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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

In re:
BRERO CONSTRUCTION, INC.,
Debtors.

Case No. 96-56086-JRG
Chapter 11

**MEMORANDUM DECISION AND ORDER
DENYING MOTION TO DISQUALIFY
CALHOUN BROTHERS AND 3M AS
PETITIONING CREDITORS**

I. BACKGROUND.

Before the court is a motion by respondent, Brero Construction, Inc., to disqualify two of three creditors who filed a petition for involuntary bankruptcy against Brero. The motion is opposed by the two affected creditors, Calhoun Brothers General Engineering, Inc. and Minnesota Mining & Manufacturing ("3M"). The third petitioning creditor, Comerica Bank-California, has joined in the opposition to Brero's motion.

The involuntary petition was filed on August 14, 1996, seeking relief under Chapter 11 of the Bankruptcy Code, by the following three creditors:

- (1) Comerica Bank, asserting a claim of \$850,000 based on a secured loan;
- (2) 3M, asserting a claim of \$159,757 based upon a judgment; and

1 (3) Calhoun Brothers, asserting an unsecured claim of
2 \$15,504.37 based on "SJ Job Corp work."

3 Brero filed an answer to the involuntary petition on
4 September 4, 1996. For the following reasons, the Brero's
5 motion to disqualify petitioning creditors Calhoun Brothers and
6 3M is denied.

7 **II. DISCUSSION.**

8 A. Legal Standard.

9 An involuntary bankruptcy case may be commenced by three or
10 more entities, provided each is the holder of a claim against
11 the debtor which is not contingent as to liability or the
12 subject of bona fide dispute, and provided the aggregate of
13 their claims total "at least \$10,000 more than the value of any
14 lien on property of the debtor securing such claims held by the
15 holder of such claims." 11 U.S.C. § 303(b)(1).¹

16 Brero first moves to disqualify 3M and Calhoun Brothers on
17 the grounds that their claims are in "bona fide dispute." The
18 term "bona fide dispute" is not defined in the Bankruptcy Code.
19 The term is intended to balance the interests of debtors and
20 creditors in involuntary cases. 2 Lawrence P. King, Collier on

22 ¹ All statutory references are to title 11 of the U.S. Code, unless otherwise indicated.

23 Section 303(b)(1) provides:

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

26 (1) by three or more entities, each of which is either a holder of a claim against
27 such person that is not contingent as to liability or the subject of a bona fide
28 dispute, or an indenture trustee representing such a holder, if such claims
aggregate at least \$10,000 more than the value of any lien on property of the
debtor securing such claims held by the holders of such claims.

1 Bankruptcy, ¶ 303.03[2][b] (15th ed. rev. 1996). If creditors
2 with clearly disputed claims could initiate an involuntary
3 filing, the filing could simply be harassing a debtor into
4 paying the troubling creditors. Id. On the other hand, if a
5 debtor could challenge an involuntary filing merely by alleging
6 that a claim is disputed, even if the dispute lacks merit,
7 creditors' ability to commence an involuntary case would be
8 curtailed. Id. In ascertaining whether a "bona fide dispute"
9 exists, the trend is to apply an objective standard, by which
10 the court determines whether there is an objective basis for
11 either a factual or a legal dispute as to the validity of the
12 debt. See, In re Busick, 831 F.2d 745 (7th Cir. 1987); In re
13 Sims, 994 F.2d 210 (5th Cir. 1993); Rimell v. Mark Twain Bank
14 (In re Rimell), 949 F.2d 1363 (8th Cir. 1991); Bartmann v.
15 Maverick Tube Corp., 853 F.2d 1540 (10th Cir. 1988); and B.D.W.
16 Assoc. v. Busy Beaver Bldg. Ctrs, 865 F.2d 65, 66-67 (3rd Cir.
17 1989)(holding a bona fide dispute exists if there are
18 "'substantial'" factual and legal questions raised by the
19 debtor" bearing upon the debtor's liability).

20 The petitioning creditors have the burden to establish a
21 prima facie case that there is no bona fide dispute. See, Rubin
22 v. Belo Broad. Corp. (In re Rubin), 769 F.2d 611, 615 (9th Cir.
23 1985); and Rimell v. Mark Twain Bank at 1365. Thereafter, the
24 burden shifts to the debtor to demonstrate that a bona fide
25 dispute does exist. Id. Because the standard is objective,
26 neither the debtor's subjective intent nor his subjective belief
27 is sufficient to meet this burden. Id. The court's objective
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1 is to ascertain whether a dispute that is bona fide exists; the
2 court is not to actually resolve the dispute. Id. This does
3 not mean, however, that the court is prohibited from addressing
4 the legal merits of the alleged dispute, as a limited analysis
5 may be necessary in order to ascertain whether an objective
6 legal basis for the dispute exists. Id.

