass. 2007) (discussing Rule 60(b) requirements in the context of a bankruptcy case). “[T]here is a strong policy of determining cases on their merits and we therefore view defaults with disfavor.” *In re Worldwide Web Sys., Inc.*, 328 F.3d 1291, 1295 (11th Cir. 2003) (referring to an involuntary debtor’s Rule 60(b) motion to

of a motion to vacate an order for relief, the court may consider the existence of meritorious affirmative defenses based on a Section 303(b) deficiency.²³⁹ Finally, a debtor can object to an improper claim using the same defenses that would be available in a typical non-bankruptcy action to collect.²⁴⁰ Consequently, the apparent likelihood that the bankruptcy court will disallow a legitimately disputed claim should counteract the incentive of creditors to file involuntary petitions to coerce the payment of disputed debts. Therefore, the Bankruptcy Code already incorporates safeguards to ensure that debtors are not improperly subjected to involuntary bankruptcy proceedings.²⁴¹

CONCLUSION

While involuntary petitions may be a small percentage of total bankruptcy cases,²⁴² the proper application of the law is of the utmost importance to those against whom an involuntary

vacate a default judgment in a bankruptcy case). As the court in *Hutter* recognized, “Bankruptcy Rules 7055 (‘Default’) and 9024 (‘Relief from Judgment or Order’) make Fed.R.Civ.P. 60(b) applicable to [an involuntary] case.” 138 B.R. at 516; see also *In re Paczesny*, 282 B.R. 646, 647 (Bankr. N.D. Ill. 2002) (involuntary relief was entered after debtor failed to timely answer, but court subsequently granted debtor’s motion to vacate the order for relief); *In re Morris*, 115 B.R. 752, 754-55 (Bankr. E.D.N.Y. 1990) (vacating order for relief pursuant to FED. R. CIV. P. 60(a), where the order was prematurely entered due to administrative error).

²³⁹ See *Jet Star Enters. Ltd. v. CS Aviation Servs.*, No. 01 Civ. 6590(DAB), 2004 WL 350733, at *8 (S.D.N.Y. Feb. 25, 2004) (explaining that “the Second Circuit requires consideration of [affirmative] defenses when ruling on motions to set aside default judgments”) (citing *Enron Oil Corp. v. Diakuhara*, 10 F.3d 90, 96 (2d Cir. 1993)).

²⁴⁰ 11 U.S.C. § 502(b) (“[I]f [an] objection to a claim is made, the court, after notice and a hearing . . . shall allow such claim . . . except to the extent that . . . such claim is unenforceable against the debtor and property of the debtor, under any agreement or applicable law for a reason other than because such claim is contingent or unmatured . . .”); *Travelers Cas. & Sur. Co. of Am. v. Pac. Gas & Elec. Co.*, 549 U.S. 443, 450 (2007) (“[It is a] settled principle that ‘[c]reditors’ entitlements in bankruptcy arise in the first instance from the underlying substantive law creating the debtor’s obligation, subject to any qualifying or contrary provisions of the Bankruptcy Code. . . .’ That principle requires bankruptcy courts to consult state law in determining the validity of most claims.”) (quoting *Raleigh v. Ill. Dep’t of Revenue*, 530 U.S. 15, 20 (2000)); *In re Shaffner*, 320 B.R. 870, 876 (Bankr. W.D. Mich. 2005) (“Section 502(b)(1) permits the objecting party to challenge the validity of the claim for any of the myriad reasons that would arise either under the agreement itself (e.g., the amount owed is \$1,000, not \$2,000) or under applicable non-bankruptcy laws (e.g., lack of consideration or the statute of frauds).”).

²⁴¹ Additionally, § 303(i) provides that costs and attorney’s fees may be awarded to a debtor who succeeds in having the involuntary petition dismissed. 11 U.S.C. § 303(i)(1). If the petition was filed in bad faith, this provision also allows the court to award actual and punitive damages. 11 U.S.C. § 303(i)(2).

²⁴² See *supra* note 5.

petition is commenced. The need for uniform application of the bankruptcy laws²⁴³ suggests that the Second Circuit's position in *BDC* deserves close scrutiny. Although the Bankruptcy Code's jurisdictional structure and statutory language provide sufficient arguments against the Second Circuit's interpretation of Section 303(b) as subject-matter jurisdiction,²⁴⁴ the Supreme Court's recent decision in *Arbaugh*²⁴⁵ provides the proverbial nail in the coffin and illustrates the importance of proper statutory construction on a scale much larger than just that of the Bankruptcy Code. Therefore, it is time for the Second Circuit to confront the unworkable precedent that it created in *BDC* and explicitly hold that Section 303(b) of the Bankruptcy Code does not pertain to subject matter jurisdiction.

Rachel Green[†]

²⁴³ See, e.g., *In re Frushour*, 433 F.3d 393, 400 (4th Cir. 2005) (“Uniformity among the circuits is also important in the bankruptcy context.”); *Gonzales v. Parks*, 830 F.2d 1033, 1035 (9th Cir. 1987) (noting the importance of “the uniformity of federal bankruptcy law, a uniformity required by the Constitution”) (citing U.S. CONST. art. I, § 8, cl. 4); Robert K. Rasmussen, *A Study of the Costs and Benefits of Textualism: The Supreme Court's Bankruptcy Cases*, 71 WASH. U. L.Q. 535, 573 (1993) (“The unavoidable conclusion is that the Court is much more concerned with ensuring uniformity in the implementation of federal bankruptcy law than with the content of such law.”).

²⁴⁴ See *supra* Part III.

²⁴⁵ See *supra* Part III.A.3.

[†] J.D. Candidate, Brooklyn Law School, 2010; B.S., Cornell University, 2001. I would like to thank my parents, my brother, and Nate for their constant support and encouragement. Thanks also to everyone on *Brooklyn Law Review* for their hard work and their friendship.