



In Re Matter of the Trustee of Clothing Store Dissolution Bankruptcy Court of the Southern District of New York (1935)

Facts of the Case

The case at hand involves an involuntary bankruptcy petition levied against a series of 26 Clothing stores, in cities across the United States. The petitioners represent three suppliers of clothing articles to the stores, alleging they have not been timely paid in pursuant to their contracts. Their petition seeks dissolution of the clothing business, liquidation of its assets, and immediate payment of the amounts due and owing. One of the petitioners, claims seventy-five dollars (\$75.00) for a allegedly delinquent bill concerning hats sold on consignment. The two other petitioners each claim a far more substantial sum, for clothing articles sold on an installment basis, totaling nearly \$120,000.00.

The subject of the petition sells clothing articles at retail for both cash and credit. Due to the Depression, many accounts receivable held by the stores are delinquent or in arrears from full payment. Accordingly, despite the fact the subject of the petition has assets, including real property and inventory, greatly in excess of the amounts claimed by the petitioners, the present "Cash on Hand" of the business is presently insufficient to satisfy the total amounts of the claims of the creditor/petitioners on an immediate basis.

The petitioners object to the transformation of this filing into an Article 11 proceeding of Reorganization, and move for immediate dissolution of the business under Liquidation. Petitioners contend that their filing of the involuntary bankruptcy under Article 7 Liquidation, cannot be transformed into a different proceeding by the subject of their petition. It is undisputed that the subject of the petition, though technically not insolvent, as described above, cannot make the required payments to fully satisfy the petitioner/creditor claims for amounts due and owing on an immediate basis. It is further undisputed, that given time and a restructuring of the payments due and owing to petitioner/creditors, that the subject would most likely be able to make them whole, with interest from the operations of the business.

Questions Presented

- 1) Are the petitioners required to have their action transformed from an Article 7 Liquidation Proceeding to an Article 11 Reorganization Proceeding by the Court?
- 2) In the event the court chooses to retain the Liquidation Proceeding on an involuntary basis, what exemptions, if any, does the business and its proprietor enjoy?
- 3) The subject of the petition alleges collusion on the part of the petitioner who is owed the seventy-five dollar hat bill with the other petitioners, and to what extent does such assertion mitigate or nullify the petitioner's action before the court?

Decision and Holding

The Court finds that although this case really represents a miscarriage of justice, in that the assets of the business and operations of the subject of the petition represent many times more than the disputed amounts due and owing to the petitioners/creditors, no equitable remedies are available under current law for this court to apply to require the transformation of an involuntary petition under Article 7 Liquidation into an Article 11 Reorganization. Had the subject of the petition filed for voluntary Bankruptcy pursuant to Article 7, such a transformation of the action to an Article 11, would be so allowed. As a result, the petitioners cannot be forced to have their action so transformed, and the Article 7 Liquidation, however unjust, must proceed within the parameters of the Bankruptcy Code

The Court further finds that as personal guarantees, which are a standard course of business practice, were obtained from the owner of the subject of the petition, that his personal assets shall also be considered to a part of the Bankruptcy Estate under the Liquidation, subject to the amounts due and owing to petitioners. Accordingly, certain exemptions which otherwise might be deemed to apply, shall not apply in this matter, due to the requirement that the Trustee must take into account the personal guarantees in determining the proceeds of the Bankruptcy Estate.

Lastly, the Court cannot make a determination with respect to the alleged collusion asserted by the attorneys for the subject of the petition, despite the fact that there has been presented certain testimonial evidence regarding such. Allegations of fraud, due to its inherent scienter requirement, have a high threshold for proof. Federal courts have long held that a party must prove facts giving rise to a "strong inference" of scienter, showing cogent and compelling evidence". Such level of proof has not been established, and therefore such allegation cannot be confirmed by this court.

The Trustee is accordingly hereby ordered to proceed with Liquidation pursuant to Article 7.