7 B. The Existence of a Bona Fide Dispute.

8 1. Claim of Calhoun Brothers.

9 Calhoun Brothers was a subcontractor for Brero in a
10 construction project known as the "San Jose Job Corps," in
11 relation to Brero's contract with the U.S. Department of Labor.
12 The parties entered into a "Liquidation Agreement" in September
13 1995 pertaining to Calhoun Brothers' claims against the
14 Department of Labor and Brero in relation to the project. In
15 the Agreement, Brero acknowledged liability to Calhoun Brothers
16 in the amount of the claims set forth in Exhibit "A" thereto,
17 which totalled \$42,277.67.² The Agreement provided for a pass-
18 through arrangement, by which Calhoun Brothers would accept "in
19 full satisfaction, discharge and liquidation" of its claims, the
20 amounts Brero recovered from the Department of Labor, "if any,"
21 and that if Brero did not recover anything, then Brero would
22 cooperate and provide efforts on behalf of Calhoun Brothers to
23 obtain a recovery in full satisfaction, discharge and

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² Paragraph 2(a) of the Liquidation Agreement provides:

27 Contractor [Brero] acknowledges its liability to Subcontractor [Calhoun Brothers] for the claims set
28 forth on Schedule [sic] A . . .

1 liquidation of claims.³ Calhoun Brothers agreed to "give its
2 full cooperation and assistance to Brero in the preparation and
3 presentation of its claims and to produce and make available to
4 Contractor all necessary records and witnesses."⁴ Brero in turn
5 agreed to "present to the [U.S. Dept. of Labor], and if
6 necessary, [to] commence legal action or an arbitration
7 proceeding in its own name against the owner to prosecute the
8 claims of [Calhoun Brothers as] set forth in Schedule A [sic],
9 provided that Calhoun [was] to retain its own attorney to handle
10 such proceedings."⁵ The parties agreed that, "Except for their
11 obligations [under the Liquidation Agreement] the parties hereto
12 release each other from any and all claims or causes of action
13 each has had or may have against the other under the
14 Subcontract."⁶

15 There does not appear to be any dispute that the
16 parties intended Calhoun Brothers' claim to be passed through to
17 the Department of Labor along with Brero's claim against the
18 Department of Labor. However, Calhoun Brothers contends that an
19 implied condition of the contract was that Brero would
20 "expeditiously pursue the processing of [the] claim for Calhoun
21 Brothers' benefit." Calhoun Brothers contends that Brero
22 breached the Agreement by failing to provide Calhoun Brothers
23 with the necessary paperwork for its pass-through claim, and

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25 ³ Paragraph 2(b) of Liquidation Agreement.

26 ⁴ Paragraph 5 of Liquidation Agreement.

27 ⁵ Paragraph 3(a) of Liquidation Agreement.

28 ⁶ Paragraph 10 of Liquidation Agreement.

1 after waiting approximately eleven months, Calhoun Brothers
2 "terminated" the Agreement. There are a series of letters
3 between counsel for Brero, Ronald Roberts, and counsel for
4 Calhoun Brothers, John Pope, which Calhoun Brothers contends
5 support its right to disregard the Liquidation Agreement for
6 failure of Brero to expeditiously pursue the processing of
7 Calhoun Brothers' claim. The following is the chronology of
8 correspondence between counsel:

- 9 C Letter dated 9/11/95 from Mr. Roberts to Mr. Pope
10 transmitting Liquidation Agreement for execution.
- 11 C Letter dated 9/13/95 from Mr. Roberts to Mr. Pope re return
12 of executed Liquidation Agreement.
- 13 C Letter dated 9/14/95 from Mr. Pope to Mr. Roberts
14 transmitting executed Liquidation Agreement.
- 15 C Letter dated 11/3/95 from Mr. Roberts' office to Mr. Pope
16 transmitting what appears to be legal reference materials,
17 and apologizing for delay and indicating certain
18 information "will be sent when it is generated."
- 19 C Letter dated 12/7/95 from Mr. Pope to Mr. Roberts
20 indicating that approximately ten days earlier Roberts had
21 advised that Pope would be receiving a "package of
22 documents, instructions and questions to which I would then
23 be able to respond in support of your claim for Calhoun's
24 balance owed by Brero;" and stating: "Since this matter
25 should proceed without further delay, I would greatly
26 appreciate your courtesy in responding by return mail."
- 27 C Letter dated 1/8/96 from Mr. Pope to Mr. Roberts,

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1 providing: "I wrote to you again on December 7, 1995
2 reminding you that I am still awaiting response from your
3 office with the appropriate forms and instructions for my
4 use in preparing Calhoun's portion of your presentation to
5 collect the entire contract on my client's behalf as well
6 as for other subcontractors and your client Brero
7 Construction. May I please have the courtesy of your reply
8 within the next seven (7) days so I may respond as required
9 by our agreement."

