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Eleventh Circuit Directs Bankruptcy Court to Vacate Sale Order Based on New Evidence that Involuntary Bankruptcy Case Was Filed In Bad Faith

A recent decision arising out of the involuntary chapter 11 case of Global Energies, LLC highlights the perils of invoking the bankruptcy process to obtain a tactical advantage in a business dispute – ongoing vulnerability to attack and dismissal on bad faith grounds. Relying on newly discovered evidence that certain parties orchestrated Global's 2010 involuntary chapter 11 filing to oust one of the LLC's members and to obtain control over its assets (and gave false testimony about their plan during depositions), a three-judge panel for the United States Court of Appeals for the Eleventh Circuit ruled that Global's involuntary chapter 11 petition was filed by Chrispus Venture Capital, LLC, one of its members, in bad faith. *Wortley* v. *Chrispus Venture Capital, LLC (In re Global Energies, LLC)*, No. 13-11666, 2014 WL 3974577 (11th Cir. Aug. 15, 2014). The court directed the bankruptcy court to vacate its order approving the sale of Global's assets to Chrispus and opened the door for the bankruptcy court to grant further relief, including sanctions, following a hearing.

Global's Involuntary Chapter 11 Case

Global was owned by Joseph Wortley, James Juranitch and Chrispus. In mid-2010, the relationship among the owners grew strained. On July 1, 2010, Chrispus filed an involuntary petition against Global. A trustee was appointed and Global's assets were ultimately sold to Chrispus.

A few months after the involuntary petition was filed, Wortley became suspicious that Juranitch and Richard Tarrant (the owner of 93% of the interest in Chrispus) had colluded to engineer the involuntary filing (and, thus, circumvent Wortley's voting rights under Global's LLC agreement), eliminate Wortley's equity and through a bankruptcy sale, acquire Global's assets.

On two separate occasions, Wortley moved to dismiss the bankruptcy case on the ground that it was filed in bad faith. Discovery was conducted and all non-privileged responsive documents were purportedly produced but no direct evidence of bad faith emerged. Tarrant and Juranitch testified under oath that they had no plan to file (or perhaps more accurately, cause Chrispus to file) an involuntary petition; Chrispus's counsel, Chad Pugatch, represented to the court that "[t]hroughout the entire process, representatives of Chrispus . . . [had] the stated purpose of trying to salvage [Global] . . . all with the goal of saving the monetary investment." *Id.* at *2. Unable to put forward any direct evidence of bad faith, Wortley withdrew his motion. Wortley renewed the motion to dismiss approximately a year later but the motion was denied.

New Evidence

In connection with a separate state court proceeding, Wortley obtained copies of emails exchanged between Tarrant, Juranitch, and Chrispus's bankruptcy counsel, Chad Pugatch in June 2010. The emails (a) outline a plan or strategy to eliminate Wortley's interest in Global and obtain control over Global's assets by having Chrispus file an involuntary chapter 11 petition and (b) contradict sworn testimony given by Juranitch and Tarrant. [1]

Wortley filed a motion for relief from the order denying the renewed motion to dismiss under Rule 60(b) of the Federal Rules of Civil Procedure. The bankruptcy court denied the motion and the district court affirmed its decision.

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[1] For example, on June 17, 2010, approximately two weeks before Chrispus filed the involuntary petition, Juranitch sent the following email to Tarrant:

> The following is my humble attempt at presenting a strategy for Global Energies/Plasma Power starting next week. If you and Ron [Roberts, Chrispus's primary officer,] agree with the memo, I recommend we have Chad Pugatch review it, and add his insight. The plan is:
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> 1. [Tarrant] communicates with [Wortley] on Tuesday when he is back, and requests a response on the offer that [Tarrant] extended Sunday night, which expired last Tuesday. [Tarrant] gives [Wortley] until the end of the business day.
> 2. If a meaningful response is received [Tarrant] and [Juranitch] start negotiating . . . . A two[-]day window is given to [Wortley] for a completed agreement.
> 3. If no meaningful response is received from [Wortley], Chrispus Ventures files for "Debtor in Possession" rights under Chapter 11 law on Wednesday. . . .
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> . . . .
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> 6. . . . Finally the [new company, Plasma Power LLC] may have to stand up to a legal battle from [Wortley] and needs to dot its I's and cross its T's. . . .
> 7. I am not clear how the Debtor in Possession eradicates the $200k note to [Wortley] and how [Wortley's] stock is dissolved. If this is accomplished in a bidding war to buy the complete assets of Global including the patents by its debtors than [sic] that is clear. If on the other hand the Debtor in Possession is to dissolve the company as an end game then we need to start spinning Plasma Power at this time. It might also become Global Plasma Power etc. I think we need to have this memo reviewed and a conference call with [Pugatch] to fill in the blanks at this point.

Id. at *1. This plan was sent to, and reviewed by, Pugatch, who then scheduled a time to discuss it with Tarrant, Juranitch and Chrispus's primary officer.

Key Holdings

The three judge panel reversed, finding that the bankruptcy court committed clear errors of judgment and abused its discretion with respect to the Rule 60(b) motion. In connection with its Rule 60(b) analysis, the court ruled, among other things, that:

- Wortley exercised due diligence in trying to discover the emails but his efforts were obstructed by the parties who had the evidence he needed to substantiate his claim, including Pugatch. *Id.* at *4-5.

- The newly discovered emails were not merely cumulative or impeaching but were instead direct evidence of a plan to orchestrate a bad faith involuntary filing. *Id.* at *5.

- The emails showed bad faith under all three recognized tests for bad faith. The court described the tests as follows:

  > Under the improper purpose test, "bad faith exists where the filing of the petition was motivated by ill will, malice or the purpose of embarrassing or harassing the debtor." Filing an involuntary bankruptcy petition deliberately to gain advantage in a business dispute is considered an improper purpose, as is filing an involuntary bankruptcy petition in order to take control of a corporation or its assets. . . .
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  > Under the improper use test, bad faith exists when a creditor uses a bankruptcy proceeding to accomplish objectives not intended by the Bankruptcy Code, such as taking over a debtor corporation and its assets. . . .
  >
  > Finally, under the test modeled on Rule 9011 of the Federal Rules of Bankruptcy Procedure, bad faith exists, where a filing party (1) fails to make a reasonable inquiry into the facts and the law before filing and (2) files the petition for an improper purpose. . . . A reasonable party would not believe that the Bankruptcy Code permits it to use a bankruptcy proceeding to rid itself of business partners. . . .

  Id. at *5 n.5 (emphasis supplied and internal citations and quotations omitted).

- The court concluded that "it would be clear error to interpret the emails as anything other than that Tarrant and Juranitch conspired to have Chrispus file the bankruptcy petition in bad faith." *Id.* at *5.

The court directed the bankruptcy court to grant Wortley's Rule 60(b) motion and vacate its order approving the sale of Global's assets to Chrispus. The court invited the bankruptcy court, following a hearing, to grant further relief to ensure that Chrispus, Juranitch, Tarrant and Pugatch do not profit from their misconduct and abuse of the bankruptcy process.

Conclusion

While *Global* provides further guidance as to what may constitute "bad faith" in connection with an involuntary chapter 11 filing, its true import (and impact on bankruptcy planning by owners) remains to be seen. Would similar emails require or support a bad faith finding if the emails were produced in connection with discovery and acknowledged and explained during depositions? Perhaps not.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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