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Non-Debtor Awarded Sanctions for Improper Filing of Involuntary Petition

By Shmuel Vasser and J.J. Moser*

The authors analyze a bankruptcy court decision awarding a non-debtor third party sanctions on account of an improper filing of an involuntary bankruptcy petition.

Section 303(i) of the Bankruptcy Code authorizes the court to award the debtor sanctions on account of an improper filing of an involuntary petition against it. But can a non-debtor third-party obtain such a relief? Yes, says the bankruptcy court in *In re Vascular Access Centers, L.P.*[1]

BACKGROUND

Dr. James McGuckin thought an unusual involuntary bankruptcy filing against Vascular Access Centers, L.P. (VAC) would provide him with an innovative way to delay a payout as part of a derivative litigation against VAC in which he was found liable. After the bankruptcy court's December 1, 2022 decision, McGuckin's liability evasion tactic has ended up costing him nearly $1.5 million in sanctions as the court not only admonished McGuckin's behavior, but also awarded significant sanctions against him and an entity under his control for their conduct in filing a bad faith involuntary bankruptcy petition against VAC.

These unique circumstances provide a case study on what can go wrong when a party forces a debtor into bankruptcy using unscrupulous means for self-preservation. The result also shows the extent to which bankruptcy courts will make sure that parties are held accountable for bad faith involuntary petitions. Notably, the beneficiary of these sanctions was not the debtor, but William Whitfield Gardner, VAC's majority limited partner who opposed the involuntary bankruptcy petition and had previously emerged victorious in the derivative litigation against McGuckin.

FACTS

McGuckin was the general partner of debtor VAC, a limited partnership managing outpatient vascular access centers across the country. Gardner became a limited partner in 2005, and, in January 2016, he instituted a derivative

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[1] In re Vascular Access Centers, L.P., No. 19-17117 (AMC) (Bankr. E.D. Pa. Dec. 1, 2022).

action against McGuckin and VAC LLC, the entity which managed VAC.[2] Gardner claimed breach of fiduciary duty, breach of contract, and unjust enrichment against VAC LLC and McGuckin on behalf of VAC, generally alleging that both misappropriated from VAC when they opened competing vascular centers. When Gardner won at the state trial court level, the superior court denied re-argument, and the Pennsylvania Supreme Court denied McGuckin's re-argument application, McGuckin changed strategies. He instructed at least one entity under his control – Crestwood Associates, LLC – to create sham invoices against VAC, and then, in his capacity as controlling owner of alleged creditor Philadelphia Vascular Institute (PVI), signed off on an involuntary Chapter 11 petition against VAC. With the immediate relief of the automatic stay, the court would later find that McGuckin intended to delay the derivative action through the involuntary bankruptcy petition based on illegitimate claims.

In McGuckin's involuntary petition against VAC, he alleged three claims: A secured claim for $1,202,120 owed to PVI, another for $11,911.25 owed to Metter & Company, and a claim for $6,090 owed to Crestwood Associates, LLC. In the bankruptcy case it was discovered that the Crestwood claim was a sham as McGuckin instructed the Crestwood accounting team to create an invoice for $6,000 just before McGuckin filed the involuntary petition. In addition, it became clear that PVI never lent money to VAC. As a result, both Gardner and the U.S. Trustee filed motions to dismiss the petition, alleging that the creditors filed the petition in bad faith so that McGuckin could delay the derivative litigation. At the hearing for the motion, McGuckin testified to the amount which PVI allegedly loaned VAC (a secured loan of $1.2 million), but the number conflicted with the cash collateral motion filed by the debtor under McGuckin's instructions which alleged a secured loan of $4,257,626. On cross-examination, McGuckin admitted that VAC did not owe PVI anything.

THE SANCTIONS DECISION

Based on the facts, Gardner filed a sanctions motion against McGuckin and PVI, claiming that McGuckin used the involuntary petition to interfere with the derivative litigation and manufactured fraudulent claims against VAC. After delays and extensive testimony as a part of the sanctions hearings, the court found that McGuckin's counsel had told VAC's former counsel, who was cooperating with McGuckin to file the involuntary petition, that they needed to have the petition filed before the November 13, 2019 since they "want[ed]

[2] VAC LLC was controlled by McGuckin.

to avoid" it. With a clear connection between the involuntary bankruptcy petition and the derivative suit established, the court awarded applied sanctions in Gardner's favor.

The court held that it had the authority under Section 105(a) of the Bankruptcy Code and Rule 9011 of the Bankruptcy Rules of Bankruptcy Procedure to award sanctions in favor of a third party. Under Section 105(a), the court has the power to issue any order to enforce court orders or rules, or to prevent an abuse of process; this includes sanctions against parties which abuse the bankruptcy process. The court also held that it had the power to impose sanctions based on Rule 9011(b) of the Bankruptcy Rules. The court found violations of Rule 9011(b)(1), since filings or advocacy in support of filings must not be presented for an improper purpose, and of Rule 9011(b)(3), as allegations made by parties must have sufficient evidentiary support.

The court found McGuckin's acts for which sanctions were warranted to include a bad faith filing of the involuntary petition, directing a creditor to file a false claim, falsely claiming that PVI had a $1.2 million secured claim against VAC, consenting to the petition in bad faith, and affirming the false claims to delay the derivative litigation. The court also found PVI jointly and severally liable for signing and filing the involuntary petition in addition to certifying falsely that it held a $1.2 million secured claim against VAC.

In determining the appropriate amount of the sanctions, the court held that Gardner could recover fees and expenses that he would not have incurred but for the sanctioned parties' misconduct. The court analyzed the hours billed by Gardner's counsel under the lodestar test using the well-known methodology followed by bankruptcy courts in awarding fees resulting in an award of $1,417,861.75.

WHAT'S NEXT

In re Vascular Access Centers, L.P., illustrates the risks of filing bad faith involuntary bankruptcies, particularly where the alleged claims are manufactured bogus ones. McGuckin acted primarily through PVI, but in the end was held jointly and severally liable for all sanctions with PVI. The decision is also notable since the party seeking sanctions was a third party, not the debtor.

Thus, parties filing involuntary petitions without legitimate reasons are not only exposed for sanctions awarded to the debtor under Section 363(i) but may also be exposed to damages suffered by third parties.