10 C Letter dated 1/9/96 from Mr. Roberts to Mr. Pope,
11 providing: "I am writing to inform you of the status of the
12 OREA to date and advise you of a revise submission date.
13 My consultant, ICE, Inc., informs me that the impacted as-
14 built schedule analysis should be completed within 2 to 3
15 weeks. We will then be able to provide you with the
16 pertinent schedule information for your use in preparing
17 your OREA section. We have also encountered a delay in
18 obtaining information from the DOL regarding the contract
19 and other project documentation. We also hope to have this
20 information within the next week. I will be in contact
21 with you again on or before January 22, 1996 to provide you
22 with further information regarding this project."

23 C Letter dated August 9, 1996 from Mr. Pope to Mr. Roberts
24 providing: "Although our most recent exchange of
25 correspondence earlier this year indicated a prompt
26 response from your office in facilitating the paper work on
27 the Job Corps matter, nothing has occurred. My efforts to
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1 reach you have been in vain since you have left your own
2 office with no explanation. Given the circumstances, you
3 may consider our professional relationship terminated.
4 Calhoun will therefore proceed with its own remedies
5 without reference to yours against the City."

6 In his declaration filed on April 9, 1997, John Pope
7 states that between January 9, 1996 and August 9, 1996, "there
8 was no further contact from Roberts to [himself], despite
9 unanswered interim efforts by declarant to reach Roberts by
10 telephone." Ronald Roberts indicates in his declaration filed
11 on March 27, 1997, that he was engaged in July 1995 to analyze
12 and present claims to the Department of Labor, which were
13 anticipated to be approximately \$1,692,803.26. He states that
14 Brero has incurred in excess of \$300,000 in attorneys fees and
15 consulting fees and costs in an effort to substantiate and
16 quantify the "Omnibus Request for Equitable Adjustment"
17 ("OREA"). Brero contends that this demon-strates that it was
18 performing under the Liquidation Agreement, and that by joining
19 in the filing of the involuntary bankruptcy petition, Calhoun
20 has breached the agreement.

21 The court need not determine if Calhoun Brothers was
22 entitled to terminate or rescind the agreement for purposes of
23 determining whether Calhoun is a proper petitioning creditor.
24 There is no evidence of any dispute as to the validity of the
25 underlying debt to Calhoun Brothers⁷--only the mechanism for
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27 ⁷ Brero does not even allege that Calhoun's claim is in "bona fide dispute" in its answer. See, ¶ 3 of "Answer to
28 Involuntary Petition," alleging that only the claims of Comerica and 3M are in "bona fide dispute."

1 payment of the debt is at issue. If Calhoun Brothers in fact
2 breached the agreement by improperly treating the agreement as
3 having been rescinded or terminated, Brero may have a
4 counterclaim against Calhoun.⁸ The existence of a counterclaim,
5 however, does not create a bona fide dispute, it "merely serves
6 to offset the amount owing if the counterclaim is proven." See,
7 In re Data Synco, Inc., 142 B.R. 181, 182 (Bankr.N.D. Ohio
8 1992)(citations omitted); and In re Everett, 178 B.R. 132
9 (Bankr.N.D. Ohio 1994). The court does not find Calhoun
10 Brothers' claim to be the subject of bona fide dispute for
11 purposes of the filing of the involuntary petition. Brero's
12 motion to disqualify Calhoun Brothers as a petitioning creditor
13 is therefore denied.

14 2. Claim of 3M.

15 The underlying action by 3M against Brero arose from a
16 contract under which 3M supplied materials and services to
17 Brero. 3M ultimately obtained a default judgment against Brero
18 in July 1996, and recorded a judgment lien on personal property
19 with the Secretary of State, and also an abstract of judgment in
20 Santa Clara County. Brero contends that there is a bona fide
21 dispute regarding the claim as evidenced by a written request
22 for continuance of a case management conference filed in state
23 court by 3M prior to the default being taken, indicating that
24 absent a settlement it was anticipated that Brero would file an
25 answer and cross-complaint. The parties did not settle and
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27 ⁸ One of Brero's affirmative defenses in fact contends that it "is entitled to recoupment and/or setoff against
28 Petitioners' claims for damages suffered by Respondent as a consequence of Petitioners' actions."

1 ultimately Brero's default was taken.

2 The default judgment of 3M was not appealed. The
3 majority of courts have found that claims based on final
4 judgments are not subject to bona fide dispute. See, In re
5 Norris, 183 B.R. 437, 453 (Bankr.W.D.La. 1995), and cases cited
6 therein. The court finds that on the evidence presented, 3M
7 has met its burden of demonstrating that there is no bona fide
8 dispute with respect to its claim.

9 Brero contends that it can move to set aside the
10 judgment, and that the time to do so is stayed under Calif. Code
11 of Civ. Proc. § 473 due to the existence of the automatic stay.
12 Brero is correct that the automatic stay applies to a debtor
13 taking any action with respect to a pre-petition lawsuit in
14 which it is the defendant. See, 11 U.S.C. § 362(a); and
15 Ingersoll-Rand Financial Corp. v. Miller Mining Co., Inc., 817
16 F.2d 1424 (9th Cir. 1987). However, even the existence of an
17 appeal of a default judgment entered in a state court has been
18 held not to be a claim subject to bona fide dispute. See, In re
19 Drexler, 56 B.R. 960, 967-68 (Bankr.S.D.N.Y. 1986). In this
20 case, no appeal has been filed, and Brero does not indicate on
21 what basis it could move to set aside the judgment. Moreover,
22 assuming Brero could have the judgment set aside, as already
23 indicated the possible existence of a counterclaim does not
24 establish a bona fide dispute. The court finds that there is no
25 bona fide dispute with respect to the claim of 3M for purposes
26 of the filing of the involuntary petition. This aspect of
27 Brero's motion is therefore denied. The court next addresses
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1 the remaining objection as to whether 3M is a proper petitioning
2 creditor.

3 C. Eligibility of 3M as Petitioning Creditor.

4 It is unclear whether 3M is a secured creditor or an
5 unsecured creditor. 3M contends that it perfected its lien, as
6 did Hartford, within the preference period and therefore the
7 liens are avoidable. Even if not avoidable, there is a question
8 as to whether 3M is fully or partially secured if Hartford
9 perfected its lien first. The court need not resolve this
10 issue, however, because even a fully secured creditor may
11 properly join in the filing of an involuntary bankruptcy
12 petition. See, Paradise Hotel Corp. v. Bank of Nova Scotia, 842
13 F.2d 47, 49 (3rd Cir. 1988); and Collier on Bankruptcy at ¶
14 303.03[2][c]. The language of the statute does not limit
15 petitioning creditors to only those holding unsecured claims.
16 Section 303(b)(1) requires "three or more entities, each of
17 which is . . . a holder of a claim." The definition of "claim"
18 is very broad and encompasses both secured and unsecured claims.
19 Section 101(5) defines "claim" in relevant part as follows:

20 "claim" means--

21 (A) right to payment, whether or not such right is
22 reduced to judgment, liquidated, unliquidated, fixed,
23 contingent, matured, unmatured, disputed, undisputed,
24 legal, equitable, secured, or unsecured . . . (emphasis
25 added).

26 § 101(5).

27 Thus, a petitioning creditor may hold a secured or an
28 unsecured claim, provided the claims held by the three or more
petitioning entities "aggregate at least \$10,000 more than the

1 value of any lien on property of the debtor securing such claims
2 by the holders of such claims." § 303(b)(1). Assuming 3M is
3 fully secured, the claims of Calhoun Brothers and Comerica must
4 total at least \$10,000 in unsecured debt. There is no apparent
5 dispute that whatever claims are held by those creditors are
6 unsecured. Calhoun Brothers indicates on the Involuntary
7 Petition that it is the holder of an unsecured claim in the
8 amount of \$15,504.37, which in and of itself is sufficient to
9 satisfy the aggregate dollar limit. Comerica indicates an
10 \$850,000 claim arising from a secured loan. At the hearing,
11 counsel for Comerica indicated that the claim is unsecured,
12 which does not appear to be disputed. Thus, even if 3M is fully
13 secured, the minimum aggregate unsecured claim amount set forth
14 in § 303(b)(1) appears to be satisfied. The case cited by
15 Brero, In re Morris, 115 B.R. 752 (Bankr.E.D.N.Y. 1990), is
16 distinguishable from the present case, because that case
17 involved only one petitioning creditor whose secured claim had
18 to satisfy the unsecured debt minimum. The aggregate \$10,000
19 minimum of unsecured debt does not appear to be an issue in this
20 case so as to necessitate 3M waiving all or part of whatever
21 security interest it holds. The court denies Brero's motion to
22 disqualify 3M on the grounds that it is an improper petitioning
23 creditor on the basis of its secured status.

24 **III. CONCLUSION.**

25 For the foregoing reasons, Brero's motion is denied.

26 DATED: _____

JAMES R. GRUBE
UNITED STATES BANKRUPTCY JUDGE